



AICPA Professional Standards

June 15, 2022



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WHAT'S NEW IN THIS EDITION

STANDARDS RECENTLY ISSUED

<u>Statement</u>	<u>Title</u>	<u>Issue Date</u>	<u>Section</u>
Statement of Position (SOP) 21-1	<i>Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936</i>	June 2021	AUD 65
Statement on Auditing Standards (SAS) No. 145	<i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	October 2021	AU-C 315
Standards for Performing and Reporting on Peer Reviews		April 2022	PR-C 100, 200, 210, 220, 300, 310, 320, 400, 410, 420, 430
Statement on Standards for Accounting and Review Services (SSARS) No. 26	<i>Quality Management for an Engagement Conducted in Accordance With Statements on Standards for Accounting and Review Services</i>	June 2022	
SAS No. 146	<i>Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i>	June 2022	AU-C 220
Statement on Quality Management Standards (SQMS) No. 1	<i>A Firm's System of Quality Management</i>	June 2022	QM 10
SQMS No. 2	<i>Engagement Quality Reviews</i>	June 2022	QM 20
SAS No. 147	<i>Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations</i>	June 2022	AU-C 210

ADDITIONAL CHANGES

In addition to these recently issued standards, other changes in this edition of AICPA Professional Standards include the following.

<u>Section</u>	<u>Change</u>
AU-C 210	Amended by SAS Nos. 146-147.
AU-C 210A	Added to retain currently effective content until SAS No. 147 becomes effective.

<u>Section</u>	<u>Change</u>
AU-C 220	Superseded by SAS No. 146.
AU-C 220A	Added to retain currently effective content until SAS No. 146 becomes effective.
AU-C 315	Superseded by SAS No. 145.
AU-C 315A	Added to retain currently effective content until SAS No. 145 becomes effective.
AU-C 501	Amended by SAS No. 145.
AU-C 540	Amended by SAS No. 145.
AU-C 580	Reverted language in exhibit A, "Illustrative Representation Letter."
AU-C 620	Amended by SAS No. 145.
AT-C Introduction	Revised to reflect the issuance of SSAE No. 21, <i>Direct Examination Engagements</i> .
AT-C Preface	Revised to reflect the issuance of SSAE No. 21.
AT-C Glossary	Revised to reflect the issuance of SSAE No. 21.
AT-C 9105	Revised to reflect conforming changes necessary due to the issuance of SSAE No. 19, <i>Agreed-Upon Procedures Engagements</i> , and the effective dates of SSAE Nos. 21-22.
AT-C 105A	Replaced to retain currently effective guidance until SSAE No. 21 becomes effective.
AT-C 9205	Revised to reflect conforming changes necessary due to the effective date of SSAE No. 21.
AT-C 215A	Removed due to the effective date of SSAE No. 19.
AT-C 9215A	Removed due to the effective date of SSAE No. 19.
AT-C 305	Revised to reflect conforming changes necessary due to the issuance of SSAE No. 19 and the effective date of SSAE No. 21.
AT-C 310	Revised to reflect conforming changes necessary due to the effective dates of SSAE Nos. 21-22.
AT-C 315	Revised to reflect conforming changes necessary due to the issuance of SSAE No. 19, and the effective date of SSAE No. 21.
AT-C 320	Revised to reflect conforming changes necessary due to the effective date of SSAE No. 21.
AUD 15A	Removed due to the effective date of SSAE No. 19.
AUD 20	Removed due to the passage of time.
AUD 25A	Removed due to the effective date of SSAE No. 19.
AUD 30A	Removed due to the effective date of SSAE No. 19.
AUD 40A	Removed due to the effective date of SSAE No. 19.
AUD 55A	Removed due to the effective date of SSAE No. 19.
AUD 60	Superseded by SOP 21-1 (AUD 65).
AR-C 60	Amended by SSARS No. 26.
AR-C 60A	Added to retain currently effective content until SSARS No. 26 becomes effective.
AR-C 70	Amended by SSARS No. 26.
AR-C 70A	Added to retain currently effective content until SSARS No. 26 becomes effective.

<u>Section</u>	<u>Change</u>
AR-C 80	Amended by SSARS No. 26.
AR-C 80A	Added to retain currently effective content until SSARS No. 26 becomes effective.
AR-C 90	Amended by SSARS No. 26.
AR-C 90A	Added to retain currently effective content until SSARS No. 26 becomes effective.
ET 0.400.06	Revised "beneficially owned" definition.
ET 0.600.030	Revised "Temporary Enforcement Policies" section.
ET 1.000.020	Revised "Ethical Conflicts" interpretation.
ET 1.180.010	Added "Responding to Noncompliance With Laws and Regulations" interpretation.
ET 1.210.010	Revised "Conceptual Framework for Independence" interpretation.
ET 1.224.010	Revised "Client Affiliates" interpretation.
ET 1.224.020	Revised "State and Local Government Client Affiliates" interpretation.
ET 1.230.010	Revised "Unpaid Fees" interpretation.
ET 1.260.010	Revised "Loans" interpretation.
ET 1.260.020	Revised "Loans and Leases with Lending Institutions" interpretation.
ET 1.270.010	Revised "Immediate Family Members" interpretation.
ET 1.295.113	Added "Assisting Attest Clients With Implementing Accounting Standards" interpretation.
ET 2.000.020	Revised "Ethical Conflicts" interpretation.
ET 2.180.010	Added "Responding to Noncompliance With Laws and Regulations" interpretation.
BL 340R	Revised to reflect recent amendments.
BL 360R	Revised to reflect recent amendments.
QC 10	Superseded by SQMS No. 1.
QM 10A	Added to retain currently effective content until SQMS No. 1 becomes effective.
PR 100	Removed due to the effective date of <i>Standards for Performing and Reporting on Peer Reviews</i> .
PR 9100	Removed due to the effective date of <i>Standards for Performing and Reporting on Peer Reviews</i> .

HOW THIS PUBLICATION IS ORGANIZED

Scope of *Professional Standards*

Professional Standards brings together for continuing reference the currently effective pronouncements on professional standards issued by the AICPA and contains a section detailing the applicability and integration of AICPA *Professional Standards* and PCAOB Standards.

Arrangement of Material in *Professional Standards*

The material in *Professional Standards* is arranged as follows:

Applicability of AICPA Professional Standards

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Introduction

Statement of Position Accounting

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Description of Content

Applicability of AICPA Professional Standards

Part I is a narrative that provides guidance about standards applicable to entities as defined by the Sarbanes-Oxley Act of 2002, as amended, and standards applicable to nonissuers.¹

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

A cross-reference chart is provided for this division and is identified as AU-C Cross-References to SASs. There are two parts to this cross-references section

Part I is a list of all Statements on Auditing Standards (SASs) issued beginning with SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, and a list of sources of sections in the current text.

Part II is a list of SAS Nos. 1–121 and a list of Statement on Auditing Procedures Nos. 1–54.

The major divisions are divided into sections, each with its own section number. Each paragraph within a section is decimally numbered. For example, AU-C section 210.04 refers to the fourth paragraph of AU-C section 210, *Terms of Engagement*.

Auditing interpretations are numbered in the 9000 series with the last three digits indicating the section to which the interpretation relates. Interpretations immediately follow their corresponding section. For example, interpretations related to AU-C section 230 are numbered 9230, which directly follows AU-C section 230.

There are two exhibits relating to auditing standards as follows:

Exhibit A provides a list of AU-C sections designated by SAS No. 122 cross referenced to a list of AU sections.

Exhibit B provides a list of retained interpretations.

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

There are five appendixes relating to auditing standards as follows:

Appendix A provides the historical background for the present SASs.

Appendix B highlights substantive differences between the International Standards on Auditing and Generally Accepted Auditing Standards.

Appendix C is reserved.

Appendix D provides a list of AICPA Audit and Accounting Guides and Statements of Position.

Appendix E provides a schedule of changes that lists changes that are the result of Statements on Auditing Standards issued after SAS No. 122, which was issued in October 2011.

Appendix F provides a list of other auditing publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff.

A topical index is provided for this division and is identified as AU-C Topical Index.

U.S. Attestation Standards—AICPA (Clarified) [AT-C]

A cross-reference chart is provided for this division and is identified as AT-C Cross-References to SSAEs. There are two parts to this cross-references section

Part I is a list of all Statements on Auditing Standards (SSAEs) issued beginning with SSAE No. 18, *Attestation Standards: Clarification and Recodification*, and a list of sources of sections in the current text.

Part II is a list of SSAE Nos. 1–17.

The standards are divided into sections, each with its own section number. Each paragraph within a section is decimally numbered.

There is one exhibit relating to attestation standards as follows:

The exhibit provides a list of AT-C sections designated by SSAE No. 18 cross referenced to a list of AT sections.

There are two appendixes relating to attestation standards as follows:

Appendix A provides a list of AICPA attestation guides and Statements of Position.

Appendix B identifies other attestation publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff.

The AT-C topical index uses the keyword method to facilitate reference to the pronouncements. The index is arranged alphabetically by topic and refers to major divisions, sections, and paragraph numbers.

Statements of Position

Statements of Position are assigned section numbers in chronological order as they are issued. Each paragraph or equivalent is decimally numbered for reference purposes.

Accounting and Review Services (Clarified) [AR-C]

A cross-reference chart is provided for this division and is identified as AR-C Cross-References to SSARs. There are two parts to this cross-references section:

Part I is a list of all SSARs issued beginning with SSAR No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, and a list of sources of sections in the current text.

Part II is a list of SSARs Nos. 1–20.

The standards are divided into sections, each with its own section number. Each paragraph within a section is decimally numbered.

Accounting and review services interpretations are numbered in the 9000 series with the last two digits indicating the section to which the interpretation relates. Interpretations immediately follow their corresponding section. For example, interpretations related to section 90 are numbered 9090, which directly follows section 90.

There is one appendix, Appendix A, that provides a schedule of changes resulting from SSARs issued subsequent to SSAR No. 21.

The AR-C topical index uses the keyword method to facilitate reference to the pronouncements. The index is arranged alphabetically by topic and refers to major divisions, sections, and paragraph numbers.

Code of Professional Conduct

The AICPA Code of Professional Conduct (the code) begins with a preface, which applies to all members. The term *member*, when used in part 1 of the code, applies to and means a member in public practice; when used in part 2 of the code, applies to and means a member in business; and when used in part 3 of the code, applies to and means all other members, such as those members who are retired or unemployed. A member may have multiple roles, such as a member in business and a member in public practice. In such circumstances, the member should consult all applicable parts of the code and apply the most restrictive provisions.

The code consists of principles and rules as well as interpretations and other guidance. The principles provide the framework for the rules that govern the performance of member's professional responsibilities.

A variety of topics appear in parts 1–3 of the code. When applicable, topics are aligned with the relevant rule or rules of conduct. Topics may be further divided into subtopics, and some subtopics include one or more sections. Topics, subtopics, and sections interpret the rules of conduct.

There are four appendixes relating to the code as follows:

Appendix A provides the AICPA Council's resolution on bodies designated to promulgate technical standards.

Appendix B provides the AICPA Council's resolution on the "Form of Organization and Name Rule" (ET sec. 1.800.001).

Appendix C contains a revision history table of changes made to the code subsequent to June 1, 2014.

Appendix D provides a mapping document that identifies where the content from the prior code appears in the effective code.

A topical index is provided for this division and is identified as ET Topical Index.

Bylaws

The Bylaws of the AICPA and the related Implementing Resolutions of Council are assembled within the major divisions by section numbers. For example, BL section 230, *Requirements for Retention of Membership*, is followed by BL section 230R, *Implementing Resolutions Under Section 2.3 Requirements for Retention of Membership*.

In BL section 900, *General*, the following sections are included:

AICPA Mission Statement

A Description of the Professional Practice of Certified Public Accountants

A topical index is provided for this division and is identified as BL Topical Index.

Valuation Services

Statements on Standards for Valuation Services and Valuation Services Interpretations appear with the prefix VS in their section numbers.

Consulting Services

Statement on Standards for Consulting Services appears with the prefix CS in its section number.

A topical index is provided for this division and is identified as CS Topical Index.

Quality Management

Statements on Quality Management Standards appear with the prefix QM in their section numbers.

Peer Review

Standards for Performing and Reporting on Peer Reviews and Peer Review Interpretations appear with the prefix PR in their section numbers.

Tax Services

Statements on Standards for Tax Services and Tax Services Interpretations appear with the prefix TS in their section numbers.

A topical index is provided for this division and is identified as TS Topical Index.

Personal Financial Planning

Statements on Standards in Personal Financial Planning Services appear with the prefix PFP in their section numbers.

A topical index is provided for this division and is identified as PFP Topical Index.

Continuing Professional Education

Policies for the CPE Membership Requirement and Statement on Standards for Continuing Professional Education (CPE) Programs appear with the prefix CPE in their section numbers.

A topical index is provided for this division and is identified as CPE Topical Index.

Topical Index

The topical indexes use the keyword method to facilitate reference to the pronouncements. The indexes are arranged alphabetically by topic and refer the reader to major divisions, sections, and paragraph numbers.

	<i>Citation</i>
Auditing (United States)—Clarified	AU-C
Attestation (United States)—Clarified	AT-C
Accounting and Review Services—Clarified	AR-C
Code of Professional Conduct	ET
Bylaws	BL
Consulting Services	CS
Tax Services	TS
Personal Financial Planning	PFP
Continuing Professional Education	CPE

AICPA TECHNICAL HOTLINE

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Special Note About FASB Accounting Standards Codification®

FASB released the *FASB Accounting Standards Codification* (ASC) on July 1, 2009. On its effective date, FASB ASC became the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the SEC. FASB ASC significantly changes the way financial statement preparers, auditors, and academics perform accounting research.

FASB ASC flattens the U.S. generally accepted accounting principles (GAAP) hierarchy to two levels: one that is authoritative (in FASB ASC) and one that is nonauthoritative (not in FASB ASC). Exceptions include all rules and interpretive releases of the SEC under the authority of federal securities laws, which are sources of authoritative GAAP for SEC registrants, and certain grandfathered guidance having an effective date before March 15, 1992. The codification creates FASB ASC 105, *Generally Accepted Accounting Principles*.

Amendments to FASB ASC are now issued by FASB through Accounting Standards Updates (ASUs) and serve only to update FASB ASC. FASB does not consider the ASUs authoritative in their own right; such amendments become authoritative when they are incorporated into FASB ASC. The ASUs issued include the amendments to the codification and an appendix of FASB ASC update instructions. ASUs also provide background information about the amendments, and explain the basis for FASB's decisions. This method of updating the accounting guidance means that there will no longer be, for example, accounting standards in the form of statements, staff positions, Emerging Issues Task Force (EITF) abstracts, or AICPA Accounting Statements of Position. ASUs are issued in the form of ASU No. 20YY-XX, in which "YY" is the last two digits of the year and "XX" is the sequential number for each update. For example, ASU No. 2011-01 is the first update in the year 2011. FASB organizes the contents of each ASU using the same section headings as those used in FASB ASC.

FASB ASC is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative GAAP by providing the authoritative literature in a topically organized structure. FASB ASC disassembled thousands of nongovernmental accounting pronouncements (including those of FASB, the EITF, and the AICPA) and reassembled them under approximately 90 topics and included all accounting standards issued by a standard setter within levels A–D of the current GAAP hierarchy. FASB ASC also includes relevant portions of authoritative content issued by the SEC, as well as selected SEC staff interpretations and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance. Moreover, FASB ASC does not include governmental accounting standards. FASB ASC is not intended to change GAAP or any requirements of the SEC.

FASB ASC uses a topical structure in which guidance is organized into *areas*, *topics*, *subtopics*, *sections*, and *subsections*. These terms are defined as follows:

Areas. The broadest category in FASB ASC and represent a grouping of topics.

Topics. The broadest categorization of related content and correlate with the International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs).

Subtopics. Represent subsets of a topic and are generally distinguished by type or scope.

Sections. Indicate the nature of the content such as recognition, measurement, or disclosure. The sections' structure correlates with the IASs and IFRSs.

Subsections. Allow further segregation and navigation of content.

Topics, subtopics, and sections are numerically referenced. This effectively organizes the content without regard to the original standard setter or standard from which the content was derived. An example of the numerical referencing is FASB ASC 305-10-05, in which 305 is the *Cash and Cash Equivalents* topic, 10 represents the "Overall" subtopic, and 05 represents the "Overview and Background" section.

FASB ASC represents a major shift in the organization and presentation of GAAP. Users are encouraged to read the notice to constituents, which explains the scope, structure, and usage of consistent terminology in FASB ASC. This document is available on the FASB website at <http://asc.fasb.org>. In addition to the notice, this link contains information on the options available for users to access the codification. FASB ASC is offered by FASB at no charge in a Basic View and for an annual fee in a Professional View. FASB ASC and the notice to constituents are also offered by certain third party licensees, including the AICPA.

Levels of Authority

The following outlines the three levels of authority for auditing, attestation, and preparation, compilation and review publications, including levels of authority under Statements on Standards for Accounting and Review Services (SSARS) No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*.

Auditing Publications

AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, sets forth the following three types of auditing publications and their authority:

- Auditing Standards: Authoritative per the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct (ET sec. 1.310.001 and 2.310.001).
- Interpretive Publications: Issued under the authority of the Auditing Standards Board; if the auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should be prepared to explain how he or she complied with the Statements on Auditing Standards (SASs) provisions addressed by such auditing guidance.
- Other Auditing Publications: No authoritative status; however, other auditing publications may help the auditor understand and apply the SASs.

Attestation Publications

AT-C section 105, *Concepts Common to All Attestation Engagements*, sets forth the following three types of attestation publications and their authority:

- Attestation Standards: Authoritative per the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct (ET sec. 1.310.001 and 2.310.001).

- Interpretive Publications: Issued under the authority of the Auditing Standards Board; if the practitioner does not apply the attestation guidance included in an applicable interpretive publication, the practitioner should be prepared to explain how he or she complied with the Statements on Standards for Attestation Engagements (SSAEs) provisions addressed by such attestation guidance.
- Other Attestation Publications: No authoritative status; however, other attestation publications may help the practitioner understand and apply the SSAEs.

Preparation, Compilation and Review Publications

AR-C section 60, *General Principles for Engagements Performing in Accordance With Statements on Standards for Accounting and Review Services*, sets forth the following three types of preparation, compilation and review publications and their authority:

- Statements on Standards for Accounting and Review Services (SSARSs: Authoritative per the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct (ET sec. 1.310.001 and 2.310.001).
 - Interpretive Publications: Issued under the authority of the Accounting and Review Services Committee; the accountant should consider applicable interpretive publications in the performance of a preparation, compilation, or review service.
 - Other Preparation, Compilation and Review Publications: No authoritative status; however, other compilation and review publications may help the accountant understand and apply the SSARSs. In applying the guidance included in an other preparation, compilation and review publication, the accountant should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. Other preparation, compilation and review publications that have not been reviewed by the AICPA Audit and Attest Standards staff that contradict an other preparation, compilation and review publication that has been reviewed by the AICPA Audit and Attest Standards staff is inappropriate.
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APPLICABILITY OF AICPA PROFESSIONAL STANDARDS

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Applicability of AICPA Professional Standards to Audits of Financial Statements

Who Is a Nonissuer?

Appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of the AICPA Code of Professional Conduct recognizes both the Auditing Standards Board (ASB) and the PCAOB as standard setting bodies designated to promulgate auditing, attestation, and quality control standards. Paragraph .01 of the "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) requires an AICPA member who performs an audit to comply with the applicable standards.

Audits of the financial statements of those entities subject to the oversight authority of the PCAOB (that is, those audit reports within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended), are to be conducted in accordance with standards established by the PCAOB, a private sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002. The SEC has oversight authority over the PCAOB, including the approval of its rules, standards, and budget.

Audits of the financial statements of those entities not subject to the oversight authority of the PCAOB (that is, those audit reports not within the PCAOB's jurisdiction as defined by the Act, as amended — hereinafter referred to as *nonissuers*¹) are to be conducted in accordance with generally accepted auditing standards (GAAS) as issued by the ASB, a senior committee of the AICPA.

Standards Applicable to the Audits of Entities as Defined by the Act, as Amended

Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*,² issued by the PCAOB, generally requires all registered public accounting firms to adhere to the PCAOB's standards in connection with the preparation or issuance of any audit report on the financial statements of an entity as defined by the Act, as amended. Rule 3100 requires registered public accounting firms and their associated persons to comply with all applicable standards. Accordingly, if the PCAOB's standards do not apply to an engagement or other activity of the firm, Rule 3100, by its own terms, does not apply to that engagement or activity.

Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards*, issued by the PCAOB, defines the degree of responsibility imposed on the auditor by the use of certain terms in the PCAOB's auditing and related professional practice standards, including the interim standards adopted in Rule 3200, *Auditing Standards*; Rule 3300T, *Interim Attestation Standards*; Rule 3400T, *Interim Quality Control Standards*; and Rule 3500T, *Interim Ethics and Independence Standards*.

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

² All PCAOB Rules can be found in *PCAOB Standards and Related Rules*.

Standards Applicable to the Audits of *Nonissuers*

The ASB is the body authorized to promulgate auditing, attestation and quality control standards for nonissuers. The ASB develops and issues standards in the form of Statements on Auditing Standards (SASs) through a due process that includes deliberation in meetings open to the public, public exposure of proposed SASs, and a formal vote.

Pursuant to AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, professional requirements under GAAS are categorized as either "unconditional requirements" or "presumptively mandatory requirements," each of which is identified by specific terms. Unconditional requirements are stated with "must." Presumptively mandatory requirements are stated with "should." In the clarified auditing standards, application and explanatory guidance does not create or impose requirements; rather, it is relevant to the proper application of the requirements of an AU-C section.

As a caution to readers, pursuant to AU-C section 200, interpretive publications are recommendations on the application of GAAS in specific circumstances, including engagements for entities in specialized industries. Interpretive publications, which include auditing interpretations, auditing guidance in AICPA Audit and Accounting Guides, and auditing guidance found in Statements of Position, are issued under the authority of the ASB. Although interpretive publications are not auditing standards, AU-C section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance included in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

Failure to follow ASB standards in the audit of a nonissuer would be considered a violation of the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (ET sec. 2.310.001) of the AICPA Code of Professional Conduct, as applicable.

The ASB continues to issue SASs and interpretive publications that relate to audits of nonissuers, and auditors should be alert to those issuances.

Audits of a Nonissuer's Financial Statements Audited in Accordance With Both GAAS and Another Set of Auditing Standards

AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, addresses the auditor's report for audits conducted in accordance with both GAAS and another set of auditing standards. Paragraph .44 of AU-C section 700 explains that the auditor may indicate that the audit was conducted in accordance with GAAS and also conducted in accordance with another set of auditing standards (for example, International Standards on Auditing or *Government Auditing Standards*). Paragraph .44 also states that the auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS, unless the audit was conducted in accordance with both sets of standards in their entirety. Paragraph .45 of AU-C section 700 goes on to state that when the auditor's report refers to both GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards, as well as their origin.

Audits of a Nonissuer's Financial Statements Audited in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB

When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB, paragraph .46 of AU-C section 700 states that the auditor is required to also conduct the audit in accordance with GAAS. Paragraph .46 goes on to state that, in such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS.

Integrated Audit of a Nonissuer's Financial Statements

AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements (*integrated audit*).

AICPA Standards and the Audits of Entities as Defined by the Act, as Amended

If a registered public accounting firm performs an audit of an entity as defined by the Act, as amended, in accordance with PCAOB standards, the auditor does not need to follow standards promulgated by the ASB. However, AICPA members are required to comply with the AICPA Code in addition to the ethics and independence rules and standards required by the SEC and PCAOB.

AU-C Cross-References to SASs

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AU-C Cross-References to SASs

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

Statements on Auditing Standards*

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

(continued)

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

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

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

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

No.	Date Issued	Title	AU-C Section
133	July 2017	<i>Auditor Involvement With Exempt Offering Documents</i>	945
134	May 2019	<i>Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements</i> ⁴	700, 701, 705, 706
135	May 2019	<i>Omnibus Statement on Auditing Standards — 2019</i> ⁵	
136	July 2019	<i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i> ⁶	703
137	July 2019	<i>The Auditor's Responsibilities Relating to Other Information Included in Annual Reports</i> ⁷	720
138	December 2019	<i>Amendments to the Description of the Concept of Materiality</i> ⁸	
139	March 2020	<i>Amendments to AU-C Sections 800, 805, and 810 to Incorporate Auditor Reporting Changes From SAS No. 134</i> ⁹	
140	April 2020	<i>Amendments to AU-C Sections 725, 730, 930, 935, and 940 to Incorporate Auditor Reporting Changes From SAS Nos. 134 and 137</i> ¹⁰	

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

⁵ SAS No. 135 has been integrated within sections 210A.A32, 240.11, 240.17, 240.19, 240.21, 240.32, 240.A19, 240.A54–A55, 240.A72, 240.A76, 260.12–13, 260.17, 260.21, 260.A30, 265.A8, 315.29, 315.A36, 315.A148–A149, 315.A153, 330.A58–A59, 510.A5, 550.01, 550.14–18, 550.20, 550.22–23, 550.26, 550.29, 550.A3, 550.A11, 550.A14, 550.A16–A18, 550.A20, 550.A22, 550.A26–A29, 550.A36, 550.A42–A45, 550.A52–A53, 550.A6, 580.17, 580.A16, 580.A18, 600.A1, 600.A94, 930.22, 930.A32, 930.A59, 940.A25, and 940.A91.

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

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

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

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

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

No.	Date Issued	Title	AU-C Section
141	May 2020	<i>Amendment to the Effective Dates of SAS Nos. 134–140</i> ¹¹	
142	July 2020	<i>Audit Evidence</i> ¹²	500
143	July 2020	<i>Auditing Accounting Estimates and Related Disclosures</i> ¹³	540
144	June 2021	<i>Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources</i> ¹⁴	
145	October 2021	<i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i> ¹⁵	315

(continued)

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

¹² SAS No. 142 has been integrated within SAS No. 122 sections 200.14, 200.19, 200.A26–.A27, 200.A76, 230.06, 315.A81, 330.06, 330.28, 330.A48, 330.A51–.A52, 330.A59, 330.A66, 330.A75, 330.A77, 501.01, 501.03–.04, 501.26, 501.A69–.A83, 530.02, 540.A28, and 540.A70.

The amendments in SAS No. 142 are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to these sections.

¹³ SAS No. 143 has been integrated within SAS No. 122 sections 200.A44, 230.A9, 230.A12, 230.A30, 240.A53, 260.A27–.A28, 260.A56–.A57, 501.01, 501.04, 501.06–.10, 501.A1–.A2, 501.A5–.A6, 501.A8, and 501.A11–.A19; SAS No. 134 sections 580.16, 580.A13–.A14, 580.A35, 700.15c, 701.08b, and time before 701.A21; and SAS No. 136 section 703.40.

The SAS No. 132 amendments in SAS No. 143 are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix C of section 540 until the effective date, when they will be applied to these sections.

The SAS Nos. 134 and 136 amendments in SAS No. 143 are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix C of section 540 until the effective date, when they will be applied to these sections.

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

¹⁵ SAS No. 145 has been integrated within SAS No. 122 sections 200.08, 200.14, 200.A15, 200.A44–.A47, 200.A67, 200.A72–.A74, 210.A16, 230.A20, 240.07, 240.16, 240.20, 240.27, 240.32, 240.43, 240.A9, 240.A21–.A22, 240.A27, 240.A30, 240.A37, 240.A48–.A49, 240.A76–.A77, 250.A24, 260.A20–.A21, 265.01–.02, 265.07, 265.A1, 265.A4, 265.A11, 300.A26, 330.07–.08, 330.10, 330.13, 330.15–.18, 330.29, 330.A1, 330.A4, 330.A7, 330.A10, 330.A11, 330.A19, 330.A21, 330.A25, 330.A29, 330.A32–.A37, 330.A40–.A41, 330.A43, 330.A47, 330.A50–.A51, 330.A64, 330.A66, 330.A76, 330.A79–.A80, 402.01, 402.03, 402.07, 4402.10–.12, 402.14, 402.17, 402.A14, 402.A19, 402.A24, 402.A31–.A32, 402.A35–.A36, 402.A41; 501.A24, 505.03, 530.A10, 550.A7, 550.A10, 550.A21, 550.A30, 550.A38, 600.20, 600.A7, 600.A94, 600.A96, 620.A5, 805.A7, 930.11, 930.A7, and 930.A11; SAS No. 128 sections 610.05, 610.A3, 610.A12, and 610.A26; SAS No. 130 sections 940.26, 940.31, 940.57, 940.A6, 940.A22, 940.A26–.A27, 940.A34, and 940.A51–.A52; SAS No. 134 section 701.A18; SAS No. 136 sections 703.18, 703.20, 703.A19–.A20, and 703.A153; SAS No. 137 sections 720.A34 and 720.A55; SAS No. 142 section 500.A67; and SAS No. 143 sections 504.04–.05, 540.07, 540.12, 540.15–.16, 540.18, 540.A8–.A10, 540.A19–.A21, 540.A24–.A25, 540.A29, 540.A35, 540.A39, 540.A44, 540.A50–.A54, 540.A64–.A66, 540.A68, 540.A70, 540.A79, and 540.A85.

The amendments in SAS No. 145 are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to these sections.

No.	Date Issued	Title	AU-C Section
146	June 2022	<i>Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i> ¹⁶	220
147	June 2022	<i>Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations</i> ¹⁷	210

¹⁶ SAS No. 147 has also been integrated within SAS No. 117 section 935.A35; SAS No. 122 sections 200.A20, 200.A32, 210.A1, 230.03, 230.A9, 230.A15, 230.A23–.A24, 230.A27–.A28, 260.A37, 260.A51, 300.02, 300.06, 300.08–.09, 300.11, 300.14, 300.A1–.A2, 300.A4, 300.A7–.A11, 300.A20–.A21, 300.A24–.A26, 300.A30, 600.05, 620.08, 620.A7, 620.A11–.A14, 620.A16, 620.A29, and 930.A60; SAS No. 130 section 940.A117; SAS No. 134 sections 700.A39, 700.A54, 701.A13, 701.A60, and 701.A62; SAS No. 136 section 703.A119; SAS No. 137 section 720.A27; and SAS No. 142 section 500.A68.

The amendments in SAS No. 146 are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to these sections.

¹⁷ SAS No. 147 has been integrated within SAS No. 122 sections 210.11–.13, 210.15, 210.A30–.A35.

The amendments in SAS No. 147 are effective for audits of financial statements for periods beginning on or after June 30, 2023.

Sources of Sections in Current Text

<i>AU-C Section</i>	<i>Contents</i>	<i>Source</i>
200–299	General Principles and Responsibilities	
200	<i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards</i>	SAS No. 122
210	<i>Terms of Engagement</i>	SAS No. 122
220	<i>Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i>	SAS No. 146
230	<i>Audit Documentation</i>	SAS No. 122
240	<i>Consideration of Fraud in a Financial Statement Audit</i>	SAS No. 122
250	<i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	SAS No. 122
260	<i>The Auditor's Communication With Those Charged With Governance</i>	SAS No. 122
265	<i>Communicating Internal Control Related Matters Identified in an Audit</i>	SAS No. 122
300–499	Risk Assessment and Response to Assessed Risks	
300	<i>Planning an Audit</i>	SAS No. 122
315	<i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	SAS No. 145
320	<i>Materiality in Planning and Performing an Audit</i>	SAS No. 122
330	<i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>	SAS No. 122
402	<i>Audit Considerations Relating to an Entity Using a Service Organization</i>	SAS No. 122
450	<i>Evaluation of Misstatements Identified During the Audit</i>	SAS No. 122
500–599	Audit Evidence	
500	<i>Audit Evidence</i>	SAS No. 142
501	<i>Audit Evidence — Specific Considerations for Selected Items</i>	SAS No. 122
505	<i>External Confirmations</i>	SAS No. 122
510	<i>Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	SAS No. 122
520	<i>Analytical Procedures</i>	SAS No. 122
530	<i>Audit Sampling</i>	SAS No. 122
540	<i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i>	SAS No. 143
550	<i>Related Parties</i>	SAS No. 122

<i>AU-C Section</i>	<i>Contents</i>	<i>Source</i>
560	<i>Subsequent Events and Subsequently Discovered Facts</i>	SAS No. 122
570	<i>The Auditor's Consideration of An Entity's Ability to Continue as a Going Concern</i>	SAS No. 132
580	<i>Written Representations</i>	SAS No. 122
585	<i>Consideration of Omitted Procedures After the Report Release Date</i>	SAS No. 122
600–699	Using the Work of Others	
600	<i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	SAS No. 122
610	<i>Using the Work of Internal Auditors</i>	SAS No. 128
620	<i>Using the Work of an Auditor's Specialist</i>	SAS No. 122
700–799	Audit Conclusions and Reporting	
700	<i>Forming an Opinion and Reporting on Financial Statements</i>	SAS No. 134
701	<i>Communicating Key Audit Matters in the Independent Auditor's Report</i>	SAS No. 134
703	<i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>	SAS No. 136
705	<i>Modifications to the Opinion in the Independent Auditor's Report</i>	SAS No. 134
706	<i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i>	SAS No. 134
708	<i>Consistency of Financial Statements</i>	SAS No. 122
720	<i>The Auditor's Responsibilities Relating to Other Information Included in Annual Reports</i>	SAS No. 137
725	<i>Supplementary Information in Relation to the Financial Statements as a Whole</i>	SAS No. 119 ¹⁸
730	<i>Required Supplementary Information</i>	SAS No. 120 ¹⁹

(continued)

¹⁸ To address practice issues, SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, was issued in February 2010 as a SAS resulting from the Clarification and Convergence Project of the ASB, and became effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 119 was previously codified as AU section 551 until December 2013, when all AU sections were deleted from AICPA *Professional Standards*, as described in the AU-C Foreword. SAS No. 122 redesignated AU section 551 as AU-C section 725 but did not supersede SAS No. 119. AU-C section 725 contains conforming changes necessary due to the issuance of SAS No. 122.

¹⁹ To address practice issues, SAS No. 120, *Required Supplementary Information*, was issued in February 2010 as a SAS resulting from the Clarification and Convergence Project of the ASB, and became effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 120 was previously codified as AU section 558 until December 2013, when all AU sections were deleted from AICPA *Professional Standards*, as described in the AU-C Foreword. SAS No. 122 redesignated AU section 558 as AU-C section 730 but did not supersede SAS No. 120. AU-C section 730 contains conforming changes necessary due to the issuance of SAS No. 122.

<i>AU-C Section</i>	<i>Contents</i>	<i>Source</i>
800–899	Special Considerations	
800	<i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	SAS No. 122
805	<i>Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	SAS No. 122
806	<i>Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	SAS No. 122
810	<i>Engagements to Report on Summary Financial Statements</i>	SAS No. 122
900–999	Special Considerations in the United States	
905	<i>Alert That Restricts the Use of the Auditor's Written Communication</i>	SAS No. 125
910	<i>Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	SAS No. 124
915	<i>Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	SAS No. 122
920	<i>Letters for Underwriters and Certain Other Requesting Parties</i>	SAS No. 122
925	<i>Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	SAS No. 122
930	<i>Interim Financial Information</i>	SAS No. 122
935	<i>Compliance Audits</i>	SAS No. 117 ²⁰
940	<i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	SAS No. 130
945	<i>Auditor Involvement With Exempt Offering Documents</i>	SAS No. 133

²⁰ To address practice issues, SAS No. 117, *Compliance Audits*, was issued in December 2009 as a SAS resulting from the Clarification and Convergence Project of the ASB, and became effective for compliance audits for fiscal periods ending on or after June 15, 2010. SAS No. 117 was previously codified as AU section 801 until December 2013, when all AU sections were deleted from AICPA *Professional Standards*, as described in the AU-C Foreword. SAS No. 122 redesignated AU section 801 as AU-C section 935 but did not supersede SAS No. 117. AU-C section 935 contains conforming changes necessary due to the issuance of SAS No. 122.

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

Statement on Auditing Standards Nos. 1–121

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

(continued)

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>
27	Dec. 1979	<i>Supplementary Information Required by the Financial Accounting Standards Board</i>
28	June 1980	<i>Supplementary Information on the Effects of Changing Prices</i>
29	July 1980	<i>Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents</i>
30	July 1980	<i>Reporting on Internal Accounting Control</i>
31	Aug. 1980	<i>Evidential Matter</i>
32	Oct. 1980	<i>Adequacy of Disclosure of Financial Statements</i>
33	Oct. 1980	<i>Supplementary Oil and Gas Reserve Information</i>
34	Mar. 1981	<i>The Auditor's Considerations When a Question Arises About an Entity's Continued Existence</i>
35	April 1981	<i>Special Reports — Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement</i>
36	April 1981	<i>Review of Interim Financial Information</i>
37	April 1981	<i>Filings Under Federal Securities Statutes</i>
38	April 1981	<i>Letters for Underwriters</i>
39	June 1981	<i>Audit Sampling</i>
40	Feb. 1982	<i>Supplementary Mineral Reserve Information</i>
41	April 1982	<i>Working Papers</i>
42	Sept. 1982	<i>Reporting on Condensed Financial Statements and Selected Financial Data</i>
43	Aug. 1982	<i>Omnibus Statement on Auditing Standards</i>
44	Dec. 1982	<i>Special-Purpose Reports on Internal Accounting Control at Service Organizations</i>
45	Aug. 1983	<i>Omnibus Statement on Auditing Standards — 1983</i>
46	Sept. 1983	<i>Consideration of Omitted Procedures After the Report Date</i>
47	Dec. 1983	<i>Audit Risk and Materiality in Conducting an Audit</i>
48	July 1984	<i>The Effects of Computer Processing on the Audit of Financial Statements</i>
49	Sept. 1984	<i>Letters for Underwriters</i>
50	July 1986	<i>Reports on the Application of Accounting Principles</i>
51	July 1986	<i>Reporting on Financial Statements Prepared for Use in Other Countries</i>
52	April 1988	<i>Omnibus Statement on Auditing Standards — 1987</i>
53	April 1988	<i>The Auditor's Responsibility to Detect and Report Errors and Irregularities</i>
54	April 1988	<i>Illegal Acts by Clients</i>
55	April 1988	<i>Consideration of Internal Control in a Financial Statement Audit</i>
56	April 1988	<i>Analytical Procedures</i>
57	April 1988	<i>Auditing Accounting Estimates</i>

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>
58	April 1988	<i>Reports on Audited Financial Statements</i>
59	April 1988	<i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i>
60	April 1988	<i>Communication of Internal Control Related Matters Noted in an Audit</i>
61	April 1988	<i>Communication With Audit Committees</i>
62	April 1989	<i>Special Reports</i>
63	April 1989	<i>Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance</i>
64	Dec. 1990	<i>Omnibus Statement on Auditing Standards — 1990</i>
65	April 1991	<i>The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</i>
66	June 1991	<i>Communication of Matters About Interim Financial Information Filed or to Be Filed With Specified Regulatory Agencies — An Amendment to SAS No. 36, Review of Interim Financial Information</i>
67	Nov. 1991	<i>The Confirmation Process</i>
68	Dec. 1991	<i>Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance</i>
69	Jan. 1992	<i>The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles</i>
70	April 1992	<i>Service Organizations</i>
71	May 1992	<i>Interim Financial Information</i>
72	Feb. 1993	<i>Letters for Underwriters and Certain Other Requesting Parties</i>
73	July 1994	<i>Using the Work of a Specialist</i>
74	Feb. 1995	<i>Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance</i>
75	Sept. 1995	<i>Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement</i>
76	Sept. 1995	<i>Amendments to Statement on Auditing Standards No. 72, Letters for Underwriters and Certain Other Requesting Parties</i>
77	Nov. 1995	<i>Amendments to Statements on Auditing Standards No. 22, Planning and Supervision, No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, and No. 62, Special Reports</i>
78	Dec. 1995	<i>Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55</i>
79	Dec. 1995	<i>Amendment to Statement on Auditing Standards No. 58, Reports on Audited Financial Statements</i>

(continued)

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>
80	Dec. 1996	<i>Amendment to Statement on Auditing Standards No. 31, Evidential Matter</i>
81	Dec. 1996	<i>Auditing Investments</i>
82	Feb. 1997	<i>Consideration of Fraud in a Financial Statement Audit</i>
83	Oct. 1997	<i>Establishing an Understanding With the Client</i>
84	Oct. 1997	<i>Communications Between Predecessor and Successor Auditors</i>
85	Nov. 1997	<i>Management Representations</i>
86	Mar. 1998	<i>Amendment to Statement on Auditing Standards No. 72, Letters for Underwriters and Certain Other Requesting Parties</i>
87	Sept. 1998	<i>Restricting the Use of an Auditor's Report</i>
88	Dec. 1999	<i>Service Organizations and Reporting on Consistency</i>
89	Dec. 1999	<i>Audit Adjustments</i>
90	Dec. 1999	<i>Audit Committee Communications</i>
91	Apr. 2000	<i>Federal GAAP Hierarchy</i>
92	Sept. 2000	<i>Auditing Derivative Instruments, Hedging Activities, and Investments in Securities</i>
93	Oct. 2000	<i>Omnibus Statement on Auditing Standards — 2000</i>
94	May 2001	<i>The Effect of Information Technology on the Auditor's Consideration of Internal Control in a Financial Statement Audit</i>
95	Dec. 2001	<i>Generally Accepted Auditing Standards</i>
96	Jan. 2002	<i>Audit Documentation</i>
97	June 2002	<i>Amendment to Statement on Auditing Standards No. 50, Reports on the Application of Accounting Principles</i>
98	Sept. 2002	<i>Omnibus Statement on Auditing Standards — 2002</i>
99	Oct. 2002	<i>Consideration of Fraud in a Financial Statement Audit</i>
100	Nov. 2002	<i>Interim Financial Information</i>
101	Jan. 2003	<i>Auditing Fair Value Measurements and Disclosures</i>
102	Dec. 2005	<i>Defining Professional Requirements in Statements on Auditing Standards</i>
103	Dec. 2005	<i>Audit Documentation</i>
104	Mar. 2006	<i>Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures ("Due Professional Care in the Performance of Work")</i>
105	Mar. 2006	<i>Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards</i>
106	Mar. 2006	<i>Audit Evidence</i>
107	Mar. 2006	<i>Audit Risk and Materiality in Conducting an Audit</i>

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>
108	Mar. 2006	<i>Planning and Supervision</i>
109	Mar. 2006	<i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>
110	Mar. 2006	<i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>
111	Mar. 2006	<i>Amendment to Statement on Auditing Standards No. 39, Audit Sampling</i>
112	May 2006	<i>Communicating Internal Control Related Matters Identified in an Audit</i>
113	Nov. 2006	<i>Omnibus Statement on Auditing Standards — 2006</i>
114	Dec. 2006	<i>The Auditor's Communication With Those Charged With Governance</i>
115	Sept. 2008	<i>Communicating Internal Control Related Matters Identified in an Audit</i>
116	Feb. 2009	<i>Interim Financial Information</i>
117	Dec. 2009	<i>Compliance Audits</i>
118	Feb. 2010	<i>Other Information in Documents Containing Audited Financial Statements</i>
119	Feb. 2010	<i>Supplementary Information in Relation to the Financial Statements as a Whole</i>
120	Feb. 2010	<i>Required Supplementary Information</i>
121	Feb. 2011	<i>Revised Applicability of Statement on Auditing Standards No. 100, Interim Financial Information</i>

Statement on Auditing Procedure Nos. 1–54

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

No.	Date Issued	Title
28	Oct. 1957	<i>Special Reports</i>
29	Oct. 1958	<i>Scope of the Independent Auditor's Review of Internal Control</i>
30	Sept. 1960	<i>Responsibilities and Functions of the Independent Auditor in the Examination of Financial Statements</i>
31	Oct. 1961	<i>Consistency</i>
32	Sept. 1962	<i>Qualifications and Disclaimers</i>
33	Dec. 1963	<i>Auditing Standards and Procedures (a codification)</i>
34	Sept. 1965	<i>Long-Term Investments</i>
35	Nov. 1965	<i>Letters for Underwriters</i>
36	Aug. 1966	<i>Revision of "Extensions of Auditing Procedure" Relating to Inventories</i>
37	Sept. 1966	<i>Special Report: Public Warehouses Controls and Auditing Procedures for Goods Held</i>
38	Sept. 1967	<i>Unaudited Financial Statements</i>
39	Sept. 1967	<i>Working Papers</i>
40	Oct. 1968	<i>Reports Following a Pooling of Interests</i>
41	Oct. 1969	<i>Subsequent Discovery of Facts Existing at the Date of the Auditor's Report</i>
42	Jan. 1970	<i>Reporting When a Certified Public Accountant Is Not Independent</i>
43	Sept. 1970	<i>Confirmation of Receivables and Observation of Inventories</i>
44	Apr. 1971	<i>Reports Following a Pooling of Interests</i>
45	July 1971	<i>Using the Work and Reports of Other Auditors</i>
46	July 1971	<i>Piecemeal Opinions</i>
47	Sept. 1971	<i>Subsequent Events</i>
48	Oct. 1971	<i>Letters for Underwriters</i>
49	Nov. 1971	<i>Reports on Internal Control</i>
50	Nov. 1971	<i>Reporting on the Statement of Changes in Financial Position</i>
51	July 1972	<i>Long-Term Investments</i>
52	Oct. 1972	<i>Reports on Internal Control Based on Criteria Established by Governmental Agencies</i>
53	Nov. 1972	<i>Reporting on Consistency and Accounting Changes</i>
54	Nov. 1972	<i>The Auditor's Study and Evaluation of Internal Control</i>

AU-C Introduction

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AU-C Introduction

Foreword

Authority of the SASs

SASs are issued by the ASB, the senior committee of the AICPA designated to issue pronouncements on auditing matters applicable to the preparation and issuance of audit reports for entities not subject to the oversight authority of the PCAOB (that is, those entities whose audits are not within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended). The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit (the auditor) of the financial statements of a nonissuer¹ to comply with standards promulgated by the ASB. An auditor must comply with an unconditional requirement in all cases in which such requirement is relevant. An auditor also must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant. However, if, in rare circumstances, an auditor judges it necessary to depart from a relevant presumptively mandatory requirement, the auditor must document the justification for the departure and how the alternative audit procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

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

AUDITING STANDARDS BOARD
Tracy W. Harding, *Chair*
Jennifer Burns, Chief Auditor — AICPA

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

AU-C Preface

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

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

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

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

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

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

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide the auditor with
 - i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
 - ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and

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

Responsibilities

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

Performance

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

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

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

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

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

Reporting

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

AU-C Glossary

Glossary of Terms^{1, 2}

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

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

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

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

acknowledgment letter. See **awareness letter**.

advisory accountant. See **reporting accountant**.

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

The use of analytical procedures as risk assessment procedures may be referred to as *analytical procedures used to plan the audit*. The auditor's

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

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

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

use of analytical procedures as substantive procedures is referred to as *substantive analytical procedures*. Also see **risk assessment procedures**, **scanning**, and **substantive procedure**.

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

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

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

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

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

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

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

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

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

audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence is information to

which audit procedures have been applied and consists of information that corroborates or contradicts assertions in the financial statements.

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

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

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

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

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

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

audited financial statements. In the context of section 560, *Subsequent Events and Subsequently Discovered Facts*, reference to *audited financial statements* means the financial statements, together with the auditor's report thereon. In the context of section 810, the term *audited financial statements* refers to those financial statements audited by the auditor in accordance with GAAS and from which the summary financial statements are derived. Also see **financial statements**.

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

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

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

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

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

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

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

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

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

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

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

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

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

capsule financial information (in the context of section 920, *Letters for Underwriters and Certain Other Requesting Parties*). Unaudited summarized interim financial information for periods subsequent to the periods covered by the audited financial statements or unaudited condensed interim financial information included in the securities offering. Capsule

financial information may be presented in narrative or tabular form and is often provided for the most recent interim period and for the corresponding period of the prior year.

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

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

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

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

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

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

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

comparative information. Prior period information presented for purposes of comparison with current period amounts or disclosures that is not in the form of a complete set of financial statements. Comparative information includes prior period information presented as condensed financial statements or summarized financial information. Also see **condensed financial statements** and **summary financial statements**.

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

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

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

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

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

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

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

component. An entity or business activity for which group or component management prepares financial information that is required by the applicable financial reporting framework to be included in the group financial statements.

In the context of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, an investment accounted for under the equity method constitutes a component. Investments accounted for under the cost method may be analogous to a component when the work and reports of other auditors constitute a major element of evidence for such investments. Also see **group** and **significant component**.

component auditor. An auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. A component auditor may be part of the group engagement partner's firm, a network firm of the group engagement partner's firm, or another firm.

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

component management. Management responsible for preparing the financial information of a component. Also see **management**.

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

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

- a. The control environment
- b. The entity's risk assessment process

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

- c. The information system, including the related business processes relevant to financial reporting and communication
- d. Control activities
- e. Monitoring of controls

Also see **internal control**.

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

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

- a. The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial statements by way of inclusion, consolidation, proportionate consolidation, or the equity or cost methods of accounting
- b. The aggregation in combined financial statements of the financial information of components that are under common control

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

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

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

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

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

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

- i. policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be

documented, explicitly stated in communications, or implied through actions and decisions.

- ii. procedures are actions to implement policies.

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

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

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

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

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

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

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

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

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

deficiency in internal control over compliance (in the context of adapting GAAS to a compliance audit). A deficiency in internal control over compliance exists when the design or operation of a control over compliance

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

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

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

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

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

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

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

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

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

documentation. See **audit documentation**.

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

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

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

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

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

emphasis-of-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements. Also see **other-matter paragraph**.

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

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

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

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

engagement team. All partners and staff performing the audit engagement and any other individuals who perform audit procedures on the engagement, excluding an auditor's external specialist⁸ and internal auditors who provide direct assistance on an engagement.⁹

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

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

- a. identifying **business risks relevant to financial reporting objectives**,
- b. estimating **the significance of the risks**,

⁶ See footnote 3.

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

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

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

- c. assessing **the likelihood of their occurrence, and**
- d. deciding **about actions to address those risks.**

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

evidence. See **audit evidence.**

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

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

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

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

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

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

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

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

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

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

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

fair value accounting estimates (in the context of section 540A). Accounting estimates involving measurement at fair value. Also see **accounting estimate.**

financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items

appearing in the financial statements; for example, U.S. GAAP, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework.

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

- a. acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- b. acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

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

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

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

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

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

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

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

GAGAS. See *Government Auditing Standards*.

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

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

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

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

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

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

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

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

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

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

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

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

group. All the components whose financial information is included in the group financial statements. A group always has more than one component. Also see **component** and **significant component**.

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

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

group engagement partner. The partner or other person in the firm who is responsible for the group audit engagement and its performance and for the auditor's report on the group financial statements that is issued on behalf of the firm. When joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team. *Group engagement partner* and *firm* refer to their governmental equivalents when relevant. Also see **engagement partner** and **partner**.

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

group financial statements. Financial statements that include the financial information of more than one component. The term *group financial statements* also refers to combined financial statements aggregating the financial information prepared by components that are under common control. Also see **financial statements**.

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

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

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

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

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

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

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

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

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

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

- a. Independence of mind is the state of mind that permits a member to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- b. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the safeguards applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or member of the attest engagement team is compromised.

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

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

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

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

inherent risk factors. Characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk.

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

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

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

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

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

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

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

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

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

- i. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity;
- ii. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the applicable financial reporting framework, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and
- iii. provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

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

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

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

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

Also see **nonissuer**.

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

- i. an *IT application* is a program or a set of programs that is used in the initiation, processing, recording, and reporting of transactions or information. IT applications include data warehouses and report writers.
- ii. the IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.

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

judgmental misstatements. Differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate. Also see **factual misstatements**, **misstatement**, and **projected misstatements**.

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

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

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

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

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

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

- a. Circumstances beyond the control of the entity
- b. Circumstances relating to the nature or timing of the auditor's work
- c. Limitations imposed by management

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

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

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

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

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

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

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

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

material weakness. A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probably as defined as follows:

reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

probable. The future event or events are likely to occur.

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

reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

probable. The future event or events are likely to occur.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

nonstatistical sampling. See **statistical sampling**.

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

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

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

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

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

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

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

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

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

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

other-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report. Also see **emphasis-of-matter paragraph**.

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

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

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

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

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

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

personnel. Partners and staff in the firm.

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

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent or could represent a substantial proportion of the financial statements; or
- with regard to disclosures, are fundamental to users' understanding of the financial statements.

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

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

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

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

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

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

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

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide the auditor with
 - i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and

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

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

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

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

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

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

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

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

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

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

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

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

projected misstatements. The auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn.

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

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

purchase agreement. See **underwriter.**

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

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

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

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

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

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

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

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

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

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

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

related notes. See **financial statements.**

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

relevant assertions. An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material

¹⁴ See footnote 11.

misstatement. A risk of material misstatement exists when (a) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (b) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude). The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (that is, the determination is based on inherent risk).

relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

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

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

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

- a. Management's description of the service organization's system
- b. A written assertion by management of the service organization about whether, in all material respects, and based on suitable criteria
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date
- c. A service auditor's report that expresses an opinion on the matters in b(i–ii)

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

- a. Management's description of the service organization's system
- b. A written assertion by management of the service organization about whether in all material respects and, based on suitable criteria
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period
 - ii. the controls related to the control objectives stated in management's description of the service organization's system

were suitably designed throughout the specified period to achieve those control objectives

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

c. A service auditor's report that

- i. expresses an opinion on the matters in *b(i-iii)*
- ii. includes a description of the service auditor's tests of controls and the results thereof

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

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

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

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

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

required supplementary information. Information that a designated accounting standards setter requires to accompany an entity's basic financial

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

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

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

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

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

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

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

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

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

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

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

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

inherent risk of noncompliance. The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.

control risk of noncompliance. The risk that noncompliance with a compliance requirement that could occur and that could be

material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

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

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

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

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

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

sampling unit. The individual items constituting a population.

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

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

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

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

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

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

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

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

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

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

significant deficiency. A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance. Also see **material weakness**.

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

significant risk. An identified risk of material misstatement

- i. for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or
- ii. that is to be treated as a significant risk in accordance with the requirements of other AU-C sections.

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

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

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

- a. Concentration of ownership and management in a small number of individuals; and
- b. One or more of the following:
 - i. Straightforward or uncomplicated transactions
 - ii. Simple record keeping
 - iii. Few lines of business and few products within business lines
 - iv. Few internal controls
 - v. Few levels of management with responsibility for a broad range of controls
 - vi. Few personnel, many having a wide range of duties

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

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

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

- a. **cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. **contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- e. **other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

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

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

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

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

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

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

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

- a. Random selection of the sample items
- b. The use of an appropriate statistical technique to evaluate sample results, including measurement of sampling risk

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

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

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

subsequently discovered facts. Facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

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

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

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

- a. tests of details (classes of transactions, account balances, and disclosures) and
- b. substantive analytical procedures.

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

successor auditor. See **auditor**.

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

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

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

¹⁵ See footnote 11.

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

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

- i. Control environment
- ii. The entity's risk assessment process
- iii. The entity's process to monitor the system of internal control
- iv. The information system and communication
- v. Control activities

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

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

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

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

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

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

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

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

tolerable rate of deviation. A rate of deviation set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that

the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

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

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

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

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

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

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

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

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

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

underwriting agreement. See **underwriter.**

unmodified opinion. The opinion expressed by the auditor when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. Also see **group audit opinion** and **modified opinion.**

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

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

¹⁶ See footnote 13.

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

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

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

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

Yellow Book. See *Government Auditing Standards*.

AU-C Sections 200–299

GENERAL PRINCIPLES AND RESPONSIBILITIES

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

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

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AU-C Section 200

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

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

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

NOTE

In July 2020, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) Nos. 142, *Audit Evidence*, and 143, *Auditing Accounting Estimates and Related Disclosures*, which contain amendments to this section.

- The amendments to SAS No. 142 are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.
- The amendments to SAS No. 143 are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

In October 2021, the ASB issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with generally accepted auditing standards (GAAS). Specifically, it sets out the overall

objectives of the independent auditor (the auditor) and explains the nature and scope of an audit designed to enable the auditor to meet those objectives. It also explains the scope, authority, and structure of GAAS and includes requirements establishing the general responsibilities of the auditor applicable in all engagements conducted in accordance with GAAS, including the obligation to comply with GAAS. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

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

Association With Financial Statements

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

An Audit of Financial Statements

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

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

.06 As the basis for the auditor's opinion, GAAS require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high, but not absolute, level of assurance. It is obtained

when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of an audit that result in most of the audit evidence, on which the auditor draws conclusions and bases the auditor's opinion, being persuasive rather than conclusive. (Ref: par. .A32–.A56)

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

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

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

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

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

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

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

Effective Date

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

Overall Objectives of the Auditor

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

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

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

Definitions

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

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

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. *Sufficiency of audit evidence* is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence. *Appropriateness of audit evidence* is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

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

Auditor. The term used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. When an AU-C section expressly intends that a requirement or responsibility

be fulfilled by the engagement partner, the term *engagement partner* rather than *auditor* is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant.

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

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

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

- a. acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or
- b. acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

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

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

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

Interpretive publications. Auditing interpretations of GAAS, exhibits to GAAS, auditing guidance included in AICPA Audit and

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

Accounting Guides, and AICPA Auditing Statements of Position (SOP).

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

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

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

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

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide the auditor with
 - i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and
 - iii. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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

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

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

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

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

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

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

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

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

Requirements

Ethical Requirements Relating to an Audit of Financial Statements

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

.16 The auditor should comply with relevant ethical requirements relating to financial statement audit engagements. (Ref: par. .A15–.A21)

Professional Skepticism

.17 The auditor should plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: par. .A22–.A26)

Professional Judgment

.18 The auditor should exercise professional judgment in planning and performing an audit of financial statements. (Ref: par. .A27–.A31)

Sufficient Appropriate Audit Evidence and Audit Risk

.19 To obtain reasonable assurance, the auditor should obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: par. .A32–.A56)

Conduct of an Audit in Accordance With GAAS

Complying With AU-C Sections Relevant to the Audit

.20 The auditor should comply with all AU-C sections relevant to the audit. An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist. (Ref: par. .A57–.A62)

.21 The auditor should have an understanding of the entire text of an AU-C section, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: par. .A63–.A71)

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

Objectives Stated in Individual AU-C Sections

.23 To achieve the overall objectives of the auditor, the auditor should use the objectives stated in individual AU-C sections in planning and performing the audit considering the interrelationships within GAAS to (Ref: par. .A72–.A74)

- a. determine whether any audit procedures in addition to those required by individual AU-C sections are necessary in pursuance of the objectives stated in each AU-C section; and (Ref: par. .A75)
- b. evaluate whether sufficient appropriate audit evidence has been obtained. (Ref: par. .A76)

Complying With Relevant Requirements

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

- a. the entire AU-C section is not relevant; or
- b. the requirement is not relevant because it is conditional and the condition does not exist. (Ref: par. .A77–.A78)

Defining Professional Responsibilities in GAAS

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

- Unconditional requirements. The auditor must comply with an unconditional requirement in all cases in which such requirement is relevant. GAAS use the word "must" to indicate an unconditional requirement.
- Presumptively mandatory requirements. The auditor must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant except in rare circumstances discussed in paragraph .26. GAAS use the word "should" to indicate a presumptively mandatory requirement. (Ref: par. .A79)

.26 In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the auditor should perform alternative audit procedures to achieve the intent of that requirement. The need for the auditor to depart from a relevant presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the audit, that procedure would be ineffective in achieving the intent of the requirement. (Ref: par. .A80)

Interpretive Publications

.27 The auditor should consider applicable interpretive publications in planning and performing the audit. (Ref: par. .A81)

Other Auditing Publications

.28 In applying the auditing guidance included in an other auditing publication, the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. (Ref: par. .A82–.A84)

Failure to Achieve an Objective

.29 If an objective in a relevant AU-C section cannot be achieved, the auditor should evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with GAAS, to modify the auditor's opinion or withdraw from the engagement (when withdrawal is possible under applicable law or regulation). Failure to achieve an objective represents a significant finding or issue requiring documentation in accordance with section 230, *Audit Documentation*.⁴ (Ref: par. .A85–.A86)

Application and Other Explanatory Material**An Audit of Financial Statements****Scope of the Audit (Ref: par. .04)**

.A1 The auditor's opinion on the financial statements addresses whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is

⁴ Paragraph .08c of section 230, *Audit Documentation*.

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

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

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

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide the auditor with
 - i. access to all information of which management and, when appropriate, those charged with governance are aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - ii. additional information that the auditor may request from management and, when appropriate, those charged with governance for the purpose of the audit; and
 - iii. unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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

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

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

.A4 The auditor may make suggestions about the form or content of the financial statements, or assist management by preparing them, in whole or in part, based on information provided to the auditor by management during the

performance of the audit. * However, the auditor's responsibility for the audited financial statements is confined to the expression of the auditor's opinion on them. [Revised, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3.]

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

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

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

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

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

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

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

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

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

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

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

.A10 Section 210A, *Terms of Engagement*, establishes requirements and provides guidance on determining the acceptability of the applicable financial reporting framework.⁵ Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses engagements in which the auditor issues a report in connection with financial statements prepared in accordance with a special purpose framework.

.A11 Because of the significance of the premise to the conduct of an audit, the auditor is required to obtain the agreement of management and, when appropriate, those charged with governance, that they acknowledge and understand that they have the responsibilities set out in paragraph .A2 as a precondition for accepting the audit engagement.⁶

⁵ Paragraph .06a of section 210A, *Terms of Engagement*.

⁶ Paragraph .06b of section 210A.

Considerations Specific to Audits of Governmental Entities

.A12 The requirements for audits of the financial statements of governmental entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a governmental entity is conducted, may include additional responsibilities, such as the responsibility for the execution of transactions and events in accordance with law, regulation, or other authority. (See paragraph .A63.)

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

Materiality (Ref: par. .07)*Considerations Specific to Audits of Governmental Entities*

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

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

.A15 The auditor is subject to relevant ethical requirements relating to financial statement audit engagements. Ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.

.A16 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

.A17 In the case of an audit engagement, it is in the public interest and, therefore, required by this section, that the auditor be independent of the entity subject to the audit. The concept of independence refers to both independence in fact and independence in appearance. The auditor's independence from the entity safeguards the auditor's ability to form an audit opinion without being affected by influences that might compromise that opinion. Independence enhances the auditor's ability to act with integrity, to be objective, and to maintain an attitude of professional skepticism. Independence implies an impartiality that recognizes an obligation to be fair not only to management and those

charged with governance of an entity but also users of the financial statements who may rely upon the independent auditor's report. Guidance on threats to independence is set forth in the AICPA's "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A18 When the auditor is not independent but is required by law or regulation to report on the financial statements, section 705, *Modifications to the Opinion in the Independent Auditor's Report*, applies.

.A19 Due care requires the auditor to discharge professional responsibilities with competence and to have the appropriate capabilities to perform the audit and enable an appropriate auditor's report to be issued.

.A20 QM section 10A, *A Firm's System of Quality Control*, sets out the firm's responsibilities to establish and maintain its system of quality control for audit engagements, and to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.⁷ Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, addresses the engagement partner's responsibilities regarding relevant ethical requirements. These include remaining alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team, determining, in consultation with others in the firm as appropriate, the appropriate action if matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, and forming a conclusion on compliance with independence requirements that apply to the audit engagement.⁸ Section 220A recognizes that the engagement team is entitled to rely on a firm's system of quality control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.

Considerations Specific to Audits of Governmental Entities

.A21 In addition to the AICPA Code of Professional Conduct and GAAS, *Government Auditing Standards*, which may be required by law, regulation, contract, or grant agreement in audits of governmental entities and entities that receive government awards, set forth relevant ethical principles and auditing standards, including standards on auditor independence, professional judgment, competence, and audit quality control and assurance.

Professional Skepticism (Ref: par. .17)

.A22 Professional skepticism includes being alert to the following, for example,

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.

⁷ Paragraphs .21–.25 of QM section 10A, *A Firm's System of Quality Control*.

⁸ Paragraphs .11–.13 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- Circumstances that suggest the need for audit procedures in addition to those required by GAAS.

.A23 Maintaining professional skepticism throughout the audit is necessary if the auditor is, for example, to reduce the risks of

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

.A24 Professional skepticism is necessary to the critical assessment of audit evidence. This includes questioning contradictory audit evidence and the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in light of the circumstances; for example, in the case when fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

.A25 The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.⁹ In cases of doubt about the reliability of information or indications of possible fraud (for example, if conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document may have been falsified), GAAS require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.¹⁰

.A26 The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive audit evidence when obtaining reasonable assurance.

Professional Judgment (Ref: par. .18)

.A27 Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and GAAS and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. In particular, professional judgment is necessary regarding decisions about the following:

- Materiality and audit risk
- The nature, timing, and extent of audit procedures used to meet the requirements of GAAS and gather audit evidence

⁹ Paragraphs .07–.09 of section 500A, *Audit Evidence*.

¹⁰ Paragraph .10 of section 500A and paragraphs .10–.11 and .16 of section 505, *External Confirmations*.

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

.A28 The distinguishing feature of professional judgment expected of an auditor is that such judgment is exercised based on competencies necessary to achieve reasonable judgments, developed by the auditor through relevant training, knowledge, and experience.

.A29 The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as those required by section 220A, assists the auditor in making informed and reasonable judgments.¹¹

.A30 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of auditing standards and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report.

.A31 Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant findings or issues arising during the audit.¹² Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or by sufficient appropriate audit evidence.

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

Sufficiency and Appropriateness of Audit Evidence

.A32 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit¹³) or a firm's quality control

¹¹ Paragraph .20 of section 220A.

¹² Paragraph .08 of section 230.

¹³ Paragraph .10 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by a specialist employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and, therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

.A33 The sufficiency and appropriateness of audit evidence are interrelated. *Sufficiency* is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

.A34 *Appropriateness* is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

.A35 Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby to enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. Section 500A, *Audit Evidence*, and other relevant AU-C sections, establish additional requirements and provide further guidance applicable throughout the audit regarding the auditor's considerations in obtaining sufficient appropriate audit evidence.

Audit Risk

.A36 Audit risk is a function of the risks of material misstatement and detection risk. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

.A37 For purposes of GAAS, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant. Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks, such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

Risks of Material Misstatement

.A38 The risks of material misstatement exist at two levels:

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

.A39 Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

.A40 Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk. Auditors use various approaches to accomplish the objective of assessing the risks of material misstatement. For example, the auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an acceptable level of detection risk. Some auditors find such a model to be useful when planning audit procedures.

.A41 The risks of material misstatement at the assertion level consist of two components: inherent risk and control risk. Inherent risk and control risk are the entity's risks; they exist independently of the audit of the financial statements.

.A42 Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations or for accounts consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

.A43 Control risk is a function of the effectiveness of the design, implementation, and maintenance of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation and fair presentation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal control. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. GAAS provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures to be performed.¹⁴

.A44 GAAS do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the risks of material misstatement. However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages or in nonquantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

¹⁴ Paragraph .08 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

.A45 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

Detection Risk

.A46 For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

.A47 Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. The following matters assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results:

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

.A48 Section 300, *Planning an Audit*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

Inherent Limitations of an Audit

.A49 The auditor is not expected to, and cannot, reduce audit risk to zero and cannot, therefore, obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because inherent limitations of an audit exist, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The principal inherent limitations of an audit arise from

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

The Nature of Financial Reporting

.A50 The preparation and fair presentation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and a range exists of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability that cannot be eliminated by the application of additional auditing procedures. For example, this

is often the case with respect to certain accounting estimates that are dependent on predictions of future events. Nevertheless, GAAS require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and to related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.¹⁵

The Nature of Audit Procedures

A51 There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

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

Timeliness of Financial Reporting and the Balance Between Benefit and Cost

A52 The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, FASB's Statements of Financial Accounting Concepts). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and so as to achieve a balance between benefit and cost, recognizing that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is fraudulent or erroneous until proved otherwise.

A53 Consequently, it is necessary for the auditor to

- plan the audit so that it will be performed in an effective manner;

¹⁵ See section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, and section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

- direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- use testing and other means of examining populations for misstatements.

.A54 In light of the approaches described in paragraph .A53, GAAS contain requirements for the planning and performance of the audit and requires the auditor, among other things, to

- have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;¹⁶ and
- use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.¹⁷

Other Matters That Affect the Inherent Limitations of an Audit

.A55 In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include the following:

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

Relevant AU-C sections identify specific audit procedures to assist in lessening the effect of the inherent limitations. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.]

.A56 Because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in accordance with GAAS is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof, and the suitability of the

¹⁶ See section 315A.

¹⁷ See section 330, section 500A, section 520, *Analytical Procedures*, and section 530, *Audit Sampling*.

auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

Conduct of an Audit in Accordance With GAAS

Nature of GAAS (Ref: par. .20)

.A57 The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit to comply with standards promulgated by the Auditing Standards Board (ASB). The ASB develops and issues standards in the form of SASs through a process that includes deliberation in meetings open to the public, public exposure of proposed SASs, and a formal vote. The SASs are codified in AU-C sections. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A58 GAAS provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. GAAS address the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics.

.A59 The scope, effective date, and any specific limitation of the applicability of a specific AU-C section are made clear in the AU-C section. Unless otherwise stated in the AU-C section, the auditor is permitted to apply an AU-C section before the effective date specified therein.

.A60 In certain audit engagements, the auditor also may be required to comply with other auditing requirements in addition to GAAS. GAAS do not override law or regulation that governs an audit of financial statements. In the event that such law or regulation differs from GAAS, an audit conducted only in accordance with law or regulation will not necessarily comply with GAAS.

.A61 The auditor may also conduct the audit in accordance with both GAAS and

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

In such cases, in addition to complying with each of the AU-C sections relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the other auditing standards.

Considerations Specific to Audits of Governmental Entities

.A62 GAAS are relevant to financial statement audits of governmental entities. The auditor's responsibilities, however, may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with GAAS. These additional responsibilities are not addressed in GAAS. *Government Auditing Standards* are relevant for engagements to audit U.S. government entities, and when required by law, regulation, contract, or grant agreement. The appendix to *Government Auditing*

Standards includes a listing of some of the laws, regulations, and guidelines that require use of *Government Auditing Standards*.

Contents of GAAS (Ref: par. .21)

.A63 In addition to objectives and requirements, an AU-C section contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the AU-C section and definitions. The entire text of an AU-C section, therefore, is relevant to an understanding of the objectives stated in an AU-C section and the proper application of the requirements of an AU-C section.

.A64 When necessary, the application and other explanatory material provides further explanation of the requirements of an AU-C section and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.
- include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section. The auditor is required by paragraph .21 to understand the application and other explanatory material; how the auditor applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AU-C section. The words "may," "might," and "could" are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AU-C section.

.A65 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AU-C section or within the title and introduction of the appendix itself.

.A66 Introductory material may include, as needed, such matters as explanation of the following:

- The purpose and scope of the AU-C section, including how the AU-C section relates to other AU-C sections.
- The subject matter of the AU-C section.
- The respective responsibilities of the auditor and others regarding the subject matter of the AU-C section.
- The context in which the AU-C section is set.

.A67 An AU-C section may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of GAAS. These are provided to assist in the consistent application and interpretation of GAAS, and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout GAAS.

.A68 When appropriate, additional considerations specific to audits of smaller, less complex entities and governmental entities are included within the application and other explanatory material of an AU-C section. These

additional considerations assist in the application of the requirements of GAAS in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of GAAS.

Considerations Specific to Audits of Smaller, Less Complex Entities

.A69 For purposes of specifying additional considerations to audits of smaller, less complex entities, a *smaller, less complex entity* refers to an entity that typically possesses qualitative characteristics, such as the following:

- a. Concentration of ownership and management in a small number of individuals; and
- b. One or more of the following:
 - i. Straightforward or uncomplicated transactions
 - ii. Simple record keeping
 - iii. Few lines of business and few products within business lines
 - iv. Few internal controls
 - v. Few levels of management with responsibility for a broad range of controls
 - vi. Few personnel, many having a wide range of duties

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

.A70 GAAS refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the *owner-manager*.

Considerations Specific to Governmental Entities

.A71 Considerations specific to governmental entities may also be applicable to nongovernmental entities that receive government awards. In audits of governmental entities, the considerations specific to audits of smaller, less complex entities may not apply, even if the governmental entity has few employees, simple operations, or a relatively small budget, because small governmental entities (1) may have complex transactions with federal and state governments, (2) are required to comply with laws, regulations, policies, and systems determined by a higher level of government, and (3) are subject to additional public expectations of accountability and transparency.

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

.A72 Each AU-C section contains one or more objectives that provide a link between the requirements and the overall objectives of the auditor. The objectives in individual AU-C sections serve to focus the auditor on the desired outcome of the AU-C section, while being specific enough to assist the auditor in

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

.A73 Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph .12. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

.A74 In using the objectives, the auditor is required to consider the interrelationships among the AU-C sections. This is because, as indicated in paragraph .A58, the AU-C sections in some cases address general responsibilities and in others address the application of those responsibilities to specific topics. For example, this section requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each AU-C section. At a more detailed level, section 315A and section 330 contain, among other things, objectives and requirements that address the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An AU-C section addressing specific aspects of the audit may expand on how the objectives and requirements of other AU-C sections are to be applied regarding the subject of that AU-C section, but does not repeat those objectives and requirements. For example, section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures*, expands on how the objectives and requirements of section 315A and section 330 are to be applied regarding the subject of section 540A, but section 540A does not repeat those objectives and requirements. Thus, in achieving the objective stated in section 540A, the auditor considers the objectives and requirements of other relevant AU-C sections.

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

.A75 The requirements of GAAS are designed to enable the auditor to achieve the objectives specified in GAAS, and thereby the overall objectives of the auditor. The proper application of the requirements of GAAS by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in GAAS, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of GAAS and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by GAAS to meet the objectives specified in GAAS.

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

.A76 The auditor is required by paragraph .23b to use the objectives stated in the relevant AU-C sections to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If, as a result, the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph .23b:

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

When none of the preceding is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by GAAS to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

Complying With Relevant Requirements

Relevant Requirements (Ref: par. .24)

.A77 In some cases, an AU-C section (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in section 610, *Using the Work of Internal Auditors*, is relevant. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A78 Within a relevant AU-C section, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

- The requirement to modify the auditor's opinion if there is a limitation of scope¹⁸ represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies and material weaknesses in internal control identified during the audit to management and those charged with governance,¹⁹ which depends on the existence and identification of such deficiencies, represents an implicit conditional requirement.

In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the auditor may be required to withdraw from the audit engagement, when withdrawal is possible under applicable law or regulation, or the auditor may be required to perform a certain action, unless prohibited by law or regulation. Depending on the jurisdiction, the legal or regulatory permission or prohibition may be explicit or implicit.

Presumptively Mandatory Requirements (Ref: par. .25)

.A79 If an AU-C section provides that a procedure or action is one that the auditor *should consider*, consideration of the procedure or action is presumptively required. Whether the auditor performs the procedure or action is based upon the outcome of the auditor's consideration and the auditor's professional judgment.

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

.A80 Section 230 establishes documentation requirements in those exceptional circumstances when the auditor departs from a relevant requirement.²⁰ GAAS do not call for compliance with a requirement that is not relevant in the circumstances of the audit.

Interpretive Publications (Ref: par. .27)

.A81 Interpretive publications are not auditing standards. *Interpretive publications* are recommendations on the application of GAAS in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. Auditing interpretations of GAAS are included in AU-C sections. AICPA Audit and Accounting Guides and auditing SOPs are listed in AU-C appendix D, *AICPA Audit and Accounting Guides and Statements of Position*.

¹⁸ See section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

¹⁹ Paragraph .11 of section 265.

²⁰ Paragraph .13 of section 230.

Other Auditing Publications (Ref: par. .28)

.A82 Other auditing publications have no authoritative status; however, they may help the auditor understand and apply GAAS. The auditor is not expected to be aware of the full body of other auditing publications.

.A83 Although the auditor determines the relevance of these publications in accordance with paragraph .28, the auditor may presume that other auditing publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other auditing publications are listed in AU-C appendix F, *Other Auditing Publications*.

.A84 In determining whether an other auditing publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the audit, the auditor may consider the degree to which the publication is recognized as being helpful in understanding and applying GAAS and the degree to which the publisher or author is recognized as an authority in auditing matters. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

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

.A85 Whether an objective has been achieved is a matter for the auditor's professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of GAAS, and the auditor's evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in GAAS. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that

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

.A86 Audit documentation that meets the requirements of section 230 and the specific documentation requirements of other relevant AU-C sections provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. Although it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor's evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.

AU-C Section 210

Terms of Engagement

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 137; SAS No. 138; SAS No. 145; SAS No. 146; SAS No. 147.

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

Introduction

Scope of This Section

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

Effective Date

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

Objective

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

- a. establishing whether the preconditions for an audit are present and
- b. confirming that a common understanding of the terms of the audit engagement exists between the auditor and management and, when appropriate, those charged with governance.

Definitions

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

Preconditions for an audit. The use by management of an acceptable financial reporting framework in the preparation and fair presentation of the financial statements and the agreement of management and, when appropriate, those charged with governance, to the premise¹ on which an audit is conducted.

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

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

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

Requirements

Preconditions for an Audit

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

- a. determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable and (Ref: par. .A2–.A8)
- b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A9–.A12 and .A18)
 - i. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; (Ref: par. .A13)
 - ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: par. .A14–.A16)
- iii. to provide the auditor with
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - (2) additional information that the auditor may request from management for the purpose of the audit; and (Ref: par. .A17)
 - (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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

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

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

Other Factors Affecting Audit Engagement Acceptance

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

- a.* if the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- b.* if the agreement referred to in paragraph .06*b* has not been obtained.

Agreement on Audit Engagement Terms

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

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

- a.* The objective and scope of the audit of the financial statements
- b.* The responsibilities of the auditor
- c.* The responsibilities of management
- d.* A statement that because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS
- e.* Identification of the applicable financial reporting framework for the preparation of the financial statements
- f.* Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content (Ref: par. .A25)

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

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

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

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

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

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

- a. identified or suspected fraud involving
 - i. management,
 - ii. employees who have significant roles in internal control, or
 - iii. others, when the fraud resulted in a material misstatement in the financial statements.
- b. matters involving noncompliance or suspected noncompliance with laws and regulations that came to the predecessor auditor's attention during the audit, other than when matters are clearly inconsequential.

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

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

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

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

- a. the inquiries of the predecessor auditor and
- b. the results of those inquiries.

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

Recurring Audits

.16 On recurring audits, the auditor should assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of

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

the engagement, and the reminder should be documented. (Ref: par. .A38–.A39) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

Acceptance of a Change in the Terms of the Audit Engagement

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

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

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

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

- a. withdraw from the audit engagement when possible under applicable law or regulation,
- b. communicate the circumstances to those charged with governance, and
- c. determine whether any obligation, either legal, contractual, or otherwise, exists to report the circumstances to other parties, such as owners, or regulators.

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

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation

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

- a. whether users might misunderstand the auditor's report and, if so,
- b. whether the auditor would be permitted to reword the prescribed form to be in accordance with the requirements of GAAS or attach a separate report.³

If the auditor determines that rewording the prescribed form or attaching a separate report would not be permitted or would not mitigate the risk of users misunderstanding the auditor's report, the auditor should not accept the audit engagement unless the auditor is required by law or regulation to do so. An audit performed in accordance with such law or regulation does not comply with GAAS. Accordingly, for such an audit, the auditor should not include any reference to the audit having been performed in accordance with GAAS within the

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

auditor's report.⁴ (Ref: par. .A45–.A46) [Paragraph renumbered by the issuance of SAS No. 147, June 2022.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 Statement on Quality Management Standards No. 1, *A Firm's System of Quality Management* (QM sec. 10), addresses the firm's responsibilities regarding the acceptance and continuance of client relationships and specific engagements. The auditor's responsibilities regarding relevant ethical requirements, including those related to independence, in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are addressed in Statement on Auditing Standards No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C sec. 220). This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree. [As amended, effective for audits of financial statements for periods beginning on or after December 15, 2025, by SAS No. 146.]

Preconditions for an Audit

The Financial Reporting Framework (Ref: par. .06a)

.A2 An applicable financial reporting framework provides the criteria for management to present the financial statements of an entity, including the fair presentation of those financial statements. The criteria used by the auditor to evaluate or measure the subject matter, including, when relevant, a basis for presentation and disclosure, are also provided by the financial reporting framework. These criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

.A3 Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements, and the auditor does not have suitable criteria for auditing the financial statements. In many cases, the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs .A6–.A8.

Determining the Acceptability of the Financial Reporting Framework

.A4 Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)

⁴ Paragraph .22 of section 800. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

- Whether law or regulation prescribes the applicable financial reporting framework

.A5 Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. Although all the information needs of specific users cannot be met, financial information needs that are common to a wide range of users exist. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as *general purpose financial statements*.

.A6 *General purpose frameworks*. The sources of established accounting principles that are generally accepted are accounting principles promulgated by a body designated by the Council of the AICPA to establish such principles, pursuant to the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. Such financial reporting standards often are identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A7 *Special purpose frameworks*. In some cases, the financial statements will be prepared in accordance with a special purpose framework. For example, law or regulation may prescribe the financial reporting framework to be used in the preparation of financial statements for certain types of entities. Such financial statements are referred to as *special purpose financial statements*. Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses the acceptability of special purpose frameworks.⁵

.A8 After the audit engagement has been accepted, the auditor may encounter deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the previously agreed-upon terms will have changed, and the auditor is required by paragraph .19 to agree upon new terms of the audit engagement that reflect the change in the framework.

Agreement of the Responsibilities of Management (Ref: par. .06b)

.A9 An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph .06b.⁶ The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit.* However, the concept

⁵ Paragraph .10 of section 800. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

⁶ Paragraphs .05 and .A2 of section 200. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

* In January 2013, the Professional Ethics Executive Committee adopted a provision in the "Scope and Applicability of Nonattest Services" interpretation (ET sec. 1.295.010) under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. This provision provides, among other things, that financial statement preparation is considered outside the scope of the attest engagement and, therefore, constitutes a nonattest service subject to the requirements of the "Nonattest Services" subtopic (ET sec. 1.295). The provision is effective for engagements covering periods beginning on or after December 15, 2014. [Footnote added, October 2013, to reflect conforming

(continued)

of an independent audit requires that the auditor's role does not involve assuming management's responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity's related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (including information obtained from outside of the general and subsidiary ledgers) insofar as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the audit engagement as required by paragraphs .09–.10. [Revised, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A10 The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution and those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

.A11 Section 580, *Written Representations*, requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities.⁷ It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other AU-C sections and, when necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

.A12 If management will not acknowledge its responsibilities or indicates that it will not provide written representations as requested, the auditor will be unable to obtain sufficient appropriate audit evidence.⁸ In such circumstances, it would not be appropriate for the auditor to accept the audit engagement unless law or regulation requires the auditor to do so. In cases when the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters and the implications for the auditor's report.

Preparation and Fair Presentation of the Financial Statements (Ref: par. .06b(i))

.A13 In an audit of special purpose financial statements, the auditor is required by section 800 to obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures

(footnote continued)

changes necessary due to the revision of Ethics Interpretation No. 101-3. Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

⁷ Paragraphs .10–.11 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

⁸ Paragraph .A34 of section 580. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

that are appropriate for the special purpose framework used to prepare the entity's financial statements.⁹ This agreement is a precondition of the audit included in the terms of the engagement.

Internal Control (Ref: par. .06b(ii))

.A14 Management maintains such internal control as it determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives, due to the inherent limitations of internal control.

.A15 An independent audit conducted in accordance with GAAS does not act as a substitute for the maintenance of internal control necessary for the preparation and fair presentation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands that it has responsibility for the design, implementation, and maintenance of internal control necessary for this purpose. However, the agreement required by paragraph .06b(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free from deficiencies.

.A16 Management has the responsibility to determine what internal control is necessary to enable the preparation and fair presentation of the financial statements. The term *internal control* encompasses a wide range of activities within components of the system of internal control that may be described as the control environment; the entity's risk assessment process; the entity's process to monitor the system of internal control; the information system and communication; and control activities. This division, however, does not necessarily reflect how a particular entity may design, implement, and maintain its internal control or how it may classify any particular component.¹⁰ An entity's internal control will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulations. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Additional Information (Ref: par. .06biii(2))

.A17 Additional information that the auditor may request from management for the purpose of the audit may include, when applicable, matters related to other information in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. When the auditor expects to obtain other information after the date of the auditor's report, the terms of the audit engagement may also acknowledge the auditor's responsibilities relating to such other information including, if applicable, the actions that may be appropriate or necessary if the auditor concludes that an uncorrected material misstatement of the other information exists in such other information. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Considerations Relevant to Smaller Entities (Ref: par. .06b)

.A18 One of the purposes of agreeing upon the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when the auditor or a third party has

⁹ Paragraph .11 of section 800. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

¹⁰ Paragraph .A51 and appendix B, "Internal Control Components," of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

assisted with drafting the financial statements, it may be useful to remind management that the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Management-Imposed Limitation on Scope Prior to Audit Engagement Acceptance That Would Result in a Disclaimer of Opinion (Ref: par. .07)

.A19 Scope limitations may be imposed by management or by circumstances. Examples of scope limitations that would not preclude the auditor from accepting the engagement include the following:

- A restriction imposed by management that the auditor believes will result in a qualified opinion
- A restriction imposed by circumstances beyond the control of management

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A20 Employee benefit plans are an example of entities that are required to have an audit by law or regulation and a disclaimer of opinion is acceptable under the applicable law or to the regulator. For such entities, the auditor is neither precluded from accepting, nor required to accept, the engagement, regardless of whether management imposes a scope limitation that is expected to result in the auditor disclaiming an opinion on the financial statements as a whole. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Agreement on Audit Engagement Terms

Agreeing Upon the Terms of the Audit Engagement (Ref: par. .09)

.A21 The roles of management and those charged with governance in agreeing upon the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless in accordance with paragraph .06, the auditor is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A22 When a third party has contracted for the audit of the entity's financial statements, agreeing the terms of the audit with management of the entity is necessary in order to establish that the preconditions for an audit are present. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Audit Engagement Letter or Other Form of Written Agreement¹¹ (Ref: par. .10)

.A23 Both management and the auditor have an interest in documenting the agreed-upon terms of the audit engagement before the commencement of the audit to help avoid misunderstandings with respect to the audit. For example, it reduces the risk that management may inappropriately rely on the auditor to protect management against certain risks or to perform certain functions

¹¹ In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

that are management's responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Form and Content of the Audit Engagement Letter

.A24 The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.¹² Paragraph .06b of this section addresses the description of the responsibilities of management. In addition to including the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team
- The communication of key audit matters
- The form of any other communication about the results of the audit engagement
- The expectation that management will provide written representations (see also paragraph .A11)
- The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, including an expectation that management will provide access to information relevant to disclosures
- The agreement of management to make available to the auditor draft financial statements, including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures), and any accompanying other information¹³ in time to allow the auditor to complete the audit in accordance with the proposed timetable
- The agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- The basis on which fees are computed and any billing arrangements
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by management signing the engagement letter

¹² Paragraphs .04–.10 of section 200. [Footnote renumbered by the issuance of SAS No. 147, June 2022.]

¹³ As defined in section 720B, *Other Information in Documents Containing Audited Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Footnote renumbered by the issuance of SAS No. 147, June 2022.]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A25 Although there is no requirement in GAAS to communicate key audit matters, the engagement letter may acknowledge that management has requested that the auditor communicate key audit matters in the auditor's report. If the terms of the audit engagement initially acknowledge that key audit matters will be communicated, but it is later decided that this will not be done, the engagement letter may need to be modified accordingly. If, after the engagement letter is signed, management requests that the auditor communicate key audit matters, the auditor may acknowledge this agreement in a new engagement letter or as an addendum to the originally signed letter. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A26 When relevant, the following points also could be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and specialists in some aspects of the audit
- Arrangements concerning the involvement of internal auditors and other staff of the entity
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit
- Any restriction of the auditor's liability when not prohibited
- Any obligations of the auditor to provide audit documentation to other parties
- Additional services to be provided, such as those relating to regulatory requirements
- A reference to any further agreements between the auditor and the entity

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A27 Reference to the expected form and content of any reports to be issued by the auditor may include a description of the types of reports to be issued. The auditor need not describe the type of opinion expected to be expressed. An example of an audit engagement letter is set out in the exhibit "Example of an Audit Engagement Letter." [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A28 *Audits of components.* When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to obtain a separate audit engagement letter from the component include the following:

- Who engages the component auditor
- Whether a separate auditor's report is to be issued on the component
- Legal requirements regarding the appointment of the auditor
- Degree of ownership by parent

- Degree of independence of the component management from the parent entity

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Initial Audits, Including Reaudit Engagements — Communications With the Predecessor Auditor (Ref: par. .11–.15)

.A29 An auditor may make a proposal for an audit engagement before being granted permission to make inquiries of a predecessor auditor. The auditor may advise management in the proposal or otherwise that the auditor's acceptance of the engagement cannot be final until the inquiries have been made and the responses of the predecessor auditor have been evaluated. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A30 Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor and management, as well as the predecessor auditor's response. Such requirements provide that, except as permitted by the rules of the AICPA Code of Professional Conduct, an auditor is precluded from disclosing confidential information obtained in the course of an engagement unless management specifically consents. Relevant ethical and professional requirements also provide that both the auditor and the predecessor auditor hold in confidence information obtained from each other. This obligation applies regardless of whether the auditor accepts the engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph renumbered and amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.A31 The inquiries specified in paragraph .12a–b are consistent with matters that the predecessor auditor communicated with those charged with governance as required by section 240, *Consideration of Fraud in a Financial Statement Audit*,¹⁴ and section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*,¹⁵ respectively. [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

[.A32] [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph deleted by the issuance of SAS No. 147, June 2022.]

.A33 The communication with the predecessor auditor may be either written or oral. In addition to the inquiries specified in paragraph .12a–b, matters subject to the auditor's inquiry of the predecessor auditor may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters

¹⁴ Paragraph .40 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

¹⁵ Paragraph .21 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. [Footnote added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
- The predecessor auditor's understanding about the reasons for the change of auditors
- The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. As amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.A34 Before responding to the auditor's inquiries made pursuant to paragraph .12, the predecessor auditor may consider it appropriate to obtain legal advice to determine whether any professional or legal requirements or unusual circumstances may limit the predecessor auditor's ability to respond. [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

.A35 When more than one auditor is considering accepting an engagement, the predecessor auditor is not expected to be available to respond to inquiries until an auditor has been selected by the entity. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph renumbered and amended, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

Considerations Specific to Governmental Entities

.A36 When the auditor is required by law or regulation to audit a governmental entity, inquiries of the predecessor auditor for the purpose of obtaining information about whether to accept the engagement may not be relevant. However, inquiries of the predecessor auditor may still be relevant for the purpose of obtaining information that is used by the auditor in planning and performing the audit.¹⁶ [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A37 In accordance with generally accepted governmental auditing standards, if the law or regulation requiring an audit specifically identifies the entities to be audited, in addition to management, the auditor may find it necessary to obtain authorization from those individuals contracting for or requesting the audit and from those legislative committees, if any, that have ongoing oversight responsibilities for the audited entity. [Paragraph added, effective for audits of financial statements for periods beginning on or after June 30, 2023, by SAS No. 147.]

¹⁶ Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Recurring Audits (Ref: par. .16)

.A38 The following factors may make it appropriate to revise the terms of the audit engagement:

- Any indication that management misunderstands the objective and scope of the audit
- Any revised or special terms of the audit engagement
- A change of senior management
- A significant change in ownership
- A significant change in the nature or size of the entity's business
- A change in legal or regulatory requirements
- A change in the financial reporting framework adopted in the preparation of the financial statements
- A change in other reporting requirements

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A39 The auditor may remind management of the terms of the engagement in writing or orally. A written reminder might be a letter confirming that the terms of the preceding engagement will govern the current engagement. If the reminder is oral, audit documentation may include with whom the discussion took place, when, and the significant points discussed. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Acceptance of a Change in the Terms of the Audit Engagement

Request to Change the Terms of the Audit Engagement (Ref: par. .17)

.A40 A request from management for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding about the nature of an audit as originally requested, or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor, as required by paragraph .17, considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A41 A change in circumstances that affects management's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A42 In contrast, a change may not be considered reasonable if the change appears to relate to information that is incorrect, incomplete, or otherwise unsatisfactory. An example might be when the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and management asks

for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Request to Change to a Review or Other Service (Ref: par. .18)

.A43 Before agreeing to change an audit engagement to a review or other service, an auditor who was engaged to perform an audit in accordance with GAAS may need to assess, in addition to the matters referred to in paragraphs .A40–.A42, any legal or contractual implications of the change. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A44 If the auditor concludes that reasonable justification to change the audit engagement to a review or other service exists, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the other service would not include reference to the following:

- a. The original audit engagement
- b. Any procedures that may have been performed in the original audit engagement, except when the audit engagement is changed to an engagement to undertake agreed-upon procedures and, thus, reference to the procedures performed is a normal part of the report

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation (Ref: par. .21)

.A45 GAAS require that the auditor not represent compliance with GAAS unless the auditor has complied with all of the AU-C sections relevant to the audit.¹⁷ If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, section 800 requires that the auditor's report refer to GAAS only if the auditor's report includes the minimum reporting elements.¹⁸ In accordance with section 800, if the specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor is required to reword the prescribed form of report or attach an appropriately worded separate report.¹⁹ When the auditor concludes that rewording the prescribed form to be in accordance with the requirements of GAAS or attaching a separate report would not be permitted, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with GAAS. The

¹⁷ Paragraph .22 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

¹⁸ Paragraph .22 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

¹⁹ Paragraph .23 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019. Footnote subsequently renumbered by the issuance of SAS No. 147, June 2022.]

auditor is, however, encouraged to apply GAAS, including the AU-C sections that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with GAAS. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

Considerations Specific to Governmental Entities

.A46 For governmental entities, specific legal or regulatory requirements may exist; for example, the auditor may be required to report directly to the legislature or the public if management attempts to limit the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

.A47

Exhibit — Example of an Audit Engagement Letter (Ref: par. .A27)

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board. This letter is intended to be a guide that may be used in conjunction with the considerations outlined in this section. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of those charged with governance of ABC Company:¹

[The objective and scope of the audit]

You² have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with GAAS. As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

¹ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A21.

² Throughout this letter, references to *you, we, us, management, those charged with governance, and auditor* would be used or amended as appropriate in the circumstances.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.³ However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Conclude, based on the audit evidence obtained, whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

[The responsibilities of management and identification of the applicable financial reporting framework]

Our audit will be conducted on the basis that *[management and, when appropriate, those charged with governance]*⁴ acknowledge and understand that they have responsibility

- a. for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide us with
 - i. access to all information of which *[management]* is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
 - ii. additional information that we may request from *[management]* for the purpose of the audit; and
 - iii. unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

³ This sentence would be modified, as appropriate, in circumstances in which the auditor also has a responsibility to issue an opinion on the effectiveness of internal control over financial reporting in conjunction with the audit of the financial statements. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁴ Use terminology as appropriate in the circumstances. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

As part of our audit process, we will request from *[management and, when appropriate, those charged with governance]*, written confirmation concerning representations made to us in connection with the audit.

[Other relevant information]

[Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.]

[Reporting]

[Insert appropriate reference to the expected form and content of the auditor's report, including, when applicable, the reporting on other information in accordance with section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports. Example follows:]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. Circumstances may arise in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances, it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or if necessary, withdraw from the engagement.

We also will issue a written report on *[insert appropriate reference to other auditor's reports expected to be issued]* upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

[Signed]

[Name and Title]

[Date]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138. Paragraph subsequently renumbered by the issuance of SAS No. 147, June 2022.]

AU-C Section 210A

Terms of Engagement

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

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

Introduction

Scope of This Section

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

Effective Date

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

Objective

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

- a. establishing whether the preconditions for an audit are present and
- b. confirming that a common understanding of the terms of the audit engagement exists between the auditor and management and, when appropriate, those charged with governance.

Definitions

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

Preconditions for an audit. The use by management of an acceptable financial reporting framework in the preparation and fair presentation of the financial statements and the agreement of management and, when appropriate, those charged with governance, to the premise¹ on which an audit is conducted.

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

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

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

Requirements

Preconditions for an Audit

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

- a. determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable and (Ref: par. .A2–.A8)
- b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A9–.A12 and .A18)
 - i. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; (Ref: par. .A13)
 - ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: par. .A14–.A16)
- iii. to provide the auditor with
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - (2) additional information that the auditor may request from management for the purpose of the audit; and (Ref: par. .A17)
 - (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

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

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

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

Other Factors Affecting Audit Engagement Acceptance

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

- a. if the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- b. if the agreement referred to in paragraph .06b has not been obtained.

Agreement on Audit Engagement Terms

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

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

- a. The objective and scope of the audit of the financial statements
- b. The responsibilities of the auditor
- c. The responsibilities of management
- d. A statement that because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content (Ref: par. .A25)

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

Initial Audits, Including Reaudit Engagements

.11 Before accepting an engagement for an initial audit, including a reaudit engagement, the auditor should request management to authorize the predecessor auditor to respond fully to the auditor's inquiries regarding matters that will assist the auditor in determining whether to accept the engagement. If management refuses to authorize the predecessor auditor to respond, or limits the response, the auditor should inquire about the reasons and consider the implications of that refusal in deciding whether to accept the engagement.

.12 The auditor should evaluate the predecessor auditor's response, or consider the implications if the predecessor auditor provides no response or a limited response, in determining whether to accept the engagement. (Ref: par. .A29–.A34)

Recurring Audits

.13 On recurring audits, the auditor should assess whether circumstances require the terms of the audit engagement to be revised. If the auditor concludes that the terms of the preceding engagement need not be revised for the current engagement, the auditor should remind management of the terms of the engagement, and the reminder should be documented. (Ref: par. .A35–.A36)

Acceptance of a Change in the Terms of the Audit Engagement

.14 The auditor should not agree to a change in the terms of the audit engagement when no reasonable justification for doing so exists. (Ref: par. .A37–.A39)

.15 If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement for which the auditor obtains a lower level of assurance, the auditor should determine whether reasonable justification for doing so exists. (Ref: par. .A40–.A41)

.16 If the terms of the audit engagement are changed, the auditor and management should agree on and document the new terms of the engagement in an engagement letter or other suitable form of written agreement.

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

- a. withdraw from the audit engagement when possible under applicable law or regulation,
- b. communicate the circumstances to those charged with governance, and
- c. determine whether any obligation, either legal, contractual, or otherwise, exists to report the circumstances to other parties, such as owners, or regulators.

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation

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

- a. whether users might misunderstand the auditor's report and, if so,
- b. whether the auditor would be permitted to reword the prescribed form to be in accordance with the requirements of GAAS or attach a separate report.²

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

² Paragraphs .22–.23 of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*.

reference to the audit having been performed in accordance with GAAS within the auditor's report.³ (Ref: par. .A42–.A43)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibilities regarding relevant ethical requirements in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are addressed in section 220A. This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

Preconditions for an Audit

The Financial Reporting Framework (Ref: par. .06a)

.A2 An applicable financial reporting framework provides the criteria for management to present the financial statements of an entity, including the fair presentation of those financial statements. The criteria used by the auditor to evaluate or measure the subject matter, including, when relevant, a basis for presentation and disclosure, are also provided by the financial reporting framework. These criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

.A3 Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements, and the auditor does not have suitable criteria for auditing the financial statements. In many cases, the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs .A6–.A8.

Determining the Acceptability of the Financial Reporting Framework

.A4 Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)
- Whether law or regulation prescribes the applicable financial reporting framework

.A5 Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. Although all the information needs of specific users cannot be met, financial information needs that are common to a wide range of users exist. Financial statements prepared in accordance with a financial reporting framework designed to meet

³ Paragraph .22 of section 800.

the common financial information needs of a wide range of users are referred to as *general purpose financial statements*.

.A6 *General purpose frameworks.* The sources of established accounting principles that are generally accepted are accounting principles promulgated by a body designated by the Council of the AICPA to establish such principles, pursuant to the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. Such financial reporting standards often are identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A7 *Special purpose frameworks.* In some cases, the financial statements will be prepared in accordance with a special purpose framework. For example, law or regulation may prescribe the financial reporting framework to be used in the preparation of financial statements for certain types of entities. Such financial statements are referred to as *special purpose financial statements*. Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses the acceptability of special purpose frameworks.⁴

.A8 After the audit engagement has been accepted, the auditor may encounter deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the previously agreed-upon terms will have changed, and the auditor is required by paragraph .16 to agree upon new terms of the audit engagement that reflect the change in the framework.

Agreement of the Responsibilities of Management (Ref: par. .06b)

.A9 An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph .06b.⁵ The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit.^{*} However, the concept of an independent audit requires that the auditor's role does not involve assuming management's responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity's related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (including information obtained from outside of the general and subsidiary ledgers) insofar as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of

⁴ Paragraph .10 of section 800.

⁵ Paragraphs .05 and .A2 of section 200.

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

an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the audit engagement as required by paragraphs .09–.10. [Revised, October 2013, to reflect conforming changes necessary due to the revision of Ethics Interpretation No. 101-3. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A10 The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution and those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

.A11 Section 580, *Written Representations*, requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities.⁶ It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other AU-C sections and, when necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

.A12 If management will not acknowledge its responsibilities or indicates that it will not provide written representations as requested, the auditor will be unable to obtain sufficient appropriate audit evidence.⁷ In such circumstances, it would not be appropriate for the auditor to accept the audit engagement unless law or regulation requires the auditor to do so. In cases when the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters and the implications for the auditor's report.

Preparation and Fair Presentation of the Financial Statements (Ref: par. .06b(i))

.A13 In an audit of special purpose financial statements, the auditor is required by section 800 to obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements.⁸ This agreement is a precondition of the audit included in the terms of the engagement.

Internal Control (Ref: par. .06b(ii))

.A14 Management maintains such internal control as it determines is necessary to enable the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives, due to the inherent limitations of internal control.

⁶ Paragraphs .10–.11 of section 580, *Written Representations*.

⁷ Paragraph .A34 of section 580.

⁸ Paragraph .11 of section 800.

.A15 An independent audit conducted in accordance with GAAS does not act as a substitute for the maintenance of internal control necessary for the preparation and fair presentation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands that it has responsibility for the design, implementation, and maintenance of internal control necessary for this purpose. However, the agreement required by paragraph .06b(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free from deficiencies.

.A16 Management has the responsibility to determine what internal control is necessary to enable the preparation and fair presentation of the financial statements. The term *internal control* encompasses a wide range of activities within components that may be described as the control environment; the entity's risk assessment process; the information system, including the related business processes relevant to financial reporting, and communication; control activities; and monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement, and maintain its internal control or how it may classify any particular component.⁹ An entity's internal control will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulations.

Additional Information (Ref: par. .06biii(2))

.A17 Additional information that the auditor may request from management for the purpose of the audit may include, when applicable, matters related to other information in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. When the auditor expects to obtain other information after the date of the auditor's report, the terms of the audit engagement may also acknowledge the auditor's responsibilities relating to such other information including, if applicable, the actions that may be appropriate or necessary if the auditor concludes that an uncorrected material misstatement of the other information exists in such other information. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Considerations Relevant to Smaller Entities (Ref: par. .06b)

.A18 One of the purposes of agreeing upon the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when the auditor or a third party has assisted with drafting the financial statements, it may be useful to remind management that the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Management-Imposed Limitation on Scope Prior to Audit Engagement Acceptance That Would Result in a Disclaimer of Opinion (Ref: par. .07)

.A19 Scope limitations may be imposed by management or by circumstances. Examples of scope limitations that would not preclude the auditor from accepting the engagement include the following:

- A restriction imposed by management that the auditor believes will result in a qualified opinion

⁹ Paragraph .A51 and appendix B, "Internal Control Components," of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

- A restriction imposed by circumstances beyond the control of management

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A20 Employee benefit plans are an example of entities that are required to have an audit by law or regulation and a disclaimer of opinion is acceptable under the applicable law or to the regulator. For such entities, the auditor is neither precluded from accepting, nor required to accept, the engagement, regardless of whether management imposes a scope limitation that is expected to result in the auditor disclaiming an opinion on the financial statements as a whole. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Agreement on Audit Engagement Terms

Agreeing Upon the Terms of the Audit Engagement (Ref: par. .09)

.A21 The roles of management and those charged with governance in agreeing upon the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless in accordance with paragraph .06, the auditor is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A22 When a third party has contracted for the audit of the entity's financial statements, agreeing the terms of the audit with management of the entity is necessary in order to establish that the preconditions for an audit are present. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Audit Engagement Letter or Other Form of Written Agreement¹⁰ (Ref: par. .10)

.A23 Both management and the auditor have an interest in documenting the agreed-upon terms of the audit engagement before the commencement of the audit to help avoid misunderstandings with respect to the audit. For example, it reduces the risk that management may inappropriately rely on the auditor to protect management against certain risks or to perform certain functions that are management's responsibility. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Form and Content of the Audit Engagement Letter

.A24 The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.¹¹ Paragraph .06b of this section addresses the description of the responsibilities of management. In addition to including

¹⁰ In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

¹¹ Paragraphs .04–.10 of section 200.

the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team
- The communication of key audit matters
- The form of any other communication about the results of the audit engagement
- The expectation that management will provide written representations (see also paragraph .A11)
- The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, including an expectation that management will provide access to information relevant to disclosures
- The agreement of management to make available to the auditor draft financial statements, including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures), and any accompanying other information¹² in time to allow the auditor to complete the audit in accordance with the proposed timetable
- The agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- The basis on which fees are computed and any billing arrangements
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by management signing the engagement letter

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A25 Although there is no requirement in GAAS to communicate key audit matters, the engagement letter may acknowledge that management has requested that the auditor communicate key audit matters in the auditor's report. If the terms of the audit engagement initially acknowledge that key audit matters will be communicated, but it is later decided that this will not be done, the engagement letter may need to be modified accordingly. If, after the engagement letter is signed, management requests that the auditor communicate key

¹² As defined in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Footnote revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

audit matters, the auditor may acknowledge this agreement in a new engagement letter or as an addendum to the originally signed letter. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.A26 When relevant, the following points also could be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and specialists in some aspects of the audit
- Arrangements concerning the involvement of internal auditors and other staff of the entity
- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit
- Any restriction of the auditor's liability when not prohibited
- Any obligations of the auditor to provide audit documentation to other parties
- Additional services to be provided, such as those relating to regulatory requirements
- A reference to any further agreements between the auditor and the entity

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A27 Reference to the expected form and content of any reports to be issued by the auditor may include a description of the types of reports to be issued. The auditor need not describe the type of opinion expected to be expressed. An example of an audit engagement letter is set out in the exhibit "Example of an Audit Engagement Letter." [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A28 *Audits of components.* When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to obtain a separate audit engagement letter from the component include the following:

- Who engages the component auditor
- Whether a separate auditor's report is to be issued on the component
- Legal requirements regarding the appointment of the auditor
- Degree of ownership by parent
- Degree of independence of the component management from the parent entity

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Initial Audits, Including Reaudit Engagements (Ref: par. .11–.12)

.A29 An auditor may make a proposal for an audit engagement before being granted permission to make inquiries of a predecessor auditor. The auditor may advise management in the proposal or otherwise that the auditor's acceptance of the engagement cannot be final until the inquiries have been made

and the responses of the predecessor auditor have been evaluated. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A30 When more than one auditor is considering accepting an engagement, the predecessor auditor is not expected to be available to respond to inquiries until an auditor has been selected by the entity and has accepted the engagement, subject to the evaluation of the communications with the predecessor auditor as provided in paragraph .12. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A31 Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor and management, as well as the predecessor auditor's response. Such requirements provide that, except as permitted by the rules of the AICPA Code of Professional Conduct, an auditor is precluded from disclosing confidential information obtained in the course of an engagement unless management specifically consents. Such requirements also provide that both the auditor and the predecessor auditor hold in confidence information obtained from each other. This obligation applies regardless of whether the auditor accepts the engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A32 In accordance with the AICPA Code of Professional Conduct, which states that members have a responsibility to cooperate with each other, the predecessor auditor is expected to respond to the auditor's inquiries promptly and, in the absence of unusual circumstances, fully, on the basis of known facts. If, due to unusual circumstances, such as pending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, the predecessor auditor decides not to respond fully to the inquiries, the predecessor auditor is expected to clearly state that the response is limited. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A33 The communication with the predecessor auditor may be either written or oral. Matters subject to the auditor's inquiry of the predecessor auditor may include the following:

- Information that might bear on the integrity of management
- Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters
- Communications to those charged with governance regarding fraud and noncompliance with laws or regulations by the entity
- Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
- The predecessor auditor's understanding about the reasons for the change of auditors
- The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Considerations Specific to Governmental Entities

.A34 When the auditor is required by law or regulation to audit a governmental entity, inquiries of the predecessor auditor for the purpose of obtaining information about whether to accept the engagement may not be relevant. However, inquiries of the predecessor auditor may still be relevant for the purpose of obtaining information that is used by the auditor in planning and performing the audit.¹³ [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Recurring Audits (Ref: par. .13)

.A35 The following factors may make it appropriate to revise the terms of the audit engagement:

- Any indication that management misunderstands the objective and scope of the audit
- Any revised or special terms of the audit engagement
- A change of senior management
- A significant change in ownership
- A significant change in the nature or size of the entity's business
- A change in legal or regulatory requirements
- A change in the financial reporting framework adopted in the preparation of the financial statements
- A change in other reporting requirements

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A36 The auditor may remind management of the terms of the engagement in writing or orally. A written reminder might be a letter confirming that the terms of the preceding engagement will govern the current engagement. If the reminder is oral, audit documentation may include with whom the discussion took place, when, and the significant points discussed. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Acceptance of a Change in the Terms of the Audit Engagement**Request to Change the Terms of the Audit Engagement (Ref: par. .14)**

.A37 A request from management for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding about the nature of an audit as originally requested, or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor, as required by paragraph .14, considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

¹³ Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's responsibilities relating to opening balances when conducting an initial audit engagement. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

.A38 A change in circumstances that affects management's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A39 In contrast, a change may not be considered reasonable if the change appears to relate to information that is incorrect, incomplete, or otherwise unsatisfactory. An example might be when the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and management asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Request to Change to a Review or Other Service (Ref: par. .15)

.A40 Before agreeing to change an audit engagement to a review or other service, an auditor who was engaged to perform an audit in accordance with GAAS may need to assess, in addition to the matters referred to in paragraphs .A37–.A39, any legal or contractual implications of the change. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

.A41 If the auditor concludes that reasonable justification to change the audit engagement to a review or other service exists, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the other service would not include reference to the following:

- a. The original audit engagement
- b. Any procedures that may have been performed in the original audit engagement, except when the audit engagement is changed to an engagement to undertake agreed-upon procedures and, thus, reference to the procedures performed is a normal part of the report

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Additional Considerations in Engagement Acceptance

Auditor's Report Prescribed by Law or Regulation (Ref: par. .18)

.A42 GAAS require that the auditor not represent compliance with GAAS unless the auditor has complied with all of the AU-C sections relevant to the audit.¹⁴ If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, section 800 requires that the auditor's report refer to GAAS only if the auditor's report includes the minimum reporting elements.¹⁵ In accordance with section 800, if the specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor is required

¹⁴ Paragraph .22 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

¹⁵ Paragraph .22 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

to reword the prescribed form of report or attach an appropriately worded separate report.¹⁶ When the auditor concludes that rewording the prescribed form to be in accordance with the requirements of GAAS or attaching a separate report would not be permitted, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with GAAS. The auditor is, however, encouraged to apply GAAS, including the AU-C sections that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with GAAS. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

Considerations Specific to Governmental Entities

.A43 For governmental entities, specific legal or regulatory requirements may exist; for example, the auditor may be required to report directly to the legislature or the public if management attempts to limit the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 137, July 2019.]

¹⁶ Paragraph .23 of section 800. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

.A44

Exhibit — Example of an Audit Engagement Letter (Ref: par. .A27)

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board. This letter is intended to be a guide that may be used in conjunction with the considerations outlined in this section. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of those charged with governance of ABC Company:¹

[The objective and scope of the audit]

You² have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

[The responsibilities of the auditor]

We will conduct our audit in accordance with GAAS. As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

¹ The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A21.

² Throughout this letter, references to *you, we, us, management, those charged with governance, and auditor* would be used or amended as appropriate in the circumstances.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.³ However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Conclude, based on the audit evidence obtained, whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

[The responsibilities of management and identification of the applicable financial reporting framework]

Our audit will be conducted on the basis that *[management and, when appropriate, those charged with governance]*⁴ acknowledge and understand that they have responsibility

- a. for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide us with
 - i. access to all information of which *[management]* is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
 - ii. additional information that we may request from *[management]* for the purpose of the audit; and
 - iii. unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

³ This sentence would be modified, as appropriate, in circumstances in which the auditor also has a responsibility to issue an opinion on the effectiveness of internal control over financial reporting in conjunction with the audit of the financial statements. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁴ Use terminology as appropriate in the circumstances. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

As part of our audit process, we will request from *[management and, when appropriate, those charged with governance]*, written confirmation concerning representations made to us in connection with the audit.

[Other relevant information]

[Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.]

[Reporting]

[Insert appropriate reference to the expected form and content of the auditor's report, including, when applicable, the reporting on other information in accordance with section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports. Example follows:]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. Circumstances may arise in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances, it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or if necessary, withdraw from the engagement.

We also will issue a written report on *[insert appropriate reference to other auditor's reports expected to be issued]* upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

[Signed]

[Name and Title]

[Date]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

AU-C Section 220

Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards

(Supersedes SAS No. 122.)

Source: SAS No. 146.

Effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025.

Introduction

Scope of This Section

.01 This section addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. This section also applies, adapted as necessary, to other engagements conducted in accordance with generally accepted auditing standards (GAAS) (for example, a review of interim financial information conducted in accordance with section 930, *Interim Financial Information*). This section is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. (Ref: par. .A1 and .A38)

.02 Although government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*, and Statements on Quality Management Standards (SQMSs) are not applicable to auditors in government audit organizations,¹ this section is applicable to auditors in government audit organizations who perform financial audits in accordance with GAAS.

The Firm's System of Quality Management and the Role of Engagement Teams

.03 Under SQMS No. 1, *A Firm's System of Quality Management* (QM sec. 10), the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that (Ref: par. .A2–.A3)

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and

¹ Paragraph 5 of Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management* (QM sec. 10).

- b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.²

.04 The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this section, for the following: (Ref: par. .A4–.A11)

- a. Implementing the firm's responses to quality risks (that is, the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm
- b. Given the nature and circumstances of the audit engagement, determining whether to design and implement responses at the engagement level beyond those in the firm's policies or procedures
- c. Communicating to the firm information from the audit engagement that is required by the firm's policies or procedures to be communicated to support the design, implementation, and operation of the firm's system of quality management

.05 Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. (Ref: par. .A12)

.06 The public interest is served by the consistent performance of quality audit engagements that achieve the objective of this section and other AU-C sections. A quality audit engagement is achieved through planning and performing the engagement and reporting on it in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and maintaining professional skepticism.

.07 In accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,³ the engagement team is required to plan and perform an audit with professional skepticism and to exercise professional judgment. Professional judgment is exercised in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate maintenance of professional skepticism may be demonstrated through the actions and communications of the engagement team. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate maintenance of professional skepticism, such as unconscious bias or resource constraints. (Ref: par. .A33–.A36)

Scalability

.08 The requirements of this section are intended to be applied in the context of the nature and circumstances of each audit. Examples follow:

² Paragraph 15 of SQMS No. 1.

³ Paragraphs .17–.18 and .A22–.A31 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

- When an audit is carried out entirely by the engagement partner, which may be the case for an audit of a less complex entity, some requirements in this section are not relevant because they are conditional on the involvement of other members of the engagement team. (Ref: par. .A13–.A14)
- When an audit is not carried out entirely by the engagement partner, or in an audit of an entity whose nature and circumstances are more complex, the engagement partner may assign the design or performance of some procedures, tasks, or actions to other members of the engagement team.

The Engagement Partner's Responsibilities

.09 The engagement partner remains ultimately responsible and, therefore, accountable for compliance with the requirements of this section. Nevertheless, the engagement partner may seek assistance from others to fulfill these responsibilities. The phrase "take responsibility for..." is used for those requirements for which the engagement partner is permitted to assign the design or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team. For other requirements, this section expressly intends that the requirement or responsibility be fulfilled by the engagement partner. In such circumstances, the engagement partner may need to obtain information from the firm or other members of the engagement team. For example, when others perform supervisory and review activities, the outcomes of those activities can be taken into account by the engagement partner in fulfilling these responsibilities. (Ref: par. .A22–.A25)

Effective Date

.10 This section is effective for engagements conducted in accordance with GAAS for periods beginning on or after December 15, 2025.

Objective

.11 The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that

- a. the auditor has fulfilled the auditor's responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements, and
- b. the auditor's report issued is appropriate in the circumstances.

Definitions

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

Engagement partner.⁴ The partner or other individual appointed by the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

⁴ *Engagement partner, partner, and firm* refer to their governmental equivalents when relevant.

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

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

Engagement team. All partners and staff performing the audit engagement and any other individuals who perform audit procedures on the engagement, excluding an auditor's external specialist⁵ and internal auditors who provide direct assistance on an engagement.⁶ (Ref: par. .A15–.A25)

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice. (Ref: par. .A26)

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

Network. As defined in "Definitions" (ET sec. 0.400) in the AICPA code, an association of entities that includes one or more firms. (Ref: par. .A27)

Network firm. As defined in "Definitions" in the AICPA code, a firm or other entity that belongs to a network. References to a *network firm* are to be read hereafter as "another firm or entity that belongs to the same network as the firm." (Ref: par. .A27)

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

Personnel. Partners and staff in the firm.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA code, or by other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer are subject, which consist of the AICPA code together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

⁵ Paragraph .06 of section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

⁶ Section 610, *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance.

Response (in relation to a system of quality management).

Policies or procedures designed and implemented by the firm to address one or more quality risks.

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

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

Requirements

Leadership Responsibilities for Managing and Achieving Quality on Audits

.13 The engagement partner should take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner should be sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the engagement. (Ref: par. .A28–.A37)

.14 In creating the environment described in paragraph .13, the engagement partner should take responsibility for clear, consistent, and effective actions being taken that reflect the firm's commitment to quality and that establish and communicate the expected behavior of engagement team members, including emphasizing the following: (Ref: par. .A30–.A34)

- a. That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level
- b. The importance of professional ethics, values, and attitudes to the members of the engagement team
- c. The importance of open and robust communication within the engagement team and supporting the ability of engagement team members to raise concerns without fear of reprisal
- d. The importance of each engagement team member maintaining professional skepticism throughout the audit engagement

.15 If the engagement partner assigns the design or performance of procedures, tasks, or actions related to a requirement of this section to other members of the engagement team to assist the engagement partner in complying with the requirements of this section, the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement through direction and supervision of those members of the engagement team and review of their work. (Ref: par. .09 and .A37)

Relevant Ethical Requirements, Including Those Related to Independence

.16 The engagement partner should have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: par. .A38–.A42 and .A48)

.17 The engagement partner should take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that address the following: (Ref: par. .A23–.A25 and .A40–.A44)

- a. Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence
- b. Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches
- c. The responsibilities of members of the engagement team when they become aware of an instance of noncompliance with laws and regulations by the entity⁷

.18 If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner should evaluate the threats by complying with the firm's policies or procedures, using relevant information from the firm, the engagement team, or other sources, and take appropriate action. (Ref: par. .A43–.A44)

.19 The engagement partner should remain alert throughout the audit engagement, through observation and making inquiries as necessary, for breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: par. .A45)

.20 If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the audit engagement have not been fulfilled, the engagement partner, in consultation with others in the firm, should take appropriate action. (Ref: par. .A46)

.21 Prior to dating the auditor's report, the engagement partner should take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: par. .A38 and .A47)

Acceptance and Continuance of Client Relationships and Audit Engagements

.22 The engagement partner should determine that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed and that conclusions reached in this regard are appropriate. (Ref: par. .A49–.A52 and .A58)

⁷ See section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

.23 The engagement partner should take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with GAAS and complying with the requirements of this section. (Ref: par. .A53–.A56)

.24 If the engagement team becomes aware of information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner should communicate that information promptly to the firm so that the firm and the engagement partner can take the necessary action. (Ref: par. .A57)

Engagement Resources

.25 The engagement partner should determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the audit engagement, the firm's policies or procedures, and any changes that may arise during the engagement. (Ref: par. .A59–.A71, .A74–.A75, and .A80)

.26 The engagement partner should determine that members of the engagement team, and any auditor's external specialists and internal auditors who provide direct assistance who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: par. .A62 and .A72–.A75)

.27 If, as a result of complying with the requirements in paragraphs .25–.26, the engagement partner determines that resources assigned or made available are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner should take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement. (Ref: par. .A76–.A79)

.28 The engagement partner should take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement. (Ref: par. .A63–.A69)

Engagement Performance

Direction, Supervision, and Review

.29 The engagement partner should take responsibility for the direction and supervision of the members of the engagement team and the review of their work. (Ref: par. .A81)

.30 The engagement partner should determine that the nature, timing, and extent of direction, supervision, and review are (Ref: par. .A82–.A90 and .A95–.A98)

- a. planned⁸ and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements, and

⁸ Paragraph .11 of section 300, *Planning an Audit*.

- b. responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team by the firm.

.31 The engagement partner should review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to (Ref: par. .A91–.A94)

- a. significant matters;⁹
- b. significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
- c. other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

.32 On or before the date of the auditor's report, the engagement partner should determine, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: par. .A91–.A95)

.33 Prior to dating the auditor's report, the engagement partner should review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters¹⁰ and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.¹¹

.34 The engagement partner should review, prior to their issuance, formal written communications to management, those charged with governance, or regulatory authorities. (Ref: par. .A99)

Consultation

.35 The engagement partner should do the following: (Ref: par. .A100–.A103)

- a. Take responsibility for the engagement team undertaking consultation on
 - i. difficult or contentious matters and matters on which the firm's policies or procedures require consultation and
 - ii. other matters that, in the engagement partner's professional judgment, require consultation.
- b. Determine that members of the engagement team have undertaken appropriate consultation during the audit engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm.
- c. Determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted.
- d. Determine that conclusions agreed have been implemented.

⁹ Paragraph .08 of section 230, *Audit Documentation*.

¹⁰ See section 701, *Communicating Key Audit Matters in the Auditor's Report*.

¹¹ See section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Engagement Quality Review

.36 For audit engagements for which an engagement quality review is required, the engagement partner should (Ref: par. .A104)

- a. determine that an engagement quality reviewer has been appointed.
- b. cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so.
- c. discuss significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer.
- d. not release the auditor's report until the completion of the engagement quality review. (Ref: par. .A105–.A107)

Differences of Opinion

.37 If differences of opinion arise within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, including those who provide consultation, the engagement team should follow the firm's policies or procedures for dealing with and resolving such differences of opinion. (Ref: par. .A108–.A109)

.38 The engagement partner should

- a. take responsibility for differences of opinion being addressed and resolved in accordance with the firm's policies or procedures.
- b. determine that conclusions reached are documented and implemented.
- c. not date the auditor's report until any differences of opinion are resolved.

Monitoring and Remediation

.39 The engagement partner should take responsibility for the following: (Ref: par. .A110–.A113)

- a. Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm, including, as applicable, the information from the monitoring and remediation process of the network and across the network firms
- b. Determining the relevance and effect on the audit engagement of the information referred to in paragraph .39a and taking appropriate action
- c. Remaining alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicating such information to those responsible for the process

Taking Overall Responsibility for Managing and Achieving Quality

.40 Prior to dating the auditor's report, the engagement partner should determine that the engagement partner has taken overall responsibility for

managing and achieving quality on the audit engagement. In doing so, the engagement partner should determine that (Ref: par. .A113–.A116)

- a. the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement.
- b. the nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures have been taken into account in complying with the requirements of this section.

Documentation

.A1 In applying section 230, *Audit Documentation*, the auditor should include the following in the audit documentation:¹² (Ref: par. .A118–.A121)

- a. Significant issues identified, relevant discussions with personnel, and conclusions reached with respect to
 - i. fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence
 - ii. the acceptance and continuance of the client relationship and audit engagement
- b. The nature and scope of, and conclusions resulting from, consultations undertaken during the audit engagement and how such conclusions were implemented
- c. If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed before the release of the auditor's report

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 This section applies to all audits of financial statements, including audits of group financial statements. Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, deals with special considerations that apply to an audit of group financial statements, including when component auditors are involved. Section 600 also provides guidance on how to adapt and apply the requirements of this section in an audit of group financial statements involving component auditors. Section 600, adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, section 600 may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

¹² Paragraphs .08–.11 of section 230.

The Firm's System of Quality Management and the Role of Engagement Teams (Ref: par. .03–.09)

.A2 SQMS No. 1 addresses a firm's responsibilities for designing, implementing, and operating its system of quality management.

.A3 Firms may use different terminology or frameworks to describe the components of the system of quality management.

The Engagement Team's Responsibilities Relating to the Firm's System of Quality Management (Ref: par. .04)

.A4 Quality management at the engagement level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with SQMS No. 1, the firm is responsible for communicating information that enables the engagement team to understand and carry out their responsibilities relating to performing engagements. For example, such communications may cover policies or procedures to undertake consultations with designated individuals in certain situations involving complex technical or ethical matters or to involve firm-designated experts in specific engagements to perform audit procedures related to particular matters (for example, the firm may specify that firm-designated credit-risk modeling experts are to be involved in auditing expected credit loss allowances in audits of financial institutions).

.A5 Firm-level responses may include policies or procedures established by a network or by other firms, structures, or organizations within the same network (network requirements or network services are described further in SQMS No. 1 within the "Network Requirements or Network Services" section).¹³ The requirements of this section are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network requirements or network services on the audit engagement (for example, a requirement to use an audit methodology developed for use by a network firm). Under SQMS No. 1, the firm is responsible for determining how network requirements or network services are relevant to, and are taken into account in, the firm's system of quality management.¹⁴

.A6 Some firm-level responses to quality risks are not performed at the engagement level but are, nevertheless, relevant when complying with the requirements of this section. For example, firm-level responses that the engagement team may be able to depend on when complying with the requirements of this section include the following:

- Personnel recruitment and professional training processes
- The IT applications that support the firm's monitoring of independence
- The development of IT applications that support the acceptance and continuance of client relationships and audit engagements
- The development of audit methodologies and related implementation tools and guidance

.A7 Due to the specific nature and circumstances of each audit engagement and changes that may occur during the audit engagement, a firm cannot

¹³ Paragraph 50b of SQMS No. 1.

¹⁴ Paragraph 50a of SQMS No. 1.

identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement team exercises professional judgment in determining whether to design and implement responses, beyond those set forth in the firm's policies or procedures, at the engagement level to meet the objective of this section.¹⁵

.A8 The engagement team's determination of whether engagement-level responses are necessary (and, if so, what those responses are) is influenced by the requirements of this section, the engagement team's understanding of the nature and circumstances of the engagement, and any changes during the audit engagement. For example, unanticipated circumstances may arise during the engagement that may cause the engagement partner to request the involvement of appropriately experienced personnel in addition to those initially assigned or made available by the firm.

.A9 The relative balance of the engagement team's efforts to comply with the requirements of this section (that is, between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (for example, an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement team's actions in complying with the engagement performance requirements of this section may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (for example, planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

.A10 Ordinarily, the engagement team may depend on the firm's policies or procedures in complying with the requirements of this section, unless

- the engagement team's understanding or practical experience indicates that the firm's policies or procedures will not effectively address the nature and circumstances of the engagement, or
- information provided by the firm or other parties about the effectiveness of such policies or procedures suggests they cannot be relied on (for example, information provided by the firm's monitoring activities, external inspections, or other relevant sources indicates that the firm's policies or procedures are not operating effectively).

.A11 If the engagement partner becomes aware (including by being informed by other members of the engagement team) that the firm's responses to quality risks are ineffective in the context of the specific engagement, or the engagement partner is unable to depend on the firm's policies or procedures, the engagement partner communicates such information promptly to the firm in accordance with paragraph .39c because such information is relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit software program has a security weakness, timely communication of such information to the appropriate personnel enables the firm to take steps to update and reissue the audit program. See also paragraph .A69 in respect of sufficient and appropriate resources.

¹⁵ Section 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.

**Information Relevant to Quality Management at the Engagement Level
(Ref: par. .05)**

.A12 Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its environment required to be obtained under section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides information that may be relevant to complying with the requirements of this section. Such information may be relevant to the determination of one or more of the following:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts to deal with complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations
- The nature, timing, and extent of review of the work performed by members of the team based on the assessed risks of material misstatement
- The allocation of the budgeted audit hours, including allocating more time and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher

Scalability (Ref: par. .08)

.A13 In a smaller firm, the firm's policies or procedures may designate an engagement partner or partners, on behalf of the firm, to design many of the responses to the firm's quality risks at the engagement level because doing so may be a more effective approach to designing and implementing responses as part of the firm's system of quality management. Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence and, rather, independence will be monitored at the individual engagement level by the engagement partner.

.A14 The requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

Definitions**Engagement Team (Ref: par. .12)**

.A15 The engagement team may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations and may be organized in groups by the activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures¹⁶ on the audit engagement, excluding an

¹⁶ Paragraph .A44 of section 500, *Audit Evidence*.

auditor's external specialist¹⁷ and internal auditors who provide direct assistance on an engagement,¹⁸ is a member of the engagement team.

.A16 The definition of an *engagement team* focuses on individuals who perform audit procedures on the audit engagement. *Audit evidence*, which is necessary to support the auditor's opinion and report, is primarily obtained from audit procedures performed during the course of the audit.¹⁹ Audit procedures comprise risk assessment procedures²⁰ and further audit procedures.²¹ As explained in section 500, *Audit Evidence*, audit procedures may include inspection, observation, confirmation, recalculation, reperformance, analytical procedures, and inquiry, often performed in some combination.²² Other AU-C sections may also include specific procedures to obtain audit evidence, for example, section 520, *Analytical Procedures*.

.A17 Engagement teams include personnel and may also include other individuals who perform audit procedures who are from

- a network firm, or
- a firm that is not a network firm or another service provider.²³

For example, an individual from another firm may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count, or inspect physical fixed assets at a remote location.

.A18 Engagement teams may also include individuals from service delivery centers who perform audit procedures. For example, it may be determined that specific tasks that are repetitive or specialized in nature will be performed by a group of appropriately skilled personnel; thus, the engagement team includes such individuals. Service delivery centers may be established by the firm, the network, or by other firms, structures, or organizations within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.

.A19 Engagement teams may include individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes or in analyzing complex information produced by automated tools and techniques for the purpose of identifying unusual or unexpected relationships. An individual is not a member of the engagement team if that individual's involvement with the engagement is limited to consultation. Consultations are addressed in paragraphs .35 and .A99–.A102.

.A20 If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and any other individuals performing the engagement quality review, are not members of the engagement team. Such individuals may be subject to specific independence requirements.

.A21 An internal auditor providing direct assistance and an auditor's external specialist whose work is used in the engagement are not members of the

¹⁷ Paragraph .06 of section 620 defines the term *auditor's specialist*.

¹⁸ Section 610 establishes limits on the use of direct assistance.

¹⁹ Paragraph .A32 of section 200.

²⁰ Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides requirements related to risk assessment procedures.

²¹ Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides requirements related to further audit procedures, including tests of controls and substantive procedures.

²² Paragraph .A43 of section 500.

²³ Paragraph 17 of SQMS No. 1.

engagement team.²⁴ Section 610, *Using the Work of Internal Auditors*, and section 620, *Using the Work of an Auditor's Specialist*, provide requirements and guidance for the auditor when using the work of internal auditors in a direct assistance capacity or when using the work of an external specialist, respectively. Compliance with these AU-C sections requires the auditor to obtain sufficient appropriate audit evidence on the work performed by an internal auditor who is providing direct assistance and perform audit procedures on the work of an auditor's specialist.

The Engagement Partner's Responsibilities (Ref: par. .09 and .12)

.A22 When this section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the engagement partner may need to obtain information from the firm or other members of the engagement team to fulfill the requirement (for example, information to make the required decision or judgment). For example, the engagement partner is required to determine that members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement. To make a judgment on whether the competence and capabilities of the engagement team are appropriate, the engagement partner may need to use information compiled by the engagement team or from the firm's system of quality management.

The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. .08 and .17)

.A23 Within the context of the firm's system of quality management, engagement team members from the firm are responsible for implementing the firm's policies or procedures that are applicable to the audit engagement. Engagement team members from another firm are neither partners nor staff of the engagement partner's firm. As such, they may not be subject to the firm's system of quality management or the firm's policies or procedures. Further, the policies or procedures of another firm may not be similar to those of the engagement partner's firm. For example, policies or procedures regarding direction, supervision, and review may be different, particularly when the other firm is in a jurisdiction with a different legal system, language, or culture than that of the engagement partner's firm. Accordingly, when the engagement team includes individuals who are from another firm, different actions may need to be taken by the firm or the engagement partner to implement the firm's policies or procedures with respect to the work of those individuals.

.A24 In particular, the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm's recruitment and training processes, and therefore, the firm's policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. Paragraphs .22 and .A47–.A48 of section 600 contain guidance on obtaining an understanding of the competence and capabilities of component auditors.

²⁴ See paragraphs .12–.13 of section 620 and paragraphs .20–.24 of section 610.

- understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm's training with regard to the firm's policies or procedures for relevant ethical requirements. The firm's policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals, or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement to the individual.
- will confirm independence. For example, individuals who are not personnel may not be able to complete independence declarations directly on the firm's independence systems. The firm's policies or procedures may state that such individuals can provide evidence of their independence in relation to the audit engagement in other ways, such as through written confirmation.

A25 When firm policies or procedures require specific activities to be undertaken in certain circumstances (for example, consultation on a particular matter), it may be necessary to communicate with individuals who are not personnel about what is expected of them to enable the engagement partner to comply with the firm's policies or procedures. For example, in a group audit engagement, communicating the group auditor's policies and procedures about matters subject to consultation to a component auditor enables the component auditor to determine which identified difficult or contentious matters that are relevant to the group financial statements to bring to the attention of the group engagement team.

Firm (Ref: par. .12)

A26 The definition of *firm* in relevant ethical requirements may differ from the definition set out in this section.

"Network" and "Network Firm" (Ref: par. .12)

A27 The definitions of *network* or *network firm* in relevant ethical requirements may differ from those set out in this section. The AICPA code also provides guidance in relation to the terms *network* and *network firm*. Networks and other network firms may be structured in a variety of ways and are in all cases external to the firm. The provisions in this section in relation to networks also apply to any structures or organizations that do not form part of the firm but that exist within the network.

Leadership Responsibilities for Managing and Achieving Quality in Audits (Ref: par. .13–.15)

Taking Overall Responsibility for Managing and Achieving Quality

A28 SQMS No. 1 requires the firm to establish quality objectives that address the firm's governance and leadership, which support the design, implementation, and operation of the system of quality management. The engagement partner's responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality. In addressing the requirements in paragraphs .13–.14 of this section, the engagement partner may communicate directly to other members of the engagement team and reinforce this communication through personal conduct and actions (such as leading by example). A culture that demonstrates a commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement.

Scalability

.A29 The nature and extent of the actions of the engagement partner to demonstrate the firm's commitment to quality may depend on a variety of factors, including the size, structure, geographical dispersion, and complexity of the firm and the engagement team and the nature and circumstances of the audit engagement. With a smaller engagement team with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary.

Sufficient and Appropriate Involvement

.A30 Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including the following:

- Taking responsibility for the nature, timing, and extent of the direction and supervision of the members of the engagement team and the review of their work in complying with the requirements of this section
- Varying the nature, timing, and extent of such direction, supervision, and review in the context of the nature and circumstances of the engagement

Communication

.A31 Communication is the means through which the engagement team shares relevant information on a timely basis to comply with the requirements of this section, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team or with

- a. the firm (for example, individuals performing activities within the firm's system of quality management, including those assigned ultimate or operational responsibility for the firm's system of quality management),
- b. others involved in the audit (for example, internal auditors who provide direct assistance²⁵ or an auditor's external specialist²⁶), or
- c. parties that are external to the firm (for example, management, those charged with governance, or regulatory authorities).

.A32 The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the appropriate means of effective communication with the members of the engagement team. For example, to support appropriate direction, supervision, and review, the firm may use IT applications to facilitate communication between the members of the engagement team when they are performing work across different geographical locations.

Professional Skepticism (Ref: par. .07)

.A33 The engagement partner is responsible for emphasizing the importance of each engagement team member maintaining professional skepticism

²⁵ See paragraph .A47 of section 610.

²⁶ See paragraphs .11c and .A33 of section 620.

throughout the audit engagement. Conditions inherent in some audit engagements can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Accordingly, when developing the overall audit strategy in accordance with section 300, *Planning an Audit*, the engagement team may need to consider whether such conditions exist in the audit engagement and, if so, what actions the firm or the engagement team may need to undertake to mitigate such impediments.

.A34 Impediments to the exercise of professional skepticism at the engagement level may include the following:

- Budget constraints, which may discourage the use of sufficiently experienced or technically qualified resources, including experts, necessary for audits of entities in which technical expertise or specialized skills are needed for effective understanding, assessment of, and responses to risks and informed questioning of management.
- Tight deadlines, which may negatively affect the behavior of those who perform the work as well as those who direct, supervise, and review. For example, external time pressures may create restrictions to analyzing complex information effectively.
- Lack of cooperation or undue pressures imposed by management, which may negatively affect the engagement team's ability to resolve complex or contentious issues.
- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework, which may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others, which may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.
- Overreliance on automated tools and techniques, which may result in the engagement team not critically assessing audit evidence.

.A35 Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including, for example, in the design and performance of audit procedures, or the evaluation of audit evidence. Examples of unconscious auditor biases that may impede the exercise of professional skepticism and, therefore, the reasonableness of the professional judgments made by the engagement team in complying with the requirements of this section may include the following:

- *Availability bias*, which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not
- *Confirmation bias*, which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief
- *Groupthink*, which is a tendency to think or make decisions as a group, discouraging creativity or individual responsibility

- *Overconfidence bias*, which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions
- *Anchoring bias*, which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed
- *Automation bias*, which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose

.A36 Possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level may include the following:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement
- Explicitly alerting the engagement team to instances or situations in which vulnerability to unconscious or conscious auditor biases may be greater (for example, areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures
- Changing the composition of the engagement team, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise be assigned to the engagement
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with
- Involving members of the engagement team with specialized skills and knowledge or an auditor's expert to assist the engagement team with complex or subjective areas of the audit
- Modifying the nature, timing, and extent of direction, supervision, or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis, or more in-depth reviews of certain working papers for
 - complex or subjective areas of the audit,
 - areas that pose risks to achieving quality on the audit engagement,
 - areas with a fraud risk, and
 - identified or suspected noncompliance with laws or regulations
- Setting expectations for
 - less experienced members of the engagement team to seek advice frequently and in a timely manner from more experienced engagement team members or the engagement partner, and

- more experienced members of the engagement team to be available to less experienced members of the engagement team throughout the audit engagement and to respond positively and in a timely manner to their insights, requests for advice, or assistance
- Communicating with those charged with governance when management imposes undue pressure or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought

Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team (Ref: par. .15)

.A37 Being sufficiently and appropriately involved throughout the audit engagement when procedures, tasks, or actions have been assigned to other members of the engagement team may be demonstrated by the engagement partner in different ways, including the following:

- Informing assignees about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof, and providing any other necessary instructions and relevant information
- Directing and supervising the assignees
- Reviewing the assignees' work to evaluate the conclusions reached, in addition to the requirements in paragraphs .29–.34

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. .16–.21)

Relevant Ethical Requirements (Ref: par. .01 and .16–.21)

.A38 Section 200²⁷ requires that the auditor comply with relevant ethical requirements relating to financial statement audit engagements, including those requirements pertaining to independence. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, certain requirements related to independence may be applicable only when performing audits of depository institutions or employee benefit plans. Section 600 includes additional requirements and guidance to those in this section regarding communications about relevant ethical requirements with component auditors.

.A39 Based on the nature and circumstances of the audit engagement, certain law, regulation, or aspects of relevant ethical requirements, such as those pertaining to noncompliance with laws or regulations, may be relevant to the engagement (for example, laws or regulations dealing with money laundering, corruption, or bribery).

.A40 The firm's information system and the resources provided by the firm may assist the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement. For example, the firm may do the following:

²⁷ Paragraphs .16 and .A15–.A21 of section 200.

- Communicate the independence requirements to engagement teams.
- Provide training for engagement teams on relevant ethical requirements.
- Establish manuals and guides (that is, intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the nature and circumstances of the firm and its engagements.
- Assign personnel to manage and monitor compliance with relevant ethical requirements (for example, SQMS No. 1 requires that the firm obtains, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or provide consultation on matters related to relevant ethical requirements.
- Establish policies or procedures for engagement team members to communicate relevant and reliable information to appropriate parties within the firm or to the engagement partner, such as policies or procedures for engagement teams to
 - communicate information about client engagements and the scope of services, including nonassurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.
 - communicate circumstances and relationships that may create a threat to independence so that the firm can evaluate whether such a threat is at an acceptable level and, if it is not, address the threat by eliminating it or reducing it to an acceptable level.
 - promptly communicate any breaches of the relevant ethical requirements, including those related to independence.

.A41 The engagement partner may take into account the information, communication, and resources described in paragraph .A39 when determining whether the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements.

.A42 Open and robust communication between the members of the engagement team about relevant ethical requirements may also assist in

- drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement, and
- keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

Identifying and Evaluating Threats to Compliance With Relevant Ethical Requirements (Ref: par. .17–.18)

.A43 In accordance with SQMS No. 1, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence for engagement team members, include policies or

procedures for identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements.

.A44 Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with. For example, the "General Requirements for Performing Nonattest Services" interpretation (ET sec. 1.295.040) of the "Independence Rule" in the AICPA code provides guidance regarding safeguards for reducing threats to independence to an acceptable level when performing nonattest services for an attest client.

Breaches of Relevant Ethical Requirements (Ref: par. .19)

.A45 In accordance with SQMS No. 1, the firm is required to establish policies or procedures for identifying, communicating, evaluating, and reporting any breaches of relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner.

Taking Appropriate Action (Ref: par. .20)

.A46 Examples of appropriate actions may include the following:

- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate individuals so that appropriate action can be taken, including as applicable, disciplinary action.
- Communicating with those charged with governance.
- Communicating with regulatory authorities or professional bodies. In some circumstances, communication with regulatory authorities may be required by law or regulation.
- Seeking legal advice.
- Withdrawing from the audit engagement when withdrawal is possible under applicable law or regulation.

Prior to Dating the Auditor's Report (Ref: par. .21)

.A47 Section 700, *Forming an Opinion and Reporting on Financial Statements*, requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.²⁸ Performing the procedures required by paragraphs .16–.21 of this section provides the basis for these statements in the auditor's report.

Considerations Specific to Governmental Audit Organizations

.A48 Law or regulation may provide safeguards for the independence of governmental audit organizations and the auditors they employ. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor's report the circumstances affecting the auditor's independence.

²⁸ Paragraph .28c of section 700.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. .22–.24)

.A49 SQMS No. 1 requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements.

.A50 Information such as the following may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity and ethical values of the principal owners, key management, and those charged with governance of the entity
- Whether sufficient and appropriate resources are available to perform the engagement
- Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement
- Whether the engagement team has the competence and capabilities, including sufficient time, to perform the engagement
- Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement

.A51 Under SQMS No. 1, for acceptance and continuance decisions, the firm is required to make judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process.

.A52 If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained or used by the firm in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner's determination that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.

.A53 Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this section and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity's timetable for reporting, such as at interim and final stages
- In relation to group audits, the nature of the control relationships between the parent and its components
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources required, as well as

the manner in which the work of the engagement team will be directed, supervised, and reviewed

.A54 Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other sections, as well as this section, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by section 210, *Terms of Engagement*²⁹
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with section 315 and section 240, *Consideration of Fraud in a Financial Statement Audit*
- Understanding the group, its components, and their environments, in the case of an audit of group financial statements in accordance with section 600, and directing, supervising, and reviewing the work of component auditors
- Determining whether, and how, to involve an auditor's specialist in accordance with section 620
- The entity's governance structure in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*, and section 265, *Communicating Internal Control Related Matters Identified in an Audit*

.A55 Law, regulation, or relevant ethical requirements may require the successor auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected noncompliance with laws and regulations to the proposed successor auditor.

.A56 In circumstances in which the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement.

.A57 In deciding on the necessary action, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement and, if so, determine what additional steps are necessary at the engagement level (for example, the assignment of more staff or staff with specific expertise). If the engagement partner has further concerns or is not satisfied that the matter has been appropriately resolved, the firm's policies or procedures for resolving differences of opinion may be applicable.

Considerations Specific to Governmental Audit Organizations **(Ref: par. .22–.24)**

.A58 When the auditor is a government audit organization, the auditor may be appointed in accordance with law or regulation, and the auditor may not need to establish all policies or procedures regarding the acceptance and continuance of audit engagements. Nevertheless, the requirements and considerations for the acceptance and continuance of client relationships and

²⁹ Paragraph .09 of section 210, *Terms of Engagement*.

engagements as set out in paragraphs .22–.24 and .A48–.A56 may be valuable to such auditors in performing risk assessments and in carrying out reporting responsibilities.

Engagement Resources (Ref: par. .25–.28)

.A59 Under SQMS No. 1, the resources assigned or made available by the firm to support the performance of audit engagements include

- human resources,
- technological resources, and
- intellectual resources.

.A60 Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances in which the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group engagement team.³⁰ In such circumstances, the firm's policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available.

.A61 A relevant consideration for the engagement partner, in complying with the requirements in paragraphs .25–.26, may be whether the resources assigned or made available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles such as professional competence and due care.

Human Resources

.A62 Human resources include members of the engagement team (see also paragraphs .A5 and .A15–.A21) and, when applicable, an auditor's external specialist and individuals from within the entity's internal audit function who provide direct assistance on the audit.

Technological Resources

.A63 The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technological resources may include tools that allow the auditor to more effectively and efficiently manage the audit. Technological tools may also allow the auditor to evaluate large amounts of data more easily to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Technological tools may also be used to conduct meetings and provide communication tools to the engagement team. Inappropriate use of technological resources may, however, increase the risk of overreliance on the information produced for decision-making purposes or may create threats to complying with relevant ethical requirements, for example, requirements related to confidentiality.

³⁰ See paragraph .03 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

.A64 The firm's policies or procedures may include required considerations or responsibilities for the engagement team when using firm-approved technological tools to perform audit procedures and may require, depending on the tool used, the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output.

.A65 When the engagement partner requires individuals from another firm to use specific automated tools and techniques when performing audit procedures, communications with those individuals may indicate that the use of such automated tools and techniques needs to comply with the engagement team's instructions.

.A66 The firm's policies or procedures may specifically prohibit the use of certain IT applications or features of IT applications (for example, software that has not yet been specifically approved for use by the firm). Alternatively, the firm's policies or procedures may require the engagement team to take certain actions before using an IT application that is not firm approved to determine it is appropriate for use, for example, by requiring

- the engagement team to have appropriate competence and capabilities to use the technological resource.
- testing of the operation and security of the IT application.
- specific documentation to be included in the audit file.

.A67 The engagement partner may exercise professional judgment in considering whether the use of an IT application on the audit engagement is appropriate in the context of the engagement, and if so, how the IT application is to be used. Factors that may be considered in determining whether a particular IT application that has not been specifically approved for use by the firm is appropriate for use in the audit engagement include whether

- use and security of the IT application comply with the firm's policies or procedures.
- the IT application operates as intended.
- personnel have the competence and capabilities required to use the IT application.

Intellectual Resources

.A68 Intellectual resources include, for example, audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms.

.A69 The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, law and regulation, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, an industry-specific methodology or related guides and performance aids.

Sufficient and Appropriate Resources to Perform the Engagement (Ref: par. .25)

.A70 In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement

team, ordinarily, the engagement partner may depend on the firm's related policies or procedures (including resources) as described in paragraph .A6. For example, based on information communicated by the firm, the engagement partner may be able to depend on the firm's technological development, implementation, and maintenance programs when using firm-approved technology to perform audit procedures.

.A71 The engagement partner may find it necessary to seek input from others with responsibilities for direction, supervision, and review to make the determinations required by paragraphs .25–.27 of this section.

Competence and Capabilities of the Engagement Team (Ref: par. .26)

.A72 When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- expertise in specialized areas of accounting or auditing.
- expertise in IT used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- knowledge of relevant industries in which the entity being audited operates.
- ability to exercise professional skepticism and professional judgment.
- understanding of the firm's policies or procedures.

.A73 Internal auditors and an auditor's external specialist are not members of the engagement team. Section 610³¹ and section 620³² include requirements and guidance relating to the assessment of the competence and capabilities of internal auditors and an auditor's external specialist, respectively.

Project Management

.A74 In situations in which there are many engagement team members, for example, in an audit of a larger or more complex entity, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, in an audit of a less complex entity with few engagement team members, project management may be achieved by a member of the engagement team through less formal means.

.A75 Project management techniques and tools may support the engagement team in managing the quality of the audit engagement by, for example,

- increasing the engagement team's ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism.

³¹ Paragraph .13 of section 610.

³² Paragraph .09 of section 620.

- facilitating timely performance of audit work to effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise.
- monitoring the progress of the audit against the audit plan,³³ including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources.
- facilitating communication among members of the engagement team, for example, coordinating arrangements with component auditors and auditor's experts.

Insufficient or Inappropriate Resources (Ref: par. .27)

.A76 SQMS No. 1 addresses the firm's commitment to quality through its culture that exists throughout the firm, which recognizes and reinforces the firm's role in serving the public interest by consistently performing quality engagements, and the importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities. SQMS No. 1 also addresses the firm's responsibilities for planning for resource needs and obtaining, allocating, or assigning resources in a manner that is consistent with the firm's commitment to quality. However, in certain circumstances, the firm's financial and operational priorities may place constraints on the resources assigned or made available to the engagement team. In such circumstances, these constraints do not override the engagement partner's responsibility for achieving quality at the engagement level, including for determining that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement.

.A77 In an audit of group financial statements, when there are insufficient or inappropriate resources in relation to work being performed at a component by a component auditor, the engagement partner may discuss the matter with the component auditor, management, or the firm to make sufficient and appropriate resources available.

.A78 The engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this section and the nature and circumstances of the audit engagement. As described in paragraph .A11, in certain circumstances, the engagement partner may determine that the firm's responses to quality risks are ineffective in the context of the specific engagement, including that certain resources assigned or made available to the engagement team are insufficient. In those circumstances, the engagement partner is required to take appropriate action, including communicating such information to the appropriate individuals in accordance with paragraphs .27 and .39c. For example, if an audit software program provided by the firm has not incorporated new or revised audit procedures regarding recently issued industry regulation, timely communication of such information to the firm enables the firm to take steps to update and reissue the software promptly or to provide an alternative resource that enables the engagement team to comply with the new regulation in the performance of the audit engagement.

.A79 If the resources assigned or made available are insufficient or inappropriate in the circumstances of the engagement and additional or alternative

³³ See paragraph .09 of section 300.

resources have not been made available, appropriate actions may include the following:

- Changing the planned approach to the nature, timing, and extent of direction, supervision, and review (see also paragraph .A94)
- Discussing an extension to reporting deadlines with management or those charged with governance, when an extension is possible under applicable law or regulation
- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation

Considerations Specific to Audits of Governmental Entities

(Ref: par. .25–.28)

.A80 For audits of governmental entities, competence may include skills that are necessary to comply with applicable law or regulation, such as knowledge of *Government Auditing Standards* and an understanding of the applicable reporting requirements, including reporting to the legislature or other governing body or reporting in the public interest. The scope of a governmental audit may include, for example, additional requirements with respect to detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect on the determination of financial statement amounts or the need to examine and report on internal control over financial reporting or compliance.

Engagement Performance

Scalability (Ref: par. .29)

.A81 When an audit is not carried out entirely by the engagement partner, or in an audit of an entity whose nature and circumstances are more complex, it may be necessary for the engagement partner to assign direction, supervision, and review to other members of the engagement team. However, as part of the engagement partner's overall responsibility for managing and achieving quality on the audit engagement and to be sufficiently and appropriately involved, the engagement partner is required to determine that the nature, timing, and extent of direction, supervision, and review is undertaken in accordance with paragraph .30. In such circumstances, personnel or members of the engagement team, including component auditors, may provide information to the engagement partner to enable the engagement partner to make the determination required by paragraph .30.

Direction, Supervision, and Review (Ref: par. .30)

.A82 Under SQMS No. 1, the firm is required to establish a quality objective that addresses the nature, timing, and extent of the direction and supervision of engagement teams and review of their work. SQMS No. 1 also requires that such direction, supervision, and review be planned and performed on the basis that the work performed by less experienced members of the engagement team be directed, supervised, and reviewed by more experienced engagement team members.

.A83 Direction and supervision of the engagement team and the review of the work of the engagement team are firm-level responses that are implemented at the engagement level, of which the nature, timing, and extent may be further tailored by the engagement partner in managing the quality of the audit engagement. Accordingly, the approach to direction, supervision, and review will vary from one engagement to the next, taking into account the nature and circumstances of the engagement. The approach will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses.

.A84 The approach to the direction and supervision of the members of the engagement team and the review of their work provides support for the engagement partner in fulfilling the requirements of this section and in concluding that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph .40.

.A85 Ongoing discussion and communication among members of the engagement team allows less experienced engagement team members to raise questions with more experienced engagement team members (including the engagement partner) in a timely manner and enables effective direction, supervision, and review in accordance with paragraph .30.

Direction

.A86 Direction of the engagement team may involve informing the members of the engagement team of their responsibilities, such as the following:

- Contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions
- Maintaining a questioning mind and being aware of unconscious or conscious auditor biases in maintaining professional skepticism when gathering and evaluating audit evidence (see paragraph .A35)
- Fulfilling relevant ethical requirements
- The responsibilities of respective partners when more than one partner is involved in the conduct of an audit engagement
- The responsibilities of respective engagement team members to perform audit procedures and of more experienced engagement team members to direct, supervise, and review the work of less experienced engagement team members
- Understanding the objectives of the work to be performed and the detailed instructions regarding the nature, timing, and extent of planned audit procedures as set forth in the overall audit strategy and audit plan
- Addressing threats to the achievement of quality, and the engagement team's expected response, for example, the threat that budget constraints or resource constraints result in the engagement team members inappropriately modifying planned audit procedures or failing to perform planned audit procedures

Supervision

.A87 Supervision may include matters such as the following:

- Tracking the progress of the audit engagement, which includes monitoring

- the progress against the audit plan,
 - whether the objective of work performed has been achieved, and
 - the ongoing adequacy of assigned resources
- Taking appropriate action to address issues arising during the engagement, including, for example, reassigning planned audit procedures to more experienced engagement team members when issues are more complex than initially anticipated
 - Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement
 - Providing coaching and on-the-job training to help engagement team members develop skills or competencies
 - Creating an environment where engagement team members raise concerns without fear of reprisals

Review

.A88 Review of the engagement team's work provides support for the conclusion that the requirements of this section have been addressed.

.A89 Review of the engagement team's work consists of consideration of whether, for example,

- the work has been performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements;
- significant matters have been raised for further consideration;
- appropriate consultations have taken place, and the resulting conclusions have been documented and implemented;
- there is a need to revise the nature, timing, and extent of work performed;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion; and
- the objectives of the audit procedures have been achieved.

.A90 The firm's policies or procedures may contain specific requirements regarding

- the nature, timing, and extent of review of audit documentation;
- different types of review that may be appropriate in different situations (for example, review of each individual working paper or selected working papers); and
- which members of the engagement team are required to perform the different types of review.

The Engagement Partner's Review (Ref: par. .30–.34)

.A91 As required by section 300, the engagement partner reviews the overall audit strategy and audit plan.³⁴ As required by section 230, the engagement partner documents the date and extent of the review.³⁵

.A92 Timely review of documentation by the engagement partner at appropriate stages throughout the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation. The engagement partner exercises professional judgment in determining the extent of documentation to be reviewed, for example, when determining the nature and extent of the review of component auditor documentation in a group audit.

.A93 The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm's policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

- Matters related to planning the engagement, such as matters related to determining materiality
 - The composition of the engagement team, including
 - personnel using expertise in a specialized area of accounting or auditing
 - the use of personnel from service delivery centers
 - The decision to involve an auditor's specialist, including the decision to involve an external specialist
- The engagement team's consideration of information obtained in the acceptance and continuance process and proposed responses to that information
- The engagement team's risk assessment process, including situations in which consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team
- The engagement team's consideration of related party relationships and transactions and disclosures
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions concerning certain accounting estimates, accounting policies, or going concern considerations
- The engagement team's evaluation of the work performed by specialists and conclusions drawn therefrom
- In group audit situations,
 - the proposed overall group audit strategy and group audit plan;

³⁴ Paragraph .11 of section 300, as amended by Statement on Auditing Standards No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

³⁵ Paragraph .09c of section 230.

- decisions about the involvement of component auditors, including how to direct and supervise them and review their work, including, for example, when there are areas of higher assessed risk of material misstatement of the financial information of a component; and
 - the evaluation of work performed by component auditors and the conclusions drawn therefrom
- How matters affecting the overall audit strategy and audit plan have been addressed
 - The significance and disposition of corrected and uncorrected misstatements identified during the engagement
 - The proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.

.A94 The engagement partner exercises professional judgment in determining other matters to review, for example, based on

- the nature and circumstances of the audit engagement.
- which engagement team member performed the work.
- matters relating to recent inspection findings.
- the requirements of the firm's policies or procedures.

Nature, Timing, and Extent

.A95 The nature, timing, and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm's policies or procedures, as well as professional standards and applicable legal and regulatory requirements. For example, the firm's policies or procedures may include the following:

- Work planned to be performed at an interim date is to be directed, supervised, and reviewed at the same time as the performance of the procedures, rather than at the end of the period, so that any necessary corrective action can be taken in a timely manner.
- Certain matters are to be reviewed by the engagement partner, and the firm may specify the circumstances or engagements in which such matters are expected to be reviewed.

Scalability

.A96 The following are examples of factors that may influence the firm's approach to direction, supervision, and review:

- The engagement team member's previous experience with the entity and the area to be audited. For example, if the work related to the entity's information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and frequency of the direction and supervision of the engagement team member may be less, and the review of the related working papers may be less detailed.
- The complexity of the audit engagement. For example, if significant events have occurred that make the audit engagement more complex, the extent and frequency of the direction and supervision of the engagement team member may be greater, and the review of the related working papers may be more detailed.

- The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.
- The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced engagement team members may require more detailed instructions and more frequent, or in-person, interactions as the work is performed.
- The manner in which the reviews of the work performed are expected to take place. For example, in some circumstances, remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
- The structure of the engagement team and the location of engagement team members. For example, direction and supervision of individuals located at service delivery centers and the review of their work may
 - be more formalized and structured than when members of the engagement team are all situated in the same location or
 - use IT to facilitate the communication between the members of the engagement team.

.A97 Identification of changes in the engagement circumstances may warrant reevaluation of the planned approach to the nature, timing, or extent of direction, supervision, or review. For example, if the assessed risk of material misstatement at the financial statement level increases because of a complex transaction, the engagement partner may need to change the planned level of review of the work related to the transaction.

.A98 In accordance with paragraph .30b, the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced engagement team member becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members.

Review of Communications to Management, Those Charged With Governance, or Regulatory Authorities (Ref: par. .34)

.A99 The engagement partner uses professional judgment in determining which written communications to review, taking into account the nature and circumstances of the audit engagement. For example, it may not be necessary for the engagement partner to review communications between the engagement team and management in the ordinary course of the audit.

Consultation (Ref: par. .35)

.A100 SQMS No. 1 requires the firm to establish a quality objective that addresses consultation on difficult or contentious matters and how the conclusions agreed are implemented. Consultation may be appropriate or required, for example, for

- issues that are complex or unfamiliar (for example, issues related to an accounting estimate with a high degree of estimation uncertainty),
- significant risks,
- significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual,
- limitations imposed by management, and
- noncompliance with laws or regulations.

.A101 Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm, may be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, seniority, and experience.

.A102 It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, in areas where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

.A103 The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.³⁶

Engagement Quality Review (Ref: par. .36)

.A104 SQMS No. 1 contains requirements that the firm establish policies or procedures addressing engagement quality reviews in accordance with SQMS No. 2, *Engagement Quality Reviews* (QM sec. 20),³⁷ and requiring an engagement quality review for certain types of engagements.³⁸ SQMS No. 2 deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review.

Completion of the Engagement Quality Review Before Dating of the Auditor's Report (Ref: par. .36d)

.A105 Section 700 requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.³⁹ If applicable to the audit engagement, SQMS No. 2 and this section require that the engagement partner be precluded from releasing the engagement report until notification has been received from the engagement quality reviewer that the engagement quality review is complete. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate, then the engagement quality review is not complete.⁴⁰

³⁶ Paragraphs .09 and .A13b of section 701.

³⁷ SQMS No. 2, *Engagement Quality Reviews* (QC sec. 20).

³⁸ Paragraph 35f of SQMS No. 1.

³⁹ Paragraph .43 of section 700.

⁴⁰ Paragraph 21b of SQMS No. 2.

.A106 An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report.

.A107 Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the engagement partner may assign responsibility for coordinating requests from the engagement quality reviewer to another member of the engagement team.

Differences of Opinion (Ref: par. .37–.38)

.A108 SQMS No. 1 requires the firm to establish a quality objective that addresses differences of opinion that arise within the engagement team or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management. SQMS No. 1 also requires that differences of opinion be brought to the attention of the firm and resolved. For example, a component auditor may be instructed to communicate differences of opinion to the group engagement team.

.A109 In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example,

- seeking legal advice or
- withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Monitoring and Remediation (Ref: par. .39)

.A110 SQMS No. 1 sets out requirements for the firm's monitoring and remediation process. SQMS No. 1 requires the firm to communicate to engagement teams information about the firm's monitoring and remediation process to enable them to take prompt and appropriate action in accordance with their responsibilities. Further, information provided by members of the engagement team may be used by the firm in the firm's monitoring and remediation process, and exercising professional judgment and maintaining professional skepticism while conducting the audit may assist the members of the engagement team in remaining alert for information that may be relevant to that process.

.A111 Information provided by the firm may be relevant to the audit engagement when, for example, it relates to findings on another engagement performed by the engagement partner or other members of the engagement team, findings from the local firm office, or inspection results of previous audits of the entity.

.A112 In considering information communicated by the firm through its monitoring and remediation process and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to address deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that

- an auditor's specialist is needed or

- the nature, timing, and extent of direction, supervision, and review need to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (for example, if it relates to a technological resource that the engagement team did not use), then no further action may be needed.

.A113 A deficiency in the firm's system of quality management does not necessarily indicate that an audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the auditor's report was not appropriate in the circumstances.

Taking Overall Responsibility for Managing and Achieving Quality
(Ref: par. .40)

.A114 SQMS No. 1 requires the firm to establish a quality objective addressing the engagement team's understanding and fulfillment of their responsibilities in connection with the engagement. SQMS No. 1 further requires that the quality objective include the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.

.A115 Relevant considerations in addressing paragraph .40 include determining how the engagement partner has complied with the requirements of this section, given the nature and circumstances of the audit engagement and how the audit documentation evidences the engagement partner's involvement throughout the audit engagement, as described in paragraph .A118.

.A116 Indicators that the engagement partner may not have been sufficiently and appropriately involved include, for example, the following:

- Lack of timely review by the engagement partner of the audit engagement planning, including reviewing the assessment of risks of material misstatement and the design of responses to those risks toward the end of the audit
- Evidence that assignees were not provided necessary instructions and relevant information, such as not being adequately informed about the nature of their responsibilities and authority, the scope of the work being assigned, and the objectives thereof
- A lack of evidence of the engagement partner's direction and supervision of the other members of the engagement team and the review of their work

.A117 If the engagement partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph .40. In addition to taking into account firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example,

- updating and changing the audit plan,
- reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner, or
- consulting with personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

Documentation (Ref: par. .41)

.A118 In accordance with section 230,⁴¹ audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (such as in a checklist) compliance with matters for which compliance is demonstrated by documents included within the audit file.

.A119 Documentation of the performance of the requirements of this section, including evidencing the involvement of the engagement partner and the engagement partner's determination in accordance with paragraph .40, may be accomplished in different ways depending on the nature and circumstances of the audit engagement. Examples follow:

- Direction of the engagement team can be documented through sign-offs of the audit plan and project management activities.
- Minutes from formal meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions regarding culture and expected behaviors that demonstrate the firm's commitment to quality.
- Agendas from discussions between the engagement partner and other members of the engagement team and, when applicable, the engagement quality reviewer, and related sign-offs and records of the time the engagement partner spent on the engagement, may provide evidence of the engagement partner's involvement throughout the audit engagement and supervision of other members of the engagement team.
- Sign-offs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

.A120 When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to decline the engagement (see paragraph .24), the documentation may include explanations of how the engagement team dealt with the circumstance.

.A121 Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- the nature and scope of the issue on which consultation was sought and
- the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented.

⁴¹ Paragraph .A9 of section 230.

.A122

Appendix — Amendments to Various Statements on Auditing Standards, as Amended, and Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, as Amended, Section 105, *Concepts Common to All Attestation Engagements*, in AICPA Professional Standards

Amendment to Statement on Auditing Standards (SAS) No. 117, *Compliance Audits*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 935, *Compliance Audits*

[No amendment to paragraphs .01–.A34.]

~~.A35 Section 220, *Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner **determine**, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.~~^{fn 20} ***When an engagement quality control review is performed, section 220 SAS No. 146 requires that the auditor's report not be released prior to until the completion of the engagement quality control review.***^{fn 21}

^{fn 20} ~~See paragraph **Paragraph 19 32** of section 220, *SAS No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.~~

^{fn 21} ~~Paragraph 2136d of section 220 SAS No. 146.~~

[No further amendment to section 935.]

1. This amendment is effective for compliance audits for fiscal periods ending on or after December 15, 2025.

Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

[No amendment to paragraphs .01–.A19.]

~~.A20 QC section 10 *Statement on Quality Management Standards (SQMS) No. 1, A Firm's System of Quality Control Management*, sets out the firm's responsibilities to establish and maintain its design, implement, and operate a system of quality control for audit engagements, and to establish policies and procedures designed to provide it management that provides~~

the firm with reasonable assurance that the firm and its personnel **fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements.** SQMS No. 1 requires the firm, as part of its system of quality management, to establish quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those pertaining **related** to independence.^{fn 7} Section 220 **Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**, addresses the engagement partner's responsibilities regarding relevant ethical requirements, **including those related to independence.** These include remaining alert for evidence of noncompliance with relevant ethical requirements by members of the engagement team; determining, in consultation with others in the firm as appropriate, the appropriate action if matters come to the engagement partner's attention; through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements; and forming a conclusion on compliance with independence requirements that apply to the audit engagement.^{fn 8} Section 220 **SAS No. 146** recognizes that **also describes when** the engagement team is entitled to rely on a firm's system of quality control in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties **may depend on the firm's policies or procedures in managing and achieving quality at the engagement level.**^{fn 9}

^{fn 7} Paragraphs 21–25 **30 of QC section 10—Statement on Quality Management Standards (SQMS) No. 1, A Firm's System of Quality Control Management.**

^{fn 8} Paragraphs 116–132 **1 of section 220 Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

^{fn 9} **Paragraph A10 of SAS No. 146.**

[No amendment to paragraphs A21–A31. Subsequent footnotes are renumbered.]

A32 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit¹³) **or through the information obtained by the firm in the acceptance or continuance of the client relationship or engagement** firm's quality control procedures for client acceptance or continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared by a specialist employed or engaged by the entity. Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

^{fn 13} [Footnote omitted for purposes of this standard.]

[No further amendment to section 200.]

2. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 210, *Terms of Engagement*

[No amendment to paragraphs .01–.18.]

.A1 Statement on Quality Management Standards No. 1, A Firm's System of Quality Management, addresses the firm's responsibilities regarding the acceptance and continuance of client relationships and specific engagements. The auditor's responsibilities regarding relevant ethical requirements, **including those related to independence**, in the context of the acceptance of an audit engagement, insofar as they are within the control of the auditor, are dealt with in ~~section 220~~ **Statement on Auditing Standards No. 146, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**. This section addresses those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

[No further amendment to section 210.]

3. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 230, *Audit Documentation*

[No amendment to paragraphs .01–.02.]

.03 Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with ~~section 220~~ **Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**^{fn 3}
- Enabling the engagement team to demonstrate that it is accountable for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached
- Retaining a record of matters of continuing significance to future audits of the same entity
- Enabling the conduct of **engagement** quality control reviews, **other types of engagement reviews, and monitoring activities under the firm's system of quality management** ~~inspections in accordance with QC section 10, A Firm's System of Quality Control~~
- Enabling the conduct of external inspections in accordance with applicable legal, regulatory, or other requirements
- Assisting an auditor who reviews a predecessor auditor's audit documentation
- Assisting auditors to understand the work performed in the prior year as an aid in planning and performing the current engagement

^{fn 3} *Paragraphs .17–.19 29–33 of section 220 Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

[No amendment to paragraphs .04–.A8.]

.A9 Audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed to the terms of the audit engagement with management or, when appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances in accordance with GAAS.
- Regarding requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with GAAS. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
 - Similarly, that the engagement partner has taken responsibility for the direction, *and* supervision, *and* performance of the *engagement team and review of their work* ^{fn 6} audit in compliance with GAAS may be evidenced in a number of ways within the audit documentation. This may include documentation of *that evidences* the engagement partner's timely *sufficient and appropriate* involvement in aspects of the audit, such as participation in the *engagement* team discussions. required by section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.* ^{fn 6}

^{fn 6} *Paragraph 29 of SAS No. 146.*

[No amendment to paragraphs .A10–.A14.]

.A15 ~~Section 220~~ **SAS No. 146 contains requirements and guidance on the** requires the auditor to review the audit work performed through review of the audit documentation. ^{fn 9} The requirement to document who reviewed the audit work performed and the extent of the review, in accordance with the firm's policies and procedures addressing review responsibilities does not imply a need for each specific working paper to include evidence of review. The requirement,

however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

^{fn 9} ~~Paragraph 0931 of section 220 SAS No. 146.~~

[No amendment to paragraphs .A16–.A22.]

Matters Arising After the Date of the Auditor's Report (Ref: par. .14)

.A23 Examples of rare circumstances in which the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report include

- when, after the date of the auditor's report, the auditor becomes aware of facts that existed at that date and which, if known at that date, might have caused the financial statements to be revised or the auditor to modify the opinion in the auditor's report.^{fn 11}
- when the auditor concludes that procedures necessary at the time of the audit, in the circumstances then existing, were omitted from the audit of the financial information.^{fn 12}

The resulting changes to the audit documentation are reviewed in accordance with the firm's ~~quality control procedures as required by QC section 10~~ ***under its system of quality management***.

^{fns 11–12} [Footnotes omitted for purposes of this standard.]

Assembly and Retention of the Final Audit File (Ref: par. .16–.18)

.A24 Statutes, regulations, or the audit firm's ~~quality control policies~~ ***or procedures under its system of quality management*** may specify a period of time shorter than 60 days following the report release date in which this assembly process is to be completed.

[No amendment to paragraphs .A25–.A26.]

.A27 Firms are required to establish policies and procedures for the retention of engagement documentation.^{fn 13} Statutes, regulations, or the audit firm's ~~quality control policies~~ ***or procedures under its system of quality management*** may specify a retention period longer than five years.

^{fn 13} ~~Paragraph .50 of QC section 10.~~

.A28 An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need to clarify existing audit documentation arising from comments received during monitoring inspections performed by internal ~~activities~~ or external parties ***inspections***.

[No further amendment to section 230.]

4. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 260, The Auditor's Communication With Those Charged With Governance

[No amendment to paragraphs .01–.A36.]

.A37 To the extent not already addressed by the requirements in paragraph .12a–f and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, ~~in accordance with section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.~~^{fn 14}

^{fn 14} ~~Paragraphs .21–.22 of section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.~~

[No amendment to paragraphs .A38–.A50.]

.A51 Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, the importance of the matter to those charged with governance, and the action expected to be taken by those charged with governance. The following are examples of the timing of communications for certain matters:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- It may be appropriate to communicate significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.
- When section 701 applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.

The following are examples of matters for which communication with those charged with governance may be important prior to issuance of the auditor's report:

- Uncorrected misstatements accumulated by the auditor and the effect that they may have, individually or in the aggregate, on the opinion in the auditor's report, including possible implications with respect to future financial statements.
- Circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired.
- Significant findings or issues from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices.
- An expectation by the auditor that the opinion in the auditor's report will be modified in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.^{fn16}
- When section 701 applies, the matters planned to be included in the auditor's report. **SAS No. 146, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires the engagement partner, prior to dating the auditor's report, to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.**¹⁷

^{fn 16} Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

^{fn 17} Paragraph 33 of SAS No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

[Subsequent footnotes are renumbered.]

[No further amendment to section 260.]

5. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 300, *Planning an Audit*

Introduction

Scope of This Section

[No amendment to paragraph .01.]

The Role and Timing of Planning

.02 Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate ***Quality management at the engagement level in accordance with Statement on Auditing Standards (SAS) No. 146, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, in conjunction with adequate*** planning ***in accordance with this section***, benefits the audit of financial statements in several ways, including the following:

- Helping the auditor identify and devote appropriate attention to important areas of the audit
- Helping the auditor identify and resolve potential problems on a timely basis
- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and allocating team member responsibilities
- Facilitating the direction and supervision of engagement team members and the review of their work
- Assisting, when applicable, in coordination of work done by auditors of components and specialists

[No amendment to paragraphs .03–.05.]

Preliminary Engagement Activities

.06 The auditor should undertake the following activities at the beginning of the current audit engagement:

- a. Performing procedures required by ~~section 220,~~ **SAS No. 146** regarding the ***acceptance and*** continuance of the client relationship and the ~~specific~~ audit engagement;
- b. Evaluating compliance with relevant ethical requirements in accordance with ~~section 220,~~ **SAS No. 146**
- c. Establishing an understanding of the terms of the engagement, as required by section 210, *Terms of Engagement*. (Ref: par. .A6–.A8)

[No amendment to paragraph .07.]

Planning Activities

.08 In establishing the overall audit strategy, the auditor should ***consider the information obtained from complying with the requirements of SAS No. 146 and***

- a. identify the characteristics of the engagement that define its scope;
- b. ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- c. consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- d. consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- e. ascertain the nature, timing, and extent of resources necessary to perform the engagement. (Ref: par. .A9–.A13)

.09 The auditor should develop an audit plan that includes a description of the following:

- a. ***The nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work*** (Ref: par. ~~.A18–.A19.~~**A14–.A15**)
- b. ~~a.~~ The nature and extent of planned risk assessment procedures, as determined under section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- c. ~~b.~~ The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- d. ~~c.~~ Other planned audit procedures that are required to be carried out so that the engagement complies with generally accepted auditing standards (Ref: par. ~~.A14–.A16–.~~**A18**)

[No amendment to paragraph .10.]

.11 The auditor ~~***engagement partner***~~ should ~~plan the nature, timing, and extent of direction and supervision of engagement team members and the review of their work~~ ***review the overall audit strategy and audit plan.*** (Ref: par. ~~.A18–.A19~~)

[No amendment to paragraphs .12–.13.]

Documentation

.14 The auditor should include in the audit documentation the following:^{fn 3}

- a. The overall audit strategy
- b. The audit plan
- c. Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, ***including any significant changes to the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work,***^{fn 4} and the reasons for such changes. (Ref: par. .A23–.A26)

^{fn 3} [Footnote omitted for purposes of this standard.]

^{fn 4} **Paragraphs 30 and A93–A94 of SAS No. 146, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.**

Application and Other Explanatory Material

.A1 SAS No. 146 addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. Information obtained from complying with the requirements of SAS No. 146 is relevant to this section. For example, in accordance with SAS No. 146, the engagement partner is required to determine that sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, taking into account the nature and circumstances of the audit engagement. Such a determination is directly relevant when ascertaining the nature, timing, and extent of resources necessary to perform the engagement in the overall strategy, as required by paragraph .08 of this section.

The Role and Timing of Planning (Ref: par. .01)

~~.A1.~~***.A2*** The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement. ***In planning the audit, the auditor may use project management techniques and tools. SAS No. 146 ^{fn5} describes how such techniques and tools may support the engagement team in managing the quality of the engagement.***

^{fn 5} **Paragraphs A73–A74 of SAS No. 146.**

[Subsequent footnotes are renumbered.]

[No amendment to paragraph .A2, renumbered as paragraph .A3.]

~~.A3.~~***.A4*** The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit ***help the auditor manage and achieve quality at the engagement level*** (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

[No amendment to paragraphs .A4–.A5, renumbered as paragraphs .A5–.A6.]

Preliminary Engagement Activities (Ref: par. .06)

.A67 Performing the preliminary engagement activities, which are specified in paragraph .06, at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement ***manage and achieve quality at the engagement level in accordance with SAS No. 146.***

~~.A7A~~***.8*** Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which ***to***, for example,

- the auditor maintains ***maintain*** the necessary independence and ability to perform the engagement.

- **determine that** the auditor has no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- **determine that there is** the auditor has no misunderstanding **between the auditor and** with the entity about the terms of the engagement.

~~A8A9~~ The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur. Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often begin shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: par. .07-.08)

~~A9A10~~ The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, **may include** such matters as the following:

- The **nature of** resources (**human, technological, or intellectual**) to deploy **be deployed** for specific audit areas, such as **for example**, the use **deployment** of appropriately experienced team members for high-risk areas or the involvement **assignment of** specialists **on to address** complex matters
- The amount of resources to allocate **be allocated** to specific audit areas, such as **for example**, the number of team members assigned to observe **attend the physical** inventory count at material **multiple** locations, the extent of review of component auditors' work in the case of group audits, or the audit budget (in hours) to allocate to high-risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are managed, directed, and supervised, such as **or used, for example**, when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews

.A11 SAS No. 146 contains requirements and guidance on engagement resources and engagement performance (including direction and supervision of the members of the engagement team and the review of their work).

[No amendment to paragraphs .A10-.A17, renumbered as paragraphs .A12-.A19.]

Direction, Supervision, and Review (Ref: par. .11)

~~A18A20~~ **SAS No. 146 addresses the engagement partner's responsibility for the** The nature, timing, and extent of the direction and supervision of engagement team members and review of their work. ^{fn 10} vary, depending on many factors, including the following:

- The size and complexity of the entity

- The area of the audit
- The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members and a more detailed review of their work)
- The capabilities and competence of the individual team members performing the audit work

Section 220 contains further guidance on the direction, supervision, and review of audit work.

^{fn 10} **Paragraphs 29–31 of SAS No. 146.**

[Subsequent footnotes are renumbered.]

Considerations Specific to Smaller, Less-Complex Entities **Scalability**

.A19A21 If an audit is carried out entirely by the engagement partner, questions of direction and supervision of engagement team members and review of their work do not arise. In such cases, the engagement partner, having personally conducted all aspects of the work, will be aware of all material issues. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved, and the audit is performed by a sole practitioner, it may be desirable to consult with other suitably experienced auditors or the auditor's professional body.

[No amendment to paragraphs .A20–.A21, renumbered as paragraphs .A22–.A23.]

Additional Considerations in Initial Audit Engagements (Ref: par. .13)

.A22A24 The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Arrangements to be made with the predecessor auditor (for example, to review the predecessor auditor's working papers [see section 510, *Opening Balances —Initial Audit Engagements, Including Reaudit Engagements*])^{fn 8}
- Any major issues (including the application of accounting principles or auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance, and how these matters affect the overall audit strategy and audit plan
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (see section 510)^{fn 9}
- Other procedures required **responses designed and implemented** by the firm's system of quality control **firm** for initial audit engagements (For example, the firm's system of quality control **management** may **include responses that** require the

involvement of another partner or senior individual **with appropriate authority** to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance.)

fns 8–9 [Footnotes renumbered as 11 and 12, and omitted for purposes of this standard.]

Documentation (Ref: par. .14)

~~A23.~~**A25** The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit **in managing quality at the engagement level** and **a means to** communicate significant issues to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing, and conduct of the audit.

.A26 *Documentation of the direction and supervision of engagement team members and the review of their work in accordance with SAS No. 146 may also provide a record of significant changes to the planned nature, timing, and extent of the direction, supervision, and review.*

[No amendment to paragraphs .A24–.A26, renumbered as paragraphs .A27–.A29.]

Appendix — Considerations in Establishing the Overall Audit Strategy Managing Quality at the Engagement Level (Ref: par. .07–.08 and .A9–.A12)

~~A27.~~**A30**

This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy **managing quality at the engagement level**. Many of these matters also will influence the auditor's **overall audit strategy and** detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

...

Nature, Timing, and Extent of Resources

The following examples illustrate the nature, timing, and extent of resources:

- The selection **human, technological, and intellectual resources assigned or made available to the engagement (for example, assignment** of the engagement team (including, when necessary, the engagement quality control reviewer [see section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*]) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas in which there may be higher risks of material misstatement
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas in which there may be higher risks of material misstatement

[No further amendment to section 300.]

6. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*

Introduction

Scope of This Section

[No amendment to paragraphs .01–.04.]

.05 In accordance with section ~~220~~, ***Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***, the group engagement partner is required to be satisfied ~~determine~~ that those performing the group audit engagement, ~~including component auditors~~, collectively possess the appropriate competence and capabilities, ***including sufficient time***.^{fn 1} ***Those performing the group audit engagement include component auditors whose work the group auditor assumes responsibility for but not component auditors whose audits the group auditor makes reference to (see paragraph .08).*** The group engagement partner also is responsible for the direction ~~and~~, supervision ***of members of the group engagement team*** and performance of the group audit engagement ***review of their work***.^{fn 2} In this section, requirements to be undertaken by the group engagement partner are addressed to the group engagement partner. When the group engagement team may assist the group engagement partner in fulfilling a requirement, the requirement is addressed to the group engagement team. When it may be appropriate in the circumstances for the firm to fulfill a requirement, the requirement is addressed to the auditor of the group financial statements.

^{fn 1} Paragraphs ~~16~~ **25–26** of section ~~220~~, ***Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***.

^{fn 2} ***Paragraphs 29–31 of SAS No. 146.***

[Subsequent footnotes are renumbered.]

[No further amendment to section 600.]

7. This amendment is effective for audits of group financial statements for periods beginning on or after December 15, 2025.

AU-C Section 620, *Using the Work of an Auditor's Specialist*

[No amendment to paragraphs .01–.07.]

.08 The nature, timing, and extent of the auditor's procedures with respect to the requirements in paragraphs .09–.13 will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the auditor should consider matters including (Ref: par. .A11)

- a. the nature of the matter to which the work of the auditor's specialist relates;
- b. the risks of material misstatement in the matter to which the work of the auditor's specialist relates;
- c. the significance of the work of the auditor's specialist in the context of the audit;
- d. the auditor's knowledge of, and experience with, previous work performed by the auditor's specialist; and
- e. whether the auditor's specialist is subject to the auditor's firm's ***system of quality management*** control policies and procedures. (Ref: par. .A12–.A14)

[No amendment to paragraphs .09–.A6.]

.A7 If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required by section 220 **Statement on Auditing Standards (SAS) No. 146, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**, to be satisfied ~~determine~~ that the engagement team and any external auditor's specialists who are not part of the engagement team, collectively, have the appropriate competence and capabilities, **including sufficient time**, to perform the audit engagement.^{fn 6} Further, the auditor is required by section 300 to ascertain the nature, timing, and extent of resources necessary to perform the engagement.^{fn 7} The auditor's determination of whether to use the work of an auditor's specialist, and, if so, when and to what extent, assists the auditor in meeting these requirements. As the audit progresses or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's specialist.

^{fn 6} Paragraph 1626 of section 220 **Statement on Auditing Standards (SAS) No. 146, Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

^{fn 7} [Footnote omitted for purposes of this standard.]

[No amendment to paragraphs .A8–.A10.]

.A11 The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's specialist relates to a significant finding or issue that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's specialist and has no prior knowledge of that specialist's competence, capabilities, and objectivity.
- The auditor's specialist is performing procedures that are integral to the audit rather than being consulted to provide advice on an individual matter.
- The specialist is an auditor's external specialist and is not, therefore, subject to the firm's **system of quality management** ~~control policies and procedures~~.

The Auditor's Firm's System of Quality Control Policies and Procedures Management (Ref: par. .08e)

.A12 An auditor's internal specialist may be a partner or staff, including temporary staff (**that is, personnel**), of the auditor's firm and, therefore, subject to the **system of quality control policies and procedures management** of that firm in accordance with QC section 10, **Statement on Quality Management Standards (SQMS) No. 1, A Firm's System of Quality Control Management**.^{fn 10} An auditor's internal specialist also may be a partner or staff, including temporary staff, of a network firm, **and is subject to the firm's policies or procedures for network requirements and network services in accordance with SQMS No. 1. In some instances, the auditor's internal specialist of a network firm may be subject to** which may share common quality control **management** policies and ~~or~~ procedures with **as** the auditor's firm, **given that they are part of the same network**.

^{fn 10} Paragraph 1317 of **Statement on Quality Management Standards (SQMS) No. 1, A Firm's System of Quality Management**.

~~.A13 In accordance with~~ ***As described in section 220 SAS No. 146, quality management at the*** engagement teams are entitled to rely on the firm's system of quality control unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.^{fn 11} The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the auditor's ***level is supported by the firm's system of quality management and informed by the specific nature and circumstances of the audit engagement.***^{fn 12} ***For example, the auditor may be able to depend on the firm's related policies or*** procedures with respect to such matters as the following:

- Competence and capabilities through recruitment and training programs.
- Objectivity. The auditor's internal specialists are subject to relevant ethical requirements, including those pertaining ***relating*** to independence.
- Agreement with the auditor's specialist.
- The auditor's evaluation of the adequacy of the work of the auditor's specialist. For example, the firm's training programs may provide the auditor's internal specialists with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm processes, such as protocols for scoping the work of the auditor's internal specialists, may affect the nature, timing, and extent of the auditor's procedures to evaluate the adequacy of the work of the auditor's specialist.
- Adherence to regulatory and legal requirements through monitoring processes.

~~Such reliance~~ ***Matters that the auditor may take into account when determining whether to depend on the firm's policies or procedures are described in SAS No. 146.***^{fn 13} ***Depending on the firm's policies or procedures*** does not reduce the auditor's responsibility to meet the requirements of this section.

^{fn 11} *Paragraph .05 of section 220.*

^{fn 12} *Paragraph A4 of SAS No. 146.*

^{fn 13} *Paragraphs 4b and A10 of SAS No. 146.*

.A14 SQMS No. 1 requires the firm to address the use of resources from a service provider, which includes the use of an external specialist.^{fn 14} An auditor's external specialist is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with QC section 10 ***the firm's policies or procedures under its system of quality management.***^{fn 15} ***Furthermore, the firm's policies or procedures for relevant ethical requirements may include policies or procedures that apply to the auditor's external specialist.***^{fn 1216}

^{fn 14} *Paragraph 33 of SQMS No. 1.*

^{fn 15} *Paragraph 17 of SQMS No. 1.*

^{fn 1216} *Paragraph 1330b of QC section 10 SQMS No. 1.*

[Subsequent footnotes are renumbered.]

[No proposed amendment to paragraph .A15.]

.A16 Information regarding the competence, capabilities, and objectivity of an auditor's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other auditors or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The **system of quality management** control policies and procedures of the auditor's firm and such other procedures the auditor considers necessary in the circumstances (see paragraphs .A12–.A13).

[No amendment to paragraphs .A17–.A28.]

.A29 When no written agreement exists between the auditor and the auditor's specialist, evidence of the agreement may be included in, for example,

- planning memoranda or related working papers, such as the audit program.
- the policies ~~and~~ procedures of the auditor's firm's **system of quality management**. In the case of an auditor's internal specialist, the established policies and procedures to which the auditor's specialist is subject ~~firm's system of quality management~~ may include particular policies and ~~or~~ procedures regarding the work of the auditor's specialist. The extent of documentation in the auditor's working papers depends on the nature of such policies and ~~or~~ procedures. For example, no documentation may be required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an auditor's specialist is used.

[No further amendment to section 620.]

8. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 930, *Interim Financial Information*

[No amendment to paragraphs .01–.A59.]

.A60 When an engagement quality control review is performed, ~~section 220, Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards~~, requires that the **engagement partner not date** the auditor's report ~~not be released prior to~~ **until** the completion of the engagement quality control review.^{fn 27}

^{fn 27} Paragraph 2136d of ~~section 220~~ **Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards**.

[No further amendment to section 930.]

9. This amendment is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2025.

Amendment to SAS No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

[No amendment to paragraphs .01–.A116.]

~~A117 Section 220, Statement on Auditing Standards (SAS) No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,~~ requires that, on or before the date of the auditor's report, the engagement partner ***determine***, through a review of the audit documentation and discussion with the engagement team, ~~be satisfied~~ that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.^{fn 25} When an engagement quality control review is performed, ~~section 220 SAS No. 146~~ requires that the ***engagement partner not date the*** auditor's report ~~not be released prior to~~ ***until*** the completion of the engagement quality control review.^{fn 26}

^{fn 25} See ~~paragraph~~ ***Paragraph 1932*** of ~~section 220, SAS No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,~~ for further discussion.

^{fn 26} ~~Paragraph 2136d of section 220~~ ***SAS No. 146.***

[No further amendment to section 940.]

10. This amendment is effective for integrated audits for periods beginning on or after December 15, 2025.

Amendments to Various Sections in SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 700, Forming an Opinion and Reporting on Financial Statements

[No amendment to paragraphs .01–.A38.]

A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those ~~pertaining~~ ***relating*** to independence, in a group audit situation may be complex. Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,^{fn 21} provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

[No amendment to paragraphs .A40–.A53.]

.A54 Statement on Auditing Standards (SAS) No. 146, Section 220, *Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires **the following with regard to dating the auditor's report**:

- that, ~~On or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, is required to be satisfied~~ **determine** that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.^{fn 26}
- **Prior to dating the auditor's report, the engagement partner is required to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.**^{fn 27}
- When an engagement quality control review is performed, section 220 the **engagement partner is precluded from releasing the auditor's report not be released prior to until** the completion of the engagement quality control review.^{fn 27 28}

^{fn 26} See paragraph ~~1932~~ **Paragraph 1932** of section 220, **SAS No. 146**, *Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

^{fn 27} **Paragraph 33 of SAS No. 146.**

^{fn 27 28} **Paragraph 2136d of section 220 SAS No. 146.**

[No further amendment to section 700.]

11. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor's Report

[No amendment to paragraphs .01–.A12.]

.A13 Certain sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

- a. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.^{fn 7} For example, there may be potential difficulties relating to the following:
 - i. *Related party transactions.* In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction.^{fn 8}
 - ii. *Limitations on the group audit.* For example, the group engagement team's access to information may be restricted.^{fn 9}

^{fn 7–9} [Footnotes omitted for purposes of this standard.]

- b. ~~Section 220, **Statement on Auditing Standards No. 146, Quality Control Management** for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,~~ establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters, ***matters on which the firm's policies or procedures require consultation, and other matters that, in the engagement partner's professional judgment, require consultation.***^{fn 10} For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters ***and significant judgments*** arising during the audit engagement with the engagement quality control reviewer.

^{fn 10} Paragraph ~~2035~~ of ~~section 220, **SAS No. 146, Quality Control Management** for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.~~

[No amendment to paragraphs .A14–.A59.]

Communication With Those Charged With Governance (Ref: par. .16)

.A60 SAS No. 146 requires the engagement partner, prior to dating the auditor's report, to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.^{fn 19}

^{fn 19} ***Paragraph 33 of SAS No. 146.***

[No amendment to paragraph .A60, renumbered as paragraph .A61.]

.A612 The requirement in paragraph .16b to communicate with those charged with governance when the auditor has determined that there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality control reviewer, when one has been appointed). These discussions may cause the auditor to reevaluate the auditor's determination that there are no key audit matters.

[No amendment to paragraph .A62, renumbered as .A63.]

12. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

Amendment to SAS No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as Amended

(***Boldface italics*** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

[No amendment to paragraphs .01–.A118.]

Date of the Auditor's Report (Ref: par. .82 and .126)

.A119 SAS No. 146, Section 220, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires ***the following with regard to dating the auditor's report:***

- ~~that, On or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, **is required to be satisfied determine** that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.~~^{fn 44}
- ***Prior to dating the auditor's report, the engagement partner is required to review the financial statements and the auditor's report, including, if applicable, the description of the key audit matters and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.***^{fn 45}
- When an engagement quality control review is performed, ~~section 220 the engagement partner is precluded from releasing the auditor's report not be released prior to~~ **until** the completion of the engagement quality control review.^{fn 45/46}

^{fn 44} See ~~paragraph 1932 of section 220, SAS No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, for further discussion.~~ **Paragraph 1932 of section 220, SAS No. 146, Quality Control Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, for further discussion.**

^{fn 45} **Paragraph 33 of SAS No. 146.**

^{fn 45/46} ~~Paragraph 2136d of section 220~~ **Paragraph 2136d of section 220 SAS No. 146.**

[No further amendment to section 703.]

13. This amendment is effective for audits of ERISA plan financial statements for periods beginning on or after December 15, 2025.

Amendment to SAS No. 137, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports, as Amended

(**Boldface italics** denote new language. Deleted text is in ~~strikethrough~~.)

AU-C Section 720, Other Information Included in Annual Reports

[No amendment to paragraphs .01–.A26.]

.A27 In accordance with section 220, **Statement on Auditing Standards No. 146, Quality Control Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards,**^{fn 8} the engagement partner is required to take responsibility for the direction, ~~and~~ supervision, ~~and~~ performance of the audit engagement **of the members of the engagement team and the review of their work, and determine that the nature, timing, and extent of direction, supervision, and review is planned and performed** in compliance with ~~the firm's policies or procedures,~~ professional standards, and applicable legal and regulatory requirements.^{fn 8} In the context of this section, factors that may be considered when determining the appropriate engagement team members to address the requirements of paragraphs .16–.17 of this section include the following:

- The relative experience of engagement team members.
- Whether the engagement team members have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge.
- The degree of judgment involved in addressing the requirements of paragraphs .16–.17 of this section. For example, performing

procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members.

- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component.

^{fn 8} Paragraphs ~~17a.29–30~~ of section 220 **SAS No. 146, Quality Control Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards.**

[No further amendment to section 720.]

14. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

Amendment to SAS No. 142, Audit Evidence

Appendix B — Amendments to Various Sections in Statement on Auditing Standards No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

.A68

...

AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

.A27 Unconscious or conscious auditor biases may affect the auditor's professional skepticism and professional judgment, including, for example, in the design and performance of audit procedures or the evaluation of audit evidence. Examples of unconscious auditor biases are provided in paragraph .A35 of Statement on Auditing Standards No. 146, Quality Management of an Audit Conducted in Accordance With Generally Accepted Auditing Standards. ~~that may impede the maintenance of professional skepticism and, therefore, the reasonableness of the professional judgments made by the auditor in complying with the requirements of this section, may include the following:~~

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

~~information raises questions about whether such output is reliable or fit for purpose~~

[Paragraphs A27–A86 have been renumbered.]

15. This amendment is effective for audits of financial statements for periods beginning on or after December 15, 2025.

Amendment to Statement on Standards for Attestation Engagements No. 18, *Attestation Standards: Clarification and Recodification*, as Amended, Section 105, Concepts Common to All Attestation Engagements

(**Boldface italics** denote new language. Deleted text is in ~~strikethrough~~.)

AT-C Section 105, *Concepts Common to All Attestation Engagements*

[No amendment to paragraphs .01–.05.]

Relationship of Attestation Standards to Quality Control Standards

.06 Quality control **management** systems, policies, and procedures are the responsibility of the firm in conducting its attestation practice. Under ~~QC section 10~~ **Statement on Quality Management Standards No. 1, *A Firm's System of Quality Control Management***, the firm has an obligation to establish **design, implement, and maintain** ~~operate~~ a system of quality control **management** to provide it **that provides the firm** with reasonable assurance that^{fn 5} (Ref: par. A4–A6)

- a. the firm and its personnel ~~comply~~ **fulfill their responsibilities in accordance** with professional standards and applicable legal and regulatory requirements **and conduct attestation engagements in accordance with such standards and requirements**, and
- b. practitioners' reports issued by the firm are appropriate in the circumstances.

^{fn 5} Paragraph ~~1220~~ of QC section ~~10~~, **Statement on Quality Management Standards No. 1, *A Firm's System of Quality Control Management*** (AICPA, *Professional Standards*).

.07 Attestation standards relate to the conduct of individual attestation engagements; quality control **management** standards relate to the conduct of a firm's attestation practice as a whole. Thus, attestation standards and quality control **management** standards are related, and the quality control **management** policies and procedures that ~~a~~ **the** firm ~~adopts~~ **establishes** may affect both the conduct of individual attestation engagements and the conduct of ~~a~~ **the** firm's attestation practice as a whole. However, deficiencies in or instances of noncompliance with ~~a~~ **the** firm's quality control **management** policies and procedures do not, in and of themselves, indicate that a particular engagement was not performed **conducted** in accordance with the attestation standards.

[No further amendment to AT-C section 105.]

16. This amendment is effective for practitioners' reports dated on or after December 15, 2025.

AU-C Section 220A

Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards

Source: SAS No. 122; SAS No. 128; SAS No. 134; SAS No. 136.

Effective for engagements conducted in accordance with generally accepted auditing standards for periods ending on or after December 15, 2012, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, when applicable, the responsibilities of the engagement quality control reviewer. This section also applies, adapted as necessary, to other engagements conducted in accordance with generally accepted auditing standards (GAAS) (for example, a review of interim financial information conducted in accordance with section 930, *Interim Financial Information*). This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

.02 Although Statements on Quality Control Standards are not applicable to auditors in government audit organizations, this section is applicable to auditors in government audit organizations who perform financial audits in accordance with GAAS.¹

System of Quality Control and the Role of the Engagement Teams

.03 Quality control systems, policies, and procedures are the responsibility of the audit firm. Under QM section 10A, *A Firm's System of Quality Control*, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that²

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. reports issued by the firm are appropriate in the circumstances. (Ref: par. .A1)

.04 Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

¹ Paragraph .02 of QM section 10A, *A Firm's System of Quality Control*.

² Paragraph .12 of QM section 10A.

.05 Engagement teams are entitled to rely on the firm's system of quality control, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties. (Ref: par. .A2)

.06 The engagement partner may use the assistance of other members of the engagement team or other personnel within the firm in meeting the requirements of this section. The requirements imposed by this section on engagement partners do not relieve other members of the engagement team of any of their professional responsibilities.

Effective Date

.07 This section is effective for engagements conducted in accordance with GAAS for periods ending on or after December 15, 2012.

Objective

.08 The objective of the auditor³ is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that

- a. the audit complies with professional standards and applicable legal and regulatory requirements and
- b. the auditor's report issued is appropriate in the circumstances.

Definitions

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

Engagement partner.⁴ The partner or other person in the firm who is responsible for the audit engagement and its performance and for the auditor's report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report. The engagement quality control review process is only for those audit engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments that the engagement team made and the conclusions it reached in formulating the auditor's report.

³ See paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for the definition of auditor.

⁴ *Engagement partner, partner, and firm* refer to their governmental equivalents, when relevant.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external specialist engaged by the firm or a network firm.⁵

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of section 610, *Using the Work of Internal Auditors*.

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

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

Network. An association of entities, as defined in ET section 0.400, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400.

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

Personnel. Partners and staff.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Relevant ethical requirements. Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

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

⁵ Paragraph .06 of section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Leadership Responsibilities for Quality on Audits

.10 The engagement partner should take responsibility for the overall quality on each audit engagement to which that partner is assigned. In fulfilling this responsibility, the engagement partner may delegate the performance of certain procedures to, and use the work of, other members of the engagement team and may rely upon the firm's system of quality control. (Ref: par. .A3)

Relevant Ethical Requirements

.11 Throughout the audit engagement, the engagement partner and other members of the engagement team should remain alert for evidence of non-compliance with relevant ethical requirements by members of the engagement team. (Ref: par. .A4)

.12 If matters come to the engagement partner's attention, through the firm's system of quality control or otherwise, that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm as appropriate, should determine that appropriate action has been taken.

Independence

.13 The engagement partner should form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner should

- a. obtain relevant information from the firm and, when applicable, network firms to identify and evaluate circumstances and relationships that create threats to independence;
- b. evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
- c. take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the audit engagement when withdrawal is possible under applicable law or regulation. The engagement partner should promptly report to the firm any inability to resolve the matter so that the firm may take appropriate action. (Ref: par. .A5–.A6)

Acceptance and Continuance of Client Relationships and Audit Engagements

.14 The engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and should determine that conclusions reached in this regard are appropriate. (Ref: par. .A7–.A8)

.15 If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm so that the firm and the engagement partner can take the necessary action. (Ref: par. .A8)

Assignment of Engagement Teams

.16 The engagement partner should be satisfied that the engagement team and any auditor's external specialists, collectively, have the appropriate competence and capabilities to

- a. perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: par. .A9–.A11)

Engagement Performance

Direction, Supervision, and Performance

.17 The engagement partner should take responsibility for the following:

- a. The direction, supervision, and performance of the audit engagement in compliance with professional standards, applicable legal and regulatory requirements, and the firm's policies and procedures (Ref: par. .A12–.A14 and .A19)
- b. The auditor's report being appropriate in the circumstances

Review

.18 The engagement partner should take responsibility for reviews being performed in accordance with the firm's review policies and procedures. (Ref: par. .A15–.A16 and .A19)

.19 On or before the date of the auditor's report, the engagement partner should, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: par. .A17–.A19)

Consultation

.20 The engagement partner should

- a. take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters;
- b. be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;
- c. be satisfied that the nature and scope of such consultations are agreed with, and conclusions resulting from such consultations are understood by, the party consulted; and
- d. determine that conclusions resulting from such consultations have been implemented. (Ref: par. .A20–.A22)

Engagement Quality Control Review

.21 For those audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner should

- a. determine that an engagement quality control reviewer has been appointed;
- b. discuss significant findings or issues arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- c. not release the auditor's report until the completion of the engagement quality control review. (Ref: par. .A23–.A25)

.22 The engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. This evaluation should involve

- a. discussion of significant findings or issues with the engagement partner;
- b. reading the financial statements and the proposed auditor's report;
- c. review of selected audit documentation relating to the significant judgments the engagement team made and the related conclusions it reached; and
- d. evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: par. .A26–.A32)

Differences of Opinion

.23 If differences of opinion arise within the engagement team; with those consulted; or, when applicable, between the engagement partner and the engagement quality control reviewer, the engagement team should follow the firm's policies and procedures for resolving differences of opinion.

Monitoring

.24 An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner should consider

- a. the results of the firm's monitoring process as evidenced in the latest information circulated to the engagement partner by the firm and, if applicable, other network firms and
- b. whether deficiencies noted in that information may affect the audit engagement. (Ref: par. .A32–.A34)

Documentation

.25 The auditor should include in the audit documentation the following:⁶ (Ref: par. .A35)

⁶ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- a. Issues identified with respect to compliance with relevant ethical requirements and how they were resolved
- b. Conclusions on compliance with independence requirements that apply to the audit engagement and any relevant discussions with the firm that support these conclusions
- c. Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements
- d. The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement (Ref: par. .A36)

.26 The engagement quality control reviewer should document, for the audit engagement reviewed

- a. that the procedures required by the firm's policies on engagement quality control review have been performed;
- b. the date that the engagement quality control review was completed; and
- c. that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

Application and Other Explanatory Material

System of Quality Control and the Role of the Engagement Teams (Ref: par. .02)

.A1 QM section 10A addresses the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm
- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring

Reliance on the Firm's System of Quality Control (Ref: par. .05)

.A2 Unless information provided by the firm or other parties suggests otherwise, the engagement team may rely on the firm's system of quality control regarding, for example

- competence of personnel through their recruitment and formal training.
- independence through the accumulation and communication of relevant independence information.
- maintenance of client relationships through acceptance and continuance systems.
- adherence to applicable legal and regulatory requirements through the monitoring process.

Leadership Responsibilities for Quality on Audits (Ref: par. .10)

.A3 The engagement partner's actions and communications with the other members of the engagement team demonstrate responsibility for the overall quality on each audit engagement when they emphasize

- a. the importance to audit quality of
 - i. performing work that complies with professional standards and applicable legal and regulatory requirements;
 - ii. complying with the firm's applicable quality control policies and procedures;
 - iii. issuing auditor's reports that are appropriate in the circumstances; and
 - iv. the engagement team's ability to raise concerns without fear of reprisals and
- b. the fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements

Compliance With Relevant Ethical Requirements (Ref: par. .11)

.A4 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

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

Threats to Independence (Ref: par. .13)

.A5 The engagement team may identify a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, as required by paragraph .13c, the engagement partner reports to the relevant person(s) within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat or withdrawing from the audit engagement when withdrawal is possible under applicable law or regulation.

Considerations Specific to Governmental Entities

.A6 Law or regulation may provide safeguards for the independence of governmental audit organizations and the auditors employed by them. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor's report the circumstances affecting the auditor's independence.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. .14)

.A7 QM section 10A requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when

considering acceptance of a new engagement with an existing client.⁷ Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management, and those charged with governance of the entity
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources
- Whether the firm and the engagement team can comply with relevant ethical requirements
- Significant findings or issues that have arisen during the current or previous audit engagement and their implications for continuing the relationship

Considerations Specific to Governmental Entities (Ref: par. .14–.15)

.A8 For some governmental entities, auditors may be appointed in accordance with law or regulation, and the auditor may not be permitted to decline or withdraw from the engagement. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs .14–.15 and .A7 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable in planning the audit, performing risk assessments, and carrying out reporting responsibilities.

Assignment of Engagement Teams (Ref: par. .16)

.A9 A person with expertise in a specialized area of accounting or auditing is a member of the engagement team if that person performs audit procedures on the engagement. This applies whether that person is an employee of the firm or a nonemployee engaged by the firm. However, a person with such expertise is not a member of the engagement team if that person's involvement with the engagement is only consultation. Consultations are addressed in paragraphs .20 and .A20–.A22.

.A10 When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant IT and specialized areas of accounting or auditing.
- knowledge of relevant industries in which the entity operates.
- ability to apply professional judgment.
- understanding of the firm's quality control policies and procedures.

⁷ Paragraph .27 of QM section 10A.

Considerations Specific to Governmental Entities (Ref: par. .16)

.A11 For audits of governmental entities, competence may include skills that are necessary to comply with applicable law or regulation. Such competence may include knowledge of *Government Auditing Standards* and an understanding of the applicable reporting requirements, including reporting to the legislature or other governing body or in the public interest. The scope of a governmental audit may include, for example, additional requirements with respect to detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect on the determination of financial statement amounts or the need to examine and report on internal control over financial reporting or compliance.

Engagement Performance**Direction, Supervision, and Performance (Ref: par. .17a)**

.A12 Direction of the engagement team involves informing the members of the engagement team of matters such as the following:

- Their responsibilities, including the need to comply with relevant ethical requirements and to plan and perform an audit with professional skepticism as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*⁸
- Responsibilities of respective partners when more than one partner is involved in the conduct of an audit engagement
- The objectives of the work to be performed
- The nature of the entity's business
- Risk-related issues
- Problems that may arise
- The detailed approach to the performance of the engagement

Discussion among members of the engagement team allows team members to raise questions so that appropriate communication can occur within the engagement team.

.A13 Appropriate teamwork and training assist members of the engagement team to clearly understand the objectives of the assigned work.

.A14 Supervision includes matters such as the following:

- Tracking the progress of the audit engagement
- Considering the competence and capabilities of individual members of the engagement team, including whether they have sufficient time to carry out their work, they understand their instructions, and the work is being carried out in accordance with the planned approach to the audit engagement
- Addressing significant findings or issues arising during the audit engagement, considering their significance, and modifying the planned approach appropriately
- Identifying matters for consultation or consideration by qualified engagement team members during the audit engagement

⁸ Paragraphs .16–.17 of section 200.

Review*Review Responsibilities (Ref: par. .18)*

.A15 Under QM section 10A, the firm's review responsibility policies and procedures are determined on the basis that suitably experienced team members review the work of other team members.⁹ The engagement partner may delegate part of the review responsibility to other members of the engagement team, in accordance with the firm's system of quality control.

.A16 A review consists of consideration of whether, for example

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings or issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the auditor's report; and
- the objectives of the engagement procedures have been achieved.

The Engagement Partner's Review of the Work Performed (Ref: par. .19)

.A17 Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant findings or issues to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report:

- Critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement
- Significant risks
- Other areas that the engagement partner considers important

The engagement partner need not review all audit documentation but may do so. However, as required by section 230, *Audit Documentation*, the partner documents the extent and timing of the reviews.¹⁰

.A18 An engagement partner taking over an audit during the engagement may apply the review procedures as described in paragraph .A17 to review the work performed to the date of the change in order to assume the responsibilities of an engagement partner.

Considerations Relevant When a Member of the Engagement Team With Expertise in a Specialized Area of Accounting or Auditing Is Used
(Ref: par. .17–.19)

.A19 When the engagement team includes a member with expertise in a specialized area of accounting or auditing, direction, supervision, and review of

⁹ Paragraph .36 of QM section 10A.

¹⁰ Paragraph .09c of section 230.

that engagement team member's work is the same as for any other engagement team member and may include matters such as the following:

- Agreeing with that member upon the nature, scope, and objectives of that member's work and the respective roles of, and the nature, timing, and extent of communication between, that member and other members of the engagement team
- Evaluating the adequacy of that member's work, including the relevance and reasonableness of that member's findings or conclusions and the consistency of those findings or conclusions with other audit evidence

Consultation (Ref: par. .20)

.A20 Members of the engagement team have a professional responsibility to bring to the attention of appropriate personnel matters that, in their professional judgment, are difficult or contentious and may require consultation.

.A21 Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience.

.A22 The engagement team may consult outside the firm (for example, when the firm lacks appropriate internal resources). The engagement team may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

Engagement Quality Control Review

Completion of the Engagement Quality Control Review Before Releasing the Auditor's Report (Ref: par. .21c)

.A23 Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant findings or issues to be promptly resolved to the engagement quality control reviewer's satisfaction.

.A24 *Completion of the engagement quality control review* means the completion by the engagement quality control reviewer of the requirements in paragraph .22 and, when applicable, compliance with paragraph .23. Documentation of the engagement quality control review may be completed after the report release date as part of the assembly of the final audit file. Section 230 establishes requirements and provides guidance in this regard.¹¹

.A25 When the engagement quality control review is completed after the auditor's report is dated and identifies instances where additional procedures or additional evidence is necessary, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans*

¹¹ Paragraphs .15–.18 and .A24–.A29 of section 230.

Subject to ERISA. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Nature, Timing, and Extent of Engagement Quality Control Review (Ref: par. .22)

.A26 By remaining alert for changes in circumstances, the engagement partner is able to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement such a review was not required.

.A27 The extent of the engagement quality control review may depend, among other things, on the complexity of the audit engagement and the risk that the auditor's report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner for the audit engagement and its performance.

.A28 When section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the conclusions reached by the engagement team in formulating the auditor's report include determining the following:

- The key audit matters to be communicated
- The key audit matters that will not be communicated in the auditor's report in accordance with paragraph .13 of section 701, if any
- If applicable, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate in the auditor's report

In addition, the reading of the proposed auditor's report in accordance with paragraph .22b includes consideration of the proposed descriptions of the matters to be included in the "Key Audit Matters" section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A29 Matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review include the following:

- Significant risks identified during the engagement in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and the responses to those risks in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, including the engagement team's assessment of, and response to, the risk of fraud in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*
- Judgments made, particularly with respect to materiality and significant risks
- The significance and disposition of corrected and uncorrected misstatements identified during the audit
- The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A30 The engagement quality control reviewer may also consider the following:

- The evaluation of the firm's independence with regard to the audit engagement
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the related conclusions arising from those consultations
- Whether audit documentation selected for review reflects the work performed regarding the significant judgments and supports the conclusions reached

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities (Ref: par. .21–.22)

.A31 An engagement quality control review is required for audit engagements that meet the criteria established by the firm that subjects engagements to an engagement quality control review. In some cases, none of the firm's audit engagements may meet the criteria that would subject them to such a review. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities (Ref: par. .22)

.A32 A statutorily appointed auditor (for example, an auditor general or other suitably qualified person within the audit organization acting on behalf of the auditor general) may act in a role equivalent to that of engagement partner with overall responsibility for the governmental audit. In such circumstances, when applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Monitoring (Ref: par. .24)

.A33 QM section 10A requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.¹² [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A34 In considering deficiencies that may affect the audit engagement, the engagement partner may consider measures the firm took to rectify the situation that the engagement partner considers sufficient in the context of that audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A35 A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the auditor's report was not appropriate. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .25)

.A36 Section 230 addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements. Section 230 also states that it is neither necessary nor practicable for the auditor to document every matter

¹² Paragraph .52 of QM section 10A.

considered, or professional judgment made, in an audit.¹³ [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A37 Documentation of consultations with other professionals involving difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

¹³ Paragraph .A9 of section 230.

AU-C Section 230

Audit Documentation

Source: SAS No. 122; SAS No. 123; SAS No. 128; SAS No. 134; SAS No. 137.

See section 9230 for interpretations of this section.

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

NOTE

In July 2020, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) Nos. 142, *Audit Evidence*, and 143, *Auditing Accounting Estimates and Related Disclosures*, which contain amendments to this section.

- The amendments in SAS No. 142 are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.
- The amendments in SAS No. 143 are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

In October 2021, the ASB issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements. The exhibit, "Audit Documentation Requirements in Other AU-C Sections," lists other AU-C sections that contain specific documentation requirements and guidance. The specific documentation requirements of other AU-C sections do not limit the application of this section. Law, regulation, or other standards may establish additional documentation requirements.

Nature and Purposes of Audit Documentation

.02 Audit documentation that meets the requirements of this section and the specific documentation requirements of other relevant AU-C sections provides

- a. evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor;¹ and
- b. evidence that the audit was planned and performed in accordance with generally accepted auditing standards (GAAS) and applicable legal and regulatory requirements.

.03 Audit documentation serves a number of additional purposes, including the following:

- Assisting the engagement team to plan and perform the audit
- Assisting members of the engagement team responsible for supervision to direct and supervise the audit work and to discharge their review responsibilities in accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*²
- Enabling the engagement team to demonstrate that it is accountable for its work by documenting the procedures performed, the audit evidence examined, and the conclusions reached
- Retaining a record of matters of continuing significance to future audits of the same entity
- Enabling the conduct of quality control reviews and inspections in accordance with QM section 10A, *A Firm's System of Quality Control*
- Enabling the conduct of external inspections or peer reviews in accordance with applicable legal, regulatory, or other requirements
- Assisting an auditor who reviews a predecessor auditor's audit documentation
- Assisting auditors to understand the work performed in the prior year as an aid in planning and performing the current engagement

Effective Date

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

Objective

.05 The objective of the auditor is to prepare documentation that provides

- a. a sufficient and appropriate record of the basis for the auditor's report; and
- b. evidence that the audit was planned and performed in accordance with GAAS and applicable legal and regulatory requirements.

¹ Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

² Paragraphs .17–.19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Definitions

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

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

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

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

Experienced auditor. An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of (Ref: par. .A1)

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

Report release date. The date the auditor grants the entity permission to use the auditor's report in connection with the financial statements. (Ref: par. .A2)

Requirements

Timely Preparation of Audit Documentation

.07 The auditor should prepare audit documentation on a timely basis. (Ref: par. .A3)

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content, and Extent of Audit Documentation

.08 The auditor should prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand (Ref: par. .A4–.A7 and .A19–.A20)

- a. the nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements; (Ref: par. .A8–.A9)
- b. the results of the audit procedures performed, and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: par. .A10–.A13)

.09 In documenting the nature, timing, and extent of audit procedures performed, the auditor should record

- a. the identifying characteristics of the specific items or matters tested; (Ref: par. .A14)
- b. who performed the audit work and the date such work was completed; and
- c. who reviewed the audit work performed and the date and extent of such review. (Ref: par. .A15)

.10 For audit procedures related to the inspection of significant contracts or agreements, the auditor should include abstracts or copies of those contracts or agreements in the audit documentation.

.11 The auditor should document discussions of significant findings or issues with management, those charged with governance, and others, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place. (Ref: par. .A16)

.12 If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant finding or issue, the auditor should document how the auditor addressed the inconsistency. (Ref: par. .A17–.A18)

Departure From a Relevant Requirement

.13 If, in rare circumstances, the auditor judges it necessary to depart from a relevant presumptively mandatory requirement,³ the auditor must document the justification for the departure and how the alternative audit procedures performed in the circumstances were sufficient to achieve the intent of that requirement. (Ref: par. .A21–.A22)

Matters Arising After the Date of the Auditor's Report

.14 If, in rare circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor should document (Ref: par. .A23)

- a. the circumstances encountered;
- b. the new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
- c. when and by whom the resulting changes to audit documentation were made and reviewed.

Assembly and Retention of the Final Audit File

.15 The auditor should document the report release date in the audit documentation.

.16 The auditor should assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date. (Ref: par. .A24–.A26)

.17 After the documentation completion date, the auditor should not delete or discard audit documentation of any nature before the end of the specified retention period. Such retention period, however, should not be shorter than five years from the report release date. (Ref: par. .A27–.A29)

³ Paragraph .26 of section 200.

.18 In circumstances other than those addressed in paragraph .14 in which the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the documentation completion date, the auditor should, regardless of the nature of the modifications or additions, document (Ref: par. .A28)

- a. the specific reasons for making the changes; and
- b. when and by whom they were made and reviewed.

.19 The auditor should adopt reasonable procedures to maintain the confidentiality of client information.

Application and Other Explanatory Material

Definitions (Ref: par. .06)

Experienced Auditor

.A1 Having practical audit experience means possessing the competencies and skills that would have enabled the auditor to perform the audit but does not mean that the auditor is required to have performed comparable audits.

Report Release Date

.A2 In many cases, the report release date will be the date the auditor delivers the audit report to the entity. When there are delays in releasing the report, a fact may become known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report. Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities in such circumstances, and paragraph .14 addresses the documentation requirements in the rare circumstances in which the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report.

Timely Preparation of Audit Documentation (Ref: par. .07)

.A3 Preparing sufficient and appropriate audit documentation on a timely basis throughout the audit helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared at the time such work is performed or shortly thereafter is likely to be more accurate than documentation prepared at a much later time.

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content, and Extent of Audit Documentation (Ref: par. .08)

.A4 The form, content, and extent of audit documentation depend on factors such as

- the size and complexity of the entity.
- the nature of the audit procedures to be performed.
- the identified risks of material misstatement.
- the significance of the audit evidence obtained.
- the nature and extent of exceptions identified.

- the need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- the audit methodology and tools used.
- the extent of judgment involved in performing the work and evaluating the results.

.A5 Audit documentation may be recorded on paper or on electronic or other media. QM section 10A addresses a firm's responsibility to establish procedures designed to maintain the integrity, accessibility, and retrievability of documentation; for example, when original paper documentation is electronically scanned or otherwise copied to another media for inclusion in the audit file.⁴ Examples of audit documentation include the following:

- Audit plans⁵
- Analyses
- Issues memorandums
- Summaries of significant findings or issues
- Letters of confirmation and representation
- Checklists
- Correspondence (including e-mail) concerning significant findings or issues

.A6 The auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A7 On their own, oral explanations by the auditor do not represent adequate support for the work the auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation.

Documentation of Compliance With GAAS (Ref: par. .08a)

.A8 In principle, compliance with the requirements of this section will result in the audit documentation being sufficient and appropriate in the circumstances. Other AU-C sections contain specific documentation requirements that are intended to clarify the application of this section in the particular circumstances of those other AU-C sections. The specific documentation requirements of other AU-C sections do not limit the application of this section. Furthermore, the absence of a documentation requirement in any particular AU-C section is not intended to suggest that there is no documentation that will be prepared as a result of complying with that AU-C section.

.A9 Audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.

⁴ Paragraph .A58 of QM section 10A, *A Firm's System of Quality Control*.

⁵ Paragraphs .07–.11 of section 300, *Planning an Audit*.

- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed to the terms of the audit engagement with management or, when appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances in accordance with GAAS.
- Regarding requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with GAAS. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
 - Similarly, that the engagement partner has taken responsibility for the direction, supervision, and performance of the audit in compliance with GAAS may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussions required by section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.⁶

Documentation of Significant Findings or Issues and Related Significant Professional Judgments (Ref: par. .08c)

.A10 Judging the significance of a finding or issue requires an objective analysis of the facts and circumstances. Examples of significant findings or issues include

- matters involving the selection, application, and consistency of significant accounting practices, including related disclosures. Such matters include, but are not limited to (a) accounting for complex or unusual transactions or (b) accounting estimates and uncertainties and, if applicable, the related management assumptions.
- matters that give rise to significant risks (as defined in section 315A).⁷
- results of audit procedures (including identification of corrected and uncorrected misstatements)⁸ indicating (a) that the financial statements could be materially misstated or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- circumstances that cause the auditor significant difficulty in applying necessary audit procedures.

⁶ Paragraph .33 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁷ Paragraphs .28–.30 of section 315A.

⁸ See section 450, *Evaluation of Misstatements Identified During the Audit*.

- findings that could result in a modification to the audit opinion or the inclusion of an emphasis-of-matter paragraph in the auditor's report.

.A11 An important factor in determining the form, content, and extent of audit documentation of significant findings or issues is the extent of professional judgment exercised in performing the work and evaluating the results. Documentation of the professional judgments made, when significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such findings or issues are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits when reviewing items of continuing significance (for example, when performing a retrospective review of accounting estimates).

.A12 Some examples of circumstances in which, in accordance with paragraph .08, it is appropriate to prepare audit documentation relating to the exercise of professional judgment include, when the findings, issues, and judgments are significant,

- the rationale for the auditor's conclusion when a requirement provides that the auditor *should consider* certain information or factors, and that consideration is significant in the context of the particular engagement.
- the basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- the basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of a specialist or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
- when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the auditor's determination of the key audit matters or the determination that there are no key audit matters to be communicated, including in the extremely rare circumstances in which the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

.A13 The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant findings or issues identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant findings or issues. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant AU-C section objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

Identification of Specific Items or Matters Tested and of the Preparer and the Reviewer (Ref: par. .09)

.A14 Recording the identifying characteristics serves a number of purposes. For example, it improves the ability of the auditor to supervise and review the work performed and thus demonstrates the accountability of the engagement team for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter tested. For example:

- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.
- For a procedure requiring selection or review of all items over a specific amount from a given population, the auditor may record the scope of the procedure and identify the population (for example, all journal entries over a specified amount from the journal register for the period being audited).
- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point, and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period from April 1 to September 30, starting with report number 12345 and selecting every 125th report).
- For a procedure requiring inquiries of specific entity personnel, the auditor may record the inquiries made, the dates of the inquiries, and the names and job designations of the entity personnel.
- For an observation procedure, the auditor may record the process or matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out.

.A15 Section 220A requires the auditor to review the audit work performed through review of the audit documentation.⁹ The requirement to document who reviewed the audit work performed and the extent of the review, in accordance with the firm's policies and procedures addressing review responsibilities, does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

Documentation of Discussions of Significant Findings or Issues With Management, Those Charged With Governance, and Others (Ref: par. .11)

.A16 The audit documentation is not limited to documents prepared by the auditor but may include other appropriate documents such as minutes of meetings prepared by the entity's personnel and recognized by the auditor as an appropriate summary of the meeting. Others with whom the auditor may discuss significant findings or issues may include other personnel within the entity, and external parties, such as persons providing professional advice to the entity.

⁹ Paragraph .19 of section 220A.

Documentation of How Inconsistencies Have Been Addressed (Ref: par. .12)

.A17 The requirement to document how the auditor addressed inconsistencies in information does not imply that the auditor needs to retain documentation that is incorrect or superseded.

.A18 The documentation of the inconsistency may include, but is not limited to, procedures performed in response to the information, and documentation of consultations on, or resolutions of, differences in professional judgment among members of the engagement team or between the engagement team and others consulted.

Considerations Specific to Smaller, Less Complex Entities (Ref: par. .08)

.A19 The audit documentation for the audit of a smaller, less complex entity is generally less extensive than that for the audit of a larger, more complex entity. Further, in the case of an audit in which the engagement partner performs all the audit work, the documentation will not include matters that might have to be documented solely to inform or instruct members of an engagement team, or to provide evidence of review by other members of the team (for example, there will be no matters to document relating to team discussions or supervision). Nevertheless, the engagement partner complies with the overriding requirement in paragraph .08 to prepare audit documentation that can be understood by an experienced auditor, as the audit documentation may be subject to review by external parties for regulatory or other purposes.

.A20 When preparing audit documentation, the auditor of a smaller, less complex entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller, less complex entity include the understanding of the entity and its internal control; the overall audit strategy and audit plan; materiality; assessed risks, significant findings or issues noted during the audit; and conclusions reached.

Departure From a Relevant Requirement (Ref: par. .13)

.A21 The requirements of GAAS are designed to enable the auditor to achieve the objectives specified in GAAS, and thereby the overall objectives of the auditor. Accordingly, other than in rare circumstances, GAAS call for compliance with each requirement that is relevant in the circumstances of the audit.

.A22 The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant¹⁰ only in the cases in which

- a. the AU-C section is not relevant (for example, if an entity does not have an internal audit function, nothing in section 610, *Using the Work of Internal Auditors*, is relevant); or
- b. the requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor's opinion when there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability).

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

¹⁰ Paragraph .24 of section 200.

Matters Arising After the Date of the Auditor's Report (Ref: par. .14)

.A23 Examples of rare circumstances in which the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report include

- when, after the date of the auditor's report, the auditor becomes aware of facts that existed at that date and which, if known at that date, might have caused the financial statements to be revised or the auditor to modify the opinion in the auditor's report.¹¹
- when the auditor concludes that procedures necessary at the time of the audit, in the circumstances then existing, were omitted from the audit of the financial information.¹²

The resulting changes to the audit documentation are reviewed in accordance with the firm's quality control procedures as required by QM section 10A.

Assembly and Retention of the Final Audit File (Ref: par. .16–.18)

.A24 Statutes, regulations, or the audit firm's quality control policies may specify a period of time shorter than 60 days following the report release date in which this assembly process is to be completed.

.A25 Certain matters, such as auditor independence and staff training, which are not engagement specific, may be documented either centrally within a firm or in the audit documentation for an audit engagement.

.A26 The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include

- deleting or discarding superseded documentation.
- sorting, collating, and cross-referencing working papers.
- signing off on completion checklists relating to the file assembly process.
- documenting audit evidence that the auditor has obtained, discussed, and agreed with the relevant members of the engagement team before the date of the auditor's report.
- adding information received after the date of the auditor's report; for example, an original confirmation that was previously communicated electronically.

.A27 Firms are required to establish policies and procedures for the retention of engagement documentation.¹³ Statutes, regulations, or the audit firm's quality control policies may specify a retention period longer than five years.

.A28 An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after the documentation completion date is the need to clarify existing audit documentation arising from comments received during monitoring inspections performed by internal or external parties.

¹¹ Paragraphs .12 and .15 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

¹² Paragraph .07 of section 585, *Consideration of Omitted Procedures After the Report Release Date*.

¹³ Paragraph .50 of QM section 10A.

.A29 Audit documentation is the property of the auditor, and some states recognize this right of ownership in their statutes. The auditor may make available to the entity at the auditor's discretion copies of the audit documentation, provided such disclosure does not undermine the effectiveness and integrity of the audit process.

.A30

Exhibit—Audit Documentation Requirements in Other AU-C Sections

The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

- a. Paragraphs .10, .13, and .16 of section 210A, *Terms of Engagement*
- b. Paragraphs .25–.26 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
- c. Paragraphs .43–.46 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- d. Paragraph .28 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- e. Paragraph .20 of section 260, *The Auditor's Communication With Those Charged With Governance*
- f. Paragraph .12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- g. Paragraph .14 of section 300, *Planning an Audit*
- h. Paragraph .33 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- i. Paragraph .14 of section 320, *Materiality in Planning and Performing an Audit*
- j. Paragraphs .30–.33 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- k. Paragraph .12 of section 450, *Evaluation of Misstatements Identified During the Audit*
- l. Paragraph .20 of section 501, *Audit Evidence—Specific Considerations for Selected Items*
- m. Paragraph .08 of section 520, *Analytical Procedures*
- n. Paragraph .22 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- o. Paragraph .28 of section 550, *Related Parties*
- p. Paragraph .22 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- q. Paragraphs .49 and .64 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- r. Paragraphs .33–.35 of section 610, *Using the Work of Internal Auditors*
- s. Paragraph .17 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- t. Paragraph .26 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

- u. Paragraph .13 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*
- v. Paragraphs .42–.43 of section 930, *Interim Financial Information*
- w. Paragraphs .39–.42 of section 935, *Compliance Audits*

[Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

AU-C Section 9230***Audit Documentation: Auditing Interpretations of Section 230*****1. Providing Access to or Copies of Audit Documentation to a Regulator^{1,2}**

.01 Question—Paragraph .19 of section 230, *Audit Documentation*, states that "the auditor should adopt reasonable procedures to maintain the confidentiality of client information." However, auditors are sometimes required by law, regulation, or audit contract³ to provide a regulator, or a duly appointed representative, access to audit documentation. For example, a regulator may request access to the audit documentation to fulfill a quality review requirement or to assist in establishing the scope of a regulatory examination. Furthermore, as part of the regulator's review of the audit documentation, the regulator may request copies of all or selected portions of the audit documentation during or after the review. The regulator may intend, or decide, to make copies (or information derived from the audit documentation) available to others, including other governmental agencies, for their particular purposes, with or without the knowledge of the auditor or the client. When a regulator requests the auditor to provide access to (and possibly copies of) audit documentation pursuant to law, regulation, or audit contract, what steps may the auditor take?

.02 Interpretation—When a regulator requests access to audit documentation pursuant to law, regulation, or audit contract, the auditor may take the following steps:

- a. Consider advising the client that the regulator has requested access to (and possibly copies of) the audit documentation and that the auditor intends to comply with such request.⁴
- b. Make appropriate arrangements with the regulator for the review.
- c. Maintain control over the audit documentation, and
- d. Consider submitting the letter described in paragraph .05 of this interpretation to the regulator.

¹ The term *regulator(s)* includes federal, state, and local government officials with legal oversight authority over the entity. Examples of regulators who may request access to audit documentation include, but are not limited to, state insurance and utility regulators, various health care authorities, and federal agencies such as the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, the Department of Labor, and the Rural Electrification Administration.

² The guidance in this interpretation does not apply to requests from the IRS, firm practice-monitoring programs to comply with AICPA or state professional requirements such as peer or quality reviews, proceedings relating to alleged ethics violations, or subpoenas.

³ Paragraphs .11–.15 of this interpretation address situations in which the auditor is not required by law, regulation, or audit contract to provide a regulator access to the audit documentation.

⁴ The auditor may wish (and in some cases may be required by law, regulation, or audit contract) to confirm in writing with the client that the auditor may be required to provide a regulator access to the audit documentation. Sample language that may be used follows:

The audit documentation for this engagement is the property of [name of auditor] and constitutes confidential information. However, we may be requested to make certain audit documentation

(continued)

.03 Making appropriate arrangements with the regulator may include establishing the specific details such as the date, time, and location of the review. The audit documentation may be made available to a regulator at the offices of the client, the auditor, or a mutually agreed-upon location. However, maintaining control of audit documentation is necessary in order for the auditor to maintain the integrity of the audit documentation and the confidentiality of client information. For example, the auditor (or the auditor's representative) may be present when the audit documentation is reviewed by the regulator.

.04 Ordinarily, the auditor may not agree to transfer ownership of the audit documentation to a regulator. Furthermore, the auditor may not agree, without client authorization, that the information contained therein about the client may be communicated to or made available to any other party. In this regard, the action of an auditor providing access to, or copies of, the audit documentation shall not constitute transfer of ownership or authorization to make them available to any other party.

.05 An audit performed in accordance with generally accepted auditing standards is not intended to, and does not, satisfy a regulator's oversight responsibilities. To avoid any misunderstanding, prior to allowing a regulator access to the audit documentation, the auditor may submit a letter to the regulator that

- a. sets forth the auditor's understanding of the purpose for which access is being requested;
- b. describes the audit process and the limitations inherent in a financial statement audit;
- c. explains the purpose for which the audit documentation was prepared, and that any individual conclusions must be read in the context of the auditor's report on the financial statements;
- d. states, except when not applicable, that the audit was not planned or conducted in contemplation of the purpose for which access is being granted or to assess the entity's compliance with laws and regulations;
- e. states that the audit and the audit documentation should not supplant other inquiries and procedures that should be undertaken by the regulator for its purposes;
- f. requests confidential treatment under the Freedom of Information Act or similar laws and regulations,⁵ when a request for the audit documentation is made, and that written notice be given to the auditor before transmitting any information contained in the audit documentation to others, including other governmental agencies, except when such transfer is required by law or regulation; and
- g. states that if any copies are to be provided, they will be identified as "Confidential Treatment Requested by [name of auditor; address, telephone number]."

(footnote continued)

available to [name of regulator] pursuant to authority given to it by law or regulation. If requested, access to such audit documentation will be provided under the supervision of [name of auditor] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to [name of regulator]. The [name of regulator] may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

⁵ The auditor may need to consult the regulations of individual agencies and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

The auditor may obtain a signed acknowledgment copy of the letter as evidence of the regulator's receipt of the letter.

.06 An example of a letter containing the elements described in paragraph .05 of this interpretation is presented as follows:

Illustrative Letter to Regulator⁶

[Date]

[Name and Address of Regulatory Agency]

Your representatives have requested access to our audit documentation in connection with our audit of the December 31, 20XX, financial statements of [name of client]. It is our understanding that the purpose of your request is [state purpose: for example, "to facilitate your regulatory examination"].⁷

Our audit of [name of client] December 31, 20XX, financial statements was conducted in accordance with auditing standards generally accepted in the United States of America,⁸ the objective⁹ of which is to form an opinion as to whether the financial statements, which are the responsibility and representations of management, present fairly, in all material respects, the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.¹⁰ Under generally accepted auditing standards, we have the responsibility, within the inherent limitations of the auditing process, to design our audit to provide reasonable assurance that errors and fraud that have a material effect on the financial statements will be detected, and to exercise due care in the conduct of our audit. The concept of selective testing of the data being audited, which involves judgment both as to the number of transactions to be audited and as to the areas to be tested, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements. Thus, our audit, based on the concept of selective testing, is subject to the inherent risk that material errors or fraud, if they exist, would not be detected. In addition, an audit does not address the possibility that material errors or fraud may occur in the future. Also, our use of professional judgment and the assessment of materiality for the purpose of our audit means that matters may have existed that would have been assessed differently by you.

The audit documentation was prepared for the purpose of providing a sufficient and appropriate record of the basis for our report on [name of client] December 31, 20XX, financial statements and to aid in the conduct and supervision of our audit. The audit documentation is the principal record of auditing procedures

⁶ This letter may be modified appropriately when the audit has been performed in accordance with generally accepted auditing standards and also in accordance with additional auditing requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

⁷ If the auditor is not required by law, regulation, or audit contract to provide a regulator access to the audit documentation but otherwise intends to provide such access (see paragraphs .11–.15 of this interpretation), the letter may include a statement that "Management of [name of client] has authorized us to provide you access to our audit documentation for [state purpose]."

⁸ See footnote 6.

⁹ In an audit performed in accordance with the Single Audit Act of 1984, the Single Audit Act Amendments of 1996, and certain other federal audit requirements, an additional objective of the audit is to assess compliance with laws and regulations applicable to federal financial assistance. Accordingly, in these situations, the illustrative letter provided in this interpretation may be modified to include the additional objective.

¹⁰ If the financial statements have been prepared in conformity with regulatory accounting practices, the phrase "financial position, results of operations, and cash flows in conformity with generally accepted accounting principles" may be replaced with appropriate wording such as, in the case of an insurance company, the "admitted assets, liabilities . . . of the XYZ Insurance Company in conformity with accounting practices prescribed or permitted by the state of . . . insurance department."

performed, evidence obtained, and conclusions reached in the engagement. The auditing procedures that we performed were limited to those we considered necessary under generally accepted auditing standards¹¹ to enable us to formulate and express an opinion on the financial statements¹² taken as a whole. Accordingly, we make no representation as to the sufficiency or appropriateness, for your purposes, of either the information contained in our audit documentation or our auditing procedures. In addition, any notations, comments, and individual conclusions appearing on any of the audit documents do not stand alone, and should not be read as an opinion on any individual amounts, accounts, balances or transactions.

Our audit of *[name of client]* December 31, 20XX, financial statements was performed for the purpose stated above and has not been planned or conducted in contemplation of your *[state purpose: for example, "regulatory examination"]* or for the purpose of assessing *[name of client]* compliance with laws and regulations.¹³ Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our audit and the audit documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the *[name of regulatory agency]* for the purpose of monitoring and regulating the financial affairs of the *[name of client]*. In addition, we have not audited any financial statements of *[name of client]* since *[date of audited balance sheet referred to in the first paragraph above]* nor have we performed any auditing procedures since *[date]*, the date of our auditor's report, and significant events or circumstances may have occurred since that date.

The audit documentation constitutes and reflects work performed or evidence obtained by *[name of auditor]* in its capacity as independent auditor for *[name of client]*. The documents contain trade secrets and confidential commercial and financial information of our firm and *[name of client]* that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations¹⁴ when requests are made for the audit documentation or information contained therein or any documents created by the *[name of regulatory agency]* containing information derived therefrom. We further request that written notice be given to our firm before distribution of the information in the audit documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.

[If it is expected that copies will be requested, add:

Any copies of our audit documentation we agree to provide you will be identified as "Confidential Treatment Requested by *[name of auditor; address, telephone number]*."]'

[Firm signature]

.07 Question—A regulator may request access to the audit documentation before the audit has been completed and the report released. May the auditor allow access in such circumstances?

¹¹ See footnote 6

¹² See footnote 9.

¹³ See footnote 9.

¹⁴ This illustrative paragraph may not in and of itself be sufficient to gain confidential treatment under the rules and regulations of certain regulatory agencies. The auditor may tailor this paragraph to the circumstances after consulting the regulations of each applicable regulatory agency and, if necessary, may consult with legal counsel regarding the specific procedures and requirements to gain confidential treatment.

.08 Interpretation—When the audit has not been completed, the audit documentation is necessarily incomplete because (a) additional information may be added as a result of further tests and review by supervisory personnel and (b) any audit results and conclusions reflected in the incomplete audit documentation may change. Accordingly, it is preferable that access be delayed until all auditing procedures have been completed and all internal reviews have been performed. If access is provided prior to completion of the audit, the auditor may issue the letter referred to in paragraph .05 of this interpretation, appropriately modified, and including additional language along the following lines:

We have been engaged to audit in accordance with auditing standards generally accepted in the United States of America the December 31, 20XX, financial statements of XYZ Company, but have not as yet completed our audit. Accordingly, at this time we do not express any opinion on the Company's financial statements. Furthermore, the contents of the audit documentation may change as a result of additional auditing procedures and review of the audit documentation by supervisory personnel of our firm. Accordingly, our audit documentation is incomplete.

Because the audit documentation may change prior to completion of the audit, it is preferable that the auditor not provide copies of the audit documentation until the audit has been completed.

.09 Question—Some regulators may engage an independent party, such as another independent public accountant, to perform the audit documentation review on behalf of the regulatory agency. Are there any special precautions the auditor may observe in these circumstances?

.10 Interpretation—The auditor may obtain acknowledgment, preferably in writing, from the regulator stating that the third party is acting on behalf of the regulator and agreement from the third party that he or she is subject to the same restrictions on disclosure and use of audit documentation and the information contained therein as the regulator.

.11 Question—When a regulator requests the auditor to provide access to (and possibly copies of) audit documentation and the auditor is not otherwise required by law, regulation, or audit contract to provide such access, what steps may the auditor take?

.12 Interpretation—The auditor may obtain an understanding of the reasons for the regulator's request for access to the audit documentation and may consider consulting with legal counsel regarding the request. If the auditor decides to provide such access, reasonable procedures to maintain the confidentiality of client information include obtaining the client's consent, preferably in writing, to provide the regulator access to the audit documentation.

.13 Following is an example of language that may be used in the written communication to the client:

The audit documentation for this engagement is the property of [name of auditor] and constitutes confidential information. However, we have been requested to make certain audit documentation available to [name of regulator] for [describe the regulator's basis for its request]. Access to such audit documentation will be provided under the supervision of [name of auditor] personnel. Furthermore, upon request, we may provide copies of selected audit documentation to [name of regulator].

You have authorized [name of auditor] to allow [name of regulator] access to the audit documentation in the manner discussed above. Please confirm your

agreement to the above by signing below and returning to [name of auditor, address].

[Firm signature]

Agreed and acknowledged:

[Name and title]

[Date]

.14 If the client requests to review the audit documentation before allowing the regulator access, the auditor may provide the client with the opportunity to obtain an understanding of the nature of the information about its financial statements contained in the audit documentation that is being made available to the regulator. When a client reviews the audit documentation, the need to maintain control of the audit documentation is as discussed in paragraph .03 of this interpretation.

.15 The guidance in paragraphs .03–.10 of this interpretation, which provide guidance on making arrangements with the regulator for access to the audit documentation, maintaining control over the audit documentation, and submitting a letter describing various matters to the regulator, is also applicable.

[Issue Date: July, 1994; Revised: June, 1996; Revised: October, 2000; Revised: January, 2002; Revised: December, 2005; Revised: October, 2011, effective for audits of financial statements for periods ending on or after December 15, 2012.]

AU-C Section 240

Consideration of Fraud in a Financial Statement Audit

Source: SAS No. 122; SAS No. 128; SAS No. 134; SAS No. 135; SAS No. 136.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 143, *Auditing Accounting Estimates and Related Disclosures*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

In October 2021, the Auditing Standards board issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, are to be applied regarding risks of material misstatement due to fraud.

Characteristics of Fraud

.02 Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

.03 Although fraud is a broad legal concept, for the purposes of generally accepted auditing standards (GAAS), the auditor is primarily concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor — misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in

rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. (Ref: par. .A1–.A8)

Responsibility for the Prevention and Detection of Fraud

.04 The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, places a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior, which can be reinforced by active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of financial statement users regarding the entity's performance and profitability.

Responsibilities of the Auditor

.05 An auditor conducting an audit in accordance with GAAS is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Due to the inherent limitations of an audit, an unavoidable risk exists that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS.¹

.06 As described in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud.² The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. Although the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas, such as accounting estimates, are caused by fraud or error.

.07 Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information, or override control procedures designed to prevent similar frauds by other employees.

.08 When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the

¹ Paragraphs .A55–.A56 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

² Paragraph .A55 of section 200.

potential for management override of controls, and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this section are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

Effective Date

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

Objectives

- .10 The objectives of the auditor are to
- identify and assess the risks of material misstatement of the financial statements due to fraud;
 - obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
 - respond appropriately to fraud or suspected fraud identified during the audit.

Definitions

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

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

Fraud risk factors. Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action. (Ref: par. .A11, .A30, and .A57)

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

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Requirements

Professional Skepticism

.12 In accordance with section 200, the auditor should maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance.³ (Ref: par. .A9–.A10)

³ Paragraph .17 of section 200.

.13 Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor should investigate further. (Ref: par. .A11)

.14 When responses to inquiries of management, those charged with governance, or others are inconsistent or otherwise unsatisfactory (for example, vague or implausible), the auditor should further investigate the inconsistencies or unsatisfactory responses.

Discussion Among the Engagement Team

.15 Section 315A requires a discussion among the key engagement team members, including the engagement partner, and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.⁴ This discussion should include an exchange of ideas or brainstorming among the engagement team members about how and where the entity's financial statements (including the individual statements and the disclosures) might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. The discussion should occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity, and should, in particular, also address (Ref: par. .A12–.A13)

- a. known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud;
- b. the risk of management override of controls;
- c. consideration of circumstances that might be indicative of earnings management or manipulation of other financial measures and the practices that might be followed by management to manage earnings or other financial measures that could lead to fraudulent financial reporting;
- d. the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement due to fraud; and
- e. how the auditor might respond to the susceptibility of the entity's financial statements to material misstatement due to fraud.

Communication among the engagement team members about the risks of material misstatement due to fraud should continue throughout the audit, particularly upon discovery of new facts during the audit. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Risk Assessment Procedures and Related Activities

.16 When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the

⁴ Paragraph .11 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

entity's internal control, required by section 315A, the auditor should perform the procedures in paragraphs .17–.24 to obtain information for use in identifying the risks of material misstatement due to fraud.⁵

Discussions With Management and Others Within the Entity

- .17** The auditor should make inquiries of management regarding
- a. management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent, and frequency of such assessments; (Ref: par. .A14–.A15)
 - b. management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: par. .A16)
 - c. management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;
 - d. management's communication, if any, to employees regarding its views on business practices and ethical behavior; and
 - e. whether the entity has entered into any significant unusual transactions and, if so, the nature, terms, and business purpose (or the lack thereof) of those transactions and whether such transactions involved related parties.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.18 The auditor should make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity. (Ref: par. .A17–.A20)

.19 For those entities that have an internal audit function,⁶ the auditor should make inquiries of appropriate individuals within the internal audit function to obtain their views about the risks of fraud; determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity; whether they have performed any procedures to identify or detect fraud during the year; whether management has satisfactorily responded to any findings resulting from these procedures; and whether they are aware that the entity has entered into any significant unusual transactions. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Those Charged With Governance

.20 Unless all of those charged with governance are involved in managing the entity,⁷ the auditor should obtain an understanding of how those

⁵ Paragraphs .05–.25 of section 315A.

⁶ Section 610, *Using the Work of Internal Auditors*, provides guidance in audits of those entities that have an internal audit function. [Footnote amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

⁷ Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. (Ref: par. .A21–.A23)

.21 Unless all of those charged with governance are involved in managing the entity, the auditor should make inquiries of those charged with governance (or the audit committee or, at least, its chair) to determine their views about the risks of fraud, whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity, and whether the entity has entered into any significant unusual transactions. These inquiries are made, in part, to corroborate the responses received from the inquiries of management. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Unusual or Unexpected Relationships Identified

.22 Based on analytical procedures performed as part of risk assessment procedures,⁸ the auditor should evaluate whether unusual or unexpected relationships that have been identified indicate risks of material misstatement due to fraud. To the extent not already included, the analytical procedures, and evaluation thereof, should include procedures relating to revenue accounts. (Ref: par. .A24–.A26 and .A46)

Other Information

.23 The auditor should consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: par. .A27)

Evaluation of Fraud Risk Factors

.24 The auditor should evaluate whether the information obtained from the risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. Although fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances in which frauds have occurred and, therefore, may indicate risks of material misstatement due to fraud. (Ref: par. .A28–.A32)

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

.25 In accordance with section 315A, the auditor should identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances, and disclosures.⁹ The auditor's risk assessment should be ongoing throughout the audit, following the initial assessment.

.26 When identifying and assessing the risks of material misstatement due to fraud, the auditor should, based on a presumption that risks of fraud exist in revenue recognition, evaluate which types of revenue, revenue transactions, or assertions give rise to such risks. Paragraph .46 specifies the documentation required when the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: par. .A33–.A35)

⁸ Paragraphs .06(b) and .A7–.A10 of section 315A.

⁹ Paragraph .26 of section 315A.

.27 The auditor should treat those assessed risks of material misstatement due to fraud as significant risks and, accordingly, to the extent not already done so, the auditor should obtain an understanding of the entity's related controls, including control activities, relevant to such risks, including the evaluation of whether such controls have been suitably designed and implemented to mitigate such fraud risks. (Ref: par. .A36–.A37)

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

.28 In accordance with section 330, the auditor should determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.¹⁰ (Ref: par. .A38)

.29 In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor should

- a. assign and supervise personnel, taking into account the knowledge, skill, and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: par. .A39–.A40)
- b. evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings, or a bias that may create a material misstatement; and (Ref: par. .A41)
- c. incorporate an element of unpredictability in the selection of the nature, timing, and extent of audit procedures. (Ref: par. .A42)

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level

.30 In accordance with section 330, the auditor should design and perform further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.¹¹ (Ref: par. .A43–.A46)

Audit Procedures Responsive to Risks Related to Management Override of Controls

.31 Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is, nevertheless, present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and, thus, a significant risk.

¹⁰ Paragraph .05 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

¹¹ Paragraph .06 of section 330.

.32 Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor should address the risk of management override of controls apart from any conclusions regarding the existence of more specifically identifiable risks by designing and performing audit procedures to

- a. test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including entries posted directly to financial statement drafts. In designing and performing audit procedures for such tests, the auditor should (Ref: par. .A47–.A50 and .A56)
 - i. obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments,¹² and the suitability of design and implementation of such controls;
 - ii. make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
 - iii. consider fraud risk indicators, the nature and complexity of accounts, and unusual entries processed;
 - iv. select journal entries and other adjustments made at the end of a reporting period; and
 - v. consider the need to test journal entries and other adjustments throughout the period.
- b. review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor should
 - i. evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor should reevaluate the accounting estimates taken as a whole, and
 - ii. perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. Estimates selected for review should include those that are based on highly sensitive assumptions or are otherwise significantly affected by judgments made by management. (Ref: par. .A51–.A53)
- c. evaluate, given the auditor's understanding of the entity and its environment and other information obtained during the audit, whether the business purpose (or the lack thereof) of significant unusual transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. The procedures should include the following: (Ref: par. .A54–.A55)

¹² Paragraph .19 of section 315A.

- i. Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction
- ii. Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures
- iii. Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Other Audit Procedures

.33 The auditor should determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to previously (that is, when specific additional risks of management override exist that are not covered as part of the procedures performed to address the requirements in paragraph .32). (Ref: par. .A56)

Evaluation of Audit Evidence (Ref: par. .A57)

.34 The auditor should evaluate, at or near the end of the audit, whether the accumulated results of auditing procedures (including analytical procedures that were performed as substantive tests or when forming an overall conclusion) affect the assessment of the risks of material misstatement due to fraud made earlier in the audit or indicate a previously unrecognized risk of material misstatement due to fraud. If not already performed when forming an overall conclusion, the analytical procedures relating to revenue, required by paragraph .22, should be performed through the end of the reporting period. (Ref: par. .A58–.A59)

.35 If the auditor identifies a misstatement, the auditor should evaluate whether such a misstatement is indicative of fraud. If such an indication exists, the auditor should evaluate the implications of the misstatement with regard to other aspects of the audit, particularly the auditor's evaluation of materiality, management and employee integrity, and the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. (Ref: par. .A60–.A63)

.36 If the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is, or may be, the result of fraud and that management (in particular, senior management) is involved, the auditor should reevaluate the assessment of the risks of material misstatement due to fraud and its resulting effect on the nature, timing, and extent of audit procedures to respond to the assessed risks. The auditor should also consider whether circumstances or conditions indicate possible collusion involving employees, management, or third parties when reconsidering the reliability of evidence previously obtained. (Ref: par. .A61)

.37 If the auditor concludes that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud, the auditor should evaluate the implications for the audit. (Ref: par. .A62)

Auditor Unable to Continue the Engagement

.38 If, as a result of identified fraud or suspected fraud, the auditor encounters circumstances that bring into question the auditor's ability to continue performing the audit, the auditor should

- a. determine the professional and legal responsibilities applicable in the circumstances, including whether a requirement exists for the auditor to report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities;
- b. consider whether it is appropriate to withdraw from the engagement, when withdrawal is possible under applicable law or regulation; and
- c. if the auditor withdraws
 - i. discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal, and
 - ii. determine whether a professional or legal requirement exists to report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal. (Ref: par. .A64–.A67)

Communications to Management and With Those Charged With Governance

.39 If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor should communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: par. .A68)

.40 Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving

- a. management,
- b. employees who have significant roles in internal control, or
- c. others, when the fraud results in a material misstatement in the financial statements,

the auditor should communicate these matters to those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor should communicate these suspicions to those charged with governance and discuss with them the nature, timing, and extent of audit procedures necessary to complete the audit. (Ref: par. .A69–.A71)

.41 The auditor should communicate with those charged with governance any other matters related to fraud that are, in the auditor's professional judgment, relevant to their responsibilities. (Ref: par. .A72)

Communications to Regulatory and Enforcement Authorities

.42 If the auditor has identified or suspects a fraud, the auditor should determine whether the auditor has a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor's professional duty

to maintain the confidentiality of client information may preclude such reporting, the auditor's legal responsibilities may override the duty of confidentiality in some circumstances. (Ref: par. .A73–.A75)

Documentation

.43 The auditor should include in the audit documentation¹³ of the auditor's understanding of the entity and its environment and the assessment of the risks of material misstatement required by section 315A the following:¹⁴

- a. The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, and how and when the discussion occurred and the audit team members who participated
- b. The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level (See paragraphs .16–.27.)

.44 The auditor should include in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by section 330 the following:¹⁵

- a. The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing, and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level
- b. The results of the audit procedures, including those designed to address the risk of management override of controls

.45 The auditor should include in the audit documentation communications about fraud made to management, those charged with governance, regulators, and others.

.46 If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is overcome in the circumstances of the engagement, the auditor should include in the audit documentation the reasons for that conclusion.

Application and Other Explanatory Material

Characteristics of Fraud (Ref: par. .03)

.A1 Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so, and some rationalization of the act, as follows:

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps, unrealistic) earnings target or financial outcome — particularly because the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have

¹³ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

¹⁴ Paragraph .33 of section 315A.

¹⁵ Paragraph .30 of section 330.

an incentive to misappropriate assets (for example, because the individuals are living beyond their means).

- A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden (for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control).
- Individuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, character, or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.

.A2 Fraudulent financial reporting involves intentional misstatements, including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions about the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting. Such a situation could occur when, due to pressures to meet expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

.A3 An auditor conducting an audit in accordance with GAAS is responsible for obtaining reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Accordingly, the auditor is primarily concerned with fraud that causes a material misstatement of the financial statements. However, in conducting the audit, the auditor may identify misstatements arising from fraud that are not material to the financial statements. Paragraphs .35–.36 and .39–.42 address the auditor's responsibilities in such circumstances in evaluating audit evidence and in communicating audit findings, respectively.

.A4 Intent is often difficult to determine, particularly in matters involving accounting estimates and the application of accounting principles. For example, unreasonable accounting estimates may be unintentional or may be the result of an intentional attempt to misstate the financial statements. Although an audit is not designed to determine intent, the auditor's objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.¹⁶

.A5 Fraudulent financial reporting may be accomplished by the following:

- Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared
- Misrepresentation in, or intentional omission from, the financial statements of events, transactions, or other significant information

¹⁶ Paragraph .12 of section 200.

- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure

.A6 Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls intentionally using such techniques as the following:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- Omitting, obscuring, or misstating disclosures required by the applicable financial reporting framework or disclosures that are necessary to achieve fair presentation
- Concealing facts that could affect the amounts recorded in the financial statements
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- Altering records and terms related to significant and unusual transactions

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

.A7 Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management, who is usually better able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including the following:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts from written-off accounts to personal bank accounts)
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, or colluding with a competitor by disclosing technological data in return for payment)
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for approving payment at inflated prices, or payments to fictitious employees)
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party)

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Considerations Specific to Governmental Entities and Not-for-Profit Organizations

.A8 The auditor of governmental entities and not-for-profit organizations may have additional responsibilities relating to fraud

- as a result of being engaged to conduct an audit in accordance with law or regulation applicable to governmental entities and not-for-profit organizations,
- because of a governmental audit organization's mandate, or
- because of the need to comply with *Government Auditing Standards*.

Consequently, the responsibilities of the auditor of governmental entities and not-for-profit organizations may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.

Professional Skepticism (Ref: par. .12–.14)

.A9 Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance when relevant. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

.A10 Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances.

.A11 An audit performed in accordance with GAAS rarely involves the authentication of documents, nor is the auditor trained as, or expected to be, an expert in such authentication.¹⁷ However, when the auditor identifies conditions that cause the auditor to believe that a document may not be authentic, that terms in a document have been modified but not disclosed to the auditor, or that undisclosed side agreements may exist, possible procedures to investigate further may include

- confirming directly with the third party.
- using the work of a specialist to assess the document's authenticity.

Appendix C, "Examples of Circumstances That Indicate the Possibility of Fraud," contains examples of circumstances that may indicate the possibility of fraud.

Discussion Among the Engagement Team (Ref: par. .15)

.A12 Discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team

¹⁷ Paragraph .A51 of section 200.

- provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.
- enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention during the audit.

.A13 The discussion may lead to a thorough probing of the issues, acquiring of additional evidence as necessary, and consulting with other team members and, if appropriate, specialists in or outside the firm. The discussion may include the following matters:

- A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by using unclear or ambiguous language)
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud
- A consideration of how an element of unpredictability will be incorporated into the nature, timing, and extent of the audit procedures to be performed
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others
- A consideration of any allegations of fraud that have come to the auditor's attention

A number of factors may influence the extent of the discussion and how it may occur. For example, if the audit involves more than one location, there could be multiple discussions with team members in differing locations. Another factor in planning the discussions is whether to include specialists assigned to the audit team. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Risk Assessment Procedures and Related Activities

Inquiries of Management

Management's Assessment of the Risk of Material Misstatement Due to Fraud
(Ref: par. .17a)

.A14 Management accepts responsibility for the entity's internal control and for the preparation and fair presentation of the entity's financial

statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent, and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent, and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may, in some circumstances, be indicative of the lack of importance that management places on internal control.

.A15 *Considerations specific to smaller, less complex entities.* In some entities, particularly smaller entities, the focus of management's assessment may be on the risks of employee fraud or misappropriation of assets.

Management's Process for Identifying and Responding to the Risks of Fraud
(Ref: par. .17b)

.A16 In the case of entities with multiple locations, management's processes may include different levels of monitoring of operating locations or business segments. Management may also have identified particular operating locations or business segments for which a risk of fraud may be more likely to exist.

Discussions With Management and Others Within the Entity (Ref: par. .17-.19)

.A17 Inquiries of management and others within the entity are generally most effective when they involve an in-person discussion. The auditor may also determine it useful to provide the interviewee with specific questions and obtain written responses in advance of the discussion.

.A18 The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity, in addition to management, may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated. It may be useful in providing the auditor with a perspective that is different from that of individuals in the financial reporting process. The responses to these other inquiries might serve to corroborate responses received from management or, alternatively, might provide information regarding the possibility of management override of controls. The auditor may also obtain information about how effectively management has communicated standards of ethical behavior throughout the organization.

.A19 Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include the following:

- Operating personnel not directly involved in the financial reporting process
- Employees with different levels of authority
- Employees involved in initiating, processing, or recording complex or unusual transactions (for example, a sales transaction with multiple elements or a significant related party transaction) and those who supervise or monitor such employees

- In-house legal counsel
- Chief ethics officer or equivalent person
- The person or persons charged with dealing with allegations of fraud

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A20 Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.

Obtaining an Understanding of Oversight Exercised by Those Charged With Governance (Ref: par. .20)

.A21 Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control, and compliance with the law. In some circumstances, governance practices are well developed, and those charged with governance play an active role in oversight of the entity's assessment of the risks of fraud and of the relevant internal control. Because the responsibilities of those charged with governance and management may vary by entity, it is important that the auditor understands the respective responsibilities of those charged with governance and management to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals.¹⁸

.A22 An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of internal control over risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings during which such discussions take place, reading the minutes from such meetings, or making inquiries of those charged with governance.

Considerations Specific to Smaller, Less Complex Entities

.A23 In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a small entity in which a single owner manages the entity, and no one else has a governance role. In these cases, ordinarily, no action exists on the part of the auditor because no oversight exists separate from management.

Unusual or Unexpected Relationships Identified (Ref: par. .22)

.A24 Analytical procedures may include data analysis techniques ranging from a high-level review of data patterns, relationships, and trends to highly sophisticated, computer-assisted investigation of detailed transactions using electronic tools, such as data mining, business intelligence, and file query tools. The degree of reliance that can be placed on such techniques is a function primarily of the source (for example, financial, nonfinancial), completeness and reliability of the data, the level of disaggregation, and the nature of the analysis.

.A25 Analytical procedures relating to revenue that are performed with the objective of identifying unusual or unexpected relationships that may indicate a material misstatement due to fraudulent financial reporting may include

¹⁸ Paragraphs .A6–.A12 of section 260 discuss with whom the auditor communicates when the entity's governance structure is not well defined.

- a. a comparison of sales volume, as determined from recorded revenue amounts, with production capacity. An excess of sales volume over production capacity may be indicative of recording fictitious sales.
- b. a trend analysis of revenues by month and sales returns by month, during and shortly after the reporting period. This may indicate the existence of undisclosed side agreements with customers involving the return of goods, which, if known, would preclude revenue recognition.
- c. a trend analysis of sales by month compared with units shipped. This may identify a material misstatement of recorded revenues.

.A26 Analytical procedures performed during planning may be helpful in identifying the risks of material misstatement due to fraud. However, if such analytical procedures use data aggregated at a high level, generally the results of those analytical procedures provide only a broad initial indication about whether a material misstatement of the financial statements may exist. Accordingly, the results of analytical procedures performed during planning may be considered along with other information gathered by the auditor in identifying the risks of material misstatement due to fraud.

Other Information (Ref: par. .23)

.A27 In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example, engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud.

Evaluation of Fraud Risk Factors (Ref: par. .24)

.A28 The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, the auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors), such as the following:

- The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud.
- The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud.
- A control environment that is not effective may create an opportunity to commit fraud.

.A29 Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities in which the specific conditions do not present risks of material misstatement. Accordingly, the determination of whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement of the financial statements due to fraud requires the exercise of professional judgment.

.A30 Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in appendix A, "Examples of Fraud Risk Factors." These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud
- A perceived opportunity to commit fraud
- An ability to rationalize the fraudulent action

The inability to observe one or more of these conditions does not necessarily mean that no risk of material misstatement due to fraud exists.

Risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information. Although the fraud risk factors described in appendix A cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.

.A31 The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, in the case of a large entity, there may be factors that generally constrain improper conduct by management, such as

- effective oversight by those charged with governance.
- an effective internal audit function.
- the existence and enforcement of a written code of conduct.

Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level.

Considerations Specific to Smaller, Less Complex Entities

.A32 In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a small entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control because an opportunity exists for management override of controls.

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

Risks of Fraud in Revenue Recognition (Ref: par. .26)

.A33 Material misstatement due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may result also from an understatement of revenues through, for example, improperly shifting revenues to a later period.

.A34 The risks of fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks

of fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales.

.A35 The presumption that risks of fraud exist in revenue recognition may be rebutted. For example, the auditor may conclude that no risk of material misstatement due to fraud relating to revenue recognition exists in the case in which a single type of simple revenue transaction exists, for example, leasehold revenue from a single unit rental property.

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: par. .27)

.A36 Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.¹⁹ In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.

.A37 It is, therefore, important for the auditor to obtain an understanding of the controls that management has designed, implemented, and maintained to prevent and detect fraud. In doing so, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from obtaining this understanding may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses (Ref: par. .28)

.A38 Determining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism through, for example, increased

- sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
- recognition of the need to corroborate management explanations or representations concerning material matters.

Determining overall responses to address the assessed risks of material misstatement due to fraud also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters listed in paragraph .29, which are discussed in the following sections.

Assignment and Supervision of Personnel (Ref: par. .29a)

.A39 The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized

¹⁹ Paragraph .A49 of section 315A.

skill and knowledge, such as forensic and IT specialists, or by assigning more experienced individuals to the engagement.

.A40 The extent of supervision reflects the auditor's assessment of risks of material misstatement due to fraud and the competencies of the engagement team members performing the work.

Accounting Principles (Ref: par. .29b)

.A41 Management bias in the selection and application of accounting principles may individually or collectively involve matters such as contingencies, fair value measurements, revenue recognition, accounting estimates, related party transactions, or other transactions without a clear business purpose.

Unpredictability in the Selection of Audit Procedures (Ref: par. .29c)

.A42 Incorporating an element of unpredictability in the selection of the nature, timing, and extent of audit procedures to be performed is important because individuals within the entity who are familiar with the audit procedures normally performed on engagements may be better able to conceal fraudulent financial reporting. This can be achieved by, for example,

- performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk.
- adjusting the timing of audit procedures from that otherwise expected.
- using different sampling methods.
- performing audit procedures at different locations or at locations on an unannounced basis.

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (Ref: par. .30)

.A43 The auditor's responses to address the assessed risks of material misstatement due to fraud at the assertion level may include changing the nature, timing, and extent of audit procedures in the following ways:

- The nature of audit procedures to be performed may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information. This may affect both the type of audit procedures to be performed and their combination. For example:
 - Physical observation or inspection of certain assets may become more important, or the auditor may choose to use computer-assisted audit techniques to gather more evidence about data contained in significant accounts or electronic transaction files.
 - The auditor may design procedures to obtain additional corroborative information. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example, design external

confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. In addition, the auditor might find it effective to supplement such external confirmations with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms.

- The timing of substantive procedures may need to be modified. The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period end would not be effective. In contrast, because an intentional misstatement — for example, a misstatement involving improper revenue recognition — may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in or throughout the reporting period.
- The extent of the procedures applied reflects the assessment of the risks of material misstatement due to fraud. For example, increasing sample sizes or performing analytical procedures at a more detailed level may be appropriate. Also, computer-assisted audit techniques may enable more extensive testing of electronic transactions and account files. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

.A44 If the auditor identifies a risk of material misstatement due to fraud that affects inventory quantities, examining the entity's inventory records may help to identify locations or items that require specific attention during or after the physical inventory count. Such a review may lead to a decision to observe inventory counts at certain locations on an unannounced basis or to conduct inventory counts at all locations on the same date.

.A45 The auditor may identify a risk of material misstatement due to fraud affecting a number of accounts and assertions. These may include asset valuation, estimates relating to specific transactions (such as acquisitions, restructurings, or disposals of segments of the business), and other significant accrued liabilities (such as pension and other postemployment benefit obligations, or environmental remediation liabilities). The risk may also relate to significant changes in assumptions relating to recurring estimates. Information gathered through obtaining an understanding of the entity and its environment may assist the auditor in evaluating the reasonableness of such management estimates and underlying judgments and assumptions. A retrospective review of similar management judgments and assumptions applied in prior periods may also provide insight about the reasonableness of judgments and assumptions supporting management estimates.

.A46 Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud, including those that illustrate the incorporation of an element of unpredictability, are presented in appendix B, "Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud." The appendix includes examples of responses to the auditor's assessment of the risks of material misstatement resulting from

both fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments (Ref: par. .32a)

.A47 Material misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by (a) recording inappropriate or unauthorized journal entries throughout the year or at period end, or (b) making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries, such as through consolidating adjustments, report combinations, and reclassifications.

.A48 The auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries is important because automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, when IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

.A49 When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters may be relevant:

- *The assessment of the risks of material misstatement due to fraud.* The presence of fraud risk factors and other information obtained during the auditor's assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.
- *Controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.
- *The entity's financial reporting process and the nature of evidence that can be obtained.* For many entities, routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments may involve both manual and automated procedures and controls. When IT is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.
- *The characteristics of fraudulent journal entries or other adjustments.* Inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts; (b) made by individuals who typically do not make journal entries; (c) recorded at the end of the period or as postclosing entries that have little or no explanation or description; (d) made either before or during the preparation of the financial statements

that do not have account numbers; or (e) containing round numbers or consistent ending numbers.

- *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to misstatements in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified risk of material misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.
- *Journal entries or other adjustments processed outside the normal course of business.* Nonstandard journal entries, and other entries such as consolidating adjustments, may not be subject to the same level of internal control as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements.

.A50 The auditor exercises professional judgment in determining the nature, timing, and extent of testing of journal entries and other adjustments. However, because fraudulent journal entries and other adjustments are often made at the end of a reporting period, paragraph .32a(iv) requires the auditor to select the journal entries and other adjustments made at that time. Further, because material misstatements in financial statements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished, paragraph .32a(v) requires the auditor to consider whether a need also exists to test journal entries and other adjustments throughout the period.

Accounting Estimates (Ref: par. .32b)

.A51 The preparation and fair presentation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, for example, understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions about the entity's performance and profitability.

.A52 The purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether an indication exists of a possible bias on the part of management. This review is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.

.A53 A retrospective review is also required by section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.²⁰ That review is conducted as a risk assessment procedure to

²⁰ Paragraph .09 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

obtain information regarding the effectiveness of management's prior period estimation process, audit evidence about the outcome, or when applicable, the subsequent reestimation of prior period accounting estimates that is pertinent to making current period accounting estimates, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could represent a risk of material misstatement due to fraud in accordance with this section may be carried out in conjunction with the review required by section 540A.

Business Purpose for Significant Unusual Transactions (Ref: par. .32c)

.A54 Indicators that may suggest that significant unusual transactions may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include the following:

- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and inadequate documentation exists.
- Management is placing more emphasis on the need for a particular accounting treatment than on the economic substance of the transaction.
- Transactions involve nonconsolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- Transactions involve related parties or relationships or transactions with related parties previously undisclosed to the auditor.
- Transactions involve other parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit or any related party of the entity.
- Transactions lack commercial or economic substance or are part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (for example, a transaction is entered into shortly prior to period end and is unwound shortly after period end).
- Transactions occur with a party that falls outside the definition of a related party (as defined by the applicable financial reporting framework), with either party able to negotiate terms that may not be available for other, more clearly independent parties on an arm's-length basis.
- Transactions exist to enable the entity to achieve certain financial targets.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A55 Procedures for evaluating significant unusual transactions may include evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees and other obligations, if any. Examples of information that might be relevant to the auditor's evaluation of a related party's financial capability

include, among other things, the audited financial statements of the related party, reports issued by regulatory agencies, financial publications, and income tax returns of the related party, to the extent available. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Other Audit Procedures (Ref: par. .32a and .33)

.A56 Risks of material misstatement, including misstatements due to fraud, cannot be reduced to an appropriately low level by performing only tests of controls.²¹ [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of Audit Evidence (Ref: par. .34–.37)

.A57 Section 330 requires the auditor, based on the audit procedures performed and the audit evidence obtained, to evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate.²² This evaluation is primarily a qualitative matter based on the auditor's professional judgment. Such an evaluation may provide further insight into the risks of material misstatement due to fraud and whether a need exists to perform additional or different audit procedures. Appendix C contains examples of circumstances that may indicate the possibility of fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion (Ref: par. .34)

.A58 Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant. These might include, for example, uncharacteristically large amounts of income being reported in the last few weeks of the reporting period or unusual transactions or income that is inconsistent with trends in cash flow from operations. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A59 Some unusual or unexpected analytical relationships may have been identified and may indicate a risk of material misstatement due to fraud because management or employees generally are unable to manipulate certain information to create seemingly normal or expected relationships. Some examples are as follows:

- The relationship of net income to cash flows from operations may appear unusual because management recorded fictitious revenues and receivables but was unable to manipulate cash.
- Changes in inventory, accounts payable, sales, or cost of sales from the prior period to the current period may be inconsistent, indicating a possible employee theft of inventory, because the employee was unable to manipulate all of the related accounts.
- A comparison of the entity's profitability to industry trends, which management cannot manipulate, may indicate trends or differences for further consideration when identifying risks of material misstatement due to fraud.

²¹ Paragraph .A9 of section 330.

²² Paragraph .27 of section 330.

- A comparison of bad debt write-offs to comparable industry data, which employees cannot manipulate, may provide unexplained relationships that could indicate a possible theft of cash receipts.
- An unexpected or unexplained relationship between sales volume, as determined from the accounting records and production statistics maintained by operations personnel, which may be more difficult for management to manipulate, may indicate a possible misstatement of sales.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Consideration of Identified Misstatements (Ref: par. .35–.37)

.A60 Because fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so, or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Accordingly, misstatements, such as numerous misstatements at a specific location even though the cumulative effect is not material, may be indicative of a risk of material misstatement due to fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A61 The implications of identified fraud depend on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question because there may be doubts about the completeness and truthfulness of representations made and the genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management, or third parties. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A62 Section 450, *Evaluation of Misstatements Identified During the Audit*, and section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, address the evaluation and disposition of misstatements and the effect on the auditor's opinion in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A63 Section 580, *Written Representations*, addresses obtaining appropriate representations from management in the audit. In addition to acknowledging its responsibility for the financial statements, it is important that, irrespective of the size of the entity, management acknowledges its responsibility for internal control designed, implemented, and maintained to prevent and detect fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Auditor Unable to Continue the Engagement (Ref: par. .38)

.A64 Examples of circumstances that may arise and bring into question the auditor's ability to continue performing the audit include the following:

- a. The entity does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances, even when the fraud is not material to the financial statements.
- b. The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud.
- c. The auditor has significant concern about the competence or integrity of management or those charged with governance.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A65 Because of the variety of circumstances that may arise, it is not possible to describe definitively when withdrawal from an engagement is appropriate. Factors that affect the auditor's conclusion include the implications of the involvement of a member of management or of those charged with governance (which may affect the reliability of management representations) and the effects on the auditor of a continuing association with the entity. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A66 The auditor has professional and legal responsibilities in such circumstances, and these responsibilities may vary by engagement. In some circumstances, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who engaged the auditor or, in some cases, to regulatory authorities. Given the nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to regulators or others.²³ [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Considerations Specific to Governmental Entities and Not-for-Profit Organizations

.A67 For governmental entities and not-for-profit organizations, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate, public interest considerations, contractual requirements, or law or regulation. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Communications to Management and With Those Charged With Governance

Communication to Management (Ref: par. .39)

.A68 When the auditor has obtained evidence that fraud exists or may exist, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable. This is true even if the matter might be considered inconsequential (for example, a minor defalcation by an employee at a low level in the entity's organization). The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the suspected fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Communication With Those Charged With Governance (Ref: par. .40)

.A69 The auditor's communication with those charged with governance may be made orally or in writing. Section 260, *The Auditor's Communication With Those Charged With Governance*, identifies factors the auditor considers in determining whether to communicate orally or in writing.²⁴ Due to the nature and sensitivity of fraud involving senior management, or fraud that results

²³ Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, provides guidance on communications with an auditor replacing the existing auditor.

²⁴ Paragraph .A49 of section 260.

in a material misstatement in the financial statements, the auditor communicates such matters on a timely basis and may consider it necessary to also communicate such matters in writing. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A70 In some cases, the auditor may consider it appropriate to communicate with those charged with governance when the auditor becomes aware of fraud involving employees other than management that does not result in a material misstatement. Similarly, those charged with governance may wish to be informed of such circumstances. The communication process is assisted if the auditor and those charged with governance agree at an early stage in the audit about the nature and extent of the auditor's communications in this regard. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A71 When the auditor has doubts about the integrity or honesty of management or those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Other Matters Related to Fraud (Ref: par. .41)

.A72 Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example, the following:

- Concerns about the nature, extent, and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.
- A failure by management to appropriately address identified significant deficiencies or material weaknesses in internal control, or to appropriately respond to an identified fraud.
- The auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions concerning the entity's performance and profitability.
- Concerns about the adequacy and completeness of the authorization of significant unusual transactions.
- The absence of programs or controls to address risks of material misstatement due to fraud that are significant deficiencies or material weaknesses.²⁵

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Communications to Regulatory and Enforcement Authorities (Ref: par. .42)

.A73 The auditor's professional duty to maintain the confidentiality of client information may preclude reporting fraud to a party outside the client

²⁵ See section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

entity. However, in certain circumstances, the duty of confidentiality may be overridden by statute, regulation, courts of law, specific requirements of audits of entities that receive government financial assistance, or waived by agreement. In some circumstances, the auditor has a statutory duty to report the occurrence of fraud to supervisory authorities. Also, in some circumstances, the auditor has a duty to report misstatements to authorities in those cases when management and those charged with governance fail to take corrective action. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A74 The auditor may consider it appropriate to obtain legal advice to determine the appropriate course of action in the circumstances, the purpose of which is to ascertain the steps necessary in considering the public interest aspects of identified fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Considerations Specific to Governmental Entities and Not-for-Profit Organizations

.A75 For governmental entities and not-for-profit organizations, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law or regulation. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A76

Appendix A—Examples of Fraud Risk Factors (Ref: par. .11, .24, and .A30)

The fraud risk factors identified in this appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration — that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives and pressures, (b) opportunities, and (c) attitudes and rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Risk Factors Relating to Misstatements Arising From Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives and Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by) the following:

- High degree of competition or market saturation, accompanied by declining margins
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates
- Significant declines in customer demand and increasing business failures in either the industry or overall economy
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry
- New accounting, statutory, or regulatory requirements

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for

example, overly optimistic press releases or annual report messages

- Need to obtain additional debt or equity financing to stay competitive — including financing of major research and development or capital expenditures
- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements
- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards
- A need to achieve financial targets required in bond covenants
- Pressure for management to meet the expectations of legislative or oversight bodies or to achieve political outcomes, or both

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity
- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow¹
- Personal guarantees of debts of the entity

Management or operating personnel are under excessive pressure to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Related party transactions that are also significant unusual transactions
- Significant transactions with related parties whose financial statements are not audited or are audited by another firm
- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions
- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate
- Significant or highly complex transactions or significant unusual transactions, especially those close to period end that pose difficult "substance over form" questions

¹ Management incentive plans may be contingent upon achieving targets relating only to certain accounts or selected activities of the entity, even though the related accounts or activities may not be material to the entity as a whole.

- Significant operations located or conducted across jurisdictional borders where differing business environments and regulations exist
- Use of business intermediaries for which there appears to be no clear business justification
- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification
- Contractual arrangements lacking a business purpose

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a nonowner-managed business) without compensating controls.
- Oversight by those charged with governance over the financial reporting process and internal control is not effective.
- The exertion of dominant influence by or over a related party.

The organizational structure is complex or unstable, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority
- High turnover of senior management, legal counsel, or those charged with governance

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (when external reporting is required)
- High turnover rates or employment of staff in accounting, IT, or the internal audit function who are not effective
- Accounting and information systems that are not effective, including situations involving significant deficiencies or material weaknesses in internal control
- Weak controls over budget preparation and development and compliance with law or regulation.

Attitudes and Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards that are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities law or other law or regulation, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of law or regulation.

- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies or material weaknesses in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- A strained relationship between management and the current or predecessor auditor, as exhibited by the following:
 - Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters
 - Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report
 - Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance
 - Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement

Risk Factors Arising From Misstatements Arising From Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives and pressures, opportunities, and attitudes and rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control that are not effective may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives and Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs
- Recent or anticipated changes to employee compensation or benefit plans
- Promotions, compensation, or other rewards inconsistent with expectations

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when the following exist:

- Large amounts of cash on hand or processed
- Inventory items that are small in size, of high value, or in high demand
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips
- Fixed assets that are small in size, marketable, or lack observable identification of ownership

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because the following exist:

- Inadequate segregation of duties or independent checks
- Inadequate oversight of senior management expenditures, such as travel and other reimbursements
- Inadequate management oversight of employees responsible for assets (for example, inadequate supervision or monitoring of remote locations)
- Inadequate job applicant screening of employees with access to assets
- Inadequate record keeping with respect to assets
- Inadequate system of authorization and approval of transactions (for example, in purchasing)
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets
- Lack of complete and timely reconciliations of assets
- Lack of timely and appropriate documentation of transactions (for example, credits for merchandise returns)
- Lack of mandatory vacations for employees performing key control functions
- Inadequate management understanding of IT, which enables IT employees to perpetrate a misappropriation
- Inadequate access controls over automated records, including controls over and review of computer systems event logs

Attitudes and Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee
- Changes in behavior or lifestyle that may indicate assets have been misappropriated
- The belief by some government or other officials that their level of authority justifies a certain level of compensation and personal privileges
- Tolerance of petty theft

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A77

Appendix B—Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud (Ref: par. .22 and .A46)

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly, they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures, and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis (for example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis)
- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period
- Altering the audit approach in the current year (for example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information)
- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear to have an unusual nature or amount
- For significant and unusual transactions, particularly those occurring at or near year end, investigating the possibility of related parties and the sources of financial resources supporting the transactions
- Performing substantive analytical procedures using disaggregated data (for example, comparing sales and cost of sales by location, line of business, or month to expectations developed by the auditor)
- Conducting interviews of personnel involved in areas in which a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk, and whether, or how, controls address the risk
- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions, or branches,

discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods, or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose
- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight
- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods
- Performing computer-assisted techniques, such as data mining to test for anomalies in a population
- Testing the integrity of computer-produced records and transactions
- Seeking additional audit evidence from sources outside of the entity being audited

Specific Responses— Misstatement Resulting From Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

Revenue Recognition

- Performing substantive analytical procedures relating to revenue using disaggregated data; for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods or with revenue related to cash collections (computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions)
- Confirming with customers certain relevant contract terms and the absence of side agreements because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented (for example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances)
- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions

- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures
- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded

Inventory Quantities

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period
- Performing additional procedures during the observation of the count; for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals (using the work of an expert may be helpful in this regard)
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records
- Using computer-assisted audit techniques to further test the compilation of the physical inventory counts (for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication)

Management Estimates

- Using an expert to develop an independent estimate for comparison to management's estimate
- Extending inquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate

Specific Responses — Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the preceding two categories may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year end
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit
- Analyzing recoveries of written-off accounts
- Analyzing inventory shortages by location or product type
- Comparing key inventory ratios to industry norm
- Reviewing supporting documentation for reductions to the perpetual inventory records
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers, or bank accounts
- Reviewing personnel files for those that contain little or no evidence of activity; for example, lack of performance evaluations
- Analyzing sales discounts and returns for unusual patterns or trends
- Confirming specific terms of contracts with third parties
- Obtaining evidence that contracts are being carried out in accordance with their terms
- Reviewing the propriety of large and unusual expenses
- Reviewing the authorization and carrying value of senior management and related party loans
- Reviewing the level and propriety of expense reports submitted by senior management

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A78

Appendix C—Examples of Circumstances That Indicate the Possibility of Fraud (Ref: par. .11, .A11, and .A57)

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

Discrepancies in the accounting records, including the following:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded by amount, accounting period, classification, or entity policy
- Unsupported or unauthorized balances or transactions
- Last minute adjustments that significantly affect financial results
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties
- Tips or complaints to the auditor about alleged fraud

Conflicting or missing evidence, including the following:

- Missing documents
- Documents that appear to have been altered
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist
- Significant unexplained items on reconciliations
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships; for example, receivables growing faster than revenues
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures
- Unusual discrepancies between the entity's records and confirmation replies
- Large numbers of credit entries and other adjustments made to accounts receivable records
- Unexplained or inadequately explained differences between the accounts receivable subledger and the control account, or between the customer statements and the accounts receivable subledger
- Missing or nonexistent cancelled checks in circumstances in which cancelled checks are ordinarily returned to the entity with the bank statement
- Missing inventory or physical assets of significant magnitude
- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies
- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated

- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments

Conditions relating to governmental entities or not-for-profit organizations:

- Significant transfers or transactions between funds or programs, or both, lacking supporting documents
- Abnormal budget conditions, such as
 - significant budget adjustments
 - requests for additional funding
 - budget adjustments made without approval
 - large amounts of over-or-under spending
 - programs with an emphasis on spending money quickly
- Procurement conditions, such as
 - lack of procurement legislation
 - recent changes to procurement legislation
 - complex or unclear legislation
 - involvement of significant monetary amounts (such as in the defense area)
 - investigation by regulatory authorities
 - complaints received from potential suppliers about questionable practices related to awarding of contracts
 - former governmental officials functioning as executives of companies to which contracts have been awarded
- Program conditions, such as
 - newly implemented programs without existing management and accountability structures
 - programs established for political purposes
 - programs established to deal with an immediate emergency or crisis
 - programs experiencing unusual growth due to conditions beyond the control of management
- Grant and donor funding conditions, such as
 - noncompliance with grant requirements
 - unclear grant requirements
 - grants not reaching the intended recipient
 - complaints from intended recipients or interest groups, and lack of monitoring of grantee compliance with applicable law or regulation

Problematic or unusual relationships between the auditor and management, including the following:

- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought

- Undue time pressures imposed by management to resolve complex or contentious issues
- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management
- Unusual delays by the entity in providing requested information
- Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques
- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel
- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable
- An unwillingness to address identified deficiencies in internal control on a timely basis

Other circumstances, including the following:

- Unwillingness by management to permit the auditor to meet privately with those charged with governance
- Accounting policies that appear to be at variance with industry norms
- Frequent changes in accounting estimates that do not appear to result from changed circumstances
- Tolerance of violations of the entity's code of conduct

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

AU-C Section 250

Consideration of Laws and Regulations in an Audit of Financial Statements

Source: SAS No. 122.

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

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to consider laws and regulations in an audit of financial statements. This section does not apply to other assurance engagements in which the auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.¹

Effect of Laws and Regulations

.02 The effect on financial statements of laws and regulations varies considerably. Those laws and regulations to which an entity is subject constitute the legal and regulatory framework. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an entity's financial statements. Other laws or regulations are to be complied with by management, or set the provisions under which the entity is allowed to conduct its business, but do not have a direct effect on an entity's financial statements. Some entities operate in heavily regulated industries (such as banks and chemical companies). Others are subject only to the many laws and regulations that relate generally to the operating aspects of the business (such as those related to occupational safety and health and equal employment opportunity). Noncompliance with laws and regulations may result in fines, litigation, or other consequences for the entity that may have a material effect on the financial statements.

¹ Section 935, *Compliance Audits*, addresses compliance audits performed in accordance with generally accepted auditing standards, the standards for financial audits under *Government Auditing Standards*, and government audit requirements.

Responsibility for Compliance With Laws and Regulations (Ref: par. .A1–.A7)

Responsibility of Management

.03 It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

Responsibility of the Auditor

.04 The requirements in this section are designed to assist the auditor in identifying material misstatement of the financial statements due to non-compliance with laws and regulations. However, the auditor is not responsible for preventing noncompliance and cannot be expected to detect noncompliance with all laws and regulations.

.05 The auditor is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.² In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Because of the inherent limitations of an audit, an unavoidable risk exists that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with generally accepted auditing standards (GAAS).³ In the context of laws and regulations, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for the following reasons:

- Many laws and regulations relating principally to the operating aspects of an entity typically do not affect the financial statements and are not captured by the entity's information systems relevant to financial reporting.
- Noncompliance may involve conduct designed to conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls, or intentional misrepresentations made to the auditor.
- Whether an act constitutes noncompliance is ultimately a matter for legal determination, such as by a court of law.

Ordinarily, the further removed noncompliance is from the events and transactions reflected in the financial statements, the less likely the auditor is to become aware of, or recognize, the noncompliance.

.06 This section distinguishes the auditor's responsibilities regarding compliance with the following two categories of laws and regulations:

- a. The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations (see paragraph .13)
- b. The provisions of other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but compliance with which may be

² Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

³ Paragraph .A49 of section 200.

- i. fundamental to the operating aspects of the business,
- ii. fundamental to an entity's ability to continue its business,
or
- iii. necessary for the entity to avoid material penalties

(for example, compliance with the terms of an operating license, regulatory solvency requirements, or environmental regulations); therefore, noncompliance with such laws and regulations may have a material effect on the financial statements (see paragraph .14).

.07 In this section, differing requirements are specified for each of the previously mentioned categories of laws and regulations. For the category referred to in paragraph .06a, the auditor's responsibility is to obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations. For the category referred to in paragraph .06b, the auditor's responsibility is limited to performing specified audit procedures that may identify noncompliance with those laws and regulations that may have a material effect on the financial statements.

.08 The auditor is required by this section to remain alert to the possibility that other audit procedures applied for the purpose of forming an opinion on financial statements may bring instances of identified or suspected noncompliance with laws and regulations to the auditor's attention. Maintaining professional skepticism throughout the audit, as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, is important in this context, given the extent of laws and regulations that affect the entity.⁴

Effective Date

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

Objectives

- .10** The objectives of the auditor are to
- a. obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations generally recognized to have a direct effect on their determination (see paragraph .06a),
 - b. perform specified audit procedures that may identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements (see paragraph .06b), and
 - c. respond appropriately to noncompliance or suspected noncompliance with laws and regulations identified during the audit.

Definition

.11 For the purposes of this section, the following term has the meaning attributed as follows:

⁴ Paragraph .17 of section 200.

Noncompliance. Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. Noncompliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Requirements

The Auditor's Consideration of Compliance With Laws and Regulations

.12 As part of obtaining an understanding of the entity and its environment, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the auditor should obtain a general understanding of the following:⁵ (Ref: par. .A8)

- a. The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates
- b. How the entity is complying with that framework

.13 The auditor should obtain sufficient appropriate audit evidence regarding material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations generally recognized to have a direct effect on their determination (see paragraph .06a). (Ref: par. .A9–.A11)

.14 The auditor should perform the following audit procedures that may identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements (see paragraph .06b): (Ref: par. .A12–.A15)

- a. Inquiring of management and, when appropriate, those charged with governance about whether the entity is in compliance with such laws and regulations
- b. Inspecting correspondence, if any, with the relevant licensing or regulatory authorities (Ref: par. .A16)

.15 During the audit, the auditor should remain alert to the possibility that other audit procedures applied may bring instances of noncompliance or suspected noncompliance with laws and regulations to the auditor's attention. (Ref: par. .A17–.A18)

.16 In the absence of identified or suspected noncompliance, the auditor is not required to perform audit procedures regarding the entity's compliance with laws and regulations, other than those set out in paragraphs .12–.15 of this section and the requirement in section 580, *Written Representations*, related to requesting written representations from management regarding the entity's compliance with laws and regulations.⁶

⁵ Paragraph .12 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁶ Paragraph .13 of section 580, *Written Representations*.

Audit Procedures When Noncompliance Is Identified or Suspected

.17 If the auditor becomes aware of information concerning an instance of noncompliance or suspected noncompliance with laws and regulations, the auditor should obtain (Ref: par. .A19–.A20)

- a. an understanding of the nature of the act and the circumstances in which it has occurred and
- b. further information to evaluate the possible effect on the financial statements. (Ref: par. .A21)

.18 If the auditor suspects noncompliance may exist, the auditor should discuss the matter with management (at a level above those involved with the suspected noncompliance, if possible) and, when appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and, in the auditor's professional judgment, the effect of the suspected noncompliance may be material to the financial statements, the auditor should consider the need to obtain legal advice. (Ref: par. .A22–.A23)

.19 If sufficient information about suspected noncompliance cannot be obtained, the auditor should evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion.

.20 The auditor should evaluate the implications of noncompliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations,⁷ and take appropriate action. (Ref: par. .A24–.A25)

Reporting of Identified or Suspected Noncompliance

Reporting Noncompliance to Those Charged With Governance

.21 Unless all of those charged with governance are involved in management of the entity and aware of matters involving identified or suspected noncompliance already communicated by the auditor,⁸ the auditor should communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential. (Ref: par. .A26)

.22 If, in the auditor's professional judgment, the noncompliance referred to in paragraph .21 is believed to be intentional and material, the auditor should communicate the matter to those charged with governance as soon as practicable.

.23 If the auditor suspects that management or those charged with governance are involved in noncompliance, the auditor should communicate the matter to the next higher level of authority at the entity, if it exists. When no higher authority exists, or if the auditor believes that the communication may not be acted upon or is unsure about the person to whom to report, the auditor should consider the need to obtain legal advice.

⁷ Paragraphs .22–.26 of section 580.

⁸ Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

Reporting Noncompliance in the Auditor's Report on the Financial Statements

.24 If the auditor concludes that the noncompliance has a material effect on the financial statements, and it has not been adequately reflected in the financial statements, the auditor should, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, express a qualified or adverse opinion on the financial statements.⁹ (Ref: par. .A27)

.25 If the auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether noncompliance that may be material to the financial statements has, or is likely to have, occurred, the auditor should express a qualified opinion or disclaim an opinion on the financial statements on the basis of a limitation on the scope of the audit, in accordance with section 705.¹⁰ (Ref: par. .A27)

.26 If the auditor is unable to determine whether noncompliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the auditor should evaluate the effect on the auditor's opinion, in accordance with section 705.¹¹

Reporting Noncompliance to Regulatory and Enforcement Authorities

.27 If the auditor has identified or suspects noncompliance with laws and regulations, the auditor should determine whether the auditor has a responsibility to report the identified or suspected noncompliance to parties outside the entity. (Ref: par. .A28–.A29)

Documentation

.28 The auditor should include in the audit documentation a description of the identified or suspected noncompliance with laws and regulations and the results of discussion with management and, when applicable, those charged with governance and other parties inside or outside the entity.¹² (Ref: par. .A30)

Application and Other Explanatory Material

Responsibility for Compliance With Laws and Regulations (Ref: par. .03–.08)

Responsibility of Management

.A1 It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with laws and regulations. Laws and regulations may affect an entity's financial statements in different ways (for example, most directly, they may affect specific disclosures required of the entity in the financial statements, or they may prescribe the applicable financial reporting framework). They also

⁹ Paragraphs .08–.09 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

¹⁰ [Footnote deleted, January 2012, to reflect conforming changes necessary due to the issuance of SAS No. 123.]

¹¹ [Footnote deleted, January 2012, to reflect conforming changes necessary due to the issuance of SAS No. 123.]

¹² Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

may establish certain legal rights and obligations of the entity, some of which will be recognized in the entity's financial statements. In addition, laws and regulations may provide for the imposition of penalties in cases of noncompliance.

.A2 The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of noncompliance with laws and regulations:

- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements
- Instituting and operating appropriate systems of internal control
- Developing, publicizing, and following a code of ethics or code of conduct
- Ensuring employees are properly trained and understand the code of ethics or code of conduct
- Monitoring compliance with the code of ethics or code of conduct and acting appropriately to discipline employees who fail to comply with it
- Engaging legal advisors to assist in monitoring legal requirements
- Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints

In larger entities, these policies and procedures may be supplemented by assigning appropriate responsibilities to the following:

- An internal audit function
- An audit committee
- A legal function
- A compliance function

Responsibility of the Auditor

.A3 Because of the inherent limitations described in paragraph .05, an audit performed in accordance with GAAS provides no assurance that all noncompliance with laws and regulations will be detected or that any contingent liabilities that result will be disclosed.

.A4 Noncompliance by the entity with laws and regulations may result in a material misstatement of the financial statements. Detection of noncompliance, regardless of materiality, may affect other aspects of the audit, including, for example, the auditor's consideration of the integrity of management or employees. Noncompliance can result from fraudulent activity. Section 240, *Consideration of Fraud in a Financial Statement Audit*, addresses the auditor's responsibility if fraud or suspected fraud is detected.

.A5 Whether an act constitutes noncompliance with laws and regulations is a matter for legal determination, which ordinarily is beyond the auditor's professional competence to determine. Nevertheless, the auditor's training, experience, and understanding of the entity and its industry or sector may provide a basis to recognize that some acts coming to the auditor's attention may constitute noncompliance with laws and regulations.

.A6 In accordance with specific statutory requirements, the auditor may be specifically required to report, as part of the audit of the financial statements, on whether the entity complies with certain provisions of laws or regulations.

In these circumstances, section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*, and section 935, *Compliance Audits*, set forth how these audit responsibilities are addressed in the auditor's report. Furthermore, when specific statutory reporting requirements exist, it may be necessary for the audit plan to include appropriate tests for compliance with these provisions of the laws and regulations.

Considerations Specific to Governmental Entities

.A7 Auditors of governmental entities may have additional responsibilities with respect to the consideration of laws and regulations, which relate to the audit of financial statements or may extend to other aspects of the entity's operations.¹³

The Auditor's Consideration of Compliance With Laws and Regulations

Obtaining an Understanding of the Legal and Regulatory Framework (Ref: par. .12)

.A8 To obtain a general understanding of the legal and regulatory framework and how the entity complies with that framework, the auditor may, for example

- use the auditor's existing understanding of the entity's industry and regulatory and other external factors;
- update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;
- inquire of management about other laws or regulations that may be expected to have a fundamental effect on the operations of the entity;
- inquire of management concerning the entity's policies and procedures regarding compliance with laws and regulations (including the prevention of noncompliance), if appropriate;
- inquire of management regarding the policies or procedures adopted for identifying, evaluating, and accounting for litigation claims;
- inquire of management regarding the use of directives issued by the entity and periodic representations obtained by the entity from management at appropriate levels of authority concerning compliance with laws and regulations; and
- consider the auditor's knowledge of the entity's history of noncompliance with laws and regulations.

Laws and Regulations Generally Recognized to Have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements (Ref: par. .13)

.A9 Certain laws and regulations are well established, known to the entity and within the entity's industry or sector, and relevant to the entity's

¹³ See section 935; *Government Auditing Standards*; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

financial statements (as described in paragraph .06a). These laws and regulations generally are directly relevant to the determination of material amounts and disclosures in the financial statements and readily evident to the auditor. They could include those that relate to, for example

- the form and content of financial statements (for example, statutorily-mandated requirements);
- industry-specific financial reporting issues;
- accounting for transactions under government contracts (for example, laws and regulations that may affect the amount of revenue to be accrued); or
- the accrual or recognition of expenses for income tax or pension costs.

.A10 Some provisions in those laws and regulations may be directly relevant to specific assertions in the financial statements (for example, the completeness of income tax provisions), whereas others may be directly relevant to the financial statements as a whole. The auditor's responsibility regarding misstatements resulting from noncompliance with laws and regulations having a direct effect on the determination of material amounts and disclosures in the financial statements is the same as that for misstatements caused by fraud or error, as described in section 200.

.A11 Noncompliance with other provisions of such laws and regulations, and the laws and regulations described in paragraph .06b, may result in fines, litigation, or other consequences for the entity, the costs of which may need to be provided for or disclosed in the financial statements but are not considered to have a direct effect on the financial statements, as described in paragraph .06a.

Procedures to Identify Instances of Noncompliance—Other Laws and Regulations (Ref: par. .14)

.A12 Certain other laws and regulations may need particular attention by the auditor because they have a fundamental effect on the operations of the entity (as described in paragraph .06b. Noncompliance with laws and regulations that have a fundamental effect on the operations of the entity may cause the entity to cease operations or call into question the entity's continuance as a going concern. For example, noncompliance with the requirements of the entity's license or other entitlement to perform its operations could have such an impact (for example, for a bank, noncompliance with capital or investment requirements).

.A13 Many laws and regulations relating principally to the operating aspects of the entity do not directly affect the financial statements (their financial statement effect is indirect) and are not captured by the entity's information systems relevant to financial reporting. Their indirect effect may result from the need to disclose a contingent liability because of the allegation or determination of identified or suspected noncompliance. Those other laws or regulations may include those related to securities trading, occupational safety and health, food and drug administration, environmental protection, equal employment, and price-fixing or other antitrust violations. An auditor may not have a sufficient basis for recognizing possible noncompliance with such laws and regulations.

.A14 For the category referred to in paragraph .06b, the auditor's responsibility is limited to performing specified audit procedures (see paragraph .14) that may identify noncompliance with those laws and regulations that may

have a material effect on the financial statements. Even when those procedures are performed, the auditor may not become aware of the existence of noncompliance unless there is evidence of noncompliance in the records, documents, or other information normally inspected in an audit of financial statements.

.A15 Because the financial reporting consequences of other laws and regulations can vary depending on the entity's operations, the audit procedures required by paragraph .14 are intended to bring to the auditor's attention instances of noncompliance with laws and regulations that may have a material effect on the financial statements.

.A16 In some cases, the amount of an entity's correspondence with licensing or regulatory authorities is voluminous. In exercising professional judgment in such circumstances, the auditor may consider the following in determining the extent of inspection that may identify instances of noncompliance:

- The nature of the entity
- The nature and type of correspondence

Noncompliance Brought to the Auditor's Attention by Other Audit Procedures (Ref: par. .15)

.A17 Audit procedures applied to form an opinion on the financial statements may bring instances of noncompliance or suspected noncompliance with laws and regulations to the auditor's attention. For example, such audit procedures may include the following:

- Reading minutes
- Inquiring of the entity's management and in-house or external legal counsel concerning litigation, claims, and assessments
- Performing substantive tests of details of classes of transactions, account balances, or disclosures

.A18 Because the effect of laws and regulations on financial statements can vary considerably, written representations, as required by section 580, provide necessary audit evidence about management's knowledge of identified or suspected noncompliance with laws and regulations, the effects of which may have a material effect on the financial statements. However, written representations do not provide sufficient appropriate audit evidence on their own and, accordingly, do not affect the nature and extent of other audit evidence that is to be obtained by the auditor.¹⁴

Audit Procedures When Noncompliance Is Identified or Suspected

Indications of Noncompliance With Laws and Regulations (Ref: par. .17)

.A19 If the auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of noncompliance with laws and regulations:

- Investigations by regulatory organizations and government departments or payment of fines or penalties

¹⁴ Paragraph .04 of section 580.

- Payments for unspecified services or loans to consultants, related parties, employees, or government officials or government employees
- Sales commissions or agent's fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received
- Purchases made at prices significantly above or below market price
- Unusual payments in cash, purchases in the form of cashiers' checks payable to bearer, or transfers to numbered bank accounts
- Unusual transactions with companies registered in tax havens
- Payments for goods or services made other than to the country from which the goods or services originated
- Existence of an information system that fails, whether by design or accident, to provide an adequate audit trail or sufficient evidence
- Unauthorized transactions or improperly recorded transactions
- Adverse media comment
- Noncompliance with laws or regulations cited in reports of examinations by regulatory agencies that have been made available to the auditor
- Failure to file tax returns or pay government duties or similar fees that are common to the entity's industry or the nature of its business

Obtaining an Understanding of an Act of Identified or Suspected Noncompliance (Ref: par. .17)

.A20 Procedures an auditor may perform to address the requirements of paragraph .17 include the following:

- Examining supporting documents, such as invoices, cancelled checks, and agreements, and comparing with accounting records
- Confirming significant information concerning the matter with the other party to the transaction or intermediaries, such as banks or lawyers
- Determining whether the transaction has been properly authorized
- Considering whether other similar transactions or events may have occurred and applying procedures to identify them

Matters Relevant to the Auditor's Evaluation (Ref: par. .17b)

.A21 Matters relevant to the auditor's evaluation of the possible effect on the financial statements include the following:

- The quantitative effect of noncompliance. The potential financial consequences of noncompliance with laws and regulations on the financial statements may include the imposition of fines, penalties, or damages; the threat of expropriation of assets; enforced discontinuation of operations; and litigation.
- The qualitative materiality of the effect of noncompliance. For example, an illegal payment of an otherwise immaterial amount

could be material if a reasonable possibility exists that it could lead to a material contingent liability or a material loss of revenue.

- Whether the potential financial consequences require accrual or disclosure under the applicable financial reporting framework. For example, if material revenue or earnings are derived from transactions involving noncompliance, or if noncompliance creates significant risks associated with material revenue or earnings, such as loss of a significant business relationship, that information may require disclosure. Loss contingencies resulting from noncompliance that may require disclosure may be evaluated in the same manner as other loss contingencies under the applicable financial reporting framework.
- Whether the potential financial consequences are so serious as to call into question the fair presentation of the financial statements or otherwise make the financial statements misleading.

Audit Procedures (Ref: par. .18)

.A22 The auditor may discuss the findings with those charged with governance, in which case they may be able to provide additional audit evidence. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to transactions or events that have led to the possibility of noncompliance with laws and regulations.

.A23 If management or, as appropriate, those charged with governance do not provide sufficient information to the auditor that the entity is in fact in compliance with laws and regulations, the auditor may consider it appropriate to consult with the entity's in-house legal counsel or external legal counsel about the application of the laws and regulations to the circumstances, including the possibility of fraud, and the possible effects on the financial statements. The auditor may request management to arrange for such consultation with the entity's legal counsel. If it is not considered appropriate to consult with the entity's legal counsel or if the auditor is not satisfied with the legal counsel's opinion, the auditor may consider it appropriate to consult the auditor's own legal counsel about whether a violation of a law or regulation is involved; the possible legal consequences, including the possibility of fraud; and what further action, if any, the auditor may take.

Evaluating the Implications of Noncompliance (Ref: par. .20)

.A24 As required by paragraph .20, the auditor evaluates the implications of noncompliance with regard to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular instances of noncompliance identified by the auditor will depend on the relationship of the perpetration and concealment, if any, of the act to specific control activities and the level of management or employees involved, especially implications arising from the involvement of the highest authority within the entity.

.A25 The auditor may consider whether withdrawal from the engagement, when withdrawal is possible under applicable law or regulation, is necessary when management or those charged with governance do not take the remedial action that the auditor considers appropriate in the circumstances, even when the noncompliance is not material to the financial statements. Factors that may

affect the auditor's decision may include the implications of the failure to take remedial action, which may affect the auditor's ability to rely on management representations, and the effects of continuing association with the entity. When deciding whether withdrawal from the engagement is necessary, the auditor may consider seeking legal advice. If withdrawal from the engagement is not possible under applicable law or regulation, the auditor may consider alternative actions, including describing the noncompliance in an other-matter(s) paragraph in the auditor's report.¹⁵

Reporting of Identified or Suspected Noncompliance

Reporting Noncompliance to Those Charged With Governance **(Ref: par. .21)**

.A26 The communication of matters involving identified or suspected noncompliance may describe the act of identified or suspected noncompliance, the circumstances of its occurrence, and the effect on the financial statements. The auditor may reach agreement in advance with those charged with governance on the nature of matters that would be considered clearly inconsequential and, thus, need not be communicated.

Issuance of a Modified Opinion on the Financial Statements **(Ref: par. .24–.25)**

.A27 If management or those charged with governance refuse to accept a modified opinion on the financial statements for the circumstances described in paragraphs .24–.25, the auditor may withdraw from the engagement, when withdrawal is possible under applicable law or regulation, and indicate the reasons for withdrawal in writing to those charged with governance.

Reporting Noncompliance to Regulatory and Enforcement Authorities **(Ref: par. .27)**

.A28 The auditor's professional duty to maintain the confidentiality of client information may preclude reporting identified or suspected noncompliance with laws and regulations to a party outside the entity. However, the auditor's legal responsibilities vary by jurisdiction, and in certain circumstances, the duty of confidentiality may be overridden by statute, the law, or courts of law. In the following circumstances, a duty to notify parties outside the entity may exist:

- In response to inquiries from an auditor to a predecessor auditor, in accordance with the requirements of section 210A, *Terms of Engagement*¹⁶
- In response to a court order
- In compliance with requirements for the audits of entities that receive financial assistance from a government agency

Because potential conflicts with the auditor's ethical and legal obligations for confidentiality may be complex, the auditor may consult with legal counsel before discussing noncompliance with parties outside the entity.

¹⁵ Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

¹⁶ Paragraphs .11–.12 of section 210A, *Terms of Engagement*.

Considerations Specific to Governmental Entities

.A29 The auditor of a governmental entity may be required to report on compliance with laws, regulations, and provisions of contracts or grant agreements as part of the audit of the governmental entity's financial statements (for example, in an audit conducted in accordance with *Government Auditing Standards*). The auditor also may be required to communicate instances of non-compliance to appropriate oversight bodies and funding agencies.

Documentation (Ref: par. .28)

.A30 The auditor's documentation of findings regarding identified or suspected noncompliance with laws and regulations may include, for example

- copies of records or documents.
 - minutes of discussions held with management, those charged with governance, or other parties inside or outside the entity.
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AU-C Section 260

The Auditor's Communication With Those Charged With Governance

Source: SAS No. 122; SAS No. 123; SAS No. 125; SAS No. 128; SAS No. 134; SAS No. 135; SAS No. 137.

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

NOTE

In July 2020, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 143, *Auditing Accounting Estimates and Related Disclosures*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

In October 2021, the ASB issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. Although this section applies regardless of an entity's governance structure or size, particular considerations apply when all of those charged with governance are involved in managing an entity. This section does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.

.02 This section is written in the context of an audit of financial statements but may also be applied, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation and fair presentation of the other historical financial information.

.03 Recognizing the importance of effective two-way communication in an audit of financial statements, this section provides an overarching framework for the auditor's communication with those charged with governance and identifies some specific matters to be communicated. Additional matters to be communicated are identified in other AU-C sections (see the exhibit, "Requirements to Communicate With Those Charged With Governance in Other AU-C Sections"). In addition, section 265, *Communicating Internal Control Related Matters Identified in an Audit*, establishes specific requirements regarding the communication of significant deficiencies and material weaknesses in internal control the auditor has identified during the audit to those charged with governance. Further matters not required by generally accepted auditing standards (GAAS) may be required to be communicated by agreement with those charged with governance or management or in accordance with law or regulation or other external requirements. Nothing in this section precludes the auditor from communicating any other matters to those charged with governance. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Effective Date

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

Objectives

.05 The objectives of the auditor are to

- a. communicate clearly with those charged with governance the responsibilities of the auditor regarding the financial statement audit and an overview of the planned scope and timing of the audit.
- b. obtain from those charged with governance information relevant to the audit.
- c. provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process.
- d. promote effective two-way communication between the auditor and those charged with governance. (Ref: par. .A1–.A5)

Definitions

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

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

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

Requirements

Those Charged With Governance

.07 The auditor should determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Ref: par. .A6–.A9)

Communication With the Audit Committee or Other Subgroup of Those Charged With Governance

.08 If the auditor communicates with a subgroup of those charged with governance, such as the audit committee or an individual, the auditor should determine whether the auditor also needs to communicate with the governing body. (Ref: par. .A10–.A12)

When All of Those Charged With Governance Are Involved in Managing the Entity

.09 In some cases, all of those charged with governance are involved in managing the entity; for example, a small business in which a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this section are communicated with a person(s) with management responsibilities and that person(s) also has governance responsibilities, the matters need not be communicated again with the same person(s) in that person's governance role. These matters are noted in paragraph .14. The auditor should, nonetheless, be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit

.10 The auditor should communicate with those charged with governance the auditor's responsibilities with regard to the financial statement audit, including that (Ref: par. .A13–.A18)

- a. the auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management, with the oversight of those charged with governance, are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- b. the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Planned Scope and Timing of the Audit

.11 The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. (Ref: par. .A19–.A24) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Significant Findings or Issues From the Audit

.12 The auditor should communicate with those charged with governance (Ref: par. .A25–.A26)

- a. the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor should (Ref: par. .A27–.A29)
 - i. explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity and
 - ii. determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.
- b. significant unusual transactions, if any. (Ref: par. .A30)
- c. significant difficulties, if any, encountered during the audit. (Ref: par. .A31)
- d. disagreements with management, if any. (Ref: par. .A32)
- e. circumstances that affect the form and content of the auditor's report, if any. (Ref: par. .A33–.A34)
- f. matters that are difficult or contentious for which the auditor consulted outside the engagement team and that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.
- g. other findings or issues, if any, arising during the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. .A35–.A37)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Uncorrected Misstatements

.13 The auditor should communicate with those charged with governance (Ref: par. .A38–.A39)

- a. uncorrected misstatements accumulated by the auditor and the effect that they, individually or in the aggregate, may have on the opinion in the auditor's report. The auditor's communication should identify material uncorrected misstatements individually. The auditor should request that uncorrected misstatements be corrected.
- b. the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
- c. that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

When Not All of Those Charged With Governance Are Involved in Management

.14 Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate

- a. material, corrected misstatements that were brought to the attention of management as a result of audit procedures. (Ref: par. .A40)
- b. significant findings or issues arising during the audit that were discussed, or were the subject of correspondence, with management. (Ref: par. .A41)
- c. the auditor's views about significant matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultation has occurred.
- d. written representations the auditor is requesting. (Ref: par. .A42)

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

The Communication Process

Establishing the Communication Process

.15 The auditor should communicate with those charged with governance the form, timing, and expected general content of communications. (Ref: par. .A43–.A47)

Forms of Communication

.16 The auditor should communicate in writing with those charged with governance significant findings or issues from the audit (see paragraphs .12–.14) if, in the auditor's professional judgment, oral communication would not be adequate. This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved. (Ref: par. .A48–.A50)

.17 If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should communicate any omitted or inadequately described matters to those charged with governance. The auditor does not need to communicate them at the same level of detail as management, as long as the auditor (a) participated in management's discussion with those charged with governance, and (b) affirmatively confirmed to those charged with governance that management has adequately communicated these matters. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Restricted Use

.18 When the auditor communicates matters in accordance with this section in writing, the communication is considered a by-product report.¹

¹ Paragraphs .06c and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Accordingly, the auditor should indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management, and is not intended to be, and should not be, used by anyone other than these specified parties. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Timing of Communications

.19 The auditor should communicate with those charged with governance on a timely basis. (Ref: par. .A51–.A52) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Adequacy of the Communication Process

.20 The auditor should evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor should evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence and should take appropriate action. (Ref: par. .A53–.A55) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Documentation

.21 When matters required to be communicated by this section have been communicated orally, the auditor should include them in the audit documentation, including when and to whom they were communicated.² When matters have been communicated in writing, the auditor should retain a copy of the communication as part of the audit documentation. If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should include a copy or summary of management's communications provided to those charged with governance in the audit documentation. (Ref: par. .A56) [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Application and Other Explanatory Material

Objectives

The Role of Communication (Ref: par. .05)

.A1 This section focuses primarily on communications from the auditor to those charged with governance. Nevertheless, effective two-way communication is important in assisting

- the auditor and those charged with governance in understanding matters related to the audit in context and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
- the auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with

² Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events.

- those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

.A2 Although the auditor is responsible for communicating specific matters in accordance with this section, management also has a responsibility to communicate matters of governance interest to those charged with governance. Communication by the auditor does not relieve management of this responsibility. Similarly, management's communication of these matters to those charged with governance does not relieve the auditor of the responsibility to also communicate them. However, communication of these matters by management may affect the form or timing of the auditor's communication.

.A3 Clear communication of specific matters required to be communicated by GAAS is an integral part of every audit. However, GAAS do not require the auditor to perform procedures specifically to identify other significant matters to communicate with those charged with governance.

Legal or Regulatory Restrictions on Communicating With Those Charged With Governance (Ref: par. .05)

.A4 Law or regulation may restrict the auditor's communication of certain matters with those charged with governance. For example, law or regulation may specifically prohibit a communication or other action that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.

.A5 In certain circumstances, the auditor may be required to report to a regulatory or enforcement body certain matters that have been communicated with those charged with governance. For example, *Government Auditing Standards* requires auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to such parties in certain circumstances.

Those Charged With Governance (Ref: par. .07)

.A6 Governance structures vary by entity, reflecting influences such as size and ownership characteristics. For example:

- In some entities, those charged with governance hold positions (for example, company directors) that are integral parts of the entity's legal structure. For other entities, a body that is not part of the entity is charged with governance, as with some government agencies.
- In some cases, some or all of those charged with governance also have management responsibilities. In others, those charged with governance and management are different people.
- Parties charged with governance of governmental entities may include members or staff of a legislative oversight committee, oversight bodies, or other parties contracting for the audit.

.A7 In most entities, governance is the collective responsibility of a governing body, such as a board of directors; a supervisory board; partners;

proprietors; a committee of management; trustees; or equivalent persons. In some smaller entities, however, one person may be charged with governance, such as the owner-manager, when there are no other owners, or a sole trustee. When governance is a collective responsibility, a subgroup, such as an audit committee or even an individual, may be charged with specific tasks to assist the governing body in meeting its responsibilities.

.A8 Such diversity means that it is not possible for this section to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the engagement circumstances. An example of this is entities in which the governance structures are not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. When the appropriate person(s) with whom to communicate is not clearly identifiable, the auditor and the engaging party may need to discuss and agree on the relevant person(s) within the entity's governance structure with whom the auditor will communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

.A9 Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, includes specific matters to be communicated by group auditors with those charged with governance.³ When the entity being audited is a component of a group, the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

Communication With the Audit Committee or Other Subgroup of Those Charged With Governance (Ref: par. .08)

.A10 When considering communicating with a subgroup of those charged with governance, the auditor may take into account matters such as

- the respective responsibilities of the subgroup and the governing body.
- the nature of the matter to be communicated.
- relevant legal or regulatory requirements.
- whether the subgroup (a) has the authority to take action regarding the information communicated and (b) can provide further information and explanations the auditor may need.
- whether the auditor is aware of potential conflicts of interest between the subgroup and other members of the governing body.

.A11 When deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the auditor may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor may make explicit in the terms of the engagement that the auditor retains the right to communicate directly with the governing body.

³ Paragraphs .46–.49 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

.A12 Audit committees (or similar subgroups with different names) exist in many entities. Although the specific authority and functions of audit committees may differ, communication with the audit committee, when one exists, is a key element in the auditor's communication with those charged with governance. Good governance principles suggest that

- the auditor has access to the audit committee as necessary.
- the chair of the audit committee and, when relevant, the other members of the audit committee meet with the auditor periodically.
- the audit committee meets with the auditor without management present at least annually, unless prohibited by law or regulation.

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit (Ref: par. .10)

.A13 The auditor's responsibilities with regard to the financial statement audit are often included in the engagement letter or other suitable form of written agreement that documents the terms of the engagement. Law, regulation, or the governance structure of the entity may require those charged with governance to agree upon the terms of the engagement with the auditor. When this is not the case, providing those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them regarding matters such as the following:

- That the auditor is responsible for performing the audit in accordance with GAAS, which are directed toward the expression of an opinion on the financial statements. The matters that GAAS require to be communicated, therefore, include significant matters arising during the audit of the financial statements that are relevant to those charged with governance in overseeing the financial reporting process.
- The fact that GAAS do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.
- That, when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the auditor is responsible for determining and communicating key audit matters in the auditor's report.
- That, when applicable, the auditor is also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement.

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

Auditor Independence (Ref: par. .10)

.A14 GAAS require independence for all audits. Relevant matters to consider in reaching a conclusion about independence include circumstances or relationships that create threats to auditor independence and the related safeguards that have been applied to eliminate those threats or reduce them to an

acceptable level. Comprehensive material on threats to independence and safeguards, including application to specific situations, is set forth in the AICPA's "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A15 Although the auditor's report affirms the auditor's independence, in certain situations, the auditor may determine that it is appropriate to communicate with those charged with governance circumstances or relationships (for example, financial interests, business or family relationships, or nonaudit services provided or expected to be provided) that, in the auditor's professional judgment, may reasonably be thought to bear on independence, and to which the auditor gave significant consideration, in reaching the conclusion that independence has not been impaired.

.A16 It may be particularly appropriate to communicate with those charged with governance those circumstances or relationships discussed in paragraph .A15 in audits of public interest entities. In addition to entities subject to Securities and Exchange Commission reporting requirements, all of the entities described in the definition of public interest entities in ET section 0.400, *Definitions*, are considered to be public interest entities. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A17 Relevant ethical requirements may also specify particular communications to those charged with governance in circumstances in which breaches of independence requirements have been identified. For example, the AICPA Code of Professional Conduct requires the auditor to communicate with those charged with governance in writing about any breach and the action the firm has taken or proposes to take.⁴ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A18 The form and timing of communications regarding independence may be affected by the entity's governance structure and whether a formal subgroup, such as an audit committee, exists. In situations in which all of those charged with governance are involved in managing the entity, the auditor may determine that those charged with governance have been informed of relevant facts regarding the auditor's independence through their management activities or through other means, such as the engagement letter. This is particularly likely when the entity is owner-managed and the auditor's firm has little involvement with the entity beyond a financial statement audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Planned Scope and Timing of the Audit (Ref: par. .11)

.A19 Communication regarding the planned scope and timing of the audit may assist

- those charged with governance to discuss issues of risk and materiality with the auditor;
- those charged with governance to understand better the consequences of the auditor's work and to identify any areas in which

⁴ The "Breach of an Independence Interpretation" interpretation (ET sec. 1.298.010), under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct, addresses breaches of independence. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

they may request the auditor to undertake additional procedures;
and

- the auditor to understand better the entity and its environment.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A20 Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A21 Other matters regarding the planned scope and timing of the audit may include the following:

- How the auditor plans to address the significant risks of material misstatement, whether due to fraud or error
- How the auditor plans to address areas of higher assessed risks of material misstatement.
- The auditor's approach to internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting
- The application of materiality in the context of an audit, as discussed in section 320, *Materiality in Planning and Performing an Audit*. The auditor may wish to focus more broadly on the factors considered by the auditor when determining materiality for purposes of the audit, rather than on specific thresholds or amounts.
- The nature and extent of specialized skills or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor's expert.⁵
- When section 701 applies, the auditor's preliminary views about matters that may be areas of significant auditor attention in the audit and that therefore may be key audit matters.
- The auditor's planned approach to addressing the implications for the individual statements and the disclosures of any significant changes within the applicable financial reporting framework or in the entity's environment, financial condition, or activities.
- If the entity has an internal audit function, how the auditor and the internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function in obtaining audit evidence and the nature and extent of any planned use of internal auditors to provide direct assistance.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁵ See section 620, *Using the Work of an Auditor's Specialist*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A22 Other planning matters that may be appropriate to discuss with those charged with governance include

- the views of those charged with governance about the following matters:
 - The appropriate person(s) in the entity's governance structure with whom to communicate
 - The allocation of responsibilities between those charged with governance and management
 - The entity's objectives and strategies and the related business risks that may result in material misstatements
 - Matters those charged with governance consider as warranting particular attention during the audit and any areas for which they request additional procedures to be undertaken
 - Significant communications between the entity and regulators
 - Other matters those charged with governance believe are relevant to the audit of the financial statements
- the attitudes, awareness, and actions of those charged with governance concerning
 - the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and
 - the detection or the possibility of fraud.
- the actions of those charged with governance in response to developments in law, accounting standards, corporate governance practices, and other related matters, and the effect of such developments on, for example, the overall presentation, structure, and content of the financial statements, including the following:
 - The relevance, reliability, comparability, and understandability of the information presented in the financial statements
 - Whether all required information has been included in the financial statements, and whether such information has been appropriately classified, aggregated or disaggregated, and presented
- the actions of those charged with governance in response to previous communications with the auditor.
- if applicable, the document or documents that comprise the annual report and the planned manner and timing of the issuance of such documents in accordance with paragraph .13 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. When the auditor expects to obtain other information after the date of the auditor's report, the discussions with those charged with governance may also include the actions that may be appropriate or necessary if the auditor concludes that a material misstatement of the other information exists.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

.A23 Although communication with those charged with governance may assist the auditor to plan the scope and timing of the audit, it does not change the auditor's sole responsibility to establish the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A24 Care is necessary when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly when some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable. Certain factors described in paragraph .A48 may be relevant in determining the nature and extent of this communication. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Significant Findings From the Audit (Ref: par. .12)

.A25 The communication of significant findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A26 When section 701 applies, the communications with those charged with governance required by paragraph .12, as well as the communication about the significant risks identified by the auditor required by paragraph .11, are particularly relevant to the auditor's determination of matters that required significant auditor attention and that therefore may be key audit matters.⁶ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Qualitative Aspects of the Entity's Significant Accounting Practices (Ref: par. .12a)

.A27 Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures, for example, the use of key assumptions in the development of accounting estimates for which there is significant measurement uncertainty. In addition, law, regulation, or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective, or complex judgments made by management in preparing the financial statements. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁶ Paragraphs .08–.09 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A28 As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph .A27, those charged with governance may be interested in the auditor's evaluation of the adequacy of disclosures of the estimation uncertainty relating to accounting estimates that give rise to significant risks and the quality of the disclosures. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may also include comment on the acceptability of significant accounting practices and the quality of the disclosures. The appendix, "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A29 Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. In communicating with those charged with governance about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates, the auditor may consider communicating

- the nature of significant assumptions,
- the degree of subjectivity involved in the development of the assumptions, and
- the relative materiality of the items being measured to the financial statements as a whole.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Significant Unusual Transactions (Ref: par. .12b)

.A30 The communication of significant unusual transactions may include

- the auditor's views on the policies and practices management used to account for significant unusual transactions; and
- the auditor's understanding of the business purpose for significant unusual transactions.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Significant Difficulties Encountered During the Audit (Ref: par. .12c)

.A31 Significant difficulties encountered during the audit may include matters such as

- significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary to perform the auditor's procedures.
- an unreasonably brief time within which to complete the audit.
- extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- the unavailability of expected information.
- restrictions imposed on the auditor by management.

- management's unwillingness to perform or extend its evaluation of the entity's ability to continue as a going concern to meet the period of time required by the applicable financial reporting framework when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Disagreements With Management (Ref: par. .12d)

.A32 Discussions with those charged with governance include any disagreements with management that arose during the audit, regardless of whether they were satisfactorily resolved, about matters that, individually or in the aggregate, could be significant to the entity's financial statements or the auditor's report. Disagreements with management may occasionally arise over, among other things, the application of accounting principles to the entity's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements may also arise regarding the scope of the audit, disclosures to be included in the entity's financial statements, and the wording of the auditor's report. For purposes of this section, disagreements do not include differences of opinion based on incomplete facts or preliminary information that are later resolved. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Circumstances That Affect the Form and Content of the Auditor's Report (Ref: par. .12e)

.A33 Section 210A, *Terms of Engagement*, requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate.⁷ The agreed terms of the audit engagement are required to be recorded in an audit engagement letter or other suitable form of written agreement and include, among other things, reference to the expected form and content of the auditor's report.⁸ As explained in paragraph .A13, if the terms of engagement are not agreed upon with those charged with governance, the auditor may provide those charged with governance with a copy of the engagement letter in order to communicate about matters relevant to the audit. The communication required by paragraph .12e is intended to inform those charged with governance about circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit that was performed. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A34 Circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with GAAS, and for which communication with those charged with governance is required, include the following:

⁷ Paragraph .09 of section 210A, *Terms of Engagement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁸ Paragraph .10 of section 210A. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- The auditor expects to modify the opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.⁹
- A "Going Concern" section is included in the auditor's report in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.¹⁰
- Key audit matters are communicated in accordance with section 701.¹¹
- The auditor considers it necessary to include an emphasis-of-matter paragraph or other-matter paragraph in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*,¹² or is required to do so by other AU-C sections.

In such circumstances, the auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate a discussion of how such matters will be addressed in the auditor's report. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Other Findings or Issues

.A35 The auditor may become aware that the entity is subject to an audit requirement that is not encompassed in the terms of the engagement. The communication to those charged with governance that an audit conducted in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements may be necessary if, for example, an entity engages an auditor to perform an audit of its financial statements in accordance with GAAS and the auditor becomes aware that by law, regulation, or contractual agreement the entity also is required to have an audit performed in accordance with one or more of the following:

- Government Auditing Standards*
- Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administration Requirements, Cost Principles, Audit Requirements for Federal Awards*
- Other compliance audit requirements, such as state or local laws or program-specific audits under federal audit guides

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Other Significant Matters Relevant to the Financial Reporting Process (Ref: par. .12g)

⁹ Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁰ Paragraphs .24 and .28 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹¹ Paragraph .16 of section 701. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹² Paragraph .12 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A36 Section 300, *Planning an Audit*,¹³ notes that, as a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and, thereby, the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The auditor may communicate with those charged with governance about such matters as, for example, an update to initial discussions about the planned scope and timing of the audit. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A37 To the extent not already addressed by the requirements in paragraph .12a–f and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.¹⁴ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Uncorrected Misstatements (Ref: par. .13)

.A38 The auditor is not required to accumulate misstatements that the auditor believes are trivial.¹⁵ When there are a large number of individually immaterial uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the uncorrected misstatements, rather than the details of each individual uncorrected misstatement. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A39 The auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, taking into account the size and nature of the misstatement judged in the surrounding circumstances, and possible implications with regard to future financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Corrected Misstatements (Ref: par. .14a)

.A40 The auditor also may communicate corrected immaterial misstatements, such as frequently recurring immaterial misstatements that may indicate a particular bias in the preparation of the financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Significant Findings or Issues Discussed or Subject to Correspondence With Management (Ref: par. .14b)

.A41 Significant findings or issues discussed, or the subject of correspondence, with management may include matters such as

¹³ Paragraph .A15 of section 300, *Planning an Audit*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁴ Paragraphs .21–.22 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁵ Paragraph .05 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

- significant events or transactions that occurred during the year.
- business conditions affecting the entity and business plans and strategies that may affect the risks of material misstatement.
- discussions or correspondence in connection with the initial or recurring engagement of the auditor including, among other matters, any discussions or correspondence regarding accounting practices or the application of auditing standards.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Written Representations (Ref: par. .14d)

.A42 The auditor may provide those charged with governance with a copy of management's written representations. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

The Communication Process

Establishing the Communication Process (Ref: par. .15)

.A43 Clear communication of the following helps establish the basis for effective two-way communication:

- The auditor's responsibilities (paragraphs .10 and .A13–.A17)
- An overview of the planned scope and timing of the audit (paragraphs .11 and .A18–.A22)
- The expected general content of communications

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A44 Matters that may also contribute to effective two-way communication include discussion of

- the purpose of communications. When the purpose is clear, the auditor and those charged with governance are in a better position to have a mutual understanding of relevant issues and the expected actions arising from the communication process.
- the form in which communications will be made.
- the person(s) on the audit team and among those charged with governance who will communicate regarding particular matters.
- the auditor's expectation that communication will be two-way and that those charged with governance will communicate with the auditor matters they consider relevant to the audit. Such matters might include (a) strategic decisions that may significantly affect the nature, timing, and extent of audit procedures; (b) the suspicion or the detection of fraud; or (c) concerns with the integrity or competence of senior management.
- the process for taking action and reporting back on matters communicated by the auditor.
- the process for taking action and reporting back on matters communicated by those charged with governance.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A45 The communication process will vary with the circumstances, including the size and governance structure of the entity, how those charged with governance operate, and the auditor's view of the significance of matters to be communicated. Difficulty in establishing effective two-way communication may indicate that the communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraph .A53). [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Communication With Management

.A46 Many matters may be discussed with management in the ordinary course of an audit, including matters to be communicated with those charged with governance in accordance with this section. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the preparation and fair presentation of the financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A47 Before communicating matters with those charged with governance, the auditor may discuss them with management unless that is inappropriate. For example, it may not be appropriate to discuss with management questions of management's competence or integrity. In addition to recognizing management's responsibility, these initial discussions may clarify facts and issues and give management an opportunity to provide further information and explanations. Similarly, when the entity has an internal audit function, the auditor may discuss matters with appropriate individuals within the function before communicating with those charged with governance. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Forms of Communication (Ref: par. .16)

.A48 Effective communication may involve formal presentations and written reports as well as less formal communications, including discussions. The auditor may communicate matters other than those identified in paragraph .16 either orally or in writing. Written communications may include an engagement letter that is provided to those charged with governance. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A49 In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a formal or informal manner) may be affected by factors such as

- whether a discussion of the matter will be included in the auditor's report. (For example, when key audit matters are communicated in the auditor's report, the auditor may consider it necessary to communicate in writing about the matters determined to be key audit matters.)
- whether the matter has been satisfactorily resolved.
- whether management has previously communicated the matter.

- the size, operating structure, control environment, and legal structure of the entity being audited.
- in the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.
- legal or regulatory requirements that may require a written communication with those charged with governance.
- the expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- the amount of ongoing contact and dialogue the auditor has with those charged with governance.
- whether there have been significant changes in the membership of a governing body.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A50 When a significant matter is discussed with an individual member of those charged with governance, such as the chair of an audit committee, it may be appropriate for the auditor to summarize the matter in later communications so that all of those charged with governance have full and balanced information. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Timing of Communications (Ref: par. .19)

.A51 Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, the importance of the matter to those charged with governance, and the action expected to be taken by those charged with governance. The following are examples of the timing of communications for certain matters:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- It may be appropriate to communicate significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.
- When section 701 applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.

The following are examples of matters for which communication with those charged with governance may be important prior to issuance of the auditor's report:

- Uncorrected misstatements accumulated by the auditor and the effect that they may have, individually or in the aggregate, on the opinion in the auditor's report, including possible implications with respect to future financial statements
- Circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired
- Significant findings or issues from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices
- An expectation by the auditor that the opinion in the auditor's report will be modified in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*¹⁶
- When section 701 applies, the matters planned to be included in the auditor's report

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A52 Other factors that may be relevant to the timing of communications include

- the size, operating structure, control environment, and legal structure of the entity being audited.
- any legal obligation to communicate certain matters within a specified timeframe.
- the expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- the time at which the auditor identifies certain matters (for example, timely communication of a material weakness to enable appropriate remedial action to be taken).
- whether the auditor is auditing both general purpose and special purpose financial statements.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Adequacy of the Communication Process (Ref: par. .20)

.A53 The auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and those charged with governance. Rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include

- the appropriateness and timeliness of actions taken by those charged with governance in response to matters communicated

¹⁶ Paragraph .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

by the auditor. When significant findings or issues raised in previous communications have not been dealt with effectively, it may be appropriate for the auditor to inquire about why appropriate action has not been taken and to consider raising the point again. This avoids the risk of giving an impression that the auditor is satisfied that the matter has been adequately addressed or is no longer significant.

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

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A54 As discussed in paragraph .A1, effective two-way communication assists both the auditor and those charged with governance. Further, section 315A identifies participation by those charged with governance, including their interaction with the internal audit function (if any) and external auditors, as an element of the entity's control environment. Inadequate two-way communication may indicate an unsatisfactory control environment, which will influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A55 If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take actions such as the following:

- Modifying the auditor's opinion on the basis of a scope limitation
- Obtaining legal advice about the consequences of different courses of action
- Communicating with third parties (for example, a regulator) or a higher authority in the governance structure that is outside the entity, such as the owners of a business (for example, shareholders in a general meeting), or the responsible government agency for certain governmental entities
- Withdrawing from the engagement when withdrawal is possible under applicable law or regulation

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

Documentation (Ref: par. .21)

.A56 Documentation of oral communication may include a copy of minutes prepared by the entity as part of the audit documentation if those minutes are an appropriate record of the communication. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A57

Appendix — Qualitative Aspects of Accounting Practices

The communication required by paragraph .12a and discussed in paragraphs .A27–.A29 may include such matters as the following:

Accounting Policies

- The appropriateness of the accounting policies to the particular circumstances of the entity, considering the need to balance the cost of providing information with the likely benefit to users of the entity's financial statements (when acceptable alternative accounting policies exist, the communication may include identification of the financial statement items that are affected by the choice of significant policies as well as information on accounting policies used by similar entities)
- The initial selection of, and changes in, significant accounting policies, including the application of new accounting pronouncements (the communication may include the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity, and the timing of a change in accounting policies with regard to expected new accounting pronouncements)
- The effect of significant accounting policies in controversial or emerging areas (or those unique to an industry, particularly when there is a lack of authoritative material or consensus)
- The effect of the timing of transactions in relation to the period in which they are recorded

Accounting Estimates

- For items for which estimates are significant, issues discussed in section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, including the following examples:
 - Management's identification of accounting estimates
 - Management's process for making accounting estimates
 - Risks of material misstatement
 - Indicators of possible management bias
 - Disclosure of estimation uncertainty in the financial statements

Financial Statement Disclosures

- The issues involved, and related judgments made, in formulating particularly sensitive financial statement disclosures (for example, disclosures related to revenue recognition, going concern, subsequent events, and contingency issues)
- The overall neutrality, consistency, and clarity of the disclosures in the financial statements

Related Matters

- The potential effect on the financial statements of significant risks and exposures and uncertainties, such as pending litigation, that are disclosed in the financial statements
- The extent to which the financial statements are affected by unusual transactions, including nonrecurring amounts recognized during the period, and the extent to which such transactions are separately disclosed in the financial statements
- The factors affecting asset and liability carrying values, including the entity's bases for determining useful lives assigned to tangible and intangible assets (the communication may explain how factors affecting carrying values were selected and how alternative selections would have affected the financial statements)
- The selective correction of misstatements (for example, correcting misstatements with the effect of increasing reported earnings, but not those that have the effect of decreasing reported earnings)

[Paragraph renumbered by the issuance of SAS No. 134, May 2019. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019.]

.A58

Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

- a. paragraph .17 of section 210A, *Terms of Engagement*
- b. paragraphs .21, .38*i*, and .39–.41 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- c. paragraphs .14, .18, and .21–.23 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- d. paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- e. paragraph .27 of section 550, *Related Parties*
- f. paragraphs .10*b*–*c*, .12*a*, .15*a*, .17*a*, and .18 of section 560, *Subsequent Events and Subsequently Discovered Facts*
- g. paragraph .28 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- h. paragraphs .46–.49 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- i. paragraph .28 of section 610, *Using the Work of Internal Auditors*
- j. paragraph .16 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- k. paragraphs .12, .14, .24, and .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*
- l. paragraph .12 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*
- m. paragraphs .15, .20*b*, and .21*a* of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- n. paragraph .06 of section 730, *Required Supplementary Information*
- o. paragraphs .23–.28 of section 930, *Interim Financial Information*
- p. paragraphs .36–.37 of section 935, *Compliance Audits*

[Revised, September 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph subsequently renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

AU-C Section 265

Communicating Internal Control Related Matters Identified in an Audit

Source: SAS No. 122; SAS No. 125; SAS No. 128; SAS No. 130; SAS No. 135.

See section 9265 for interpretations of this section.

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

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. This section does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control or designing and performing tests of controls over and above the requirements of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. Section 260, *The Auditor's Communication With Those Charged With Governance*, establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance regarding the audit.

.02 The auditor is required to obtain an understanding of internal control relevant to the audit when identifying and assessing the risks of material misstatement.¹ In making those risk assessments, the auditor considers internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify deficiencies in internal control not only during this risk assessment process but also at any other stage

¹ Paragraph .13 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. Paragraphs .A61–.A67 of section 315A provide guidance on obtaining an understanding of internal control relevant to the audit.

of the audit. This section specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management.

.03 Nothing in this section precludes the auditor from communicating to those charged with governance or management other internal control matters that the auditor has identified during the audit.

.04 This section is not applicable if the auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements. In such circumstances, section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, applies. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Revised, December 2016, to reflect conforming changes necessary to reflect the issuance of SAS No. 130.]

Effective Date

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

Objective

.06 The objective of the auditor is to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgment, are of sufficient importance to merit their respective attentions.

Definitions

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

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

Material weakness. A deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Probable. The future event or events are likely to occur.

Significant deficiency. A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Requirements

Determination of Whether Deficiencies in Internal Control Have Been Identified

.08 The auditor should determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. (Ref: par. .A1–.A4)

Evaluating Identified Deficiencies in Internal Control (Ref: par. .A5–.A14)

.09 If the auditor has identified one or more deficiencies in internal control, the auditor should evaluate each deficiency to determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies or material weaknesses.

.10 If the auditor initially determines that a deficiency, or a combination of deficiencies, in internal control is not a material weakness, the auditor should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Communication of Deficiencies in Internal Control

.11 The auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit. (Ref: par. .A15–.A20 and .A28)

.12 The auditor also should communicate to management at an appropriate level of responsibility, on a timely basis (Ref: par. .A21 and .A28)

- a. in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances. (Ref: par. .A16 and .A22–.A23)
- b. in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. If other deficiencies in internal control are communicated orally, the auditor should document the communication. (Ref: par. .A24–.A27)

.13 The communications referred to in paragraphs .11–.12 should be made no later than 60 days following the report release date. (Ref: par. .A16–.A17)

.14 The auditor should include in the auditor's written communication of significant deficiencies and material weaknesses (Ref: par. .A29–.A33)

- a. the definition of the term *material weakness* and, when relevant, the definition of the term *significant deficiency*.

- b. a description of the significant deficiencies and material weaknesses and an explanation of their potential effects. (Ref: par. .A29)
- c. sufficient information to enable those charged with governance and management to understand the context of the communication. In particular, the auditor should include in the communication the following elements that explain that (Ref: par. .A30–.A31)
 - i. the purpose of the audit was for the auditor to express an opinion on the financial statements.
 - ii. the audit included consideration of internal control over financial reporting in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control.
 - iii. the auditor is not expressing an opinion on the effectiveness of internal control.
 - iv. the auditor's consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified.
- d. an appropriate alert, in accordance with section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.² (Ref: par. .A32)

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

.15 When the auditor issues a written communication stating that no material weaknesses were identified during the audit, the communication should include the matters in paragraph .14a and c–d. (Ref: par. .A34–.A36)

.16 The auditor should not issue a written communication stating that no significant deficiencies were identified during the audit. (Ref: par. .A34)

Application and Other Explanatory Material

Determination of Whether Deficiencies in Internal Control Have Been Identified (Ref: par. .08)

.A1 In determining whether the auditor has identified one or more deficiencies in internal control, the auditor may discuss the relevant facts and circumstances of the auditor's findings with the appropriate level of management. This discussion provides an opportunity for the auditor to alert management on a timely basis to the existence of deficiencies of which management may not have been previously aware. The level of management with whom it is appropriate to discuss the findings is one that is familiar with the internal control area concerned and that has the authority to take remedial action on any identified deficiencies in internal control. In some circumstances, it may not be appropriate for the auditor to discuss the auditor's findings directly with management

² Paragraphs .06c, .07, and .11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

(for example, if the findings appear to call management's integrity or competence into question [see paragraph .A22]).

.A2 In discussing the facts and circumstances of the auditor's findings with management, the auditor may obtain other relevant information for further consideration, such as

- management's understanding of the actual or suspected causes of the deficiencies.
- exceptions arising from the deficiencies that management may have noted (for example, misstatements that were not prevented by the relevant IT controls).
- a preliminary indication from management of its response to the findings.

Considerations Specific to Smaller, Less Complex Entities

.A3 Although the concepts underlying control activities in smaller entities are likely to be similar to those in larger entities, the formality with which controls operate will vary. Further, smaller entities may find that certain types of control activities are not necessary because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for more detailed control activities.

.A4 Also, smaller entities often have fewer employees, which may limit the extent to which segregation of duties is practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. On the other hand, such increased management oversight also may increase the risk of management override of controls.

Evaluating Identified Deficiencies in Internal Control (Ref: par. .09–.10)

.A5 The severity of a deficiency, or a combination of deficiencies, in internal control depends not only on whether a misstatement has actually occurred but also on

- the magnitude of the potential misstatement resulting from the deficiency or deficiencies and
- whether there is a reasonable possibility that the entity's controls will fail to prevent, or detect and correct, a misstatement of an account balance or disclosure.

Significant deficiencies and material weaknesses may exist even though the auditor has not identified misstatements during the audit. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

.A6 Factors that affect the magnitude of a misstatement that might result from a deficiency, or deficiencies, in internal control include, but are not limited to, the following:

- The financial statement amounts or total of transactions exposed to the deficiency
- The volume of activity (in the current period or expected in future periods) in the class of transactions or account balance exposed to the deficiency

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

.A7 In evaluating the magnitude of the potential misstatement, the maximum amount by which an account balance or total of transactions can be overstated generally is the recorded amount, whereas understatements could be larger.

.A8 Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in internal control will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following:

- The nature of the financial statement classes of transactions, account balances, disclosures, and assertions involved
- The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in internal control
- The susceptibility of the related asset or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control(s) with other controls
- The interaction with other deficiencies in internal control
- The possible future consequences of the deficiency, or deficiencies, in internal control
- The importance of the controls, such as the following, to the financial reporting process:
 - General monitoring controls (such as oversight of management)
 - Controls over the prevention and detection of fraud
 - Controls over the selection and application of significant accounting policies
 - Controls over significant transactions with related parties
 - Controls over significant unusual transactions
 - Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A9 The evaluation of whether a deficiency in internal control presents a reasonable possibility of misstatement may be made without quantifying the probability of occurrence as a specific percentage or range. Also, in many cases, the probability of a small misstatement will be greater than the probability of a large misstatement.

.A10 Controls may be designed to operate individually, or in combination, to effectively prevent, or detect and correct, misstatements.³ For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency or a material

³ Paragraph .A68 of section 315A. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

weakness. However, a combination of deficiencies affecting the same class of transactions, account balance, or disclosure, relevant assertion, or component of internal control may increase the risks of misstatement to such an extent to give rise to a significant deficiency or material weakness. [As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

.A11 Indicators of material weaknesses in internal control include

- identification of fraud, whether or not material, on the part of senior management. For the purpose of this indicator, the term "senior management" includes the principal executive and financial officers as well as any other members of senior management who play a significant role in the entity's financial reporting process;
- restatement of previously issued financial statements to reflect the correction of a material misstatement due to fraud or error;
- identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's internal control; and
- ineffective oversight of the entity's financial reporting and internal control by those charged with governance.

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Considerations Specific to Governmental Entities

.A12 Law or regulation may require the auditor to communicate to those charged with governance or other relevant parties (such as regulators) deficiencies in internal control that the auditor has identified during the audit using specific terms and definitions that differ from those in this section. In such circumstances, the auditor uses such terms and definitions when communicating deficiencies in internal control in accordance with the requirements of the law or regulation and in accordance with this section.

.A13 When law or regulation requires the auditor to communicate deficiencies in internal control that the auditor has identified during the audit using specific terms, but such terms have not been defined, the auditor may use the definitions, requirements, and guidance in this section to comply with the law or regulation.

.A14 The requirements of this section remain applicable, notwithstanding that law or regulation may require the auditor to use specific terms or definitions.

Communication of Deficiencies in Internal Control (Ref: par. .11–.16)

Communication of Significant Deficiencies and Material Weaknesses to Those Charged With Governance (Ref: par. .11)

.A15 Communicating significant deficiencies and material weaknesses in writing to those charged with governance reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities. Section 260 establishes relevant considerations regarding

communication with those charged with governance when all of them are involved in managing the entity.⁴

.A16 Although the auditor is required by paragraph .13 to make the communications referred to in paragraphs .11–.12 no later than 60 days following the report release date, the communication is best made by the report release date because receipt of such communication may be an important factor in enabling those charged with governance to discharge their oversight responsibilities. Nevertheless, because the auditor's written communication of significant deficiencies and material weaknesses forms part of the final audit file, the written communication is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis, no later than 60 days following the report release date.⁵

.A17 Early communication to those charged with governance or management may be important for some matters because of their relative significance and the urgency for corrective follow-up action. Regardless of the timing of the written communication of significant deficiencies and material weaknesses, the auditor may communicate these orally in the first instance to management and, when appropriate, those charged with governance to assist them in taking timely remedial action to minimize the risks of material misstatement. However, oral communication does not relieve the auditor of the responsibility to communicate the significant deficiencies and material weaknesses in writing, as this section requires.

.A18 The level of detail at which to communicate significant deficiencies and material weaknesses is a matter of the auditor's professional judgment in the circumstances. Factors that the auditor may consider in determining an appropriate level of detail for the communication include, for example, the following:

- The nature of the entity. For example, the communication required for a governmental entity may be different from that for a non-governmental entity.
- The size and complexity of the entity. For example, the communication required for a complex entity may be different from that for an entity operating a simple business.
- The nature of significant deficiencies and material weaknesses that the auditor has identified.
- The entity's governance composition. For example, more detail may be needed if those charged with governance include members who do not have significant experience in the entity's industry or in the affected areas.
- Legal or regulatory requirements regarding the communication of specific types of deficiencies in internal control.

.A19 Management and those charged with governance may already be aware of significant deficiencies and material weaknesses that the auditor has identified during the audit and may have chosen not to remedy them because of cost or other considerations. The responsibility for evaluating the costs and benefits of implementing remedial action rests with management and those

⁴ Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

⁵ Paragraph .16 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

charged with governance. Accordingly, the requirements to communicate significant deficiencies and material weaknesses in paragraphs .11–.12 apply, regardless of cost or other considerations that management and those charged with governance may consider relevant in determining whether to remedy such deficiencies.

.A20 The fact that the auditor communicated a significant deficiency or material weakness to those charged with governance and management in a previous audit does not eliminate the need for the auditor to repeat the communication if remedial action has not yet been taken. If a previously communicated significant deficiency or material weakness remains, the current year's communication may repeat the description from the previous communication or simply reference the previous communication and the date of that communication. The auditor may ask management or, when appropriate, those charged with governance why the significant deficiency or material weakness has not yet been remedied. A failure to act, in the absence of a rational explanation, may in itself represent a significant deficiency or material weakness.

Communication of Deficiencies in Internal Control to Management
(Ref: par. .12)

.A21 Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the deficiencies in internal control and to take the necessary remedial action. For significant deficiencies and material weaknesses, the appropriate level is likely to be the CEO or CFO (or equivalent) because these matters also are required to be communicated to those charged with governance. For other deficiencies in internal control, the appropriate level may be operational management with more direct involvement in the control areas affected and with the authority to take appropriate remedial action.

Communication of Significant Deficiencies and Material Weaknesses in Internal Control to Management (Ref: par. .12a)

.A22 Certain identified significant deficiencies or material weaknesses in internal control may call into question the integrity or competence of management. For example, there may be evidence of fraud or intentional noncompliance with laws and regulations by management or management may exhibit an inability to oversee the preparation of adequate financial statements, which may raise doubt about management's competence. Accordingly, it may not be appropriate to communicate such deficiencies directly to management.

.A23 Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, establishes requirements and provides guidance on the reporting of identified or suspected noncompliance with laws and regulations, including when those charged with governance are themselves involved in such noncompliance.⁶ Section 240, *Consideration of Fraud in a Financial Statement Audit*, establishes requirements and provides guidance regarding communication to those charged with governance when the auditor has identified fraud or suspected fraud involving management.⁷

Communication of Other Deficiencies in Internal Control to Management (Ref: par. .12b)

.A24 During the audit, the auditor may identify other deficiencies in internal control that are not significant deficiencies or material weaknesses but

⁶ Paragraphs .21–.27 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

⁷ Paragraph .40 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

that may be of sufficient importance to merit management's attention. The determination regarding which other deficiencies in internal control merit management's attention is a matter of the auditor's professional judgment in the circumstances, taking into account the likelihood and potential magnitude of misstatements that may arise in the financial statements as a result of those deficiencies.

.A25 The communication of other deficiencies in internal control that merit management's attention need not be in writing. When the auditor has discussed the facts and circumstances of the auditor's findings with management, the auditor may consider an oral communication of the other deficiencies to have been made to management at the time of these discussions. Accordingly, a formal communication need not be made subsequently.

.A26 If the auditor has communicated deficiencies in internal control, other than significant deficiencies or material weaknesses, to management in a prior period and management has chosen not to remedy them for cost or other reasons, the auditor need not repeat the communication in the current period. The auditor also is not required to repeat information about such deficiencies if the information has been previously communicated to management by other parties, such as the internal audit function or regulators. However, the auditor may consider it appropriate to recommunicate these other deficiencies if there has been a change of management or if new information has come to the auditor's attention that alters the prior understanding of the auditor and management regarding the deficiencies. Nevertheless, the failure of management to remedy other deficiencies in internal control that were previously communicated may become a significant deficiency requiring communication with those charged with governance. Whether this is the case depends on the auditor's professional judgment in the circumstances. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A27 In some circumstances, those charged with governance may wish to be made aware of the details of other deficiencies in internal control that the auditor has communicated to management or be briefly informed of the nature of the other deficiencies. Alternatively, the auditor may inform those charged with governance when a communication of other deficiencies has been made to management. In either case, the auditor may communicate orally or in writing to those charged with governance, as appropriate.

Considerations Specific to Governmental Entities (Ref: par. .11–.12)

.A28 Auditors performing audits of governmental entities may have additional responsibilities to communicate deficiencies in internal control that the auditor identified during the audit, in a different format, at a level of detail or to parties not envisioned in this section. For example, significant deficiencies and material weaknesses may have to be communicated to a governmental authority, and such communications may be required to be made publicly available. Law or regulation also may require auditors to report deficiencies in internal control, irrespective of their severity. Further, law or regulation may require auditors to report on broader internal control-related matters (for example, controls related to compliance with law, regulation, or provisions of contracts or grant agreements).⁸

⁸ See section 935, *Compliance Audits*. [Footnote renumbered by the issuance of SAS No. 125, December 2011.]

Content of Written Communication of Significant Deficiencies and Material Weaknesses in Internal Control (Ref: par. .14–.16)

.A29 In explaining the potential effects of the significant deficiencies and material weaknesses, the auditor need not quantify those effects. The potential effects may be described in terms of the control objectives and types of errors the control was designed to prevent, or detect and correct, or in terms of the risk(s) of misstatement that the control was designed to address. The potential effects may be evident from the description of the significant deficiencies or material weaknesses.

.A30 The significant deficiencies or material weaknesses may be grouped together for reporting purposes when it is appropriate to do so. The auditor also may include in the written communication suggestions for remedial action on the deficiencies, management's actual or proposed responses, and a statement about whether the auditor has undertaken any steps to verify whether management's responses have been implemented (see paragraph .A33).

.A31 The auditor may consider it appropriate to include the following information as additional context for the communication:

- The general inherent limitations of internal control, including the possibility of management override of controls
- The specific nature and extent of the auditor's consideration of internal control during the audit

Restriction on Use (Ref: par. .14d)

.A32 In certain cases not involving *Government Auditing Standards*, law or regulation may require the auditor or management to furnish a copy of the auditor's written communication on significant deficiencies and material weaknesses to governmental authorities. When this is the case, the auditor's written communication may identify such governmental authorities in the paragraph containing the alert that restricts the use of the auditor's written communication. Section 905 does not permit the auditor to add parties, other than those identified in paragraph .07b of that section.⁹ [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Management's Written Response

.A33 Management may wish to or may be required by a regulator to prepare a written response to the auditor's communication regarding significant deficiencies or material weaknesses identified during the audit. Such management communications may include a description of corrective actions taken by the entity, the entity's plans to implement new controls, or a statement indicating that management believes the cost of correcting a significant deficiency or material weakness would exceed the benefits to be derived from doing so. If such a written response is included in a document containing the auditor's written communication to management and those charged with governance concerning identified significant deficiencies or material weaknesses, the auditor may add a paragraph to the written communication disclaiming an opinion on such information. The following is an example of such a paragraph:

ABC Company's written response to the significant deficiencies [and material weaknesses] identified in our audit was not subjected to the auditing procedures

⁹ Paragraph .08 of section 905. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

applied in the audit of the financial statements and, accordingly, we express no opinion on it.

No Material Weakness Communications (Ref: par. .15–.16)

.A34 Management or those charged with governance may request a written communication indicating that no material weaknesses were identified during the audit. A written communication indicating that no material weaknesses were identified during the audit does not provide any assurance about the effectiveness of an entity's internal control over financial reporting. However, an auditor is not precluded from issuing such a communication, provided that the communication includes the matters required by paragraph .15. However, a written communication indicating that no significant deficiencies were identified during the audit is precluded by paragraph .16 because such a communication has the potential to be misunderstood or misused.

.A35 Exhibit B, "Illustrative No Material Weakness Communication," includes an illustrative communication indicating that no material weaknesses were identified during the audit.

Considerations Specific to Governmental Entities

.A36 A written communication indicating that no material weaknesses were identified during the audit may be required to be furnished to governmental authorities. As described in paragraph .A32, the auditor's written communication may identify the governmental authority as a specified party in the restricted use paragraph. The auditor is not permitted to add other parties as specified parties.

.A37

Appendix—Examples of Circumstances That May Be Deficiencies, Significant Deficiencies, or Material Weaknesses

Paragraph .A11 identifies indicators of material weaknesses in internal control. The following are examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses.

Deficiencies in the Design of Controls

The following are examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses related to the design of controls:

- Inadequate design of controls over the preparation of the financial statements being audited.
- Inadequate design of controls over a significant account or process.
- Inadequate documentation of the components of internal control.
- Insufficient control consciousness within the organization (for example, the tone at the top and the control environment).
- Evidence of ineffective aspects of the control environment, such as indications that significant transactions in which management is financially interested are not being appropriately scrutinized by those charged with governance.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (for example, absence of controls over such a risk).
- Absent or inadequate segregation of duties within a significant account or process.
- Absent or inadequate controls over the safeguarding of assets (this applies to controls that the auditor determines would be necessary for effective internal control over financial reporting).
- Inadequate design of IT general and application controls that prevents the information system from providing complete and accurate information consistent with financial reporting objectives and current needs.
- Employees or management who lack the qualifications and training to fulfill their assigned functions. For example, in an entity that prepares financial statements in accordance with generally accepted accounting principles (GAAP), the person responsible for the accounting and reporting function lacks the skills and knowledge to apply GAAP in recording the entity's financial transactions or preparing its financial statements.
- Inadequate design of monitoring controls used to assess the design and operating effectiveness of the entity's internal control over time.

- Absence of an internal process to report deficiencies in internal control to management on a timely basis.
- Absence of a risk assessment process within the entity when such a process would ordinarily be expected to have been established.

Failures in the Operation of Controls

The following are examples of circumstances that may be deficiencies, significant deficiencies, or material weaknesses related to the operation of controls:

- Failure in the operation of effectively designed controls over a significant account or process (for example, the failure of a control such as dual authorization for significant disbursements within the purchasing process).
- Failure of the information and communication component of internal control to provide complete and accurate output because of deficiencies in timeliness, completeness, or accuracy (for example, the failure to obtain timely and accurate consolidating information from remote locations that is needed to prepare the financial statements).
- Failure of controls designed to safeguard assets from loss, damage, or misappropriation. This circumstance may need careful consideration before it is evaluated as a significant deficiency or material weakness. For example, assume that a company uses security devices to safeguard its inventory (preventive controls) and also performs timely periodic physical inventory counts (detective control) with regard to its financial reporting. Although the physical inventory count does not safeguard the inventory from theft or loss, it prevents a material misstatement of the financial statements if performed effectively and timely. Therefore, given that the definitions of *material weakness* and *significant deficiency* relate to the likelihood of misstatement of the financial statements, the failure of a preventive control, such as inventory tags, will not result in a significant deficiency or material weakness if the detective control (physical inventory counts) prevents a misstatement of the financial statements. Material weaknesses relating to controls over the safeguarding of assets would only exist if the company does not have effective controls (considering both safeguarding and other controls) to prevent, or detect and correct, a material misstatement of the financial statements.
- Failure to perform reconciliations of significant accounts. For example, accounts receivable subsidiary ledgers are not reconciled to the general ledger account in a timely or accurate manner.
- Undue bias or lack of objectivity by those responsible for accounting decisions (for example, consistent understatement of expenses or overstatement of allowances at the direction of management).
- Misrepresentation by entity personnel to the auditor (an indicator of fraud).
- Management override of controls.
- Failure of an application control caused by a deficiency in the design or operation of an IT general control.

- An observed deviation rate that exceeds the number of deviations expected by the auditor in a test of the operating effectiveness of a control. For example, if the auditor designs a test in which he or she selects a sample and expects no deviations, the finding of one deviation is a nonnegligible deviation rate because based on the results of the auditor's test of the sample, the desired level of confidence was not obtained.

.A38

Exhibit A—Illustrative Auditor's Written Communication

The following is an illustrative auditor's written communication encompassing the requirements in paragraph .14.

To Management and *[identify the body or individuals charged with governance, such as the entity's Board of Directors]* of ABC Company

In planning and performing our audit of the financial statements of ABC Company (the "Company") as of and for the year ended December 31, 20XX, in accordance with auditing standards generally accepted in the United States of America, we considered the Company's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be *[material weaknesses or material weaknesses or significant deficiencies]* and therefore, *[material weaknesses or material weaknesses or significant deficiencies]* may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be *[material weaknesses or significant deficiencies or material weaknesses and significant deficiencies]*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. *[We consider the following deficiencies in the Company's internal control to be material weaknesses:]*

[Describe the material weaknesses that were identified and an explanation of their potential effects.]

[A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Company's internal control to be significant deficiencies:]

[Describe the significant deficiencies that were identified and an explanation of their potential effects.]

[If the auditor is communicating significant deficiencies and did not identify any material weaknesses, the auditor may state that none of the identified significant deficiencies are considered to be material weaknesses.]

This communication is intended solely for the information and use of management, *[identify the body or individuals charged with governance]*, others within the organization, and *[identify any governmental authorities to which*

the auditor is required to report] and is not intended to be, and should not be, used by anyone other than these specified parties.¹

[Auditor's signature]

[Auditor's city and state]

[Date]

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

¹ When the engagement is also performed in accordance with *Government Auditing Standards*, the alert required by paragraph .14d may read as follows: "The purpose of this communication is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide *Government Auditing Standards and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

.A39

Exhibit B—Illustrative No Material Weakness Communication

The following is an illustrative auditor's written communication indicating that no material weaknesses were identified during the audit of a not-for-profit organization.

To Management and *[identify the body or individuals charged with governance, such as the entity's Board of Directors]* of NPO Organization

In planning and performing our audit of the financial statements of NPO Organization (the "Organization") as of and for the year ended December 31, 20XX, in accordance with auditing standards generally accepted in the United States of America, we considered the Organization's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

[If one or more significant deficiencies have been identified, the auditor may add the following: Our audit was also not designed to identify deficiencies in internal control that might be significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We communicated the significant deficiencies identified during our audit in a separate communication dated [date].]

This communication is intended solely for the information and use of management, *[identify the body or individuals charged with governance]*, others within the organization, and *[identify any governmental authorities to which the auditor is required to report]* and is not intended to be, and should not be, used by anyone other than these specified parties.¹

¹ When the engagement is also performed in accordance with *Government Auditing Standards*, the alert required by paragraph .14d may read as follows: "The purpose of this communication is solely to describe the scope of our testing of internal control over financial reporting and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide *Government Auditing Standards and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports. [Footnote added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

[Auditor's signature]

[Auditor's city and state]

[Date]

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

AU-C Section 9265***Communicating Internal Control Related Matters Identified in an Audit: Auditing Interpretations of Section 265*****1. Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Participants in Office of Management and Budget Single Audit Pilot Project**

.01 Question—On October 7, 2009, the Office of Management and Budget (OMB) published the parameters of a pilot project, which is a collaborative effort between volunteer nonfederal entities expending American Recovery and Reinvestment Act of 2009 (ARRA) awards (auditees), the auditors performing compliance audits of auditees with ARRA expenditures under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the federal government. For auditees that volunteer, the pilot project requires their auditors to issue to management an early written communication of significant deficiencies and material weaknesses in internal control over compliance at an interim date, prior to the completion of the compliance audit. Such communication would be based on internal control work performed on specified compliance requirements for two major programs with ARRA expenditures chosen from a list of approved ARRA pilot project programs. This communication also would be required to be submitted by management to the cognizant agency for audit. May an auditor issue such an interim communication in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*?

.02 Interpretation—Yes. Section 265 permits an auditor to communicate to management identified significant deficiencies and material weaknesses before the completion of a financial statement audit. It would be equally appropriate for a compliance audit. Regardless of how the early communication is delivered, the auditor should communicate all significant deficiencies and material weaknesses in writing to management and those charged with governance in accordance with section 265.¹

.03 The following is an illustrative communication that an auditor may use to comply with the pilot project communication requirement to inform management and those charged with governance of deficiencies in internal control over compliance related to ARRA funding that have been identified at an interim date prior to the completion of the compliance audit and are, or likely to be, in the auditor's judgment, significant deficiencies or material weaknesses in internal control over compliance:

This communication is provided pursuant to the parameters of the 2009 Office of Management and Budget (OMB) pilot project. Such project requires auditors

¹ Paragraphs .11–.13 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

of entities that volunteer for the project to issue, in writing, an early communication of significant deficiencies and material weaknesses in internal control over compliance for certain federal programs having expenditures of American Recovery and Reinvestment Act of 2009 (ARRA) funding at an interim date, prior to the completion of the compliance audit. Accordingly, this communication is based on our audit procedures performed through [insert "as of date"], an interim period. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit through [insert "as of date"] of [identify the federal programs selected to be tested as a major program from the federal list of approved ARRA pilot project programs], we are considering [Example Entity's] compliance with [list the applicable types of compliance requirements subject to the communication requirement in the pilot project (for example, activities allowed or unallowed, allowable costs and cost principles, cash management, eligibility, reporting, and special tests and provisions)] as described in the *OMB Circular A-133 Compliance Supplement* for the year ended June 30, 2009. We are also considering [Example Entity's] internal control over compliance with the requirements previously described that could have a direct and material effect on [identify the federal programs selected to be tested as a major program from the federal list of approved ARRA pilot project programs] in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the [Example Entity's] internal control over compliance.

Our consideration of internal control over compliance is for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraph. However, as discussed subsequently, based on the audit procedures performed through [insert "as of date"], we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement² of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control

² Under Section 510(a)(1) of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, the auditor's determination of whether a deficiency in internal control over compliance is a material weakness or significant deficiency for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the *OMB Circular A-133 Compliance Supplement* (the *Compliance Supplement*). This reference to "type of compliance requirement" refers to the 14 types of compliance requirements (identified as A-N) described in part 3 of the *Compliance Supplement*. For purposes of reporting audit findings, auditors are alerted that certain of the types of compliance requirements may include multiple compliance requirements with multiple audit objectives (for example, compliance requirement "G" covers 3 separate requirements—matching, level of effort, and earmarking; and "N" covers separate requirements specific to each individual special test and provision).

over compliance, such that there is a reasonable possibility that material non-compliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiencies in internal control over compliance to be material weaknesses:

[Describe the material weaknesses that were identified either here or by reference to a separate schedule.]³

A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in internal control over compliance to be significant deficiencies:

[Describe the significant deficiencies that were identified either here or by reference to a separate schedule.]⁴

[Example Entity's] responses to our findings are described [insert either "in the preceding paragraph" or "in the accompanying schedule"]. We did not audit [Example Entity's] responses and, accordingly, we express no opinion on the responses.⁵

This interim communication is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, [identify the legislative or regulatory body], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

[Issue Date: November 1994; Revised: March 2010; Revised: January 2012, effective for audits of financial statements for periods ending on or after December 15, 2012.]

2. Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Auditors That Are Not Participants in Office of Management and Budget Pilot Project

.04 Question—Part 6, "Internal Control," of the *OMB Circular A-133 Compliance Supplement* (the *Compliance Supplement*) stresses the importance of internal control testwork over major programs with ARRA expenditures and encourages early communication to management and those charged with governance of any significant deficiencies or material weaknesses in internal control:

³ The OMB pilot project requires the auditee, upon receipt of the interim communication from the auditor, to provide it to the federal cognizant agency for audit. Federal agencies are required to follow-up with the auditee concerning actions taken or needed to correct the finding. Therefore, to assist the federal agencies with this responsibility, significant deficiency and material weakness finding descriptions should include the level of detail required by both *Government Auditing Standards* and Section 510(b) of OMB Circular A-133. This would require the inclusion of, among other things, the views of responsible officials (see footnote 5).

⁴ See footnote 3.

⁵ The OMB pilot project requires the auditor to obtain management responses to the internal control matters identified and to include them in the interim communication.

Early communication by auditors to management, and those charged with governance, of identified control deficiencies related to ARRA funding that are, or likely to be, significant deficiencies or material weaknesses in internal control will allow management to expedite corrective action and mitigate the risk of improper expenditure of ARRA awards. Therefore, auditors are encouraged to promptly inform auditee management and those charged with governance during the audit engagement about control deficiencies related to ARRA funding that are, or likely to be, significant deficiencies or material weaknesses in internal control. The auditor should use professional judgment regarding the form of such interim communications.

.05 Although not required, if an auditor decides to make such a communication in writing at an interim date, may the auditor issue the interim communication in accordance with section 265?

.06 Interpretation—Yes. As noted in the previous question, section 265 permits an auditor to communicate to management and those charged with governance identified significant deficiencies and material weaknesses before the completion of a financial statement audit. It would be equally appropriate for a compliance audit. The auditor is reminded that, regardless of how the early communication is delivered, the auditor should communicate all significant deficiencies and material weaknesses in writing to management and those charged with governance in accordance with section 265.⁶

.07 If the auditor decides to make the interim communication encouraged in part 6 of the *Compliance Supplement* in writing, the following is an illustrative communication that an auditor may use to inform management and those charged with governance of deficiencies in internal control over compliance related to ARRA funding that have been identified at an interim date prior to the completion of the compliance audit and that are, or likely to be, in the auditor's judgment, significant deficiencies or material weaknesses in internal control:

This communication is provided pursuant to the *Office of Management and Budget (OMB) Circular A-133 Compliance Supplement*, which encourages auditors to communicate, at an interim date, control deficiencies related to federal programs with expenditures of American Recovery and Reinvestment Act of 2009 (ARRA) funding that are, or likely to be, significant deficiencies or material weaknesses in internal control over compliance. Accordingly, this communication is based on our audit procedures performed through [insert "as of date"], an interim period. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit through [insert "as of date"] of [identify the federal programs with ARRA expenditures selected by the auditor to be tested as a major program], we are considering [Example Entity's] compliance with the applicable types of compliance requirements as described in the *OMB Circular A-133 Compliance Supplement* for the year ended June 30, 20XX. We are also considering [Example Entity's] internal control over compliance with the requirements previously described that could have a direct and material effect on [identify the federal programs with ARRA expenditures selected by the auditor to be tested as a major program] in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test

⁶ See footnote 1.

and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the [Example Entity's] internal control over compliance.

Our consideration of internal control over compliance is for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraph. However, as discussed subsequently, based on the audit procedures performed through [insert "as of date"], we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A *deficiency in internal control* over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement⁷ of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiencies in internal control over compliance to be material weaknesses:

[Describe the material weaknesses that were identified either here or by reference to a separate schedule.]

A *significant deficiency* in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in internal control over compliance to be significant deficiencies:

[Describe the significant deficiencies that were identified either here or by reference to a separate schedule.]

This interim communication is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the entity, [identify the legislative or regulatory body], federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

[Issue Date: November 2009; Revised: March 2010; Revised: January 2012, effective for audits of financial statements for periods ending on or after December 15, 2012.]

3. Appropriateness of Identifying No Significant Deficiencies or No Material Weaknesses in an Interim Communication

.08 Question—In either of the previously described scenarios, may the auditor issue an interim communication in accordance with section 265 stating that as of the interim communication date, no significant deficiencies or material weaknesses have been noted?

⁷ See footnote 2.

.09 Interpretation—No. Section 265 states that the auditor should not issue a written communication stating that no significant deficiencies were identified during the audit.⁸ Such guidance would also apply to the interim communication contemplated in the previous two questions. Therefore, it would not be appropriate for an auditor to issue an interim communication stating that no significant deficiencies were identified.

.10 Although section 265 would permit the auditor to issue a communication at the end of an audit stating that no material weaknesses were identified by the auditor, it would not be appropriate for an auditor to do so at an interim date.⁹ Making such a communication at an interim date could lead to misinterpretation by management and those charged with governance, that there are no identified material weaknesses when, in fact, material weaknesses could be identified before completion of the compliance audit.

[Issue Date: November 2009; Revised: March 2010; Revised: January 2012, effective for audits of financial statements for periods ending on or after December 15, 2012.]

⁸ Paragraph .16 of section 265.

⁹ Paragraph .15 of section 265.

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AU-C Section 300

Planning an Audit

Source: SAS No. 122; SAS No. 128; SAS No. 134.

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

NOTE

In October 2021, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to plan an audit of financial statements. This section is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified in this section. Matters related to planning audits of group financial statements are addressed in section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. (Ref: par. A1–A3)

The Role and Timing of Planning

.02 Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

- Helping the auditor identify and devote appropriate attention to important areas of the audit
- Helping the auditor identify and resolve potential problems on a timely basis

- Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner
- Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks and allocating team member responsibilities
- Facilitating the direction and supervision of engagement team members and the review of their work
- Assisting, when applicable, in coordination of work done by auditors of components and specialists

Effective Date

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

Objective

.04 The objective of the auditor is to plan the audit so that it will be performed in an effective manner.

Requirements

Involvement of Key Engagement Team Members

.05 The engagement partner and other key members of the engagement team should be involved in planning the audit, including planning and participating in the discussion among engagement team members. (Ref: par. .A4–.A5)

Preliminary Engagement Activities

.06 The auditor should undertake the following activities at the beginning of the current audit engagement:

- a. Performing procedures required by section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, regarding the continuance of the client relationship and the specific audit engagement
- b. Evaluating compliance with relevant ethical requirements in accordance with section 220A
- c. Establishing an understanding of the terms of the engagement as required by section 210A, *Terms of Engagement* (Ref: par. .A6–.A8)

Planning Activities

.07 The auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit and that guides the development of the audit plan.

.08 In establishing the overall audit strategy, the auditor should

- a. identify the characteristics of the engagement that define its scope;

- b. ascertain the reporting objectives of the engagement in order to plan the timing of the audit and the nature of the communications required;
- c. consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- d. consider the results of preliminary engagement activities and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- e. ascertain the nature, timing, and extent of resources necessary to perform the engagement. (Ref: par. .A9–.A13)

.09 The auditor should develop an audit plan that includes a description of the following:

- a. The nature and extent of planned risk assessment procedures, as determined under section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- b. The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- c. Other planned audit procedures that are required to be carried out so that the engagement complies with generally accepted auditing standards (Ref: par. .A14–.A16)

.10 The auditor should update and change the overall audit strategy and audit plan, as necessary, during the course of the audit. (Ref: par. .A17)

.11 The auditor should plan the nature, timing, and extent of direction and supervision of engagement team members and the review of their work. (Ref: par. .A18–.A19)

Determining the Extent of Involvement of Professionals Possessing Specialized Skills

.12 The auditor should consider whether specialized skills are needed in performing the audit. If specialized skills are needed, the auditor should seek the assistance of a professional possessing such skills, who either may be on the auditor's staff or an outside professional.¹ In such circumstances, the auditor should have sufficient knowledge to communicate the objectives of the other professional's work; evaluate whether the specified audit procedures will meet the auditor's objectives; and evaluate the results of the audit procedures applied as they relate to the nature, timing, and extent of further planned audit procedures. Section 620, *Using the Work of an Auditor's Specialist*, addresses the auditor's use of the work of specialists in an audit. (Ref: par. .A20–.A21)

Additional Considerations in Initial Audit Engagements

.13 The auditor should undertake the following activities prior to starting an initial audit:

- a. Performing procedures required by section 220A

¹ Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- b. Communicating with the predecessor auditor when there has been a change of auditors, in accordance with section 210A² (Ref: par. .A22)

Documentation

.14 The auditor should include in the audit documentation the following:³

- a. The overall audit strategy
- b. The audit plan
- c. Any significant changes made during the audit engagement to the overall audit strategy or the audit plan and the reasons for such changes (Ref: par. .A23–.A26)

Application and Other Explanatory Material

The Role and Timing of Planning (Ref: par. .01)

.A1 The nature and extent of planning activities will vary according to the size and complexity of the entity, the key engagement team members' previous experience with the entity, and changes in circumstances that occur during the audit engagement.

.A2 Planning is not a discrete phase of an audit but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as the following:

- The analytical procedures to be applied as risk assessment procedures
- A general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework
- The determination of materiality
- The involvement of specialists
- The performance of other risk assessment procedures

.A3 The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement (for example, to coordinate some of the planned audit procedures with the work of the entity's personnel). Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor's responsibility. When discussing matters included in the overall audit strategy or audit plan, care is required in order not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed audit procedures with management may compromise the effectiveness of the audit by making the audit procedures too predictable.

² Paragraph .11 of section 210A, *Terms of Engagement*.

³ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

Involvement of Key Engagement Team Members (Ref: par. .05)

.A4 The involvement of the engagement partner and other key members of the engagement team in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The engagement partner may delegate portions of the planning and supervision of the audit to other firm personnel.

.A5 Section 315A requires a discussion among the audit team about the susceptibility of the entity's financial statements to material misstatement.⁴ This discussion also may include the discussion regarding the risks of material misstatement due to fraud, as required by section 240, *Consideration of Fraud in a Financial Statement Audit*.⁵ The objective of this discussion is for members of the audit team to gain a better understanding of the potential for material misstatements of the financial statements resulting from fraud or error in the specific areas assigned to them and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing, and extent of further audit procedures.

Preliminary Engagement Activities (Ref: par. .06)

.A6 Performing the preliminary engagement activities, which are specified in paragraph .06, at the beginning of the current audit engagement assists the auditor in identifying and evaluating events or circumstances that may adversely affect the auditor's ability to plan and perform the audit engagement.

.A7 Performing these preliminary engagement activities enables the auditor to plan an audit engagement for which, for example

- the auditor maintains the necessary independence and ability to perform the engagement.
- the auditor has no issues with management integrity that may affect the auditor's willingness to continue the engagement.
- the auditor has no misunderstanding with the entity about the terms of the engagement.

.A8 The auditor's consideration of client continuance and relevant ethical requirements, including independence, occurs throughout the audit engagement as conditions and changes in circumstances occur. Performing initial procedures on both client continuance and evaluation of relevant ethical requirements (including independence) at the beginning of the current audit engagement means that they are completed prior to the performance of other significant activities for the current audit engagement. For continuing audit engagements, such initial procedures often begin shortly after (or in connection with) the completion of the previous audit.

Planning Activities

The Overall Audit Strategy (Ref: par. .07–.08)

.A9 The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as the following:

⁴ Paragraph .11 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁵ Paragraph .15 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of specialists on complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of component auditors' work in the case of group audits, or the audit budget (in hours) to allocate to high risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are managed, directed, and supervised, such as when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, on site or off site), and whether to complete engagement quality control reviews

.A10 The appendix, "Considerations in Establishing the Overall Audit Strategy," lists examples of considerations in establishing the overall audit strategy.

.A11 Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes but are closely interrelated because changes in one may result in consequential changes to the other.

Considerations Specific to Smaller, Less Complex Entities

.A12 In audits of smaller entities, the entire audit may be conducted by a very small audit team. Many audits of smaller entities involve the engagement partner (who may be a sole practitioner) working with one engagement team member (or without any engagement team members). With a smaller team, coordination of, and communication between, team members is easier. Establishing the overall audit strategy for the audit of a smaller entity need not be a complex or time consuming exercise; it varies according to the size and complexity of the entity, the complexity of the audit, and the size of the engagement team. For example, a brief memorandum prepared at the completion of the previous audit, based on a review of the working papers and highlighting issues identified in the audit just completed, updated in the current period, based on discussions with the owner-manager, can serve as the documented audit strategy for the current audit engagement if it covers the matters noted in paragraph .07.

Communications With Those Charged With Governance

.A13 Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit.⁶

The Audit Plan (Ref: par. .09)

.A14 The audit plan is more detailed than the overall audit strategy in that it includes the nature, timing, and extent of audit procedures to be performed

⁶ Paragraph .11 of section 260, *The Auditor's Communication With Those Charged With Governance*.

by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing, and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances, and disclosures before planning all remaining further audit procedures.

.A15 Determining the nature, timing, and extent of planned risk assessment procedures, and further audit procedures, as they relate to disclosures is important in light of both the wide range of information and the level of detail that may be encompassed in those disclosures. Further, certain disclosures may contain information that is obtained from outside of the general and subsidiary ledgers, which may also affect the assessed risks and the nature, timing, and extent of audit procedures to address them. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A16 Consideration of disclosures early in the audit assists the auditor in giving appropriate attention to, and planning adequate time for, addressing disclosures in the same way as classes of transactions, events, and account balances are addressed. Early consideration may also help the auditor to determine the effects on the audit of the following:

- Significant new or revised disclosures required as a result of changes in the entity's environment, financial condition, or activities (for example, disclosures about discontinued operations or a significant business combination)
- Significant new or revised disclosures arising from changes in the applicable financial reporting framework
- The need for the involvement of an auditor's expert to assist with audit procedures related to particular disclosures (for example, disclosures related to pension or other retirement benefit obligations)
- Matters relating to disclosures that the auditor may wish to discuss with those charged with governance⁷

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

Changes to Planning Decisions During the Course of the Audit (Ref: par. .10)

.A17 As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and, thereby, the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

⁷ Paragraph .A13 of section 260. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Direction, Supervision, and Review (Ref: par. .11)

.A18 The nature, timing, and extent of the direction and supervision of engagement team members and review of their work vary, depending on many factors, including the following:

- The size and complexity of the entity
- The area of the audit
- The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members and a more detailed review of their work)
- The capabilities and competence of the individual team members performing the audit work

Section 220A contains further guidance on the direction, supervision, and review of audit work. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A19 If an audit is carried out entirely by the engagement partner, questions of direction and supervision of engagement team members and review of their work do not arise. In such cases, the engagement partner, having personally conducted all aspects of the work, will be aware of all material issues. Forming an objective view on the appropriateness of the judgments made in the course of the audit can present practical problems when the same individual also performs the entire audit. If particularly complex or unusual issues are involved and the audit is performed by a sole practitioner, it may be desirable to consult with other suitably experienced auditors or the auditor's professional body. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Determining the Extent of Involvement of Professionals Possessing Specialized Skills (Ref: par. .12)

.A20 An auditor may decide to seek the assistance of a professional with specialized skills necessary to complete various aspects of the engagement. These professionals may include valuation experts, appraisers, actuaries, tax specialists, and IT professionals. For example, the use of professionals possessing IT skills to determine the effect of IT on the audit, understand the IT controls, or design and perform tests of IT controls or substantive procedures is a significant aspect of many audit engagements. In determining whether such a professional is needed on the audit team, the auditor may consider such factors as the following:

- The complexity of the entity's systems and IT controls and the manner in which they are used in conducting the entity's business
- The significance of changes made to existing systems or the implementation of new systems
- The extent to which data is shared among systems
- The extent of the entity's participation in electronic commerce
- The entity's use of emerging technologies
- The significance of audit evidence that is available only in electronic form

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A21 Audit procedures that the auditor may assign to a professional possessing IT skills include inquiring of an entity's IT personnel how data and transactions are initiated, authorized, recorded, processed, and reported and how IT controls are designed; inspecting systems documentation; observing the operation of IT controls; and planning and performing tests of IT controls. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Additional Considerations in Initial Audit Engagements (Ref: par. .13)

.A22 The purpose and objective of planning the audit are the same whether the audit is an initial or recurring engagement. However, for an initial audit, the auditor may need to expand the planning activities because the auditor does not ordinarily have the previous experience with the entity that is considered when planning recurring engagements. For an initial audit engagement, additional matters the auditor may consider in establishing the overall audit strategy and audit plan include the following:

- Arrangements to be made with the predecessor auditor (for example, to review the predecessor auditor's working papers [see section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*])⁸
- Any major issues (including the application of accounting principles or auditing and reporting standards) discussed with management in connection with the initial selection as auditor, the communication of these matters to those charged with governance, and how these matters affect the overall audit strategy and audit plan
- The audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances (see section 510)⁹
- Other procedures required by the firm's system of quality control for initial audit engagements (for example, the firm's system of quality control may require the involvement of another partner or senior individual to review the overall audit strategy prior to commencing significant audit procedures or to review reports prior to their issuance)

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .14)

.A23 The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and communicate significant issues to the engagement team. For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing, and conduct of the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A24 The documentation of the audit plan is a record of the planned nature, timing, and extent of risk assessment procedures and further audit procedures at the relevant assertion level in response to the assessed risks. It also

⁸ Paragraphs .07 and .A2–.A11 of section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

⁹ Paragraph .08 of section 510. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs or audit completion checklists, tailored as needed to reflect the particular engagement circumstances. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A25 A record of the significant changes to the overall audit strategy and the audit plan and resulting changes to the planned nature, timing, and extent of audit procedures explain why the significant changes were made and why the overall strategy and audit plan were finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A26 As discussed in paragraph .A12, a suitable, brief memorandum may serve as the documented strategy for the audit of a smaller entity. For the audit plan, standard audit programs or checklists (see paragraph .A24) drawn up on the assumption of few relevant control activities, which is likely to be the case in a smaller entity, may be used, provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A27

Appendix — Considerations in Establishing the Overall Audit Strategy (Ref: par. .07–.08 and .A9–.A12)

This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters also will influence the auditor's detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other AU-C sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

Characteristics of the Engagement

The following are some examples of characteristics of the engagement:

- The financial reporting framework on which the financial information to be audited has been prepared, including any need for reconciliations to another financial reporting framework
- Industry specific reporting requirements, such as reports mandated by industry regulators
- The expected audit coverage, including the number and locations of components to be included
- The nature of the control relationships between a parent and its components that determine how the group is to be consolidated
- The extent to which components are audited by other auditors
- The nature of the business divisions to be audited, including the need for specialized knowledge
- The reporting currency to be used, including any need for currency translation for the audited financial information
- The need for statutory or regulatory audit requirements (for example, the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*)
- Whether the entity has an internal audit function and, if so, whether (in which areas and to what extent) the work of the internal audit function can be used in obtaining audit evidence or whether internal auditors can be used to provide direct assistance
- The entity's use of service organizations and how the auditor may obtain evidence concerning the design or operation of controls performed by them
- The expected use of audit evidence obtained in previous audits (for example, audit evidence related to risk assessment procedures and tests of controls)
- The effect of IT on the audit procedures, including the availability of data and the expected use of computer assisted audit techniques
- The coordination of the expected coverage and timing of the audit work with any reviews of interim financial information and the effect on the audit of the information obtained during such reviews
- The availability of client personnel and data

Reporting Objectives, Timing of the Audit, and Nature of Communications

The following examples illustrate reporting objectives, timing of the audit, and nature of communications:

- The entity's timetable for reporting, including interim periods
- The organization of meetings with management and those charged with governance to discuss the nature, timing, and extent of the audit work
- The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters, and communications to those charged with governance
- The discussion with management regarding the expected communications on the status of audit work throughout the engagement
- Communication with auditors of components regarding the expected types and timing of reports to be issued and other communications in connection with the audit of components
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed
- Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
 - The determination of materiality for components and communication thereof to component auditors in accordance with section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
 - The preliminary identification of significant components and material classes of transactions, account balances, and disclosures
- Preliminary identification of areas in which there may be a higher risk of material misstatement
- The effect of the assessed risk of material misstatement at the overall financial statement level on direction, supervision, and review
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and exercise

professional skepticism in gathering and evaluating audit evidence

- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity
- Evidence of management's commitment to the design, implementation, and maintenance of sound internal control, including evidence of appropriate documentation of such internal control
- Changes within the applicable financial reporting framework, such as changes in accounting standards, which may involve significant new or revised disclosures
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control
- Importance attached to internal control throughout the entity to the successful operation of the business
- The processes management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers
- Significant business developments affecting the entity, including changes in IT and business processes; changes in key management; and acquisitions, mergers, and divestments
- Significant industry developments, such as changes in industry regulations and new reporting requirements
- Other significant relevant developments, such as changes in the legal environment affecting the entity

Nature, Timing, and Extent of Resources

The following examples illustrate the nature, timing, and extent of resources:

- The selection of the engagement team (including, when necessary, the engagement quality control reviewer [see section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*]) and the assignment of audit work to the team members, including the assignment of appropriately experienced team members to areas in which there may be higher risks of material misstatement
- Engagement budgeting, including considering the appropriate amount of time to set aside for areas in which there may be higher risks of material misstatement

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

AU-C Section 315

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

(Supersedes SAS No. 122 section 315)

Source: SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2023.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements.

Key Concepts in This Section

.02 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, addresses the overall objectives of the auditor in conducting an audit of the financial statements, including to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.¹ Audit risk is a function of the risks of material misstatement and detection risk.² Section 200 explains that the risks of material misstatement may exist at two levels:³ the overall financial statement level and the assertion level for classes of transactions, account balances, and disclosures.

.03 Section 200 requires the auditor to exercise professional judgment in planning and performing an audit and to plan and perform an audit with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated.⁴

.04 Risks at the financial statement level relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of material misstatement at the assertion level consist of two components:⁵ inherent risk and control risk.

- *Inherent risk* is described as the susceptibility of an assertion about a class of transactions, account balance, or disclosure to a misstatement that could be material, either individually or when

¹ Paragraph .19 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

² Paragraph .14 of section 200.

³ Paragraph .A38 of section 200.

⁴ Paragraphs .17–.18 of section 200.

⁵ Paragraph .14 of section 200.

aggregated with other misstatements, before consideration of any related controls.

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

.05 Section 200 explains that risks of material misstatement are assessed at the assertion level in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. For purposes of generally accepted auditing standards (GAAS), a risk of material misstatement exists when (a) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (b) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).⁶ For the identified risks of material misstatement at the assertion level, a separate assessment of inherent risk and control risk is required by this section. As explained in section 200, inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. The degree to which the level of inherent risk varies is referred to in this section as the *spectrum of inherent risk*.

.06 Risks of material misstatement identified and assessed by the auditor include both those due to error and those due to fraud. Although both are addressed by this section, the significance of fraud is such that further requirements and guidance are included in section 240, *Consideration of Fraud in a Financial Statement Audit*, in relation to risk assessment procedures and related activities to obtain information that is used to identify, assess, and respond to the risks of material misstatement due to fraud.

.07 The auditor's risk identification and assessment process is iterative and dynamic. The auditor's understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control are interdependent with concepts within the requirements to identify and assess the risks of material misstatement. In obtaining the understanding required by this section, initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process. In addition, paragraph .41 of this section and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*,⁷ require the auditor to revise the risk assessments and modify further overall responses and further audit procedures, based on audit evidence obtained from performing further audit procedures in accordance with section 330, or if new information is obtained.

.08 Section 330 requires the auditor to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.⁸ Section 330 further explains that the auditor's assessment of the risks of material misstatement at the financial statement level, and the auditor's overall responses, is affected by the auditor's understanding of the control environment. Section 330 also requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on

⁶ Paragraphs .A41–.A43 of section 200 and paragraph .07 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

⁷ Paragraph .27 of section 330.

⁸ Paragraph .05 of section 330.

and are responsive to the assessed risks of material misstatement at the relevant assertion level.⁹

Scalability

.09 Section 200 states that some AU-C sections include scalability considerations, which illustrate the application of the requirements to all entities, regardless of whether their nature and circumstances are less complex or more complex.¹⁰ This section is intended for audits of all entities, regardless of size or complexity; therefore, the application material incorporates considerations specific to both less and more complex entities, where appropriate. Although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex.

Effective Date

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2023.

Objective

.11 The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Definitions

.12 For purposes of GAAS, the following terms have the meanings attributed:

Assertions. Representations, explicit or otherwise, with respect to the recognition, measurement, presentation, and disclosure of information in the financial statements, which are inherent in management, representing that the financial statements are prepared in accordance with the applicable financial reporting framework. Assertions are used by the auditor to consider the different types of potential misstatements that may occur when identifying, assessing, and responding to the risks of material misstatement. (Ref: par. .A1)

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

Controls. Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance. In this context (Ref: par. .A2–.A5)

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

⁹ Paragraph .06 of section 330.

¹⁰ Paragraph .A68 of section 200.

General information technology (IT) controls. Controls over the entity's IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information-processing controls and the integrity of information in the entity's information system. Also see **IT environment**. (Ref: par. A6)

Information-processing controls. Controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information. (Ref: par. A7–.A8)

Inherent risk factors. Characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors¹¹ insofar as they affect inherent risk.

Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as *the spectrum of inherent risk*. (Ref: par. A9–.A11, A238–.A244)

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

- i. an *IT application* is a program or a set of programs that is used in the initiation, processing, recording, and reporting of transactions or information. IT applications include data warehouses and report writers.
- ii. the IT infrastructure comprises the network, operating systems, and databases and their related hardware and software.
- iii. the IT processes are the entity's processes to manage access to the IT environment, manage program changes or changes to the IT environment, and manage IT operations.

Relevant assertions. An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement. A risk of material misstatement exists when (a) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (b) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).¹² The determination of whether an assertion is a relevant assertion is made before consideration of any related controls (that is, the determination is based on inherent risk). (Ref: par. A12)

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

¹¹ Paragraphs A28–.A32 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

¹² Paragraphs A41–.A43 of section 200 and paragraph .07 of section 330.

due to ineffective design or operation of controls in the entity's IT processes. See **IT environment**. (Ref: par. .A6 and .A13)

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

Significant class of transactions, account balance, or disclosure. A class of transactions, account balance, or disclosure for which there is one or more relevant assertions. (Ref: par. .A14)

Significant risk. An identified risk of material misstatement (Ref: par. .A15)

- i. for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or
- ii. that is to be treated as a significant risk in accordance with the requirements of other AU-C sections.¹³

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

- i. Control environment
 - ii. The entity's risk assessment process
 - iii. The entity's process to monitor the system of internal control
 - iv. The information system and communication
 - v. Control activities
- (Ref: par. .A16)

Requirements

Risk Assessment Procedures and Related Activities

.13 The auditor should design and perform risk assessment procedures to obtain audit evidence that provides an appropriate basis for (Ref: par. .A17–.A24)

- a. the identification and assessment of risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels, and
- b. the design of further audit procedures in accordance with section 330.

¹³ Paragraph .27 of section 240 and paragraph .20 of section 550, *Related Parties*.

The auditor should design and perform risk assessment procedures in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory.

.14 The risk assessment procedures should include the following: (Ref: par. .A25–.A27)

- a. Inquiries of management and of other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) (Ref: par. .A28–.A32)
- b. Analytical procedures (Ref: par. .A33–.A37)
- c. Observation and inspection (Ref: par. .A38–.A42)

Information From Other Sources

.15 In obtaining audit evidence in accordance with paragraph .13, the auditor should consider information from (Ref: par. .A43–.A44)

- a. the auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement, and
- b. when applicable, other engagements performed by the engagement partner for the entity.

.16 When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor should evaluate whether such information remains relevant and reliable as audit evidence for the current audit. (Ref: par. .A45–.A47)

Engagement Team Discussion

.17 The engagement partner and other key engagement team members should discuss the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement. (Ref: par. .A48–.A54)

.18 When there are engagement team members not involved in the engagement team discussion, the engagement partner should determine which matters are to be communicated to those members.

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: par. .A55–.A57)

Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework (Ref: par. .A58–.A63)

.19 The auditor should perform risk assessment procedures to obtain an understanding of

- a. the following aspects of the entity and its environment:
 - i. The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT (Ref: par. .A64–.A77)
 - ii. Industry, regulatory, and other external factors (Ref: par. .A78–.A82)

- iii. The measures used, internally and externally, to assess the entity's financial performance (Ref: par. .A83–.A90)
- b. the applicable financial reporting framework and the entity's accounting policies and the reasons for any changes thereto. (Ref: par. .A91–.A93)
- c. how inherent risk factors affect the susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable financial reporting framework, based on the understanding obtained in subparagraphs *a–b*. (Ref: par. .A94–.A99)

.20 The auditor should evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework.

Understanding the Components of the Entity's System of Internal Control
(Ref: par. .A100–.A111)

Control Environment, the Entity's Risk Assessment Process, and the Entity's Process to Monitor the System of Internal Control (Ref: par. .A112–.A114)

Control Environment

.21 The auditor should, through performing risk assessment procedures, obtain an understanding of the control environment relevant to the preparation of the financial statements by (Ref: par. .A115–.A116)

- a. understanding the set of controls, processes, and structures that address (Ref: par. .A117)
 - i. how management's oversight responsibilities are carried out, such as the entity's culture and management's commitment to integrity and ethical values;
 - ii. when those charged with governance are separate from management, the independence of, and oversight over the entity's system of internal control by, those charged with governance;
 - iii. the entity's assignment of authority and responsibility;
 - iv. how the entity attracts, develops, and retains competent individuals;
 - v. how the entity holds individuals accountable for their responsibilities in the pursuit of the objectives of the system of internal control; and
- b. evaluating, based on the auditor's understanding obtained in paragraph .21a, whether (Ref: par. .A118–.A123)
 - i. management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior;
 - ii. the control environment provides an appropriate foundation for the other components of the entity's system of internal control considering the nature and complexity of the entity; and
 - iii. control deficiencies identified in the control environment undermine the other components of the entity's system of internal control

The Entity's Risk Assessment Process

.22 The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's risk assessment process relevant to the preparation of the financial statements by

- a. understanding the entity's process for (Ref: par. .A124–.A126)
 - i. identifying business risks, including the potential for fraud, relevant to financial reporting objectives; (Ref: par. .A71)
 - ii. assessing the significance of those risks, including the likelihood of their occurrence;
 - iii. addressing those risks; and
- b. evaluating, based on the auditor's understanding obtained in paragraph .22a, whether the entity's risk assessment process is appropriate to the entity's circumstances considering the nature and complexity of the entity. (Ref: par. .A127–.A129)

.23 If the auditor identifies risks of material misstatement that management failed to identify, the auditor should

- a. determine whether any such risks are of a kind that the auditor expects would have been identified by the entity's risk assessment process and, if so, obtain an understanding of why the entity's risk assessment process failed to identify such risks of material misstatement; and
- b. consider the implications for the auditor's evaluation in paragraph .22b.

The Entity's Process for Monitoring the System of Internal Control

.24 The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's process for monitoring the system of internal control relevant to the preparation of the financial statements by (Ref: par. .A130–.A131)

- a. understanding those aspects of the entity's process that address
 - i. ongoing and separate evaluations for monitoring the effectiveness of controls and the identification and remediation of control deficiencies identified (Ref: par. .A132–.A133) and
 - ii. the entity's internal audit function, if any, including its nature, responsibilities, and activities (Ref: par. .A134–.A135).
- b. understanding the sources of the information used in the entity's process to monitor the system of internal control, and the basis upon which management considers the information to be sufficiently reliable for the purpose (Ref: par. .A136–.A137).
- c. evaluating, based on the auditor's understanding obtained in paragraph .24a–b, whether the entity's process for monitoring the system of internal control is appropriate to the entity's circumstances considering the nature and complexity of the entity (Ref: par. .A138–.A139).

Information System and Communication, and Control Activities (Ref: par. .A140–.A147)

The Information System and Communication

.25 The auditor should, through performing risk assessment procedures, obtain an understanding of the entity's information system and communication relevant to the preparation of the financial statements by (Ref: par. .A148–.A149)

- a. understanding the entity's information-processing activities, including its data and information, the resources to be used in such activities and the policies that define, for significant classes of transactions, account balances, and disclosures (Ref: par. .A150–.A162)
 - i. how information flows through the entity's information system, including how
 - (1) transactions are initiated, and how information about them is recorded, processed, corrected as necessary, incorporated in the general ledger, and reported in the financial statements and
 - (2) information about events and conditions, other than transactions, is captured, processed, and disclosed in the financial statements,
 - ii. the accounting records, specific accounts in the financial statements, and other supporting records relating to the flows of information in the information system,
 - iii. the financial reporting process used to prepare the entity's financial statements, including disclosures, and
 - iv. the entity's resources, including the IT environment, relevant to preceding a(i)–(iii).
- b. understanding how the entity communicates significant matters that support the preparation of the financial statements and related reporting responsibilities in the information system and other components of the system of internal control (Ref: par. .A163–.A164)
 - i. between people within the entity, including how financial reporting roles and responsibilities are communicated,
 - ii. between management and those charged with governance,
 - iii. with external parties, such as those with regulatory authorities.
- c. evaluating, based on the auditor's understanding obtained in paragraph .25a–b, whether the entity's information system and communication appropriately support the preparation of the entity's financial statements in accordance with the applicable financial reporting framework considering the nature and complexity of the entity. (Ref: par. .A165).

Control Activities

.26 The auditor should, through performing risk assessment procedures, obtain an understanding of the control activities component, by applying the requirements in paragraphs .27–.30. (Ref: par. .A167–.A179)

.27 The auditor should identify the following controls that address risks of material misstatement at the assertion level:

- a. Controls that address a risk that is determined to be a significant risk (Ref: par. .A180–.A181)
- b. Controls over journal entries and other adjustments as required by section 240¹⁴ (Ref: par. .A182–.A183)
- c. Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which should include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence (Ref: par. .A184–.A186)
- d. Other controls that, based on the auditor's professional judgment, the auditor considers are appropriate to enable the auditor to meet the objectives of paragraph .13 with respect to risks at the assertion level (Ref: par. .A187–.A188)

.28 Based on controls identified in paragraph .27, the auditor should identify the IT applications and the other aspects of the entity's IT environment that are subject to risks arising from the use of IT.

.29 For the IT applications and other aspects of the IT environment identified in paragraph .28, the auditor should identify the following: (Ref: par. .A189–.A200)

- a. The related risks arising from the use of IT
- b. The entity's general IT controls that address such risks

.30 For each control identified in paragraph .27 or .29b, the auditor should (Ref: par. .A201–.A210)

- a. evaluate whether the control is designed effectively to address the risk of material misstatement at the assertion level or effectively designed to support the operation of other controls.
- b. determine whether the control has been implemented by performing procedures in addition to inquiry of the entity's personnel.

Control Deficiencies Within the Entity's System of Internal Control

.31 Based on the auditor's understanding and evaluation of the components of the entity's system of internal control as required by this section, the auditor should determine whether one or more control deficiencies have been identified. (Ref: par. .A211–.A212)

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .A213–.A214)

Identifying Risks of Material Misstatement

.32 The auditor should identify the risks of material misstatement and determine whether they exist at (Ref: par. .A215–.A221)

- a. the financial statement level (Ref: par. .A222–.A229) or
- b. the assertion level for classes of transactions, account balances, and disclosures (Ref: par. .A230–.A231).

.33 The auditor should determine the relevant assertions and the related significant classes of transactions, account balances, and disclosures. (Ref: par. .A232–.A234)

¹⁴ Paragraph 32a(i) of section 240.

Assessing Risks of Material Misstatement at the Financial Statement Level

.34 For identified risks of material misstatement at the financial statement level, the auditor should assess the risks and (Ref: par. .A222–.A229)

- a. determine whether such risks affect the assessment of risks at the assertion level, and
- b. evaluate the nature and extent of their pervasive effect on the financial statements.

Assessing Risks of Material Misstatement at the Assertion Level*Assessing Inherent Risk (Ref: par. .A235–.A244)*

.35 For identified risks of material misstatement at the assertion level, the auditor should assess inherent risk by assessing the likelihood and magnitude of misstatement. In doing so, the auditor should take into account how, and the degree to which

- a. inherent risk factors affect the susceptibility of relevant assertions to misstatement, and
- b. the risks of material misstatement at the financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level. (Ref: par. .A245–.A246)

.36 The auditor should determine whether any of the assessed risks of material misstatement are significant risks. (Ref: par. .A247–.A251)

.37 The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material misstatement at the assertion level. (Ref: par. .A252–.A255)

Assessing Control Risk

.38 For identified risks of material misstatement at the assertion level, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: par. .A256–.A260)

Evaluating the Audit Evidence Obtained From the Risk Assessment Procedures

.39 The auditor should evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement. If not, the auditor should perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis. In identifying and assessing the risks of material misstatement, the auditor should take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management. (Ref: par. .A261–.A263)

Classes of Transactions, Account Balances, and Disclosures That Are Not Significant but Are Material

.40 For material classes of transactions, account balances, or disclosures that have not been determined to be significant classes of transactions, account

balances, or disclosures, the auditor should evaluate whether the auditor's determination remains appropriate. (Ref: par. .A264–.A265)

Revision of Risk Assessment

.41 If the auditor obtains new information that is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor should revise the identification or assessment. (Ref: par. .A266)

Documentation

.42 The auditor should include in the audit documentation¹⁵ (Ref: par. .A267–.A273)

- a. the discussion among the engagement team in accordance with paragraphs .17–.18 and the significant decisions reached;
- b. key elements of the auditor's understanding in accordance with paragraphs .19, .21–.22, and .24–.25; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
- c. the evaluation of the design of identified controls, and determination whether such controls have been implemented, in accordance with paragraph .30; and
- d. the identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.

Application and Other Explanatory Material

Definitions (Ref: par. .12)

Assertions

.A1 Categories of assertions are used by auditors to consider the different types of potential misstatements that may occur when identifying, assessing, and responding to the risks of material misstatement. Examples of these categories of assertions are described in paragraph .A219. The assertions differ from the written representations required by section 580, *Written Representations*, to confirm certain matters or support other audit evidence.

Controls

.A2 Controls are embedded within the components of the entity's system of internal control.

.A3 Policies are implemented through the actions of personnel within the entity or through the restraint of personnel from taking actions that would conflict with such policies.

.A4 Procedures may be mandated, through formal documentation or other communication by management or those charged with governance, or may result from behaviors that are not mandated but, rather, are conditioned by the

¹⁵ Paragraphs .08–.12 and .A8–.A9 of section 230, *Audit Documentation*.

entity's culture. Procedures may be enforced through the actions permitted by the IT applications used by the entity or other aspects of the entity's IT environment.

.A5 Controls may be direct or indirect (see paragraphs .A112, .A140, and .A168). *Direct controls* are controls that are precise enough to address risks of material misstatement at the assertion level. *Indirect controls* are controls that support direct controls. Although indirect controls are not sufficiently precise to prevent, or detect and correct, misstatements at the assertion level, they are foundational and may have an indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis.

General IT Controls

.A6 The integrity of information may include the completeness, accuracy, and validity of transactions and other information. Although this section does not prescribe the use of a particular internal control framework, the auditor may find the following guidance regarding the concepts encompassed by the term *validity*, from COSO's 2013 *Internal Control — Integrated Framework* (COSO framework), helpful: "Recorded transactions represent economic events that actually occurred and were executed according to prescribed procedures. Validity is generally achieved through control activities that include the authorization of transactions as specified by an organization's established policies and procedures (that is, approval by a person having the authority to do so)."¹⁶ The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book) provides similar guidance on validity.¹⁷

Information-Processing Controls

.A7 Risks to the integrity of information arise from susceptibility to ineffective implementation of the entity's information policies, which are policies that define the information flows, records, and reporting processes in the entity's information system. Information-processing controls are procedures that support effective implementation of the entity's information policies. Information-processing controls may be automated (that is, embedded in IT applications) or manual (for example, input or output controls) and may rely on other controls, including other information-processing controls or general IT controls.

.A8 Business processes result in the transactions that are recorded, processed, and reported by the information system. Information-processing controls are also known as *transaction controls*. Such controls directly support the actions to mitigate information-processing risks in an entity's business processes.

Inherent Risk Factors

.A9 Appendix B, "Understanding Inherent Risk Factors," sets out further considerations relating to understanding inherent risk factors.

.A10 Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Qualitative inherent risk factors relating to the preparation of information required by the applicable financial reporting framework include the following:

- Complexity

¹⁶ Section 7, "Control Activities" of COSO's 2013 *Internal Control—Integrated Framework*.

¹⁷ See paragraph 11.05 of *Standards for Internal Control in the Federal Government*.

- Subjectivity
- Change
- Uncertainty
- Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk

.A11 Other inherent risk factors that affect susceptibility of an assertion to misstatement about a class of transactions, account balance, or disclosure may include one or both of the following:

- The quantitative or qualitative significance of the class of transactions, account balance, or disclosure
- The volume or a lack of uniformity in the composition of the items to be processed through the class of transactions or account balance, or to be reflected in the disclosure

Relevant Assertions

.A12 A risk of material misstatement may relate to more than one assertion, in which case, all the assertions to which such a risk relates are relevant assertions. For the purposes of the AU-C sections, a risk of material misstatement exists when (a) there is a reasonable possibility of a misstatement occurring (that is, its likelihood), and (b) if it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).¹⁸ There is a reasonable possibility when the likelihood of a material misstatement occurring is more than remote. If an assertion does not have an identified risk of material misstatement, then it is not a relevant assertion.

Risks Arising From the Use of IT

.A13 Appendix E, "Considerations for Understanding IT," sets out further considerations relating to understanding IT.

Significant Class of Transactions, Account Balance, or Disclosure

.A14 A class of transactions, account balance, or disclosure is considered significant when it has an identified risk of material misstatement at the assertion level (that is, there is one or more relevant assertions). The determination of whether a class of transactions, account balance, or disclosure is significant is made before consideration of any related controls (that is, the determination is based on inherent risk).

Significant Risk

.A15 *Significance* can be described as the relative importance of a matter and is judged by the auditor in the context in which the matter is being considered. For inherent risk, significance may be considered in the context of how, and the degree to which, inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur. The determination of significant risks allows for the auditor to focus more attention on those risks that are close to the upper end of the spectrum of inherent risk through the performance of certain required responses (see paragraph .A247).

¹⁸ Paragraphs .A41–.A43 of section 200 and paragraph .07 of section 330.

System of Internal Control

.A16 Internal control frameworks may use different terms that are similar to the concept of system of internal control. For example, the 2013 COSO framework and the Green Book define *internal control* similarly to the *system of internal control* in this section.

Risk Assessment Procedures and Related Activities (Ref: par. .13–.18)

.A17 The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this section. However, the significance of fraud is such that further requirements and guidance are included in section 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud.¹⁹ In addition, the following AU-C sections provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- Section 540, *Auditing Accounting Estimates and Related Disclosures*, with regard to accounting estimates
- Section 550, *Related Parties*, with regard to related party relationships and transaction
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, with regard to going concern
- Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, with regard to group financial statements

.A18 Professional skepticism is necessary for the critical assessment of audit evidence gathered when performing risk assessment procedures. In addition, professional skepticism assists the auditor in remaining alert to audit evidence that is not biased towards corroborating the existence of risks or that may be contradictory. Professional skepticism is an attitude that is applied by the auditor when making professional judgments that then provides the basis for the auditor's actions. The auditor exercises professional judgment in determining when the auditor has audit evidence that provides an appropriate basis for risk assessment.

.A19 Examples of maintaining professional skepticism by the auditor may include the following:

- Considering information that may be used as audit evidence
- Taking into account contradictory information that comes to the auditor's attention
- Considering responses to inquiries and other information obtained from management and those charged with governance
- Being alert to conditions that may indicate possible misstatement due to fraud or error
- Considering whether audit evidence obtained supports the auditor's identification and assessment of the risks of material misstatement in light of the entity's nature and circumstances

¹⁹ Paragraphs .12–.27 of section 240.

Why Obtaining Audit Evidence in an Unbiased Manner Is Important
(Ref: par. .13)

.A20 Designing and performing risk assessment procedures to obtain audit evidence to support the identification and assessment of the risks of material misstatement in an unbiased manner may assist the auditor in identifying potentially contradictory information. This may also assist the auditor in maintaining professional skepticism in identifying and assessing the risks of material misstatement.

Sources of Audit Evidence (Ref: par. .13)

.A21 Designing and performing risk assessment procedures to obtain audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence. In addition to information from other sources,²⁰ sources of information for risk assessment procedures may include the following:

- Interactions with management, those charged with governance, and other key entity personnel, such as internal auditors
- Certain external parties such as regulators, whether obtained directly or indirectly
- Publicly available information about the entity, for example, entity-issued press releases, materials for analysts or investor group meetings, analysts' reports, or information about trading activity

Regardless of the source of information, the auditor considers the relevance and reliability of the information to be used as audit evidence in accordance with section 500, *Audit Evidence*.²¹

Scalability (Ref: par. .13)

.A22 The nature and extent of risk assessment procedures, including obtaining an understanding pursuant to the following requirements, will vary based on the nature and circumstances of the entity (for example, the formality of the entity's policies and procedures, and processes and systems):

- a. Performing risk assessment procedures (paragraph .19)
- b. Understanding the components of internal control
 - i. Control environment (paragraph .21)
 - ii. The entity's risk assessment process (paragraphs .22–.23)
 - iii. The entity's process to monitor the system of internal control (paragraph .24)
 - iv. The information system and communication (paragraph .25)
 - v. Control activities (paragraphs .26–.30)

The auditor exercises professional judgment to determine the nature and extent of the risk assessment procedures to be performed to meet the requirements of this section.

.A23 Some entities, including less complex entities, and particularly owner-managed entities, may not have established structured processes and

²⁰ See paragraphs .A43–.A44 of this section.

²¹ Paragraph .07 of section 500, *Audit Evidence*.

systems (for example, a risk assessment process or a process to monitor the system of internal control) or may have established processes or systems with limited documentation or a lack of consistency in how they are undertaken. When such systems and processes lack formality, the auditor may still be able to perform risk assessment procedures through observation and inquiry. Other entities, typically more complex entities, are expected to have more formalized and documented policies and procedures. The auditor may use such documentation in performing risk assessment procedures.

.A24 The nature and extent of risk assessment procedures to be performed in an initial audit may be more extensive than procedures for a recurring engagement. In subsequent periods, the auditor may focus on changes that have occurred since the preceding period.

Types of Risk Assessment Procedures (Ref: par. .14)

.A25 Section 500²² explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature, timing, and extent of the audit procedures may be affected by the fact that some of the accounting data and other evidence may be available only in electronic form or only at certain points in time.²³ The auditor may perform substantive procedures or tests of controls, in accordance with section 330, concurrently with risk assessment procedures, such as when it is efficient to do so. Audit evidence obtained that supports the identification and assessment of risks of material misstatement may also support the detection of misstatements at the assertion level or the evaluation of the operating effectiveness of controls.

.A26 Although the auditor is required to perform all the risk assessment procedures described in paragraph .14 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs .19–.30), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed when the information to be obtained may be helpful in identifying risks of material misstatement. Examples of such procedures may include making inquiries of the entity's external legal counsel, or of valuation specialists that the entity has used.

Automated Tools and Techniques (Ref: par. .14)

.A27 Using automated tools and techniques, the auditor may perform risk assessment procedures on large volumes of data (from the general ledger, subledgers, or other operational data), including for analysis, recalculations, reperformance, or reconciliations.

Inquiries of Management and Others Within the Entity (Ref: par. .14a)

Why Inquiries Are Made of Management and Others Within the Entity

.A28 Information obtained by the auditor to support an appropriate basis for the identification and assessment of risks, and the design of further audit procedures, may be obtained through inquiries of management and those responsible for financial reporting. As described in section 500, responses to inquiries may provide the auditor with information not previously possessed, with corroborative audit evidence, or with information that differs significantly from other information that the auditor has obtained.²⁴

²² Paragraphs .A14–.A17 and .A21–.A26 of section 500.

²³ Paragraph .A12 of section 500.

²⁴ Paragraphs .A24–.A25 of section 500.

.A29 Inquiries of management and those responsible for financial reporting and of other appropriate individuals within the entity and other employees with different levels of authority may offer the auditor varying perspectives when identifying and assessing risks of material misstatement. Examples follow:

- Inquiries directed toward those charged with governance may help the auditor understand the extent of oversight by those charged with governance over the preparation of the financial statements by management. Section 260, *The Auditor's Communication With Those Charged With Governance*,²⁵ identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
- Inquiries of employees responsible for initiating, processing, or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- Inquiries directed toward in-house legal counsel²⁶ may provide information about such matters as litigation; compliance with laws and regulations; knowledge of fraud or suspected fraud affecting the entity; warranties; post-sales obligations; arrangements (such as joint ventures) with business partners; and the meaning of contractual terms.
- Inquiries directed toward marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed toward the risk management function (or inquiries of those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- Inquiries directed toward IT personnel may provide information about IT processes as well as system changes, system or control failures, or other IT-related risks.

Considerations Specific to Governmental Entities

.A30 When making inquiries of those who may have information that is likely to assist in identifying risks of material misstatement, auditors of governmental entities may obtain information from additional sources such as from the auditors that are involved in performance or other audits related to the entity.

Inquiries of the Internal Audit Function (Ref: par. .14a)

Why Inquiries Are Made of the Internal Audit Function (If the Function Exists)

.A31 If an entity has an internal audit function, inquiries of the appropriate individuals within the function may assist the auditor in understanding the entity and its environment, and the entity's system of internal control, in the identification and assessment of risks. Appendix D, "Considerations for Understanding an Entity's Internal Audit Function," sets out considerations for understanding an entity's internal audit function.

²⁵ Paragraph .A1 of section 260, *The Auditor's Communication With Those Charged With Governance*.

²⁶ See paragraph .16 of section 501, *Audit Evidence — Specific Considerations for Selected Items*.

.A32 Some entities, for example, governmental entities, may have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Inquiries of appropriate individuals in the internal audit function may assist the auditors in identifying the risk of material noncompliance with applicable laws and regulations and the risk of control deficiencies related to financial reporting.

Analytical Procedures (Ref: par. .14b)

Why Analytical Procedures Are Performed as a Risk Assessment Procedure

.A33 Analytical procedures help identify inconsistencies, unusual transactions or events, and amounts, ratios, and trends that indicate matters that may have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

.A34 Analytical procedures performed as risk assessment procedures may, therefore, assist in identifying and assessing the risks of material misstatement by identifying aspects of the entity of which the auditor was unaware or understanding how inherent risk factors, such as change, affect susceptibility of assertions to misstatement.

Types of Analytical Procedures

.A35 Analytical procedures performed as risk assessment procedures may be as follows:

- Include both financial and nonfinancial information, for example, the relationship between sales and square footage of selling space or volume of goods sold (nonfinancial).
- Use data aggregated at a high level. Accordingly, the results of those analytical procedures may provide a broad initial indication about the likelihood and potential magnitude of a material misstatement. For example, in the audit of many entities, including those with less complex business models and processes, and a less complex information system, the auditor may perform a comparison of information, such as the change in interim or monthly account balances from balances in prior periods, to obtain an indication of potentially higher risk areas.

.A36 This section addresses the auditor's use of analytical procedures as risk assessment procedures. Section 520, *Analytical Procedures*, addresses the auditor's use of analytical procedures as substantive procedures (substantive analytical procedures) and the auditor's responsibility to perform analytical procedures near the end of the audit. Accordingly, analytical procedures performed as risk assessment procedures are not required to be performed in accordance with the requirements of section 520. However, the requirements and application material in section 520 may provide useful guidance to the auditor when performing analytical procedures as part of the risk assessment procedures.

Automated Tools and Techniques

.A37 Analytical procedures can be performed using a number of tools or techniques, which may be automated. Applying automated analytical procedures to the data may be referred to as *data analytics*. For example, the auditor may use a spreadsheet to perform a comparison of actual recorded amounts to budgeted amounts or may perform a more advanced procedure by extracting data from the entity's information system, and further analyzing this data

using visualization techniques to identify classes of transactions, account balances, or disclosures for which further specific risk assessment procedures may be warranted.

Observation and Inspection (Ref: par. .14c)

Why Observation and Inspection Are Performed as Risk Assessment Procedures

.A38 Observation and inspection may support, corroborate, or contradict inquiries of management and others and may also provide information about the entity and its environment.

Scalability

.A39 When policies or procedures are not documented, or the entity has less formalized controls, the auditor may still be able to obtain some audit evidence to support the identification and assessment of the risks of material misstatement through observation or inspection of the performance of the control. Examples are as follows:

- The auditor may obtain an understanding of controls over an inventory count, even if they have not been documented by the entity, through a combination of inquiry and direct observation.
- The auditor may be able to observe segregation of duties.
- The auditor may be able to observe passwords being entered.

Observation and Inspection as Risk Assessment Procedures

.A40 Risk assessment procedures may include observation or inspection of the following:

- The entity's operations
- Internal documents (such as business plans and strategies), records, and internal control manuals
- Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of directors' meetings)
- The entity's premises and plant facilities
- Information obtained from external sources such as trade and economic journals; reports by analysts, banks, or rating agencies; regulatory or financial publications; or other external documents about the entity's financial performance (such as those referred to in paragraph .A88)
- The behaviors and actions of management or those charged with governance (such as the observation of an audit committee meeting)

Automated Tools or Techniques

.A41 Automated tools or techniques may also be used to observe or inspect particular assets. For example, such tools and techniques may include the use of remote observation tools, such as a video camera or drone.

Considerations Specific to Governmental Entities

.A42 Risk assessment procedures performed by auditors of governmental entities may also include observation and inspection of documents prepared by management for the governing body, for example, documents related to performance reporting.

Information From Other Sources (Ref: par. .15)*Why the Auditor Considers Information From Other Sources*

.A43 Information obtained from other sources may be relevant to the identification and assessment of the risks of material misstatement by providing information and insights about the following:

- The nature of the entity and its business risks, and what may have changed from previous periods
- The integrity and ethical values of management and those charged with governance, which may also be relevant to the auditor's understanding of the control environment
- The applicable financial reporting framework and its application to the nature and circumstances of the entity

Other Relevant Sources

.A44 Other relevant sources of information are as follows:

- The auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement in accordance with section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, including the conclusions reached thereon.²⁷
- Other engagements performed for the entity by the engagement partner. The engagement partner may have obtained knowledge relevant to the audit, including about the entity and its environment, when performing other engagements for the entity. Such engagements may include agreed-upon procedures engagements or other audit or assurance engagements, including engagements to address incremental reporting requirements in the jurisdiction.

Information From the Auditor's Previous Experience With the Entity and Previous Audits (Ref: par. .16)*Why Information From Previous Audits Is Important to the Current Audit*

.A45 The auditor's previous experience with the entity and from audit procedures performed in previous audits may provide the auditor with information that is relevant to the auditor's determination of the nature and extent of risk assessment procedures, and the identification and assessment of risks of material misstatement.

Nature of the Information From Previous Audits

.A46 The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about the following matters:

- Past misstatements and whether they were corrected on a timely basis
- The nature of the entity and its environment, and the entity's system of internal control (including control deficiencies)
- Significant changes that the entity or its operations may have undergone since the prior financial period

²⁷ Paragraph .14 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- Those particular types of transactions and other events or account balances (and related disclosures) in which the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity

A47 The auditor is required to determine whether information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits remains relevant and reliable, if the auditor intends to use that information for the purposes of the current audit. If the nature or circumstances of the entity have changed, or new information has been obtained, the information from prior periods may no longer be relevant or reliable for the current audit. To determine whether changes have occurred that may affect the relevance or reliability of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of the applicable information-processing activities in the information system.

Engagement Team Discussion (Ref: par. .17–.18)

Why the Engagement Team Is Required to Discuss the Application of the Applicable Financial Reporting Framework and the Susceptibility of the Entity's Financial Statements to Material Misstatement

A48 Key engagement team members include those members who have significant engagement responsibilities, including the engagement partner. The manner in which the discussion is conducted depends on the individuals involved and the circumstances of the engagement. For example, if the audit involves more than one location, there could be multiple discussions with team members in different locations.

A49 The discussion among the engagement team about the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement accomplishes the following:

- Provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity. Sharing information contributes to an enhanced understanding by all engagement team members.
- Allows the engagement team members to exchange information about the business risks to which the entity is subject, how inherent risk factors may affect the susceptibility of classes of transactions, account balances, and disclosures to misstatement, and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.
- Assists the engagement team members in gaining a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing, and extent of further audit procedures. In particular, the discussion assists engagement team members in further considering contradictory information based on each member's own understanding of the nature and circumstances of the entity.

- Provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

Section 240 requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.²⁸

.A50 Professional skepticism is necessary for the critical assessment of audit evidence, and a robust and open engagement team discussion, including for recurring audits, may lead to improved identification and assessment of the risks of material misstatement. Another outcome from the discussion may be that the auditor identifies specific areas of the audit for which maintaining professional skepticism may be particularly important and may lead to the involvement of more experienced members of the engagement team who are appropriately skilled to be involved in the performance of audit procedures related to those areas.

.A51 As part of the discussion among the engagement team, consideration may also be given to additional broader objectives, and related risks, arising from specific audit requirements, for example, those related to governmental entities.

Scalability

.A52 When the engagement is carried out by a single individual, such as a sole practitioner (that is, when an engagement team discussion would not be possible), consideration of the matters referred to in paragraphs .A49 and .A54, nonetheless, may assist the auditor in identifying where there may be risks of material misstatement.

.A53 When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team, including, if considered appropriate, those with specific skills or knowledge and those responsible for the audits of components, while delegating discussion with others, taking into account the extent of communication considered necessary throughout the engagement team. A communications plan, agreed to by the engagement partner, may be useful.

Discussion of Disclosures in the Applicable Financial Reporting Framework

.A54 As part of the discussion among the engagement team, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement in relation to disclosures, even in circumstances in which the applicable financial reporting framework requires only simplified disclosures. Matters the engagement team may discuss include the following:

- Changes in financial reporting requirements that may result in significant, new, or revised disclosures
- Changes in the entity's environment, financial condition, or activities that may result in significant, new, or revised disclosures, for example, a significant business combination in the period under audit

²⁸ Paragraph .15 of section 240.

- Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past
- Disclosures about complex matters, including those involving significant management judgment about what information to disclose

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control (Ref: par. .19–.31)

.A55 Appendixes A–F set out further considerations relating to obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control.

Obtaining the Required Understanding (Ref: par. .19–.31)

.A56 Obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control is a dynamic and iterative process of gathering, updating, and analyzing information and continues throughout the audit. Therefore, the auditor's expectations may change as new information is obtained.

.A57 The auditor's understanding of the entity and its environment and the applicable financial reporting framework may also assist the auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant classes of transactions, account balances, and disclosures. These expected significant classes of transactions, account balances, and disclosures form the basis for the scope of the auditor's understanding of the entity's information system.

Why an Understanding of the Entity and Its Environment, and the Applicable Financial Reporting Framework, Is Required (Ref: par. .19–.20)

.A58 The auditor's understanding of the entity and its environment and the applicable financial reporting framework assist the auditor

- a. in understanding the events and conditions that are relevant to the entity, and
- b. in identifying how inherent risk factors affect the susceptibility of assertions to misstatement in the preparation of the financial statements, in accordance with the applicable financial reporting framework, and the degree to which they do so.

Such information establishes a frame of reference within which the auditor identifies and assesses risks of material misstatement. This frame of reference also assists the auditor in planning the audit, exercising professional judgment, and maintaining professional skepticism throughout the audit, for example, when

- identifying and assessing risks of material misstatement of the financial statements in accordance with this section or other relevant AU-C sections (for example, relating to risks of fraud in accordance with section 240 or when identifying or assessing risks related to accounting estimates in accordance with section 540);
- performing procedures to help identify instances of noncompliance with laws and regulations that may have a material effect on the financial statements in accordance with section 250,

*Consideration of Laws and Regulations in an Audit of Financial Statements;*²⁹

- evaluating whether the financial statements provide adequate disclosures in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*,³⁰
- determining materiality or performance materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*,³¹ or
- considering the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures.

.A59 The auditor's understanding of the entity and its environment, and the applicable financial reporting framework, also informs how the auditor plans and performs further audit procedures, for example, when

- developing expectations for use when performing substantive analytical procedures in accordance with section 520;³²
- designing and performing further audit procedures to obtain sufficient appropriate audit evidence in accordance with section 330,³³ and
- evaluating the sufficiency and appropriateness of audit evidence obtained (for example, relating to assumptions or management's oral and written representations).

Scalability (Ref: par. .19–.20)

.A60 The nature and extent of the required understanding is a matter of the auditor's professional judgment and varies from entity to entity based on the nature and circumstances of the entity, including the following:

- The size and complexity of the entity, including its IT environment
- The auditor's previous experience with the entity
- The nature of the entity's systems and processes, including whether they are formalized or not
- The nature and form of the entity's documentation

.A61 The auditor's risk assessment procedures to obtain the required understanding may be less extensive in audits of less complex entities and more extensive for entities that are more complex. The depth of the understanding that is required by the auditor is expected to be less than that possessed by management in managing the entity.

.A62 Some financial reporting frameworks allow smaller entities to provide simpler and less detailed disclosures in the financial statements. However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment and the applicable financial reporting framework as it applies to the entity.

²⁹ Paragraph .14 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

³⁰ Paragraph .15e of section 700, *Forming an Opinion and Reporting on Financial Statements*.

³¹ Paragraphs .10–.11 of section 320, *Materiality in Planning and Performing an Audit*.

³² Paragraph .05 of section 520, *Analytical Procedures*.

³³ Paragraphs .06–.07 of section 330.

.A63 The entity's use of IT and the nature and extent of changes in the IT environment, including the risks arising from the use of IT identified in accordance with paragraph .29a, may also affect the specialized skills that are needed to assist with obtaining the required understanding, including the entity's general IT controls to be identified in accordance with paragraph .29b.

The Entity and Its Environment (Ref: par. .19)

The Entity's Organizational Structure, Ownership and Governance, and Business Model (Ref: par. .19a(i))

The Entity's Organizational Structure and Ownership (Ref: par. .19a(i))

.A64 An understanding of the entity's organizational structure and ownership may enable the auditor to understand the following matters:

- The complexity of the entity's structure. For example, the entity may be a single entity or the entity's structure may include subsidiaries, divisions, or other components in multiple locations. Further, the legal structure may be different from the operating structure. Complex structures often introduce factors that may give rise to increased susceptibility to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or variable interest entities are accounted for appropriately and whether adequate disclosure of such issues in the financial statements has been made.
- The ownership, and relationships between owners and other people or entities, including related parties. This understanding may assist in determining whether related party transactions have been appropriately identified, accounted for, and adequately disclosed in the financial statements.³⁴
- The distinction between the owners, those charged with governance and management. For example, in some less complex entities, owners of the entity may be involved in managing the entity, therefore, there is little or no distinction. In contrast, such as in some larger entities with diverse ownership, there may be a clear distinction between management, the owners of the entity, and those charged with governance. Even in some larger entities, owners of the entity may be involved in managing the entity. Section 260 provides guidance on the identification of those charged with governance and explains that, in some cases, some or all of those charged with governance may be involved in managing the entity.³⁵
- The structure and complexity of the entity's IT environment. For example, an entity may
 - have multiple legacy IT systems in diverse businesses that are not well integrated, resulting in a complex IT environment.
 - be using external or internal service providers for aspects of its IT environment (for example, outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group).

³⁴ Section 550 addresses the auditor's considerations relevant to related parties.

³⁵ Paragraphs .A6–.A7 of section 260.

Automated Tools and Techniques

.A65 The auditor may use automated tools and techniques to understand flows of transactions and processing as part of the auditor's procedures to understand the information system. An outcome of these procedures may be that the auditor obtains information about the entity's organizational structure or those with whom the entity conducts business (for example, vendors, customers, or related parties).

Considerations Specific to Governmental Entities

.A66 Ownership of a governmental entity may not have the same relevance as in the private sector because many governmental entities do not have owners or because decisions related to the entity may be made outside of the entity as a result of political processes. Therefore, management may not have control over certain decisions that are made. Matters that may be relevant include understanding the ability of the entity to make unilateral decisions and the ability of other governmental entities to control or influence the entity's mandate and strategic direction. For example, a governmental entity may be subject to laws or other directives from authorities that require it to obtain approval from parties external to the entity of its strategy and objectives prior to it implementing them. Therefore, matters related to understanding the legal structure of the entity may include applicable laws and regulations, and the classification of the entity (that is, whether the entity is a department, agency, or other type of entity).

Governance (Ref: par. .19a(i))Why the Auditor Obtains an Understanding of Governance

.A67 Understanding the entity's governance may assist the auditor with understanding the entity's ability to provide appropriate oversight of its system of internal control. This understanding, in connection with the auditor's understanding of the control environment, may also provide evidence of control deficiencies, which may indicate an increase in the susceptibility of the entity's financial statements to risks of material misstatement.

Understanding the Entity's Governance

.A68 The following matters may be relevant for the auditor to consider in obtaining an understanding of the governance of the entity:

- Whether any or all of those charged with governance are involved in managing the entity and, if applicable, how those charged with governance demonstrate independence from management
- The existence (and separation) of a non-executive board, if any, from executive management
- Whether those charged with governance hold positions that are an integral part of the entity's legal structure, for example, as directors
- The existence of subgroups of those charged with governance, such as an audit committee, and the responsibilities of such a group
- The responsibilities of those charged with governance for oversight of financial reporting, including approving the financial statements or monitoring the entity's internal control related to financial reporting

The Entity's Business Model (Ref: par. .19a(i))

.A69 Appendixes A–B set out additional considerations for obtaining an understanding of the entity and its business model as well as additional considerations for auditing variable interest entities.

Why the Auditor Obtains an Understanding of the Entity's Business Model

.A70 Understanding the entity's objectives, strategy, and business model helps the auditor to understand the entity at a strategic level and to understand the business risks the entity takes and faces. An understanding of the business risks that have an effect on the financial statements assists the auditor in identifying risks of material misstatement because most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. For example, an entity's business model may rely on the use of IT in different ways:

- An entity sells shoes from a physical store and uses an advanced stock and point of sale system to record the selling of shoes.
- An entity sells shoes online so that all sales transactions are processed in an IT environment, including initiation of the transactions through a website.

The business risks arising from a significantly different business model would be substantially different, notwithstanding both entities sell shoes.

Understanding the Entity's Business Model

.A71 Not all aspects of the business model are relevant to the auditor's understanding. Business risks are broader than the risks of material misstatement of the financial statements, although business risks include the latter. The auditor does not have a responsibility to understand or identify all business risks because not all business risks give rise to risks of material misstatement.

.A72 Business risks could affect risks of material misstatement at the financial statement level or assertion level. For example, an entity's loss of financing or declining conditions affecting the entity's industry could affect its ability to settle its obligations when due and, thus, could affect the risks of material misstatement related to the classification of long-term liabilities or the valuation of long-term assets. It also could result in substantial doubt about the entity's ability to continue as a going concern. An unsuccessful new product or service or failed business expansion might affect the risks of material misstatement related to the valuation of inventory and other related assets.

.A73 Business risks increasing the susceptibility to risks of material misstatement may arise from the following:

- Inappropriate objectives or strategies, ineffective execution of strategies, or change or complexity related to the entity's business
- A failure to recognize the need for change may also give rise to business risk, for example, from
 - the development of new products or services that may fail;
 - a market which, even if successfully developed, is inadequate to support a product or service; or
 - flaws in a product or service that may result in legal liability and reputational risk
- Incentives and pressures on management, which may result in intentional or unintentional management bias and, therefore, affect the reasonableness of significant assumptions and the expectations of management or those charged with governance

.A74 Examples of matters that the auditor may consider when obtaining an understanding of the entity's business model, objectives, strategies, and related business risks that may result in a risk of material misstatement of the financial statements may include the following:

- Industry developments, such as the lack of personnel or expertise to deal with the changes in the industry
- New products and services that may lead to increased product liability
- Expansion of the entity's business, and demand has not been accurately estimated
- New accounting requirements in which there has been incomplete or improper implementation
- Regulatory requirements resulting in increased legal exposure
- Current and prospective financing requirements, such as loss of financing due to the entity's inability to meet requirements
- Use of IT, such as the implementation of a new IT system that will affect both operations and financial reporting
- The effects of implementing a strategy, particularly any effects that will lead to new accounting requirements
- Climate-related events or conditions that may affect the entity in terms of its business model, its operations and processes, or its ability to raise financing or attract investment and customers

.A75 Ordinarily, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of the entity's system of internal control and is discussed in paragraph .22 and .A124–.A129.

Considerations Specific to Governmental Entities

.A76 Entities operating in the governmental sector may create and deliver value in different ways from those creating wealth for owners but will still have an operating "model" with specific objectives. Matters that governmental sector auditors may obtain an understanding of that are relevant to the model of the entity include the following:

- Knowledge of relevant government activities, including related programs
- Program objectives and strategies, including public policy elements

.A77 For the audits of governmental entities, "management objectives" may be influenced by requirements to demonstrate public accountability and may include objectives that have their source in law, regulation, or other authority.

Industry, Regulatory, and Other External Factors (Ref: par. .19a(ii))

Industry Factors

.A78 Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. The following are matters the auditor may consider:

- The market and competition, including demand, capacity, and price competition
- Cyclical or seasonal activity

- Product technology relating to the entity's products
- Energy supply and cost

.A79 The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation. For example, in the construction industry, long-term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team include members with the appropriate competence and capabilities.³⁶

Regulatory Factors (Ref: par. .19a(ii))

.A80 Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment and any changes thereto. The following are matters the auditor may consider:

- Regulatory framework for a regulated industry, including related disclosures
- Legislation and regulation that significantly affect the entity's operations, for example, labor laws and regulations
- Taxation legislation and regulations
- Government policies currently affecting the conduct of the entity's business, such as monetary policies, including foreign exchange controls, fiscal policies, financial incentives (for example, government aid programs), and tariffs or trade restriction policies
- Environmental requirements affecting the industry and the entity's business

.A81 Section 250 includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.³⁷

Other External Factors (Ref: par. .19a(ii))

.A82 Other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation.

Measures Used by Management to Assess the Entity's Financial Performance (Ref: par. .19a(iii))

Why the Auditor Understands Measures Used by Management

.A83 An understanding of the entity's measures assists the auditor in considering whether such measures, whether used externally or internally, create pressures on the entity to achieve performance targets. These pressures may motivate management to take actions that increase the susceptibility to misstatement due to management bias or fraud (for example, to improve the business performance or to intentionally misstate the financial statements) (see section 240 for requirements and guidance in relation to the risks of fraud).

.A84 Measures may also indicate to the auditor the likelihood of risks of material misstatement of related financial statement information. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared to that of other entities in the same industry.

³⁶ Paragraph .16 of section 220.

³⁷ Paragraph .12 of section 250.

Measures Used by Management

.A85 Management and others ordinarily measure and review those matters they regard as important. Inquiries of management may reveal that it relies on certain key indicators, regardless of public availability, for evaluating financial performance and taking action. In such cases, the auditor may identify relevant performance measures, whether internal or external, by considering the information that the entity uses to manage its business. If such inquiry indicates an absence of performance measurement or review, there may be an increased risk of misstatements not being detected and corrected.

.A86 Key indicators used for evaluating financial performance may include the following:

- Key performance indicators (financial and nonfinancial) and key ratios, trends, and operating statistics
- Period-on-period financial performance analyses
- Budgets, forecasts, variance analyses, segment information and divisional, departmental, or other level performance reports
- Employee performance measures and incentive compensation policies
- Comparisons of an entity's performance with that of competitors

Scalability (Ref. par. .19a(iii))

.A87 The procedures undertaken to understand the entity's measures may vary depending on the size or complexity of the entity as well as the involvement of owners or those charged with governance in the management of the entity.

Other Considerations

.A88 External parties may also review and analyze the entity's financial performance, in particular, for entities in which financial information is publicly available. The auditor may also consider publicly available information to help the auditor further understand the business or identify contradictory information, such as information from the following sources:

- Analysts or credit agencies
- News and other media, including social media
- Taxation authorities
- Regulators
- Trade unions
- Providers of finance

Such financial information can often be obtained from the entity being audited.

.A89 The measurement and review of financial performance is not the same as the monitoring of the system of internal control (discussed as a component of the system of internal control in paragraphs .A130–.A139), though their purposes may overlap:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).
- In contrast, monitoring of the system of internal control is concerned with monitoring the effectiveness of controls, including those related to management's measurement and review of financial performance.

In some cases, however, performance indicators also provide information that enables management to identify control deficiencies.

Considerations Specific to Governmental Entities

.A90 In addition to considering relevant measures used by a governmental entity to assess the entity's financial performance, auditors of governmental entities may also consider nonfinancial information, such as achievement of public benefit outcomes (for example, the number of people assisted by a specific program).

The Applicable Financial Reporting Framework (Ref: par. .19b)

Understanding the Applicable Financial Reporting Framework and the Entity's Accounting Policies

.A91 Matters that the auditor may consider when obtaining an understanding of the entity's applicable financial reporting framework and how it applies in the context of the nature and circumstances of the entity and its environment include the following:

- The entity's financial reporting practices in terms of the applicable financial reporting framework, such as
 - accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances, and related disclosures in the financial statements (for example, loans and investments for banks or research and development for pharmaceuticals)
 - revenue recognition
 - accounting for financial instruments, including related credit losses
 - foreign currency assets, liabilities, and transactions
 - accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for cryptocurrency)
- An understanding of the entity's selection and application of accounting policies, including any changes thereto as well as the reasons therefor, may encompass the following matters:
 - The methods the entity uses to recognize, measure, present, and disclose significant and unusual transactions
 - The effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus
 - Changes in the environment, such as changes in the applicable financial reporting framework or tax reforms that may necessitate a change in the entity's accounting policies
 - Financial reporting standards and laws and regulations that are new to the entity and when and how the entity will adopt, or comply with, such requirements

.A92 Obtaining an understanding of the entity and its environment may assist the auditor in considering where changes in the entity's financial reporting (for example, from prior periods) may be expected. For example, if the entity

has had a significant business combination during the period, the auditor would likely expect changes in classes of transactions, account balances, and disclosures associated with that business combination. Alternatively, if there were no significant changes in the financial reporting framework during the period, the auditor's understanding may help confirm that the understanding obtained in the prior period remains applicable.

Considerations Specific to Governmental Entities

.A93 The applicable financial reporting framework for a governmental entity may be generally accepted accounting principles established by the Federal Accounting Standards Advisory Board or GASB, or a special purpose framework.

How Inherent Risk Factors Affect Susceptibility of Assertions to Misstatement (Ref: par. .19c)

.A94 Appendix B provides examples of events and conditions that may give rise to the existence of risks of material misstatement, categorized by inherent risk factor.

Why the Auditor Understands Inherent Risk Factors When Understanding the Entity and Its Environment, and the Applicable Financial Reporting Framework

.A95 Understanding the entity and its environment, and the applicable financial reporting framework, assists the auditor in identifying events or conditions, the characteristics of which may affect the susceptibility of assertions about classes of transactions, account balances, or disclosures to misstatement. These characteristics are inherent risk factors. Inherent risk factors may affect susceptibility of assertions to misstatement by influencing the likelihood of occurrence of a misstatement or the magnitude of the misstatement if it were to occur. Understanding how inherent risk factors affect the susceptibility of assertions to misstatement may assist the auditor with a preliminary understanding of the likelihood or magnitude of misstatements, which assists the auditor in identifying risks of material misstatement at the assertion level in accordance with paragraph .32b. Understanding the degree to which inherent risk factors affect susceptibility of assertions to misstatement also assists the auditor in assessing the likelihood and magnitude of a possible misstatement when assessing inherent risk in accordance with paragraph .35a. Accordingly, understanding the inherent risk factors may also assist the auditor in designing and performing further audit procedures in accordance with section 330.

.A96 The auditor's identification of risks of material misstatement at the assertion level and assessment of inherent risk may also be influenced by audit evidence obtained by the auditor in performing other risk assessment procedures, further audit procedures, or in fulfilling other requirements in GAAS.

The Effect of Inherent Risk Factors on a Class of Transactions, Account Balance, or Disclosure

.A97 The extent of susceptibility of a class of transactions, account balance, or disclosure to misstatement arising from complexity or subjectivity is often closely related to the extent to which it is subject to change or uncertainty. For example, if the entity has an accounting estimate that is based on assumptions, the selection of which are subject to significant judgment, the measurement of the accounting estimate is likely to be affected by both subjectivity and uncertainty.

.A98 The greater the extent to which a class of transactions, account balance, or disclosure is susceptible to misstatement because of complexity or

subjectivity, the greater the need for the auditor to maintain professional skepticism. Further, when a class of transactions, account balance, or disclosure is susceptible to misstatement because of complexity, subjectivity, change, or uncertainty, these inherent risk factors may create opportunity for management bias, whether unintentional or intentional, and affect susceptibility to misstatement due to management bias. The auditor's identification of risks of material misstatement, and assessment of inherent risk at the assertion level, are also affected by the interrelationships among inherent risk factors.

.A99 Events or conditions that may affect susceptibility to misstatement due to management bias may also affect susceptibility to misstatement due to other fraud risk factors. Accordingly, this may be relevant information for use in accordance with section 240,³⁸ which requires the auditor to evaluate whether the information obtained from the other risk assessment procedures and related activities indicates that one or more fraud risk factors are present.

Understanding the Components of the Entity's System of Internal Control (Ref: par. .21–.31)

.A100 Appendix C, "Understanding the Entity's System of Internal Control," further describes the nature of the entity's system of internal control and inherent limitations of internal control, respectively. Appendix C also provides further explanation of the components of a system of internal control for purposes of GAAS.

.A101 The components of the entity's system of internal control for the purpose of this section may not necessarily reflect how an entity designs, implements, and maintains its system of internal control or how it may classify any particular component. Management might use an internal control framework specified by COSO, the Green Book, or another internal control framework with components that differ from the components identified in this section when designing, implementing, and maintaining the entity's system of internal control. In some instances, management may not use a framework at all. For the purpose of an audit, the auditor may use the framework used by management or may use different terminology or frameworks to describe the various aspects of a system of internal control and their effect on the audit, provided all the components described in this section are addressed.

.A102 Auditors of some entities may have additional responsibilities with respect to internal control. As a result, their considerations about the system of internal control may be broader and more detailed. For example, auditors of governmental entities may have responsibilities to report on compliance with law, regulation, or other authority.

How the Understanding of the Components of the Entity's System of Internal Control Differs From Understanding Specific Controls

.A103 The entity's system of internal control is a dynamic, iterative, and integrated process. Embedded within this process are controls consisting of policies and procedures. In an audit of financial statements, the components of the entity's system of internal control represent what is required to achieve the entity's financial reporting objectives. An audit does not require an understanding of all the processes or controls within each component.

.A104 For the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control components,

³⁸ Paragraph .24 of section 240.

the auditor's understanding includes the ongoing tasks and activities, or processes, geared to the achievement of the entity's financial reporting objectives. For the information system and communication component, the auditor's understanding includes the flows of transactions and other aspects of the entity's information-processing activities as well as the entity's communication of significant matters, as required by paragraph .25a–b. Audit evidence for the auditor's understanding and evaluation may be obtained through a combination of inquiries and other risk assessment procedures (for example, corroborating inquiries about the entity's processes through observation or inspection of documents). The auditor exercises professional judgment to determine the nature and extent of the procedures to be performed to meet the requirements (see paragraph .A22 and .A108–.A109).

.A105 Controls within the information system and communication component and the control activities component of the entity's system of internal control are primarily more direct in addressing assertion level risks (see paragraphs .A5, .A140, and .A166). This section requires performing risk assessment procedures, beyond inquiry, to evaluate whether the controls identified in accordance with paragraphs .27 and .29 are effectively designed and determine whether those controls have been implemented (see paragraph .30). This evaluation involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material misstatements as well as establishing that the control exists and that the entity is using it (see paragraphs .A201–.A202). An audit does not require an understanding, including evaluating the design or determining the implementation, of all controls related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them.

.A106 The auditor may identify, in accordance with paragraphs .27 and .29, controls within the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A105, .A112, and .A170).

Scalability

.A107 The way in which the entity's system of internal control is designed, implemented, and maintained varies with an entity's size and complexity. For example, less complex entities may use less structured or simpler controls (that is, policies and procedures) to achieve their objectives.

.A108 The auditor's understanding of the entity's system of internal control is obtained through risk assessment procedures performed to understand and evaluate the components of the system of internal control as set out in paragraphs .21–.31. The nature, timing, and extent of procedures that are necessary to understand and evaluate the components of the entity's system of internal control depend on the following:

- a. The size and complexity of the entity
- b. The auditor's existing knowledge of the entity's controls
- c. The nature of the entity's controls, including the entity's use of IT
- d. The nature and extent of changes in the entity's information systems and operations
- e. The nature and form of the entity's documentation of its controls

IT in the Components of the Entity's System of Internal Control

.A109 Appendix E provides further guidance on understanding the entity's use of IT in the components of the system of internal control.

.A110 The overall objectives of the auditor do not differ whether an entity operates in a mainly manual environment, a completely automated environment, or an environment involving some combination of manual and automated elements (that is, manual and automated controls and other resources, including service organizations, used in the entity's system of internal control).

Understanding the Nature of the Components of the Entity's System of Internal Control

.A111 The auditor's understanding and evaluation of the components of the entity's system of internal control required by this section provides a preliminary understanding of how the entity identifies business risks relevant to financial reporting and how it responds to them. It may also influence the auditor's identification and assessment of the risks of material misstatement in different ways (see paragraph .A96). The auditor's identification and assessment of the risks of material misstatement assists the auditor in designing and performing further audit procedures, including any plans to test the operating effectiveness of controls. Examples follow:

- The auditor's understanding of the entity's control environment, the entity's risk assessment process, and the entity's process to monitor controls components is more likely to affect the identification and assessment of risks of material misstatement at the financial statement level.
- The auditor's understanding of the entity's information system and communication, and the entity's control activities component, is more likely to affect the identification and assessment of risks of material misstatement at the assertion level.

Control Environment, the Entity's Risk Assessment Process, and the Entity's Process to Monitor the System of Internal Control (Ref: par. .21–.24)

.A112 The controls in the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control are primarily indirect controls (see paragraph .A5). However, controls within these components may vary in nature and precision and, therefore, some controls within these components may also be direct controls that address risks of material misstatement at the assertion level (see paragraph .A170).

Why the Auditor Is Required to Understand the Control Environment, The Entity's Risk Assessment Process, and the Entity's Process to Monitor the System of Internal Control

.A113 The control environment provides an overall foundation for the operation of the other components of the system of internal control. The control environment does not directly prevent, or detect and correct, misstatements. It may, however, influence the effectiveness of controls in the other components of the system of internal control. Similarly, the entity's risk assessment process and its process for monitoring the system of internal control are designed to operate in a manner that also supports the entire system of internal control.

.A114 Because these components are foundational to the entity's system of internal control, deficiencies in their operation could have pervasive effects on the preparation of the financial statements. Therefore, the auditor's understanding and evaluations of these components required by this section affect the auditor's identification and assessment of risks of material misstatement at the financial statement level and may also affect the identification and assessment of risks of material misstatement at the assertion level (see paragraphs .A118, .A127, and .A138). Risks of material misstatement at the

financial statement level affect the auditor's design of overall responses, including, as explained in section 330, an influence on the nature, timing, and extent of the auditor's further procedures.³⁹

Obtaining an Understanding of the Control Environment (Ref: par. .21)

Scalability

.A115 The nature of the control environment in a less complex entity is likely to be different from the control environment in a more complex entity. For example, those charged with governance in less complex entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager when there are no other owners. Accordingly, some considerations about the entity's control environment may be less relevant or may not be applicable.

.A116 In addition, audit evidence about elements of the control environment in less complex entities may not be available in documentary form, in particular, when communication between management and other personnel is informal, but the evidence may still be appropriately relevant and reliable in the circumstances. Examples are as follows:

- The organizational structure in a less complex entity will likely be simpler and may include a small number of employees involved in roles related to financial reporting.
- If the role of governance is undertaken directly by the owner-manager, the auditor may determine that the independence of those charged with governance is not relevant (see paragraph .A68).
- Less complex entities may not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Consequently, the attitudes, awareness, and actions of management or the owner-manager are of particular importance to the auditor's understanding of a less complex entity's control environment.

Understanding the Control Environment (Ref: par. .21a)

.A117 In considering the extent to which management demonstrates a commitment to integrity and ethical values, the auditor may obtain an understanding through inquiries of management and employees and through considering information from external sources about

- how management communicates to employees its views on business practices and ethical behavior, and
- inspecting management's written code of conduct and observing whether management acts in a manner that supports that code.

Evaluating the Control Environment (Ref: par. .21b)

Why the Auditor Evaluates the Control Environment

.A118 The auditor's evaluation of how the entity demonstrates behavior consistent with the entity's commitment to integrity and ethical values; whether the control environment provides an appropriate foundation for the other components of the entity's system of internal control; and whether identified control deficiencies undermine the other components of the system of internal control, assists the auditor in identifying potential control deficiencies in

³⁹ Paragraphs .A1–.A3 of section 330.

the other components of the system of internal control. This is because the control environment is foundational to the other components of the entity's system of internal control. This evaluation may also assist the auditor in understanding risks faced by the entity and, therefore, in identifying and assessing the risks of material misstatement at the financial statement and assertion levels (see paragraph .A111). The auditor may also identify control deficiencies in the control environment, the severity of which may be indicative of a fraud risk factor. In addition, the auditor's understanding and evaluation of the control environment required by this section may influence the controls the auditor might identify in accordance with paragraphs .27 and .29*b* based on the auditor's knowledge of the presence or absence of such controls in other components.

The Auditor's Evaluation of the Control Environment

.A119 The auditor's evaluation of the control environment is based on the understanding obtained in accordance with paragraph .21*a*. The evaluation is focused on the matters included in paragraph .21*b* and, therefore, does not require evaluating the design or determining the implementation of individual controls within the control environment. However, as described in paragraph .A106, the auditor may identify, in accordance with paragraphs .27–.29, controls within the control environment component for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A112 and .A170).

.A120 Some entities may be dominated by a single individual who may exercise a great deal of discretion. The actions and attitudes of that individual may have a pervasive effect on the culture of the entity, which, in turn, may have a pervasive effect on the control environment. Such an effect may be positive or negative. For example, direct involvement by a single individual may be key to enabling the entity to meet its growth and other objectives and can also contribute significantly to an effective system of internal control. On the other hand, such concentration of knowledge and authority can also lead to an increased susceptibility to misstatement through management override of controls.

.A121 The auditor may consider how the different elements of the control environment may be influenced by the philosophy and operating style of senior management, taking into account the involvement of independent members of those charged with governance.

.A122 Although the control environment may provide an appropriate foundation for the system of internal control and may help reduce the risk of fraud, an appropriate control environment is not necessarily an effective deterrent to fraud. For example, human resource policies and procedures directed toward hiring competent financial, accounting, and IT personnel may mitigate the risk of errors in processing and recording financial information. However, such policies and procedures may not mitigate the risk of management override of controls (for example, fraudulent financial reporting that involves senior management overstating earnings).

.A123 The auditor's evaluation of the control environment as it relates to the entity's use of IT may include such matters as the following:

- Whether governance over IT is commensurate with the nature and complexity of the entity and its business operations enabled by IT, including the complexity or maturity of the entity's technology platform or architecture and the extent to which the entity relies on IT applications to support its financial reporting

- The management organizational structure regarding IT and the resources allocated (for example, whether the entity has invested in an appropriate IT environment and necessary enhancements or whether a sufficient number of appropriately skilled individuals have been employed, including when the entity uses commercial software [with no or limited modifications])

Obtaining an Understanding of the Entity's Risk Assessment Process (Ref: par. .22-.23)

Understanding the Entity's Risk Assessment Process (Ref: par. .22a)

.A124 As explained in paragraph .A71, not all business risks give rise to risks of material misstatement, whether due to error or fraud. In understanding how management and those charged with governance have identified business risks relevant to the preparation of the financial statements, and decided about actions to address those risks, matters the auditor may consider include how management or, as appropriate, those charged with governance, has done the following:

- Specified the entity's objectives with sufficient precision and clarity to enable the identification and assessment of the risks relating to the objectives
- Identified the risks to achieving the entity's objectives and analyzed the risks as a basis for determining how the risks should be managed
- Assessed changes that could significantly affect the system of internal control
- Considered the potential for fraud when considering the risks to achieving the entity's objectives⁴⁰

.A125 Paragraph .22 of this section requires the auditor to obtain an understanding of the entity's process for identifying business risks. Section 240⁴¹ requires the auditor to make inquiries of management regarding, among other things, management's process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist.

.A126 The auditor may consider the implications of such business risks for the preparation of the entity's financial statements and other aspects of its system of internal control.

Evaluating the Entity's Risk Assessment Process (Ref: par. .22b)

Why the Auditor Evaluates Whether the Entity's Risk Assessment Process Is Appropriate

.A127 The auditor's evaluation of the entity's risk assessment process may assist the auditor in understanding where the entity has identified risks and how the entity has responded to those risks. The auditor's evaluation of how the entity identifies its business risks and how it assesses and addresses those risks assists the auditor in understanding whether the risks faced by the entity have been identified, assessed, and addressed, as appropriate, to the nature and complexity of the entity. This evaluation may also assist the auditor with

⁴⁰ Paragraph .18 of section 240.

⁴¹ Paragraph .17 of section 240.

identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph .A111).

Evaluating Whether the Entity's Risk Assessment Process Is Appropriate (Ref: par. .22b)

.A128 The auditor's evaluation of the appropriateness of the entity's risk assessment process is based on the understanding obtained in accordance with paragraph .22a. The evaluation is focused on the matters included in paragraph .22b and, therefore, does not require evaluating the design or determining the implementation of individual controls within the entity's risk assessment process. However, as described in paragraph .A101, the auditor may identify, in accordance with paragraphs .27 and .29b, controls within the entity's risk assessment process component for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A112 and .A170).

Scalability

.A129 Whether the entity's risk assessment process is appropriate to the entity's circumstances, considering the nature and complexity of the entity, is a matter of the auditor's professional judgment. For example, in some less complex entities, and particularly owner-managed entities, an appropriate risk assessment may be performed through the direct involvement of management or the owner-manager (for example, the manager or owner-manager may routinely devote time to monitoring the activities of competitors and other developments in the marketplace to identify emerging business risks). The evidence of this risk assessment occurring in these types of entities is often not formally documented, but it may be evident from, for example, discussions the auditor has with management, corroborated by emails or other correspondence between management and other personnel, that management is, in fact, performing risk assessment procedures.

Obtaining an Understanding of the Entity's Process to Monitor the Entity's System of Internal Control (Ref: par. .24)

Scalability

.A130 In less complex entities, and in particular, owner-manager entities, the auditor's understanding of the entity's process to monitor the system of internal control is often focused on how management or the owner-manager is directly involved in operations because there may not be any other monitoring activities. For example, management may receive complaints from customers about inaccuracies in their monthly statement that alerts the owner-manager to issues with the timing of when customer payments are being recognized in the accounting records.

.A131 For entities in which there is no formal process for monitoring the system of internal control, understanding the process to monitor the system of internal control may include understanding periodic reviews of management accounting information that are designed to contribute to how the entity prevents, or detects and corrects, misstatements.

Understanding the Entity's Process to Monitor the System of Internal Control (Ref: par. .24a(i))

.A132 Matters that may be relevant for the auditor to consider when understanding how the entity monitors its system of internal control include the following:

- The design of the monitoring activities, for example, whether it is periodic or ongoing monitoring

- The performance and frequency of the monitoring activities
- The evaluation of the results of the monitoring activities, on a timely basis, to determine whether the controls have been effective
- How identified control deficiencies have been addressed through appropriate remedial actions, including timely communication of such deficiencies to those responsible for taking remedial action

.A133 The auditor may also consider how the entity's process to monitor the system of internal control addresses monitoring information-processing controls that involve the use of IT. This may include, for example

- controls to monitor complex IT environments that
 - evaluate the continuing design effectiveness of information-processing controls and modify them, as appropriate, for changes in conditions or
 - evaluate the operating effectiveness of information-processing controls.
- controls that monitor the permissions applied in automated information-processing controls that enforce the segregation of duties.
- controls that monitor how errors or control deficiencies related to the automation of financial reporting are identified and addressed.

Understanding the Entity's Internal Audit Function (Ref: par. .24a(ii))

.A134 Appendix D sets out further considerations for understanding the entity's internal audit function.

.A135 The auditor's inquiries of appropriate individuals within the internal audit function help the auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the auditor determines that the function's responsibilities are related to the entity's financial reporting, the auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. This understanding, together with the information obtained from the auditor's inquiries, may also provide information that is directly relevant to the auditor's identification and assessment of the risks of material misstatement. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, section 610, *Using the Work of Internal Auditors*, applies.

Understanding the Sources of Information (Ref: par. .24b)

Other Sources of Information Used in the Entity's Process to Monitor the System of Internal Control

.A136 Management's monitoring activities may use information in communications from external parties, such as customer complaints or regulator comments, that may indicate problems or highlight areas in need of improvement.

Why the Auditor Is Required to Understand the Sources of Information Used for the Entity's Monitoring of the System of Internal Control

.A137 The auditor's understanding of the sources of information used by the entity in monitoring the entity's system of internal control, including

whether the information used is relevant and reliable, assists the auditor in evaluating whether the entity's process to monitor the entity's system of internal control is appropriate. If management assumes that information used for monitoring is relevant and reliable without having a basis for that assumption, errors that may exist in the information could potentially lead management to draw incorrect conclusions from its monitoring activities.

Why the Auditor Evaluates Whether the Entity's Process to Monitor the System of Internal Control Is Appropriate (Ref: par. .24c)

Evaluating The Entity's Process to Monitor The System of Internal Control

.A138 The auditor's evaluation about how the entity undertakes ongoing and separate evaluations for monitoring the effectiveness of controls assists the auditor in understanding whether the other components of the entity's system of internal control are present and functioning and, therefore, assists with understanding the other components of the entity's system of internal control. This evaluation may also assist the auditor with identifying and assessing financial statement level and assertion level risks of material misstatement (see paragraph .A111) and with designing tests of controls.⁴²

Evaluating Whether the Entity's Process to Monitor the System of Internal Control Is Appropriate (Ref: par. .24c)

.A139 The auditor's evaluation of the appropriateness of the entity's process to monitor the system of internal control is based on the auditor's understanding of the entity's process to monitor the system of internal control. The evaluation is focused on the matters included in paragraph .24c and, therefore, does not require evaluating the design or determining the implementation of individual controls within the entity's process to monitor the system of internal control. However, as described in paragraph .A106, the auditor may identify, in accordance with paragraphs .27 and .29b, controls within the entity's process to monitor the system of internal control component for which the auditor also evaluates design and determines implementation as required by paragraph .30 (see paragraphs .A112 and .A170).

Information System and Communication, and Control Activities ***(Ref: par. .25–.30)***

.A140 The controls in the information system and communication, and control activities components are primarily direct controls (that is, controls that are sufficiently precise to prevent, detect, or correct misstatements at the assertion level).

Why the Auditor Is Required to Understand the Information System and Communication, and Controls in the Control Activities Component

.A141 The auditor is required to understand the entity's information system and communication because understanding the flows of transactions and other aspects of the entity's information-processing activities relevant to the preparation of the financial statements, and evaluating whether the component appropriately supports the preparation of the entity's financial statements, supports the auditor's identification and assessment of risks of material misstatement at the assertion level. This understanding and evaluation may also result in the identification of risks of material misstatement at the financial statement level when the results of the auditor's procedures are inconsistent with expectations about the entity's system of internal control that may have

⁴² Paragraph .08 of section 330.

been set based on information obtained during the engagement acceptance or continuance process (see paragraph .A111).

.A142 The auditor is required to identify specific controls in the control activities component, and evaluate the design and determine whether the controls have been implemented, because it assists the auditor's understanding about management's approach to addressing certain risks. Therefore, it provides a basis for the design and performance of further audit procedures responsive to these risks as required by section 330. The higher on the spectrum of inherent risk a risk is assessed, the more persuasive the audit evidence needs to be. Even when the auditor does not plan to test the operating effectiveness of identified controls, the auditor's understanding may still affect the design of the nature, timing, and extent of substantive procedures that are responsive to the related risks of material misstatement (see paragraph .A210).

The Iterative Nature of the Auditor's Understanding and Evaluation of the Information System and Communication, and Control Activities

.A143 As explained in paragraph .A57, the auditor's understanding of the entity and its environment, and the applicable financial reporting framework, may assist the auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant classes of transactions, account balances, and disclosures. In obtaining an understanding of the information system and communication component in accordance with paragraph .25a, the auditor may use these initial expectations to determine the extent of understanding of the entity's information-processing activities to be obtained.

.A144 The auditor's understanding of the information system includes understanding the policies that define flows of information relating to the entity's significant classes of transactions, account balances, and disclosures, and other related aspects of the entity's information-processing activities. This information and the information obtained from the auditor's evaluation of the information system and communication component required by this section may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified (see paragraph .A143).

.A145 In obtaining an understanding of how information relating to significant classes of transactions, account balances, and disclosures flows into, through, and out of the entity's information system, the auditor may also identify controls in the control activities component that are required to be identified in accordance with paragraph .27 or .29b. For example, the auditor's identification and evaluation of controls in the control activities component may first focus on controls over journal entries and other adjustments and controls that the auditor plans to test the operating effectiveness of in designing the nature, timing, and extent of substantive procedures.

.A146 The auditor's assessment of inherent risk may also influence the identification of controls in the control activities component. For example, controls that address significant risks may be identifiable only when the auditor has assessed inherent risk at the assertion level in accordance with paragraph .35. Furthermore, controls addressing risks for which the auditor has determined that substantive procedures alone do not provide sufficient appropriate audit evidence (in accordance with paragraph .37) may also be identifiable only once the auditor's inherent risk assessments have been undertaken.

.A147 The auditor's identification and assessment of risks of material misstatement at the assertion level is influenced by both of the following:

- The auditor's understanding of the entity's policies for its information-processing activities in the information system and communication component
- The auditor's identification and evaluation of controls in the control activities component

Obtaining an Understanding of the Information System and Communication (Ref: par. .25)

.A148 Appendix C⁴³ sets out further considerations relating to the information system and communication.

Scalability

.A149 The information system, and related business processes, in less complex entities are likely to be less sophisticated than in larger entities and are likely to involve a less complex IT environment; however, the role of the information system is just as important. For example, less complex entities with direct management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the relevant aspects of the entity's information system may, therefore, require less effort in an audit of a less complex entity and may involve a greater amount of inquiry than observation or inspection of documentation. The need to obtain an understanding, however, remains important to provide a basis for the design of further audit procedures in accordance with section 330 and may further assist the auditor in identifying or assessing risks of material misstatement (see paragraph .A111).

Obtaining an Understanding of the Information System (Ref: par. .25a)

.A150 Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. Understanding how the entity initiates transactions and captures information as part of the auditor's understanding of the information system may include information about the entity's systems (its policies) designed to address compliance and operations objectives because such information is relevant to the preparation of the financial statements. Further, some entities may have information systems that are highly integrated such that controls may be designed in a manner to simultaneously achieve financial reporting, compliance and operational objectives, and combinations thereof.

.A151 The auditor's understanding of the entity's information system and communication required under paragraph .25a results in obtaining an understanding of the process of reconciling detailed records to the general ledger.

.A152 Understanding the entity's information system also includes an understanding of the resources to be used in the entity's information-processing activities. Information about the human resources involved that may be relevant to understanding risks to the integrity of the information system include the following:

- The competence of the individuals undertaking the work
- Whether there are adequate resources
- Whether there is appropriate segregation of duties

⁴³ Paragraphs 15–20 of appendix C, "Understanding the Entity's System of Internal Control."

.A153 Matters the auditor may consider when understanding the policies that define the flows of information relating to the entity's significant classes of transactions, account balances, and disclosures in the information system and communication component include the nature of

- a. the data or information relating to transactions, other events, and conditions to be processed;
- b. the information processing to maintain the integrity of that data or information;
- c. the information processes, personnel, and other resources used in processing information.

.A154 Obtaining an understanding of the entity's business processes, which include how transactions are originated, assists the auditor in obtaining an understanding of the entity's information system in a manner that is appropriate to the entity's circumstances.

.A155 The auditor's understanding of the information system may be obtained in various ways and may include some or all of the following:

- Inquiries of relevant personnel about the procedures used to initiate, record, process, and report transactions or about the entity's financial reporting process
- Inspection of policy or process manuals or other documentation of the entity's information system
- Observation of the performance of the policies or procedures by entity's personnel
- Selecting transactions and tracing them through the applicable process in the information system (that is, performing a walk-through, as described in paragraphs .A204–.A205)

Automated Tools and Techniques

.A156 The auditor may also use automated techniques to obtain direct access to, or a digital download from, the databases in the entity's information system that store accounting records of transactions. By applying automated tools or techniques to this information, the auditor may confirm the understanding obtained about how transactions flow through the information system by tracing journal entries, or other digital records related to a particular transaction, or an entire population of transactions from initiation in the accounting records through to recording in the general ledger. Analysis of complete or large sets of transactions may also result in the identification of variations from the normal, or expected, processing procedures for these transactions, which may result in the identification of risks of material misstatement.

Information Obtained From Outside of the General and Subsidiary Ledgers

.A157 Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information that the auditor may consider are as follows:

- Information obtained from lease agreements relevant to disclosures in the financial statements
- Information disclosed in the financial statements that is produced by an entity's risk management system
- Fair value information produced by management's specialists and disclosed in the financial statements

- Information disclosed in the financial statements that has been obtained from models or from other calculations used to develop accounting estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as
 - assumptions developed internally that may affect an asset's useful life, or
 - data such as interest rates that are affected by factors outside the control of the entity
- Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions
- Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records
- Information disclosed in the financial statements that has been obtained from analyses prepared to support management's assessment of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that may cast significant doubt on the entity's ability to continue as a going concern⁴⁴

.A158 Certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system and exercises professional judgment in determining the necessary understanding.

The Entity's Use of IT in the Information System

Why Does the Auditor Understand the IT Environment Relevant to the Information System

.A159 The auditor's understanding of the information system includes the IT environment relevant to the flows of transactions and processing of information in the entity's information system because the entity's use of IT applications or other aspects in the IT environment may give rise to risks arising from the use of IT.

.A160 The understanding of the entity's business model and how it integrates the use of IT may also provide useful context to the nature and extent of IT expected in the information system.

Understanding the Entity's Use of IT

.A161 The auditor's understanding of the IT environment may focus on identifying, and understanding the nature and number of, the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system, may result from program changes to IT applications or direct changes to data in databases involved in processing or storing those transactions or information.

.A162 The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information

⁴⁴ Paragraphs .21–.22 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

relating to significant classes of transactions, account balances, and disclosures flow into, through, and out of the entity's information system.

Obtaining an Understanding of the Entity's Communication (Ref: par. .25b)

Scalability

.A163 In more complex entities, information the auditor may consider when understanding the entity's communication may come from policy manuals and financial reporting manuals.

.A164 In less complex entities, communication may be less structured (for example, formal manuals may not be used) due to fewer levels of responsibility and management's greater visibility and availability. Regardless of the size of the entity, open communication channels facilitate the reporting of exceptions and acting on them.

Evaluating Whether the Relevant Aspects of the Information System Support the Preparation of the Entity's Financial Statements (Ref: par. .25c)

.A165 The auditor's evaluation of whether the entity's information system and communication appropriately supports the preparation of the financial statements is based on the understanding obtained in paragraph .25a–b. The evaluation is focused on the matters included in paragraph .25c and, therefore, does not require evaluating the design or determining the implementation of individual controls within the information system and communication component. Appendix C⁴⁵ sets out further considerations relating to the information system and communication component.

.A166 Controls within the information system and communication component are primarily more direct in addressing assertion level risks but may also be indirect controls (see paragraphs .A5, .A105, and .A140). In particular, information-processing controls, also known as *transaction controls*, directly support the actions to mitigate information-processing risks in an entity's business processes (see paragraphs .A7–.A8). As described in paragraph .A169, although the auditor's identification and evaluation of controls in the control activities component as required by paragraph .30 is focused on information-processing controls, the auditor is not required to identify and evaluate all information-processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information-processing activities for the significant classes of transactions, account balances, and disclosures.

Control Activities (Ref: par. .26–.31)

Controls in the Control Activities Component (Ref: par. .26)

.A167 Appendix C⁴⁶ sets out further considerations relating to controls in the control activities component.

.A168 In obtaining an understanding of the other components of internal control, the auditor may have identified some controls described in paragraphs .27 and .29b. The control activities component includes controls that are designed to ensure the proper application of policies (which are also controls) in all the other components of the entity's system of internal control and includes both direct and indirect controls. For example, the controls that an entity has established to ensure that its personnel are properly counting and recording

⁴⁵ Paragraphs 15–20 of appendix C.

⁴⁶ Paragraphs 21–22 of appendix C.

the annual physical inventory relate directly to the risks of material misstatement relevant to the existence and completeness assertions for the inventory account balance.

.A169 The auditor's identification and evaluation of controls in the control activities component is focused on information-processing controls, which are controls relating to the processing of information in IT applications or manual information processes in the entity's information system that directly address risks to the integrity of information (that is, the completeness, accuracy, and validity of transactions and other information). However, the auditor is not required to identify and evaluate all information-processing controls related to the entity's policies that define the flows of transactions and other aspects of the entity's information-processing activities for the significant classes of transactions, account balances, and disclosures.

.A170 Direct controls may exist in the control environment, the entity's risk assessment process, or the entity's process to monitor the system of internal control, which may be identified in accordance with paragraphs .27 and .29b. An example is a management review control designed to detect misstatements by using key performance indicators or other types of information to develop sufficiently precise expectations of reported amounts. The more indirect the relationship between controls that support other controls and the control that is being considered, the less effective that control may be in preventing, or detecting and correcting, related misstatements. For example, a sales manager's review of a summary of sales activity for specific stores by region ordinarily is indirectly related only to the risks of material misstatement relevant to the completeness assertion for sales revenue. Accordingly, it may be less effective in addressing those risks than controls more directly related thereto, such as matching shipping documents with billing documents.

.A171 Paragraphs .29b and .30 require the auditor to identify and evaluate general IT controls for IT applications and other aspects of the IT environment that the auditor has determined to be subject to risks arising from the use of IT because general IT controls support the continued effective functioning of information-processing controls. A general IT control alone is typically not sufficient to address a risk of material misstatement at the assertion level.

.A172 The following are controls that the auditor is required to identify and evaluate the design, and determine the implementation of, in accordance with paragraph .30:

- Controls that the auditor plans to test the operating effectiveness of in determining the nature, timing, and extent of substantive procedures. The evaluation of such controls provides the basis for the auditor's design of tests of controls in accordance with section 330. These controls also include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
- Controls that address significant risks as well as controls over journal entries and other adjustments as required by section 240. The auditor's identification and evaluation of such controls may also influence the auditor's identification and assessment of the risks of material misstatement, including the identification of additional risks of material misstatement (see paragraph .A111). This understanding also provides the basis for the auditor's design of the nature, timing, and extent of substantive procedures that are responsive to the related assessed risks of material misstatement.

- Other controls that the auditor considers appropriate to enable the auditor to meet the objectives of paragraph .13 with respect to risks at the assertion level, based on the auditor's professional judgment.

.A173 Controls in the control activities component are required to be identified when such controls meet one or more of the criteria included in paragraphs .27 or .29b. Such identified controls are sometimes referred to by auditors as *relevant controls* or *key controls*. An audit does not require an understanding, including evaluating the design or determining the implementation, of all controls related to each significant class of transactions, account balance, and disclosure in the financial statements or to every assertion relevant to them (see paragraph .A103–.A106).

.A174 There might be more than one control that addresses the assessed risk of material misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of material misstatement to more than one relevant assertion. It may not be necessary to identify all controls, including redundant controls, related to a relevant assertion, unless redundancy is, itself, a control objective related to addressing the risk of material misstatement.

Types of Controls in the Control Activities Component (Ref: par. .26)

.A175 Examples of controls in the control activities component include authorizations and approvals, reconciliations, verifications (such as edit and validation checks or automated calculations), segregation of duties, and physical or logical controls, including those addressing safeguarding of assets.

.A176 Controls in the control activities component may also include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework. Such controls may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

.A177 Regardless of whether controls are within the IT environment or manual systems, controls may have various objectives and may be applied at various organizational and functional levels.

Scalability (Ref: par. .26)

.A178 Controls in the control activities component for less complex entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, in less complex entities, more controls may be directly applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions.

.A179 It may be less practicable to establish segregation of duties in less complex entities that have fewer employees. However, in an owner-managed entity, the owner-manager may be able to exercise more effective oversight through direct involvement than in a larger entity, which may compensate for the generally more limited opportunities for segregation of duties. Although, as also explained in section 240, domination of management by a single individual can be a potential control deficiency because there is an opportunity for management override of controls.⁴⁷

⁴⁷ Paragraph .A32 of section 240.

Controls That Address Risks of Material Misstatement at the Assertion Level
(Ref: par. .27a)

Controls That Address Risks That Are Determined to Be Significant Risks (Ref: par. .27a)

.A180 Regardless of whether the auditor plans to test the operating effectiveness of controls that address significant risks, the understanding obtained about management's approach to addressing those risks may provide a basis for the design and performance of substantive procedures responsive to significant risks as required by section 330.⁴⁸ Although risks relating to significant non-routine or judgmental matters are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. For example, when there are nonroutine events, such as a significant business acquisition, consideration of the entity's response may include such matters as whether it has been referred to appropriate specialists (such as internal or external valuation specialists), whether an assessment has been made of the potential effect, and how the circumstances are to be disclosed in the financial statements. The auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from nonroutine or judgmental matters may include whether and how management responds to the risks. Such responses may include the following:

- Controls, such as a review of assumptions by senior management or specialists
- Documented processes for accounting estimations
- Approval by those charged with governance

.A181 Section 240⁴⁹ requires the auditor to understand controls related to assessed risks of material misstatement due to fraud (which are treated as significant risks) and further explains that it is important for the auditor to obtain an understanding of the controls that management has designed, implemented, and maintained to prevent and detect fraud.

Controls Over Journal Entries and Other Adjustments (Ref: par. .27b)

.A182 How an entity incorporates information from transaction processing in the general ledger ordinarily involves the use of journal entries, whether standard or non-standard, or automated or manual. Section 240 requires the auditor to obtain an understanding of the entity's financial reporting process and controls over journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.⁵⁰

Automated Tools and Techniques

.A183 In manual general ledger systems, non-standard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain the general ledger and prepare financial statements, such entries may exist only in electronic form and, therefore, may be more easily identified through the use of automated techniques. For example, in the audit of a less complex entity, the auditor may be able to extract a total listing of all journal entries into a simple spreadsheet. It may then be possible for the auditor to sort the journal entries by applying a variety of filters such as currency amount, name of the preparer or reviewer, journal entries that gross up the balance sheet and income statement only, or viewing the listing by the date the journal entry was posted to the

⁴⁸ Paragraph .22 of section 330.

⁴⁹ Paragraphs .27 and .A37 of section 240.

⁵⁰ Paragraph .32 of section 240.

general ledger, to assist the auditor in designing responses to the risks identified related to journal entries.

Controls for Which the Auditor Plans to Test the Operating Effectiveness (Ref: par. .27c)

.A184 The auditor determines whether there are any risks of material misstatement at the assertion level for which it is not possible to obtain sufficient appropriate audit evidence through substantive procedures alone. The auditor is required, in accordance with section 330,⁵¹ to design and perform tests of controls that address such risks of material misstatement when substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level. As a result, when such controls exist that address these risks, they are required to be identified and evaluated.

.A185 In other cases, when the auditor plans to take into account the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures in accordance with section 330, such controls are also required to be identified because section 330⁵² requires the auditor to design and perform tests of those controls. For example, the auditor may plan to test the operating effectiveness of controls

- over routine classes of transactions because such testing may be more effective or efficient for large volumes of homogenous transactions.
- over the accuracy and completeness of information produced by the entity (for example, controls over the preparation and maintenance of system-generated reports) to determine the reliability of that information, when the auditor intends to take into account the operating effectiveness of those controls in designing and performing further audit procedures.
- relating to operations and compliance objectives when they relate to data the auditor evaluates or uses in applying audit procedures.

.A186 The auditor's decision whether to test the operating effectiveness of controls may also be influenced by the identified risks of material misstatement at the financial statement level. For example, if control deficiencies are identified related to the control environment, this may affect the auditor's overall expectations about the operating effectiveness of direct controls.

Other Controls That the Auditor Considers Appropriate (Ref: par. .27d)

.A187 In addition to the controls set out in paragraph .27a–c, the auditor may consider it appropriate to identify and evaluate the design and determine the implementation of other controls to have an appropriate basis for the identification and assessment of risks of material misstatement at the assertion level, in accordance with paragraph .13. Such controls may include some or all of the following:

- Controls that address risks assessed as higher on the spectrum of inherent risk but have not been determined to be a significant risk
- Controls related to reconciling detailed records to the general ledger
- Controls related to accounting estimates

⁵¹ Paragraph .08b of section 330.

⁵² Paragraph .08a of section 330.

- Complementary user entity controls, if using a service organization⁵³

.A188 The auditor's knowledge about the presence or absence of controls obtained from the understanding of the other components may inform the auditor's professional judgment in determining the extent to which it is necessary to devote additional attention to other controls.

Identifying IT Applications and Other Aspects of the IT Environment, Risks Arising From the Use of IT, and General IT Controls (Ref: par. .29)

.A189 Appendix E includes examples of considerations that may assist the auditor in determining whether IT applications are subject to risks arising from the use of IT.

Identifying IT Applications and Other Aspects of the IT Environment (Ref: par. .29)

Why the Auditor Identifies Risks Arising From the Use of IT and General IT Controls Related to Identified IT Applications and Other Aspects of the IT Environment

.A190 For controls listed in paragraph .27, paragraph .29 requires the auditor to identify related IT applications and other aspects of the IT environment that are subject to the risks described in paragraph .29a. Paragraph .29b then requires the auditor to identify general IT controls that address such risks. Such identification is necessary in order for the auditor to effectively perform the evaluation of design and determination of implementation of identified controls in accordance with paragraph .30 because general IT controls that address these risks may affect the design and implementation of the controls identified in paragraph .27.

.A191 In understanding the risks arising from the use of IT and the general IT controls implemented by the entity to address those risks, some or all of the following may be affected:

- *The auditor's decision about whether to test the operating effectiveness of controls to address risks of material misstatement at the assertion level.* For example, when general IT controls are not designed effectively or appropriately implemented to address risks arising from the use of IT (for example, controls do not appropriately prevent or detect unauthorized program changes or unauthorized access to IT applications), this may affect the auditor's decision to rely on automated controls within the affected IT applications.
- *The auditor's assessment of control risk at the assertion level.* For example, the ongoing operating effectiveness of an information-processing control may depend on certain general IT controls that prevent or detect unauthorized program changes to the IT information-processing control (that is, program change controls over the related IT application). In such circumstances, the expected operating effectiveness (or lack thereof) of the general IT control may affect the auditor's assessment of control risk (for example, control risk may be higher when such general IT controls are expected to be ineffective or if the auditor does not plan to test the general IT controls).

⁵³ Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

- *The auditor's strategy for testing information produced by the entity that is produced by or involves information from the entity's IT applications.* For example, when information produced by the entity to be used as audit evidence is produced by IT applications, the auditor may determine to test controls over system-generated reports, including identification and testing of the general IT controls that address risks of inappropriate or unauthorized program changes or direct changes to the data in such reports.
- *The auditor's assessment of inherent risk at the assertion level.* For example, when there are significant or extensive programming changes to an IT application to address new or revised reporting requirements of the applicable financial reporting framework, this may be indicative of the complexity of the new requirements and their effect on the entity's financial statements. When such extensive programming or data changes occur, the IT application is also likely to be subject to risks arising from the use of IT.
- *The design of further audit procedures.* For example, if information-processing controls depend on general IT controls, the auditor may determine to test the operating effectiveness of the general IT controls, which will then require the design of tests of controls for such general IT controls. If, in the same circumstances, the auditor determines not to test the operating effectiveness of the general IT controls, or the general IT controls are expected to be ineffective, the related risks arising from the use of IT may need to be addressed through the design of substantive procedures. However, in such circumstances, the risks arising from the use of IT may not be able to be addressed when such risks relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. In addition, the auditor may need to consider the implications for the audit opinion.

Identifying IT Applications That Are Subject to Risks Arising From the Use of IT

.A192 For the IT applications relevant to the information system, understanding the nature and complexity of the specific IT processes and general IT controls that the entity has in place may assist the auditor in determining which IT applications the entity is relying upon to accurately process and maintain the integrity of information in the entity's information system. Such IT applications may be subject to risks arising from the use of IT.

.A193 Identifying the IT applications that are subject to risks arising from the use of IT involves taking into account controls identified by the auditor because such controls may involve the use of IT or rely on IT. The auditor may focus on whether an IT application includes automated controls that management is relying on and that the auditor has identified, including controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence. The auditor may also consider how information is stored and processed in the information system relating to significant classes of transactions, account balances, and disclosures and whether management is relying on general IT controls to maintain the integrity of that information.

.A194 The controls identified by the auditor in accordance with paragraph .27 may depend on system-generated reports that contain information that is used in the operation of the controls. In such circumstances, the control owner might rely on controls over the preparation and maintenance of such reports or perform other procedures to verify the information is accurate and complete.

Likewise, the auditor may obtain audit evidence about the accuracy and completeness of the information by directly testing the inputs and outputs of the system-generated reports, rather than rely on controls over the preparation and maintenance of such reports. In such circumstances, the auditor may not identify the related IT applications as being subject to risks arising from the use of IT and, thus, such controls may not be subject to the requirement in paragraph .29b.

Scalability

.A195 The extent of the auditor's understanding of the IT processes, including the extent to which the entity has general IT controls in place, will vary with the nature and circumstances of the entity and its IT environment and will also be based on the nature and extent of controls identified by the auditor. The number of IT applications that are subject to risks arising from the use of IT also will vary based on these factors. Examples are as follows:

- An entity that uses commercial software and does not have access to the source code to make any program changes is unlikely to have a process for program changes but may have a process or procedures to configure the software (for example, the chart of accounts, reporting parameters, or thresholds). In addition, the entity may have a process or procedures to manage access to the application (for example, a designated individual with administrative access to the commercial software). In such circumstances, the entity is unlikely to have formalized general IT controls.
- In contrast, an entity may use multiple IT applications, and the IT processes to manage the IT environment may be complex (for example, a dedicated IT department exists that develops and implements program changes and manages access rights). In such circumstances, the entity likely has implemented formalized general IT controls over its IT processes.
- When management is not relying on automated controls or general IT controls to support complete and accurate transaction processing or maintain the data, and the auditor has not identified any automated controls or other information-processing controls (or any that depend on general IT controls), the auditor may plan to directly test any information produced by the entity involving IT and may not identify any IT applications that are subject to risks arising from the use of IT.
- When management relies on an IT application to process or maintain data and the volume of data is significant, and management relies upon the IT application to perform automated controls that the auditor has also identified, the IT application is likely to be subject to risks arising from the use of IT.

See paragraph 15 of appendix E for examples of considerations that may assist the auditor in determining whether IT applications are subject to risks arising from the use of IT.

.A196 When an entity has greater complexity in its IT environment, identifying the IT applications and other aspects of the IT environment, determining the related risks arising from the use of IT, and identifying general IT controls is likely to require the involvement of team members with specialized skills or knowledge in IT. Such involvement is likely to be essential and may need to be extensive for complex IT environments.

Identifying Other Aspects of the IT Environment That Are Subject to Risks Arising From the Use of IT

.A197 The other aspects of the IT environment that may be subject to risks arising from the use of IT include the network, operating system and databases, and, in certain circumstances, interfaces between IT applications. Other aspects of the IT environment are generally not identified when the auditor does not identify IT applications that are subject to risks arising from the use of IT. When the auditor has identified IT applications that are subject to risks arising from the use of IT, other aspects of the IT environment (for example, database, operating system, network) are likely to be identified because such aspects support and interact with the identified IT applications.

Identifying Risks Arising From the Use of IT and General IT Controls (Ref: par. .29)

.A198 Appendix F, "Considerations for Understanding General IT Controls," sets out considerations for understanding general IT controls.

.A199 In identifying the risks arising from the use of IT, the auditor may consider the nature of the identified IT application or other aspect of the IT environment and the reasons for it being subject to risks arising from the use of IT. For some identified IT applications or other aspects of the IT environment, the auditor may identify applicable risks arising from the use of IT that relate primarily to unauthorized access or unauthorized program changes as well as risks related to inappropriate data changes (for example, the risk of inappropriate changes to the data through direct database access or the ability to directly manipulate information).

.A200 The extent and nature of the applicable risks arising from the use of IT vary depending on the nature and characteristics of the identified IT applications and other aspects of the IT environment. Applicable IT risks may result when the entity uses external or internal service providers for identified aspects of its IT environment (for example, outsourcing the hosting of its IT environment to a third party or using a shared service center for central management of IT processes in a group). It is more likely that there will be more risks arising from the use of IT when the volume or complexity of automated application controls is higher and management is placing greater reliance on those controls for effective processing of transactions or the effective maintenance of the integrity of underlying information. Applicable risks arising from the use of IT may also be identified related to cybersecurity.

Evaluating the Design and Determining Implementation of Identified Controls in the Control Activities Component (Ref: par. .30)

.A201 Evaluating the design of an identified control involves the auditor's consideration of whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements.

.A202 The auditor determines the implementation of an identified control by establishing that the control exists and that the entity is using it. There is little point in the auditor assessing the implementation of a control that is not designed effectively. Therefore, the auditor typically evaluates the design of a control first. An improperly designed control may represent a control deficiency.

.A203 Risk assessment procedures to obtain audit evidence about the design and implementation of identified controls in the control activities component may include

- inquiring of entity personnel.

- observing the performance of specific controls.
- inspecting documents and reports.
- reperforming the specific controls.

Inquiry alone, however, is not sufficient for such purposes.

.A204 A walk-through involves following a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial records, using the same documents and IT that entity personnel use. Walk-throughs may assist the auditor in understanding the information system as required by paragraph .25 and in evaluating the design of controls that address the risks of material misstatement and determining whether those controls have been implemented as required by paragraph .30. Walk-through procedures usually include a combination of inquiry, observation, inspection of relevant documentation, and reperformance of controls. Such walk-throughs, as described in paragraph .A205, ordinarily are sufficient to evaluate design and determine implementation when risk assessment procedures beyond inquiry are performed.

.A205 In performing a walk-through, at the points at which important processing procedures occur, the auditor inquires of the entity's personnel about their understanding of what is required by the entity's prescribed procedures and controls particularly for the application of manual controls. These inquiries, combined with the other walk-through procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, inquiries that go beyond a narrow focus on the single transaction used as the basis for the walk-through allow the auditor to gain an understanding of the different types of significant transactions handled by the process.

.A206 The auditor may expect, based on experience from the previous audit or based on current period risk assessment procedures, that management does not have effectively designed or implemented controls to address a significant risk. In such instances, the procedures performed to address the requirement in paragraph .30 may consist of determining that such controls have not been effectively designed or implemented. If the results of the procedures indicate that controls have been newly designed or implemented, the auditor is required to perform the procedures in paragraph .30 on the newly designed or implemented controls.

.A207 The auditor may conclude that a control, which is effectively designed and implemented, may be appropriate to test in order to take its operating effectiveness into account in designing substantive procedures. However, when a control is not designed or implemented effectively, there is no benefit in testing it. When the auditor plans to test the operating effectiveness of a control, the information obtained about the extent to which the control addresses the risk or risks of material misstatement may be an input to the auditor's control risk assessment at the assertion level (see paragraph .A256).

.A208 Evaluating the design and determining the implementation of identified controls in the control activities component is not sufficient to test their operating effectiveness. However, for automated controls, if the procedures performed to evaluate the design of the controls and determine whether they have been implemented meets the requirements of a test of operating effectiveness in section 330,⁵⁴ the auditor may use the results of these procedures as a test of the operating effectiveness of the automated controls for the audit period if

⁵⁴ Paragraph .A34 of section 330.

general IT controls provide for the consistent operation of the automated controls. Obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. Tests of the operating effectiveness of controls, including tests of indirect controls, are further described in section 330.⁵⁵

.A209 When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's evaluation of the design and determination of the implementation of certain controls may still assist in the design of the nature, timing, and extent of substantive procedures that are responsive to the related risks of material misstatement. Examples are as follows:

- These risk assessment procedures may provide a basis for the auditor's consideration of possible misstatements or likely sources of misstatements in a population when designing substantive procedures.
- These risk assessment procedures may lead the auditor to identify inadequate segregation of duties that may affect the design of the auditor's substantive procedures (for example, inadequate segregation of duties in the payroll function may indicate a fraud risk resulting from the ability to create fictitious employees for which the auditor's substantive procedures are required to be responsive to that risk).
- These risk assessment procedures may lead the auditor to identify missing controls that may affect the design of the auditor's substantive procedures (for example, the auditor may become aware that identified controls related to sales do not address the entity's bill-and-hold transactions with customers, resulting in different substantive procedures for such transactions)

.A210 In addition, when identified controls are designed effectively and implemented, risk assessment procedures may influence the auditor's determination of the nature and timing of substantive procedures to be performed (for example, the auditor may determine to perform inspection, rather than external confirmation or to perform procedures at an interim date, rather than at period end).

Control Deficiencies Within the Entity's System of Internal Control (Ref: par. .31)

.A211 In performing the evaluations required by paragraphs .21b, .22b, .24c, .25c, and .30, the auditor may determine that certain of the entity's policies in a component are not appropriate to the nature and circumstances of the entity. Such determination may be an indicator that a control deficiency exists.

.A212 If the auditor has identified one or more control deficiencies, section 265, *Communicating Internal Control Related Matters Identified in an Audit*,⁵⁶ requires the auditor to determine whether, individually or in combination, the deficiencies constitute a material weakness or a significant deficiency. The auditor exercises professional judgment in determining whether a control deficiency represents a material weakness or a significant deficiency. Section 265 sets out

⁵⁵ Paragraphs .08–.10 of section 330.

⁵⁶ Paragraph .08 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

indicators of material weaknesses and matters to be considered in determining whether a deficiency, or a combination of deficiencies, in internal control constitute a material weakness or a significant deficiency.⁵⁷

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .32–.41)

Why the Auditor Identifies and Assesses the Risks of Material Misstatement

.A213 Risks of material misstatement are identified and assessed by the auditor in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

.A214 Information gathered by performing risk assessment procedures is used as audit evidence to provide the basis for the identification and assessment of the risks of material misstatement. For example, the audit evidence obtained when evaluating the design of identified controls and determining whether those controls have been implemented in the control activities component is used as audit evidence to support the risk assessment. Such evidence also provides a basis for the auditor to design overall responses to address the assessed risks of material misstatement at the financial statement level as well as designing and performing further audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement at the relevant assertion level, in accordance with section 330.

Identifying Risks of Material Misstatement (Ref: par. .32)

.A215 The identification of risks of material misstatement is performed before consideration of any related controls (that is, the determination is based on inherent risk) and is based on the auditor's preliminary consideration of misstatements that have a reasonable possibility of both occurring and being material if they were to occur.

.A216 Identifying the risks of material misstatement also provides the basis for the auditor's determination of relevant assertions, which assists the auditor's determination of the significant classes of transactions, account balances, and disclosures.

Assertions

Why the Auditor Uses Assertions

.A217 In identifying and assessing the risks of material misstatement, the auditor uses assertions to consider the different types of potential misstatements that may occur. Assertions for which the auditor has identified related risks of material misstatement are relevant assertions.

The Use of Assertions

.A218 In identifying and assessing the risks of material misstatement, the auditor may use the categories of assertions as described in subsequent paragraph .A219a–b or may express them differently, provided all aspects described in paragraph .A219a–b have been covered. The auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances and related disclosures.

⁵⁷ Paragraphs .A6–.A7 of section 265.

.A219 Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

- a. Assertions about classes of transactions and events, and related disclosures, for the period under audit:
 - i. *Occurrence*. Transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.
 - ii. *Completeness*. All transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
 - iii. *Accuracy*. Amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
 - iv. *Cutoff*. Transactions and events have been recorded in the correct accounting period.
 - v. *Classification*. Transactions and events have been recorded in the proper accounts.
 - vi. *Presentation*. Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
- b. Assertions about account balances, and related disclosures, at the period end:
 - i. *Existence*. Assets, liabilities, and equity interests exist.
 - ii. *Rights and obligations*. The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - iii. *Completeness*. All assets, liabilities, and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
 - iv. *Accuracy, valuation, and allocation*. Assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
 - v. *Classification*. Assets, liabilities, and equity interests have been recorded in the proper accounts.
 - vi. *Presentation*. Assets, liabilities, and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

.A220 The assertions described in preceding paragraph .A219a–b, adapted as appropriate, may also be used by the auditor in considering the different types of misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. For example, such a disclosure may be a description, required by the applicable financial reporting

framework, of an entity's exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies, and processes for managing the risks; and the methods used to measure the risks.

Considerations Specific to Governmental Entities

.A221 When making assertions about the financial statements of governmental entities, in addition to those assertions set out in paragraph .A219a–b, management may often assert that transactions and events have been carried out in accordance with law, regulation, or other authority. Such assertions may fall within the scope of the financial statement audit.

Risks of Material Misstatement at the Financial Statement Level
(Ref: par. .32a and .34)

Why the Auditor Identifies and Assesses Risks of Material Misstatement at the Financial Statement Level

.A222 The auditor identifies risks of material misstatement at the financial statement level to determine whether the risks have a pervasive effect on the financial statements and, therefore, would require an overall response in accordance with section 330.⁵⁸

.A223 In addition, risks of material misstatement at the financial statement level may also affect individual assertions, and identifying these risks may assist the auditor in assessing risks of material misstatement at the assertion level and in designing further audit procedures to address the identified risks.

Identifying and Assessing Risks of Material Misstatement at the Financial Statement Level

.A224 Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level (for example, risk of management override of controls). Rather, they represent circumstances that may pervasively increase the risks of material misstatement at the assertion level. The auditor's evaluation of whether risks identified relate pervasively to the financial statements supports the auditor's assessment of the risks of material misstatement at the financial statement level. In other cases, a number of assertions may also be identified as susceptible to the risk and, therefore, may affect the auditor's risk identification and assessment of risks of material misstatement at the assertion level (see paragraph .A246).

.A225 Depending upon the entity's nature and its environment, for example, governmental entities, the identification of risks at the financial statement level may include consideration of matters related to the political climate, public interest, and sensitivity of programs or activities.

.A226 The auditor's identification and assessment of risks of material misstatement at the financial statement level is influenced by the auditor's understanding of the entity's system of internal control, in particular, the auditor's understanding of the control environment, the entity's risk assessment process, and the entity's process to monitor the system of internal control, in addition to the following:

⁵⁸ Paragraph .05 of section 330.

- The outcome of the related evaluations required by paragraphs .21b, .22b, .24c, and .25c
- Any control deficiencies identified in accordance with paragraph .31

In particular, risks at the financial statement level may arise from control deficiencies in the control environment or from external events or conditions such as declining economic conditions. For example, control deficiencies such as a lack of management competence or a lack of oversight over the preparation and fair presentation of the financial statements may have a more pervasive effect on the financial statements and may require an overall response by the auditor in accordance with section 330.⁵⁹

.A227 Risks of material misstatement due to fraud may be particularly relevant to the auditor's consideration of the risks of material misstatement at the financial statement level. For example, the auditor understands from inquiries of management that the entity's financial statements are to be used in discussions with lenders in order to secure further financing to maintain working capital. The auditor also understands from such inquiries and other procedures that current loan agreements with these lenders contain financial covenants that the entity is at risk of failing to meet and identifies this condition as a fraud risk factor. Therefore, the auditor may determine that there is a greater susceptibility to misstatement due to this identified fraud risk factor, which affects inherent risk (that is, the susceptibility of the financial statements to material misstatement because of the risk of fraudulent financial reporting, such as overstatement of assets and revenue and understatement of liabilities and expenses to ensure that the covenants are met). The auditor may then identify assertion level risks with respect to existence, accuracy, or valuation of certain assets and completeness of certain liabilities that are susceptible to material misstatement as a result of this financial statement level risk.

.A228 The auditor's understanding, including the related evaluations, of the control environment and other components of the system of internal control may raise doubts about the auditor's ability to obtain audit evidence on which to base the audit opinion or be cause for withdrawal from the engagement when withdrawal is possible under applicable law or regulation. Examples are as follows:

- As a result of evaluating the entity's control environment, the auditor has concerns about the integrity of the entity's management, which may be so serious that it could cause the auditor to conclude that the risk of intentional misrepresentation by management in the financial statements is such that an audit cannot be conducted.
- As a result of evaluating the entity's information system and communication, the auditor determines that significant changes in the IT environment have been poorly managed, with little oversight from management and those charged with governance. The auditor concludes that there are significant concerns about the condition and reliability of the entity's accounting records. In such circumstances, the auditor may determine that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial statements.

.A229 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, establishes requirements and provides guidance in determining

⁵⁹ Paragraph .05 of section 330.

whether there is a need for the auditor to express a qualified opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.

Risks of Material Misstatement at the Assertion Level (Ref: par. .32b)

.A230 Appendix B sets out examples, in the context of inherent risk factors, of events or conditions that may indicate susceptibility to misstatement that may be material.

.A231 Risks of material misstatements that do not relate pervasively to the financial statements are risks of material misstatement at the assertion level. Assessed risks of material misstatement for the relevant assertions and the related significant classes of transactions, account balances, and disclosures are also referred to as *risks of material misstatement at the relevant assertion level*.

Relevant Assertions and Significant Classes of Transactions, Account Balances, and Disclosures (Ref: par. .33)

Why Relevant Assertions and Significant Classes of Transactions, Account Balances, and Disclosures Are Determined

.A232 Risks of material misstatement are assessed at the assertion level for significant classes of transactions, account balances, or disclosures in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. An approach to identifying and assessing risks of material misstatement may begin at the financial statement level and, with the auditor's overall understanding through risk assessment procedures, work down to significant classes of transactions, account balances, and disclosures and their relevant assertions. Further, determining the significant classes of transactions, account balances, and disclosures provides the basis for the scope of the auditor's understanding of the entity's information system required to be obtained in accordance with paragraph .25a. As described in paragraph .A144, the information obtained from the auditor's understanding and evaluation of the information system and communication component required by this section may confirm or further influence the auditor's expectations about the significant classes of transactions, account balances, and disclosures initially identified. This understanding may further assist the auditor in identifying and assessing risks of material misstatement (see paragraph .A96).

Automated Tools and Techniques

.A233 The auditor may use automated techniques to assist in the identification of significant classes of transactions, account balances, and disclosures. Examples are as follows:

- An entire population of transactions may be analyzed using automated tools and techniques to understand their nature, source, size, and volume. By applying automated techniques, the auditor may, for example, identify that an account with a zero balance at period end comprised numerous offsetting transactions and journal entries occurring during the period, indicating that the account balance or class of transactions may be significant (for example, a payroll clearing account). This same payroll clearing account may also identify expense reimbursements to management (and other employees), which could be a significant disclosure due to these payments being made to related parties.

- By analyzing the flows of an entire population of revenue transactions, the auditor may more easily identify a significant class of transactions that had not previously been identified.

Disclosures That May Be Significant

.A234 Significant disclosures include both quantitative and qualitative disclosures for which there is one or more relevant assertions. Examples of disclosures that have qualitative aspects and that may have relevant assertions and, therefore, may be considered significant by the auditor include disclosures about the following:

- Accounting and reporting complexities associated with an account
- Exposure to losses in an account
- Significant contingent liabilities arising from the activities reflected in an account
- Liquidity and debt covenants of an entity in financial distress
- Events or circumstances that have led to the recognition of an impairment loss
- Key sources of estimation uncertainty, including assumptions about the future
- The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity
- Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures
- Related parties and related party transactions
- Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount

Assessing Risks of Material Misstatement at the Assertion Level

Assessing Inherent Risk (Ref: par. .35–.37)

Assessing the Likelihood and Magnitude of Misstatement (Ref: par. .35)

Why the Auditor Assesses Likelihood and Magnitude of Misstatement

.A235 The auditor assesses the likelihood and magnitude of misstatement for identified risks of material misstatement because the significance of the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement were the misstatement to occur determines where on the spectrum of inherent risk the identified risk is assessed, which informs the auditor's design of further audit procedures to address the risk.

.A236 Assessing the inherent risk of identified risks of material misstatement also assists the auditor in determining significant risks. The auditor determines significant risks because specific responses to significant risks are required in accordance with section 330 and other AU-C sections.

.A237 Inherent risk factors influence the auditor's assessment of the likelihood and magnitude of misstatement for the identified risks of material misstatement at the assertion level. The greater the degree to which a class of

transactions, account balance, or disclosure is susceptible to material misstatement, the higher the inherent risk assessment is likely to be. Considering the degree to which inherent risk factors affect the susceptibility of an assertion to misstatement assists the auditor in appropriately assessing inherent risk for risks of material misstatement at the assertion level and in designing a more precise response to such a risk.

Spectrum of Inherent Risk

A238 In assessing inherent risk, the auditor exercises professional judgment in determining the significance of the combination of the likelihood and magnitude of a misstatement.

A239 The assessed inherent risk relating to a particular risk of material misstatement at the assertion level represents a judgment within a range, from lower to higher, on the spectrum of inherent risk. The judgment about where in the range inherent risk is assessed may vary based on the nature, size, and complexity of the entity and takes into account the assessed likelihood and magnitude of the misstatement and inherent risk factors.

A240 In considering the likelihood of a misstatement, the auditor considers the possibility that a misstatement may occur based on consideration of the inherent risk factors.

A241 In considering the magnitude of a misstatement, the auditor considers the qualitative and quantitative aspects of the possible misstatement (that is, misstatements in assertions about classes of transactions, account balances, or disclosures may be judged to be material due to size, nature, or circumstances).

A242 The auditor uses the significance of the combination of the likelihood and magnitude of a possible misstatement in determining where on the spectrum of inherent risk (that is, the range) inherent risk is assessed. The higher the combination of likelihood and magnitude, the higher the assessment of inherent risk; the lower the combination of likelihood and magnitude, the lower the assessment of inherent risk.

A243 For a risk to be assessed as higher on the spectrum of inherent risk, it does not mean that both the magnitude and likelihood need to be assessed as high. Rather, it is the intersection of the magnitude and likelihood of the material misstatement on the spectrum of inherent risk that will determine whether the assessed inherent risk is higher or lower on the spectrum of inherent risk. A higher inherent risk assessment may also arise from different combinations of likelihood and magnitude, for example, a higher inherent risk assessment could result from a lower likelihood but a very high magnitude.

A244 In order to develop appropriate strategies for responding to risks of material misstatement, the auditor may designate risks of material misstatement within categories along the spectrum of inherent risk, based on the auditor's assessment of inherent risk. These categories may be described in different ways, such as in quantitative terms or in nonquantitative terms. For example, the auditor may use percentages or classifications (for example, low, medium, or high; lower or higher; normal or elevated; or another type of nominal or arithmetic scale) to describe the level of inherent risk. Regardless of the method used, the auditor's assessment of inherent risk is appropriate when the design and implementation of further audit procedures to address the identified risks of material misstatement at the assertion level is appropriately responsive to the assessment of inherent risk and the reasons for that assessment.

Pervasive Risks of Material Misstatement at the Assertion Level (Ref: par. .35b)

.A245 In assessing the identified risks of material misstatement at the assertion level, the auditor may conclude that some risks of material misstatement relate more pervasively to the financial statements as a whole and potentially affect many assertions, in which case, the auditor may update the identification of risks of material misstatement at the financial statement level.

.A246 In circumstances in which risks of material misstatement are identified as financial statement level risks due to their pervasive effect on a number of assertions and are identifiable with specific assertions, the auditor is required to take into account those risks when assessing inherent risk for risks of material misstatement at the assertion level. Further, identified risks of material misstatement at the financial statement level may affect the auditor's assessment of significant risks at the assertion level.⁶⁰ For example, an entity may face operating losses and liquidity issues and be reliant on funding that has not yet been secured. In such a circumstance, the financial reporting framework may require management to evaluate whether there is substantial doubt about the entity remaining a going concern, and the auditor may determine that there is a significant risk associated with the related disclosures in the entity's financial statements.

Significant Risks (Ref: par. .36)Why Significant Risks Are Determined and the Implications for the Audit

.A247 The determination of significant risks allows for the auditor to focus more attention on those risks that are close to the upper end of the spectrum of inherent risk, through the performance of certain required responses, including the following:

- Controls that address significant risks are required to be identified in accordance with paragraph .27a of this section, with a requirement to evaluate whether the control has been designed effectively and implemented in accordance with paragraph .30 of this section.
- In addition to the requirements and guidance in this section, section 330 includes special audit considerations in the form of specific requirements related to significant risks because of the nature of the risk and the likelihood and potential magnitude of misstatement related to the risk. In this regard, section 330 requires controls that address significant risks to be tested in the current period (when the auditor intends to rely on the operating effectiveness of such controls) and substantive procedures to be planned and performed that are specifically responsive to the identified significant risk.⁶¹
- Section 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁶²
- Section 260 requires communicating with those charged with governance about the significant risks identified by the auditor.⁶³
- Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, if applicable, requires the auditor to take

⁶⁰ See paragraph .A214 of this section.

⁶¹ Paragraphs .15 and .22 of section 330.

⁶² Paragraph .07b of section 330.

⁶³ Paragraph .11 of section 260.

into account significant risks when determining those matters that required significant auditor attention, which are matters that may be key audit matters.⁶⁴

- Section 600 requires more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.⁶⁵

.A248 Timely review of audit documentation by the engagement partner at the appropriate stages during the audit allows significant matters, including significant risks, to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report.⁶⁶

Determining Significant Risks

.A249 In determining significant risks, the auditor may first identify those assessed risks of material misstatement that have been assessed higher on the spectrum of inherent risk to form the basis for considering which risks may be close to the upper end. Being close to the upper end of the spectrum of inherent risk will differ from entity to entity and will not necessarily be the same for an entity period on period. It may depend on the nature and circumstances of the entity for which the risk is being assessed.

.A250 The determination of which of the assessed risks of material misstatement are close to the upper end of the spectrum of inherent risk and, therefore, are significant risks, is a matter of professional judgment, unless the risk is of a type specified to be treated as a significant risk in accordance with the requirements of another AU-C section. Section 240 and section 550 provide further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud and related party transactions that are also significant unusual transactions.^{67, 68} Examples are as follows:

- Cash at a supermarket retailer would ordinarily be determined to be a high likelihood of possible misstatement (due to the risk of cash being misappropriated); however, the magnitude would typically be very low (due to the low levels of physical cash handled in the stores). The combination of these two factors on the spectrum of inherent risk would be unlikely to result in the existence of cash being determined to be a significant risk.
- An entity is in negotiations to sell a business segment. The auditor considers the effect on goodwill impairment and may determine there is a higher likelihood of possible misstatement and a higher magnitude due to the impact of inherent risk factors of subjectivity, uncertainty, and susceptibility to management bias or other fraud risk factors. This may result in goodwill impairment being determined to be a significant risk.

.A251 The auditor also takes into account the relative effects of inherent risk factors when assessing inherent risk. The lower the effect of inherent risk

⁶⁴ Paragraph .08 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

⁶⁵ Paragraphs .57–.58 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

⁶⁶ Paragraphs .19 and .A17 of section 220.

⁶⁷ Paragraphs .25–.27 of section 240.

⁶⁸ Paragraph .18 of section 550.

factors, the lower the assessed risk is likely to be. Risks of material misstatement that may be assessed as having higher inherent risk and, therefore, may be determined to be a significant risk, may arise from matters such as the following:

- Transactions for which there are multiple acceptable accounting treatments such that subjectivity is involved
- Accounting estimates that have high estimation uncertainty or complex models⁶⁹
- Accounting for unusual or complex transactions (for example, accounting for revenue with multiple performance obligations that are difficult to value)
- Emerging areas (for example, accounting for digital assets)
- Complexity in data collection and processing to support account balances
- Account balances or quantitative disclosures that involve complex calculations
- Accounting principles that may be subject to differing interpretation
- Changes in the entity's business that involve changes in accounting, for example, mergers and acquisitions

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence (Ref: par. .37)

Why Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence Are Required to Be Identified

.A252 Due to the nature of a risk of material misstatement, and the controls that address that risk, in some circumstances, the only way to obtain sufficient appropriate audit evidence is to test the operating effectiveness of controls. Accordingly, there is a requirement for the auditor to identify any such risks because of the implications for the design and performance of further audit procedures in accordance with section 330 to address risks of material misstatement at the assertion level.

.A253 Paragraph .27c also requires the identification of controls that address risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence because the auditor is required, in accordance with section 330,⁷⁰ to design and perform tests of such controls.

Determining Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

.A254 When routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures in relation to the risk. This may be the case in circumstances in which a significant amount of an entity's information is initiated, recorded, processed, or reported in the financial statements only in electronic form. For example, it is typically not possible to obtain sufficient appropriate audit evidence relating to revenue for a telecommunications entity based on substantive procedures alone. This is because the evidence of call or data activity does not exist in a form that is observable. Instead, controls testing is typically performed to determine that the origination and completion of

⁶⁹ Paragraphs .10–.11 of section 540, *Auditing Accounting Estimates and Related Disclosures*.

⁷⁰ Paragraph .08 of section 330.

calls and data activity is correctly captured (for example, minutes of a call or volume of a download) and recorded correctly in the entity's billing system. In such cases

- audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.
- the potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

.A255 Section 540 provides further guidance related to accounting estimates about risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.⁷¹ In relation to accounting estimates, this may not be limited to automated processing but may also be applicable to complex models.

Assessing Control Risk (Ref: par. .38)

.A256 The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design and the determination of implementation of the identified controls in the control activities component. The results of tests of the operating effectiveness of the controls in accordance with section 330 provide the basis for the auditor's determination of whether the initial expectation about the operating effectiveness of controls remains appropriate. If the controls are not operating effectively as expected, then the auditor will need to revise the control risk assessment in accordance with paragraph .41.

.A257 The auditor's assessment of control risk may be performed in different ways, depending on preferred audit techniques or methodologies, and may be expressed in different ways. For instance, the control risk assessment may be expressed using qualitative terms (such as control risk assessed as maximum, moderate, or minimum) or in terms of the auditor's expectation of how effective the controls are in addressing the identified risk, that is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls. In accordance with paragraph .38, tests of the operating effectiveness of controls are required to support a control risk assessment below the maximum level.

.A258 If the auditor plans to test the operating effectiveness of controls, it may be necessary to test a combination of controls to confirm the auditor's expectation that the controls are operating effectively. The auditor may plan to test both direct and indirect controls, including general IT controls and, if so, take into account the combined expected effect of the controls when assessing control risk. To the extent that the control to be tested does not fully address the assessed inherent risk, the auditor determines the implications on the design of further audit procedures to reduce audit risk to an acceptably low level.

.A259 When the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that

⁷¹ Paragraphs .A87–.A89 of section 540.

automated control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the automated control operated effectively throughout the period. When the auditor expects related general IT controls to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level, and the auditor's further audit procedures may need to include substantive procedures to address the applicable risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in section 330.⁷²

.A260 Regardless of whether the auditor plans to test the operating effectiveness of controls for the purpose of assessing control risk, the auditor's understanding of the entity and its environment, the financial reporting framework, and the entity's system of internal control informs the auditor's design of further audit procedures. Examples follow:

- The auditor's understanding of the entity's system of internal control may indicate that controls are not designed or implemented appropriately, or the entity's control environment does not support the effective operation of control. In this case, there is no point in testing the operating effectiveness of controls; the further audit procedures will consist solely of substantive procedures. If the auditor determines, pursuant to paragraph .37, that substantive procedures alone cannot provide sufficient appropriate audit evidence, the auditor may need to consider the effect on the auditor's report, as described in section 330.⁷³
- The auditor's understanding of the entity's information system and communication will inform the auditor about the nature of documentation available for testing. For example, if the entity's records are all electronic, the auditor may design audit procedures differently than if the entity's records are in paper format.

Evaluating the Audit Evidence Obtained From the Risk Assessment Procedures (Ref: par. .39)

Why the Auditor Evaluates the Audit Evidence From the Risk Assessment Procedures

.A261 Audit evidence obtained from performing risk assessment procedures provides the basis for the identification and assessment of the risks of material misstatement. This provides the basis for the auditor's design of the nature, timing, and extent of further audit procedures responsive to the assessed risks of material misstatement at the relevant assertion level in accordance with section 330. Accordingly, the audit evidence obtained from the risk assessment procedures provides a basis for the identification and assessment of risks of material misstatement whether due to fraud or error at the financial statement and assertion levels.

The Evaluation of the Audit Evidence

.A262 Audit evidence from risk assessment procedures comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.⁷⁴

⁷² Paragraphs .A32–.A33 of section 330.

⁷³ Paragraph .29 of section 330.

⁷⁴ Paragraph .A1 of section 500.

Professional Skepticism

.A263 In evaluating the audit evidence from the risk assessment procedures, the auditor considers whether sufficient understanding about the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control has been obtained to be able to identify the risks of material misstatement as well as whether there is any evidence that is contradictory that may indicate a risk of material misstatement.

Classes of Transactions, Account Balances, and Disclosures That Are Not Significant but Are Material (Ref: par. .40)

.A264 As explained in section 320,⁷⁵ materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances, and disclosures. The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements.⁷⁶ For purposes of this section, classes of transactions, account balances, or disclosures are material if there is a substantial likelihood that omitting, misstating, or obscuring information about them would influence the judgment made by a reasonable user based on the financial statements.

.A265 There may be classes of transactions, account balances, or disclosures that are material but have not been determined to be significant classes of transactions, account balances, or disclosures (that is, there are no relevant assertions identified). For example, the entity may have a disclosure about executive compensation for which the auditor has not identified a risk of material misstatement. However, the auditor may determine that this disclosure is material based on the considerations in paragraph .A264.

Revision of Risk Assessment (Ref: par. .41)

.A266 During the audit, new or other information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example, the entity's risk assessment may be based on an expectation that certain controls are operating effectively. In performing tests of those controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures, the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessments. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity, and the further planned audit procedures may not be effective in detecting material misstatements. Section 330⁷⁷ provides further guidance about evaluating the operating effectiveness of controls.

Documentation (Ref: par. .42)

.A267 For recurring audits, certain documentation may be carried forward, updated as necessary to reflect changes in the entity's business or processes.

.A268 Section 230, *Audit Documentation*, notes that among other considerations, although there may be no single way in which the auditor's profes-

⁷⁵ Paragraph .A2 of section 320.

⁷⁶ Paragraph .04 of section 320.

⁷⁷ Paragraphs .16–.17 of section 330.

sional skepticism is documented, the audit documentation may, nevertheless, provide evidence of such professional skepticism.⁷⁸ For example, when the audit evidence obtained from risk assessment procedures includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgments made in evaluating whether the audit evidence provides an appropriate basis for the auditor's identification and assessment of the risks of material misstatement. Examples of other requirements in this section for which documentation may provide evidence of the auditor's professional skepticism include the following:

- Paragraph .13, which requires the auditor to design and perform risk assessment procedures in a manner that is not biased toward obtaining audit evidence that may corroborate the existence of risks or toward excluding audit evidence that may contradict the existence of risks
- Paragraph .17, which requires a discussion among key engagement team members of the application of the applicable financial reporting framework and the susceptibility of the entity's financial statements to material misstatement
- Paragraphs .19b and .20, which require the auditor to obtain an understanding of the reasons for any changes to the entity's accounting policies and to evaluate whether the entity's accounting policies are appropriate and consistent with the applicable financial reporting framework
- Paragraphs .21b, .22b, .23b, .24c, .25c, and .31, which require the auditor to evaluate, based on the required understanding obtained, whether the components of the entity's system of internal control are appropriate to the entity's circumstances considering the nature and complexity of the entity, and to determine whether one or more control deficiencies have been identified
- Paragraph .39, which requires the auditor to take into account all audit evidence obtained from the risk assessment procedures, whether corroborative or contradictory to assertions made by management, and to evaluate whether the audit evidence obtained from the risk assessment procedures provides an appropriate basis for the identification and assessment of the risks of material misstatement
- Paragraph .40, which requires the auditor to evaluate, when applicable, whether the auditor's determination that there are no risks of material misstatement for a material class of transactions, account balance, or disclosure remains appropriate

Scalability (Ref: par. .42)

.A269 The form and extent of the auditor's documentation is influenced by the nature, size, and complexity of the entity and its system of internal control, availability of information from the entity, and the audit methodology and technology used in the course of the audit. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements of understanding documented by the auditor may include those on which the auditor based the assessment of the risks of material misstatement. However, the auditor is not required to document every inherent risk

⁷⁸ Paragraph .A9 of section 230.

factor that was taken into account in identifying and assessing the risks of material misstatement at the assertion level.

.A270 The manner in which the requirements of paragraph .42 are documented is for the auditor to determine exercising professional judgment.

.A271 The form, content, and extent of audit documentation that is sufficient to enable an experienced auditor having no previous experience with the audit to understand the nature, timing, and extent of the risk assessment procedures performed and the results of those procedures, including the conclusions reached and the rationale for the significant professional judgments made, depend on various factors. These factors include the need to document a conclusion or the basis for a conclusion otherwise not readily determinable from the documentation of the work performed or audit evidence obtained.⁷⁹ An example of such a circumstance may be the rationale for significant judgments related to the inherent risk of an identified risk of material misstatement, when such rationale is not otherwise evident from the audit documentation.

.A272 For the audits of less complex entities, the form and extent of documentation may be simple and relatively brief. Such audit documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.⁸⁰ Similarly, for example, the results of the risk assessment may be documented separately or as part of the auditor's documentation of further audit procedures.⁸¹

.A273 Section 200 states that GAAS typically refer to the risks of material misstatement, rather than inherent risk and control risk separately.⁸² However, this section requires inherent risk to be assessed separately from control risk to provide a basis for designing and performing audit procedures to respond to the assessed risks of material misstatement at the relevant assertion level in accordance with section 330. Accordingly, the auditor may, but is not required to, document a combined assessment of inherent risk and control risk (see paragraphs .A244 and .A257).

⁷⁹ Paragraph .A4 of section 230.

⁸⁰ Paragraphs .07, .09, and .A12 of section 300, *Planning an Audit*.

⁸¹ Paragraph .30 of section 330.

⁸² Paragraph .A44 of section 200.

.A274

Appendix A — Considerations for Understanding the Entity and Its Business Model (Ref: par. .A69–.A77)

This appendix explains the objectives and scope of the entity's business model and provides examples of matters that the auditor may consider in understanding the activities of the entity that may be included in the business model. The auditor's understanding of the entity's business model, and how it is affected by its business strategy and business objectives, may assist the auditor in identifying business risks that may have an effect on the financial statements. In addition, this may assist the auditor in identifying risks of material misstatement.

Objectives and Scope of an Entity's Business Model

1. An entity's business model describes how an entity considers, for example, its organizational structure, operations or scope of activities, business lines (including competitors and customers thereof), processes, growth opportunities, globalization, regulatory requirements, and technologies. The entity's business model describes how the entity creates, preserves, and captures financial or broader value for its stakeholders.

2. *Strategies* are the approaches by which management plans to achieve the entity's objectives, including how the entity plans to address the risks and opportunities that it faces. An entity's strategies are changed over time by management to respond to changes in its objectives and in the internal and external circumstances in which it operates.

3. A description of a business model typically includes the following:

- The scope of the entity's activities and why it does them
- The entity's structure and scale of its operations
- The markets or geographical or demographic spheres, and parts of the value chain, in which it operates, how it engages with those markets or spheres (main products, customer segments, and distribution methods), and the basis on which it competes
- The entity's business or operating processes (for example, investment, financing, and operating processes) employed in performing its activities, focusing on those parts of the business processes that are important in creating, preserving, or capturing value
- The resources (for example, financial, human, intellectual, environmental, and technological) and other inputs and relationships (for example, customers, competitors, suppliers, and employees) that are necessary or important to its success
- How the entity's business model integrates the use of IT in its interactions with customers, suppliers, lenders, and other stakeholders through IT interfaces and other technologies

4. A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a significant fall in real estate market values may increase the risk of material misstatement associated with the valuation assertion for a lender of medium-term real estate-backed loans. However, the same risk, particularly in combination with a severe economic downturn that concurrently increases the underlying risk of lifetime credit losses on its loans, may also have

a longer-term consequence. The resulting net exposure to credit losses may cast substantial doubt on the entity's ability to continue as a going concern. If so, this could have implications for management's, and the auditor's, conclusion regarding the appropriateness of the entity's use of the going concern basis of accounting and determination about whether substantial doubt exists; therefore, whether a business risk may result in a risk of material misstatement is considered in light of the entity's circumstances. Examples of events and conditions that may give rise to the existence of risks of material misstatement are indicated in appendix B, "Understanding Inherent Risk Factors."

Activities of the Entity

5. The following are some examples of matters that the auditor may consider when obtaining an understanding of the activities of the entity (included in the entity's business model):

- a. Business operations:
 - i. Nature of revenue sources, products or services, and markets, including involvement in electronic commerce such as internet sales and marketing activities
 - ii. Conduct of operations (for example, stages and methods of production or activities exposed to environmental risks)
 - iii. Alliances, joint ventures, and outsourcing activities
 - iv. Geographic dispersion and industry segmentation
 - v. Location of production facilities, warehouses, and offices, and location and quantities of inventories
 - vi. Key customers and important suppliers of goods and services, employment arrangements (including the existence of union contracts, pension and other post-employment benefits, stock options or incentive bonus arrangements, and government regulation related to employment matters)
 - vii. Research and development activities and expenditures
 - viii. Transactions with related parties
- b. Investments and investment activities:
 - i. Planned or recently executed acquisitions or divestitures
 - ii. Investments and dispositions of securities and loans
 - iii. Capital investment activities
 - iv. Investments in nonconsolidated entities, including non-controlled partnerships, joint ventures, and noncontrolled variable interest entities
- c. Financing and financing activities:
 - i. Ownership structure of major subsidiaries and associated entities, including consolidated and nonconsolidated structures
 - ii. Debt structure and related terms, including off-balance-sheet financing arrangements and leasing arrangements
 - iii. Beneficial owners (local, foreign, business reputation, and experience) and related parties
 - iv. Use of derivative financial instruments

Nature of Variable Interest Entities

6. A *variable interest entity* is an entity that is generally established for a narrow and well-defined purpose, such as to effect a lease or a securitization of financial assets or to carry out research and development activities. It may take the form of a corporation, trust, partnership, or unincorporated entity. The entity on behalf of which the variable interest entity has been created may often transfer assets to the latter (for example, as part of a derecognition transaction involving financial assets), obtain the right to use the latter's assets, or perform services for the latter, whereas other parties may provide the funding to the latter. In some circumstances, a variable interest entity may be a related party of the entity.

7. Financial reporting frameworks often specify detailed conditions that are deemed to amount to control or circumstances under which the variable interest entity should be considered for consolidation. The interpretation of the requirements of such frameworks often demands a detailed knowledge of the relevant agreements involving the variable interest entity.

.A275

Appendix B — Understanding Inherent Risk Factors (Ref: par. .12, .19, .A9–.A11, .A34, .A69, .A94–.A99, and .A230)

This appendix provides further explanation about inherent risk factors as well as matters that the auditor may consider in understanding and applying the inherent risk factors in identifying and assessing the risks of material misstatement at the assertion level.

The Inherent Risk Factors

1. *Inherent risk factors* are characteristics of events or conditions that affect susceptibility of an assertion about a class of transactions, account balance, or disclosure, to misstatement, whether due to fraud or error, and before consideration of controls. Such factors may be qualitative or quantitative and include complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias or other fraud risk factors¹ insofar as they affect inherent risk. In obtaining the understanding of the entity and its environment, and the applicable financial reporting framework and entity's accounting policies, in accordance with paragraph .19a–b, the auditor also understands how inherent risk factors affect susceptibility of assertions to misstatement in the preparation of the financial statements.

2. Inherent risk factors relating to the preparation of information required by the applicable financial reporting framework (referred to in this paragraph as *required information*) include the following:

- *Complexity*. Arises either from the nature of the information or in the way that the required information is prepared, including when such preparation processes are more inherently difficult to apply. For example, complexity may arise in one of the following circumstances:
 - In calculating supplier rebate provisions because it may be necessary to take into account different commercial terms with many different suppliers or many interrelated commercial terms that are all relevant in calculating the rebates due.
 - When there are many potential data sources with different characteristics used in making an accounting estimate, the processing of that data involves many interrelated steps and, therefore, the data is inherently more difficult to identify, capture, access, understand, or process.
- *Subjectivity*. Arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgment about the appropriate approach to take and about the resulting information to include in the financial statements. Because of different approaches to preparing the required information, different outcomes could result from appropriately applying the requirements of the applicable financial reporting framework. As

¹ Paragraphs .A28–.A32 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

limitations in knowledge or data increase, the subjectivity in the judgments that could be made by reasonably knowledgeable and independent individuals and the diversity in possible outcomes of those judgments will also increase.

- *Change*. Results from events or conditions that, over time, affect the entity's business or the economic, accounting, regulatory, industry, or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information. Such events or conditions may occur during, or between, financial reporting periods. For example, change may result from developments in the requirements of the applicable financial reporting framework, in the entity and its business model, or in the environment in which the entity operates. Such change may affect management's assumptions and judgments, including as they relate to management's selection of accounting policies or how accounting estimates are made or related disclosures are determined.
- *Uncertainty*. Arises when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation. In these circumstances, an approach may need to be taken that applies the available knowledge to prepare the information using sufficiently precise and comprehensive observable data, to the extent available, and reasonable assumptions supported by the most appropriate available data, when it is not. Constraints on the availability of knowledge or data, which are not within the control of management (subject to cost constraints where applicable) are sources of uncertainty, and their effect on the preparation of the required information cannot be eliminated. For example, estimation uncertainty arises when the required monetary amount cannot be determined with precision, and the outcome of the estimate is not known before the date the financial statements are finalized.
- *Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk*. Susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information. Management bias is often associated with certain conditions that have the potential to give rise to management not maintaining neutrality in exercising judgment (indicators of potential management bias), which could lead to a material misstatement of the information that would be fraudulent if intentional. Such indicators include incentives or pressures insofar as they affect inherent risk (for example, as a result of motivation to achieve a desired result, such as a desired profit target or capital ratio) and opportunity, not to maintain neutrality. Factors relevant to the susceptibility to misstatement due to fraud in the form of fraudulent financial reporting or misappropriation of assets are described in section 240, *Consideration of Fraud in a Financial Statement Audit*.²

3. When complexity is an inherent risk factor, there may be an inherent need for more complex processes in preparing the information, and such processes may

² Paragraphs .A1–.A5 of section 240.

be inherently more difficult to apply. As a result, applying them may require specialized skills or knowledge and may require the use of a management's specialists.

4. When management judgment is more subjective, the susceptibility to misstatement due to management bias, whether unintentional or intentional, may also increase. For example, significant management judgment may be involved in making accounting estimates that have been identified as having high estimation uncertainty, and conclusions regarding methods, data, and assumptions may reflect unintentional or intentional management bias.

Examples of Events or Conditions That May Give Rise to the Existence of Risks of Material Misstatement

5. The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement in the financial statements at the financial statement level or the assertion level. The examples, grouped by inherent risk factor, cover a broad range of events and conditions; however, not all events and conditions are relevant to every audit engagement, and the list of examples is not necessarily complete. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degrees.

<i>Relevant inherent risk factor</i>	<i>Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level</i>
Complexity	Regulatory: • Operations that are subject to a high degree of complex regulation Business model: • The existence of complex alliances and joint ventures Applicable financial reporting framework: • Accounting measurements that involve complex processes Transactions: • Use of off-balance-sheet financing, variable interest entities, and other complex financing arrangements
Subjectivity	Applicable financial reporting framework: • A wide range of possible measurement criteria of an accounting estimate, for example, management's recognition of depreciation or construction income and expenses • Management's selection of a valuation technique or model for a noncurrent asset, such as investment properties

<i>Relevant inherent risk factor</i>	<i>Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level</i>
Change	Economic conditions: • Operations in regions that are economically unstable, for example, countries with significant currency devaluation or highly inflationary economies Markets: • Operations exposed to volatile markets, for example, futures trading Customer loss: • Going concern and liquidity issues, including loss of significant customers Industry model: • Changes in the industry in which the entity operates Business model: • Changes in the supply chain • Developing or offering new products or services, or moving into new lines of business Geography: • Expanding into new locations Entity structure: • Changes in the entity, such as large acquisitions or reorganizations or other unusual events • Entities or business segments likely to be sold Human resources competence: • Changes in key personnel, including departure of key executives IT: • Changes in the IT environment • Installation of significant new IT systems related to financial reporting Applicable financial reporting framework: • Application of new accounting pronouncements Capital: • New constraints on the availability of capital and credit Regulatory: • Investigations into the entity's operations or financial results by regulatory or government bodies • Impact of new legislation related to environmental protection

(continued)

<i>Relevant inherent risk factor</i>	<i>Examples of events and conditions that may indicate the existence of risks of material misstatement at the assertion level</i>
Uncertainty	Reporting: • Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures • Pending litigation and contingent liabilities, for example, sales warranties, financial guarantees, and environmental remediation
Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk	Reporting: • Incentives and pressures, or opportunities, for management and employees to engage in fraudulent financial reporting, including omission or obscuring, of significant information in disclosures. See appendix A, "Examples of Fraud Risk Factors," of section 240 for additional guidance regarding fraud risk factors Transactions: • Significant transactions with related parties • Significant amount of nonroutine or nonsystematic transactions, including intercompany transactions and large revenue transactions at period end • Transactions that are recorded based on management's intent, for example, debt refinancing, assets to be sold, and classification of marketable securities

Other events or conditions that may indicate risks of material misstatement at the financial statement level:

- Lack of personnel with appropriate accounting and financial reporting skills
- Control deficiencies, particularly in the control environment, the entity's risk assessment process, and the entity's process for monitoring the system of internal control, and especially those not addressed by management
- Past misstatements, history of errors, or a significant amount of adjustments at period end

.A276

Appendix C — Understanding the Entity's System of Internal Control (Ref: par. .12, .21–.31, .A100–.A212)

1. The entity's system of internal control may be reflected in policy and procedures manuals, systems and forms, and the information embedded therein, and is effected by people. The entity's system of internal control is implemented by management, those charged with governance, and other personnel based on the structure of the entity. The entity's system of internal control can be applied based on the decisions of management, those charged with governance, or other personnel and in the context of legal or regulatory requirements to the operating model of the entity, the legal entity structure, or a combination of these.

2. This appendix further explains the components of, as well as the limitations of, the entity's system of internal control as set out in paragraphs .12, .21–.31, and .A100–.A209 as they relate to a financial statement audit.

3. Included within the entity's system of internal control are aspects that relate to the entity's reporting objectives, including its financial reporting objectives, but it may also include aspects that relate to its operations or compliance objectives, when such aspects are relevant to financial reporting. For example, controls over compliance with laws and regulations may be relevant to financial reporting when such controls are relevant to the entity's preparation of disclosures of contingencies in the financial statements.

Components of the Entity's System of Internal Control

Control Environment

4. The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's system of internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people, and provides the overall foundation for the operation of the other components of the entity's system of internal control.

5. An entity's control consciousness is influenced by those charged with governance because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. Therefore, the effectiveness of the design of the control environment in relation to participation by those charged with governance is influenced by such matters as the following:

- Their independence from management and their ability to evaluate the actions of management
- Whether they understand the entity's business transactions
- The extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, including whether the financial statements include adequate disclosures

6. The control environment encompasses the following elements:

- a. *How management's oversight responsibilities are carried out, such as creating and maintaining the entity's culture and demonstrating management's commitment to integrity and ethical values.*
The effectiveness of controls cannot rise above the integrity and

ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the products of the entity's ethical and behavioral standards or codes of conduct, as well as how they are communicated (for example, through policy statements), and how they are reinforced in practice (for example, through management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts). The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.

- b. *When those charged with governance are separate from management, how those charged with governance demonstrate independence from management and exercise oversight of the entity's system of internal control.* An entity's control consciousness is influenced by those charged with governance. Considerations may include whether there are sufficient individuals who are independent from management and objective in their evaluations and decision making; how those charged with governance identify and accept oversight responsibilities and whether those charged with governance retain oversight responsibility for management's design, implementation, and conduct of the entity's system of internal control. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle-blower procedures.
- c. *How the entity assigns authority and responsibility in pursuit of its objectives.* This may include the following considerations:
 - Key areas of authority and responsibility and appropriate lines of reporting
 - Policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties
 - Policies and communications directed at ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable
- d. *How the entity attracts, develops, and retains competent individuals in alignment with its objectives.* This includes how the entity ensures the individuals have the knowledge and skills necessary to accomplish the tasks that define the individual's job, such as the following:
 - Standards for recruiting the most qualified individuals, with an emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior
 - Training policies that communicate prospective roles and responsibilities, including practices such as training

schools and seminars that illustrate expected levels of performance and behavior

- Periodic performance appraisals driving promotions that demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility
- e. *How the entity holds individuals accountable for their responsibilities in pursuit of the objectives of the entity's system of internal control.* This may be accomplished through some of the following examples:
- Mechanisms to communicate and hold individuals accountable for performance of controls responsibilities and implement corrective actions as necessary
 - Establishing performance measures, incentives, and rewards for those responsible for the entity's system of internal control, including how the measures are evaluated and maintain their relevance
 - How pressures associated with the achievement of control objectives affect the individual's responsibilities and performance measures
 - How the individuals are disciplined as necessary

The appropriateness of the preceding matters will be different for every entity depending on its size, the complexity of its structure, and the nature of its activities.

The Entity's Risk Assessment Process

7. The entity's risk assessment process is an iterative process for identifying and analyzing risks to achieving the entity's objectives and forms the basis for how management or those charged with governance determine the risks to be managed.

8. For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to manage them and the results thereof. For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyzes significant estimates recorded in the financial statements or considers risks of fraud.

9. Risks relevant to reliable financial reporting include external and internal events, transactions, or circumstances that may occur and adversely affect an entity's ability to initiate, record, process, and report financial information consistent with the assertions of management in the financial statements. Management may initiate plans, programs, or actions to address specific risks, or it may decide to assume a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:

- *Changes in operating environment.* Changes in the regulatory, economic, or operating environment can result in changes in competitive pressures and significantly different risks.
- *New personnel.* New personnel may have a different focus on or understanding of the entity's system of internal control.

- *New or revamped information system.* Significant and rapid changes in the information system can change the risk relating to the entity's system of internal control.
- *Rapid growth.* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- *New technology.* Incorporating new technologies into production processes or the information system may change the risk associated with the entity's system of internal control.
- *New business models, products, or activities.* Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with the entity's system of internal control.
- *Corporate restructurings.* Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with the entity's system of internal control.
- *Expanded foreign operations.* The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control, for example, additional or changed risks from foreign currency transactions.
- *New accounting pronouncements.* Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.
- *Use of IT.* Risks relating to
 - maintaining the integrity of data and information processing;
 - risks to the entity's business strategy that arise if the entity's IT strategy does not effectively support the entity's business strategy; or
 - changes or interruptions in the entity's IT environment, such as those related to turnover of IT personnel, when the entity does not make necessary updates to the IT environment, or such updates are not timely.
- *Environmental, social, and governance (ESG) issues.* ESG issues, such as climate change, may affect businesses in various industries. For example, climate events or conditions may affect an entity in terms of the following:
 - Climate events or conditions may influence the entity's business model, including the entity's supply chain, resulting in different risks.
 - New technological developments to address climate change may have a significant impact on the industry, which may create new or unique risks related to the entity's operations or processes.
 - Governments may change climate-related laws and regulations that could affect risks related to taxation or the entity's business model through increased environmental requirements.

- Climate events or conditions may affect risks related to general economic conditions, interest rates and availability of financing, commodity prices and inflation, or currency revaluation.

The Entity's Process to Monitor the System of Internal Control

10. The entity's process to monitor the system of internal control is a continual process to evaluate the effectiveness of the entity's system of internal control and to take necessary remedial actions on a timely basis. The entity's process to monitor the entity's system of internal control may consist of ongoing activities, separate evaluations (conducted periodically), or some combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and may include regular management and supervisory activities. The entity's process will likely vary in scope and frequency depending on the assessment of the risks by the entity.

11. The objectives and scope of internal audit functions typically include activities designed to evaluate or monitor the effectiveness of the entity's system of internal control.¹ The entity's process to monitor the entity's system of internal control may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring is done also to ensure that controls continue to operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.

12. Controls related to the entity's process to monitor the entity's system of internal control, including those that monitor underlying automated controls, may be automated or manual, or a combination of both. For example, an entity may use automated monitoring controls over access to certain technology with automated reports of unusual activity to management, who manually investigate identified anomalies.

13. When distinguishing between a monitoring activity and a control related to the information system, the underlying details of the activity are considered, especially when the activity involves some level of supervisory review. Supervisory reviews are not automatically classified as monitoring activities, and it may be a matter of judgment whether a review is classified as a control related to the information system or a monitoring activity. For example, the intent of a monthly completeness control would be to detect and correct errors, whereas a monitoring activity would determine why errors are occurring and assign management the responsibility of fixing the process to prevent future errors. In simple terms, a control related to the information system responds to a specific risk, whereas a monitoring activity assesses whether controls within each of the five components of the entity's system of internal control are operating as intended.

14. Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of the

¹ Section 610, *Using the Work of Internal Auditors*, and appendix D, "Considerations for Understanding an Entity's Internal Audit Function," of this section provide further guidance related to internal audit.

entity's system of internal control, for example, communications concerning examinations by bank regulatory agencies. Also, management may consider in performing monitoring activities any communications relating to the entity's system of internal control from external auditors.

The Information System and Communication

15. Business processes result in the transactions that are recorded, processed, and reported by the information system. An entity's business processes include the activities designed to

- develop, purchase, produce, sell, and distribute an entity's products and services;
- ensure compliance with laws and regulations; and
- record information, including accounting and financial reporting information.

16. The information system, and related business processes, includes the financial reporting process used to prepare the entity's financial statements, including disclosures.

17. The information system relevant to the preparation of the financial statements consists of activities and policies, and accounting and supporting records, designed and established to do the following:

- Initiate, record, and process entity transactions (as well as to capture, process, and disclose information about events and conditions other than transactions, such as changes in fair values or indicators of impairment) and to maintain accountability for the related assets, liabilities, and equity
- Resolve incorrect processing of transactions, for example, automated suspense files and procedures followed to clear suspense items out on a timely basis
- Process and account for system overrides or bypasses to controls
- Incorporate information from transaction processing in the general ledger (for example, transferring of accumulated transactions from various data tables)
- Capture and process information relevant to the preparation of the financial statements for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of assets
- Ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized, and appropriately reported in the financial statements

18. The quality of information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.

19. Communication, which involves providing an understanding of individual roles and responsibilities pertaining to the entity's system of internal control, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

20. Communication by the entity of the financial reporting roles and responsibilities and of significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to

the entity's system of internal control relevant to financial reporting. It may include such matters as the extent to which personnel understand how their activities in the information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity.

Control Activities

21. Controls in the control activities component are identified in accordance with paragraphs .26–.27 and .29*b*. Such controls include information-processing controls and general IT controls, both of which may be manual or automated in nature. The greater the extent of automated controls, or controls involving automated aspects, that management uses and relies on in relation to its financial reporting, the more important it may become for the entity to implement general IT controls that address the continued functioning of the automated aspects of information-processing controls. Controls in the control activities component may pertain, for example, to the following:

- *Authorization and approvals.* An authorization affirms that a transaction is valid (that is, it represents an actual economic event or is within an entity's policy). An authorization typically takes the form of an approval by a higher level of management or of verification and a determination if the transaction is valid. For example, a supervisor approves an expense report after reviewing whether the expenses seem reasonable and within policy. An example of an automated approval is when an invoice unit cost is automatically compared with the related purchase order unit cost within a pre-established tolerance level. Invoices within the tolerance level are automatically approved for payment. Those invoices outside the tolerance level are flagged for additional investigation.
- *Reconciliations.* Reconciliations compare two or more data elements. If differences are identified, action is taken to bring the data into agreement. Reconciliations generally address the completeness or accuracy of processing transactions.
- *Verifications.* Verifications compare two or more items with each other or compare an item with a policy and will likely involve a follow-up action when the two items do not match or the item is not consistent with policy. Verifications generally address the completeness, accuracy, or validity of processing transactions.
- *Physical or logical controls, including those that address security of assets against unauthorized access, acquisition, use, or disposal.* Controls that encompass the following:
 - The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records
 - The authorization for access to computer programs and data files (that is, logical access)
 - The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security, and inventory counts with accounting records)

The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation depends on circumstances such as when assets are highly susceptible to misappropriation.

- *Segregation of duties.* Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties.

For example, a manager authorizing credit sales is not responsible for maintaining accounts receivable records or handling cash receipts. If one person is able to perform all these activities he or she could, for example, create a fictitious sale that could go undetected. Similarly, salespersons should not have the ability to modify product price files or commission rates.

Sometimes, segregation is not practical, cost effective, or feasible. For example, smaller and less complex entities may lack sufficient resources to achieve ideal segregation, and the cost of hiring additional staff may be prohibitive. In these situations, management may institute alternative controls. In the preceding example, if the salesperson can modify product price files, a detective control activity can be put in place to have personnel unrelated to the sales function periodically review whether and under what circumstances the salesperson changed prices.

22. Certain controls may depend on the existence of appropriate supervisory controls established by management or those charged with governance. For example, authorization controls may be delegated under established guidelines, such as investment criteria set by those charged with governance; alternatively, nonroutine transactions such as major acquisitions or divestments may require specific high-level approval, including, in some cases, that of shareholders.

Limitations of Internal Control

23. The entity's system of internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by the inherent limitations of internal control. These include the realities that human judgment in decision making can be faulty, and that breakdown in the entity's system of internal control can occur because of human error. For example, there may be an error in the design of, or in the change to, a control. Equally, the operation of a control may not be effective, such as when information produced for the purposes of the entity's system of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

24. Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of controls. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in an IT application that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

25. Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

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Appendix D — Considerations for Understanding an Entity's Internal Audit Function (Ref: par. .A31–.A32 and .A134)

This appendix provides further considerations relating to understanding the entity's internal audit function when such a function exists.

Objectives and Scope of the Internal Audit Function

1. The objectives and scope of an internal audit function, the nature of its responsibilities, and its status within the organization, including the function's authority and accountability, vary widely and depend on the size, complexity, and structure of the entity and the requirements of management and, when applicable, those charged with governance. These matters may be set out in an internal audit charter or terms of reference.

2. The responsibilities of an internal audit function may include performing procedures and evaluating the results to provide assurance to management and those charged with governance regarding the design and effectiveness of risk management, the entity's system of internal control, and governance processes. If so, the internal audit function may play an important role in the entity's process to monitor the entity's system of internal control. However, the responsibilities of the internal audit function may be focused on evaluating the economy, efficiency, and effectiveness of operations and, if so, the work of the function may not directly relate to the entity's financial reporting.

Inquiries of the Internal Audit Function

3. If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the auditor in obtaining an understanding of the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and in identifying and assessing risks of material misstatement at the financial statement and assertion levels. In performing its work, the internal audit function is likely to have obtained insight into the entity's operations and business risks and may have findings based on its work, such as identified control deficiencies or risks, that may provide valuable input into the auditor's understanding of the entity and its environment, the applicable financial reporting framework, the entity's system of internal control, the auditor's risk assessments, or other aspects of the audit. Therefore, the auditor's inquiries are made regardless of whether the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed.¹ Inquiries of particular relevance may be about matters the internal audit function has raised with those charged with governance and the outcomes of the function's own risk assessment process.

4. If, based on responses to the auditor's inquiries, it appears that there are findings that may be relevant to the entity's financial reporting and the audit of the financial statements, the auditor may consider it appropriate to read related reports of the internal audit function. Examples of reports of the internal audit function that may be relevant include the function's strategy and planning documents and reports that have been prepared for management or those charged with governance describing the findings of the internal audit function's examinations.

¹ The relevant requirements are contained in section 610, *Using the Work of Internal Auditors*.

5. In addition, in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*,² if the internal audit function provides information to the auditor regarding any actual, suspected, or alleged fraud, the auditor takes this into account in the auditor's identification of risk of material misstatement due to fraud.

6. Appropriate individuals within the internal audit function with whom inquiries are made are those who, in the auditor's professional judgment, have the appropriate knowledge, experience, and authority, such as the chief internal audit executive or, depending on the circumstances, other personnel within the function. The auditor may also consider it appropriate to have periodic meetings with these individuals.

Consideration of the Internal Audit Function in Understanding the Control Environment

7. In understanding the control environment, the auditor may consider how management has responded to the findings and recommendations of the internal audit function regarding identified control deficiencies relevant to the preparation of the financial statements, including whether and how such responses have been implemented, and whether they have been subsequently evaluated by the internal audit function.

Understanding the Role That the Internal Audit Function Plays in the Entity's Process to Monitor the System of Internal Control

8. If the nature of the internal audit function's responsibilities and assurance activities are related to the entity's financial reporting, the auditor may also be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the auditor in obtaining audit evidence. Auditors may be more likely to be able to use the work of an entity's internal audit function when it appears, for example, based on experience in previous audits or the auditor's risk assessment procedures, that the entity has an internal audit function that is adequately and appropriately resourced relative to the complexity of the entity and the nature of its operations and has a direct reporting relationship to those charged with governance.

9. If, based on the auditor's preliminary understanding of the internal audit function, the auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, section 610, *Using the Work of Internal Auditors*, applies.

10. As further discussed in section 610, the activities of an internal audit function are distinct from other monitoring controls that may be relevant to financial reporting, such as reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements.

11. Establishing communications with the appropriate individuals within an entity's internal audit function early in the engagement, and maintaining such communications throughout the engagement, can facilitate effective sharing of information. It creates an environment in which the auditor can be informed of significant matters that may come to the attention of the internal audit function when such matters may affect the work of the auditor. Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, discusses the importance of the auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability

² Paragraph .19 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

of documents and responses to inquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring such information to the auditor's attention. The auditor is then able to take such information into account in the auditor's identification and assessment of risks of material misstatement.

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Appendix E — Considerations for Understanding IT (Ref: par. .12, .25a, .27–.29, .A109, and .A192)

This appendix provides further matters that the auditor may consider in understanding the entity's use of IT in its system of internal control.

Understanding the Entity's Use of IT in the Components of the Entity's System of Internal Control

1. An entity's system of internal control contains manual elements and automated elements (that is, manual and automated controls and other resources used in the entity's system of internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. An entity's use of IT affects the manner in which the information relevant to the preparation of the financial statements in accordance with the applicable financial reporting framework is processed, stored, and communicated and, therefore, affects the manner in which the entity's system of internal control is designed and implemented. Each component of the entity's system of internal control may use some extent of IT.

Generally, IT benefits an entity's system of internal control by enabling an entity to do the following:

- Consistently apply predefined business rules and perform complex calculations when processing large volumes of transactions or data
- Enhance the timeliness, availability, and accuracy of information
- Facilitate the additional analysis of information
- Enhance the ability to monitor the performance of the entity's activities and its policies and procedures
- Reduce the risk that controls will be circumvented
- Enhance the ability to achieve effective segregation of duties by implementing security controls in IT applications, databases, and operating systems

2. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement and further audit procedures based thereon. Automated controls may be more reliable than manual controls because they cannot be as easily bypassed, ignored, or overridden, and they are also less prone to simple errors and mistakes. Automated controls may be more effective than manual controls in the following circumstances:

- High volume of recurring transactions, or in situations in which errors that can be anticipated or predicted can be prevented, or detected and corrected, through automation
- Controls in which the specific ways to perform the control can be adequately designed and automated

Understanding the Entity's Use of IT in the Information System (Ref: par. .25a)

3. The entity's information system may include the use of manual and automated elements, which also affect the manner in which transactions are initiated, recorded, processed, and incorporated in the general ledger and reported

in the financial statements. In particular, procedures to initiate, record, process, and report transactions may be enforced through the IT applications used by the entity and how the entity has configured those applications. In addition, records in the form of digital information may replace or supplement records in the form of paper documents.

4. In obtaining an understanding of the IT environment relevant to the flows of transactions and information processing in the information system, the auditor gathers information about the nature and characteristics of the IT applications used as well as the supporting IT infrastructure and IT. This may include, for example, the complexity or level of customization related to IT applications, third-party hosting or outsourcing, and the use of interfaces, data warehouses, or report writers.

Emerging Technologies

5. Entities may use emerging technologies (for example, blockchain, robotics, or artificial intelligence) because such technologies may present specific opportunities to increase operational efficiencies or enhance financial reporting. When emerging technologies are used in the entity's information system relevant to the preparation of the financial statements, the auditor may include such technologies in the identification of IT applications and other aspects of the IT environment that are subject to risks arising from the use of IT. Although emerging technologies may be seen to be more sophisticated or more complex compared to existing technologies, the auditor's responsibilities in relation to IT applications and identified general IT controls in accordance with paragraphs .28–.29 remain unchanged.

Scalability

6. Obtaining an understanding of the entity's IT environment may be more easily accomplished for a less complex entity that uses commercial software and when the entity does not have access to the source code to make any program changes. Such entities may not have dedicated IT resources but may have a person assigned in an administrator role for the purpose of granting employee access or installing vendor-provided updates to the IT applications. Specific matters that the auditor may consider in understanding the nature of a commercial accounting software package, which may be the single IT application used by a less complex entity in its information system, may include the following:

- The extent to which the software is well established and has a reputation for reliability.
- The extent to which it is possible for the entity to modify the source code of the software to include additional modules (that is, additions) to the base software or to make direct changes to data.
- The nature and extent of modifications that have been made to the software. Although an entity may not be able to modify the source code of the software, many software packages allow for configuration (for example, setting or amending reporting parameters). These do not usually involve modifications to source code; however, the auditor may consider the extent to which the entity is able to configure the software when considering the accuracy and completeness of information produced by the software that is used as audit evidence.
- The extent to which data related to the preparation of the financial statements can be directly accessed (that is, direct access to the database without using the IT application) and the volume of data that is processed. The greater the volume of data, the more

likely the entity may need controls that address maintaining the integrity of the data, which may include general IT controls over unauthorized access and changes to the data.

7. Complex IT environments may include highly customized or highly integrated IT applications and, therefore, may require more effort to understand. Financial reporting processes or IT applications may be integrated with other IT applications. Such integration may involve IT applications that are used in the entity's business operations and that provide information to the IT applications relevant to the flows of transactions and information processing in the entity's information system. In such circumstances, certain IT applications used in the entity's business operations may also be relevant to the preparation of the financial statements. Complex IT environments also may require dedicated IT departments that have structured IT processes supported by personnel that have software development and IT environment maintenance skills. In other cases, an entity may use internal or external service providers to manage certain aspects of, or IT processes within, its IT environment (for example, third-party hosting).

Identifying IT Applications That Are Subject to Risks Arising From the Use of IT

8. Through understanding the nature and complexity of the entity's IT environment, including the nature and extent of information-processing controls, the auditor may determine which IT applications the entity is relying upon to accurately process and maintain the integrity of financial information. The identification of IT applications on which the entity relies, may affect the auditor's decision to test the automated controls within such IT applications, assuming that such automated controls address identified risks of material misstatement. Conversely, if the entity is not relying on an IT application, the automated controls within such IT application are unlikely to be appropriate or sufficiently precise for purposes of operating effectiveness tests. Automated controls that may be identified in accordance with paragraph .27 may include, for example, automated calculations or input and processing and output controls, such as a three-way match of a purchase order, vendor shipping document, and vendor invoice. When automated controls are identified by the auditor and the auditor determines through the understanding of the IT environment that the entity is relying on the IT application that includes those automated controls, it may be more likely for the auditor to identify the IT application as one that is subject to risks arising from the use of IT.

9. In considering whether the IT applications for which the auditor has identified automated controls are subject to risks arising from the use of IT, the auditor is likely to consider whether, and the extent to which, the entity may have access to source code that enables management to make program changes to such controls or the IT applications. The extent to which the entity makes program or configuration changes and the extent to which the IT processes over such changes are formalized may also be relevant considerations. The auditor is also likely to consider the risk of inappropriate access or changes to data.

10. System-generated reports that the auditor may intend to use as audit evidence may include, for example, a trade receivable aging report or an inventory valuation report. For such reports, the auditor may obtain audit evidence about the accuracy and completeness of the reports by performing audit procedures to test the inputs and outputs of the report-generating process. In other cases, the auditor may plan to test the operating effectiveness of the controls over the preparation and maintenance of the report, in which case, the IT application from which it is produced is likely to be subject to risks arising from the use of IT. In addition to testing the accuracy and completeness of the report, the

auditor may plan to test the operating effectiveness of general IT controls that address risks related to inappropriate or unauthorized program changes to, or data changes in, the report.

11. Some IT applications may include report-writing functionality within them, whereas some entities may also use separate report-writing applications (that is, report writers). In such cases, the auditor may need to determine the sources of system-generated reports (that is, the application that prepares the report and the data sources used by the report) to determine the IT applications subject to risks arising from the use of IT.

12. The data sources used by IT applications may be databases that, for example, can be accessed only through the IT application or by IT personnel with database administration privileges. In other cases, the data source may be a data warehouse that may itself be considered to be an IT application subject to risks arising from the use of IT.

13. The auditor may have identified a risk for which substantive procedures alone are not sufficient because of the entity's use of highly automated and paperless processing of transactions, which may involve multiple integrated IT applications. In such circumstances, the controls identified by the auditor are likely to include automated controls. Further, the entity may be relying on general IT controls to maintain the integrity of the transactions processed and other information used in processing. In such cases, the IT applications involved in the processing and storage of the information are likely subject to risks arising from the use of IT.

End-User Computing

14. Although audit evidence may also come in the form of system-generated output that is used in a calculation performed in an end-user computing tool (for example, spreadsheet software or simple databases), such tools are not typically identified as IT applications in the context of paragraph .29. Designing and implementing controls around access and change to end-user computing tools may be challenging, and such controls are rarely equivalent to, or as effective as, general IT controls. Rather, the auditor may consider a combination of information-processing controls, taking into account the purpose and complexity of the end-user computing involved, such as some or all of the following:

- Information-processing controls over the initiation and processing of the source data, including relevant automated or interface controls to the point from which the data is extracted (for example, the data warehouse)
- Controls to check that the logic is functioning as intended, for example, controls that "prove" the extraction of data, such as reconciling the report to the data from which it was derived, comparing the individual data from the report to the source and vice versa, and controls that check the formulas or macros
- Use of validation software tools, which systematically check formulas or macros, such as spreadsheet integrity tools

Scalability

15. The entity's ability to maintain the integrity of information stored and processed in the information system may vary based on the complexity and volume of the related transactions and other information. The greater the complexity and volume of data that supports a significant class of transactions, account balance, or disclosure, the less likely it may become for the entity to maintain integrity of that information through information-processing controls alone (for example, input and output controls or review controls). It also becomes less

likely that the auditor will be able to obtain audit evidence about the accuracy and completeness of such information through substantive procedures alone when such information is used as audit evidence. In some circumstances, when volume and complexity of transactions are lower, management may have an information-processing control that is sufficient to verify the accuracy and completeness of the data (for example, individual sales orders processed and billed may be reconciled to the hard copy originally entered into the IT application). When the entity relies on general IT controls to maintain the integrity of certain information used by IT applications, the auditor may determine that the IT applications that maintain that information are subject to risks arising from the use of IT.

<i>Considerations That May Assist in Determining Whether IT Applications Are Subject to Risks Arising From the Use of IT</i>	
Example characteristics of an IT application that are less likely subject to risks arising from the use of IT include the following: • Stand-alone applications. • The volume of data (transactions) is not significant. • The application's functionality is not complex. • Each transaction is supported by original hard copy documentation.	Example characteristics of an IT application that are more likely subject to risks arising from the use of IT include the following: • Applications are interfaced. • The volume of data (transactions) is significant. • The application's functionality is complex because — the application automatically initiates transactions, and — there are a variety of complex calculations underlying automated entries.
IT application is likely not subject to risks arising from the use of IT because of the following: • The volume of data is not significant, and management is not relying upon an application system to process or maintain the data. • Management does not rely on automated controls or other automated functionality. The auditor has not identified automated controls in accordance with paragraph .27.	IT application is likely subject to risks arising from the use of IT because of the following: • Management relies on an application system to process or maintain data. • Management relies upon the application system to perform certain automated controls that the auditor has also identified.

<i>Considerations That May Assist in Determining Whether IT Applications Are Subject to Risks Arising From the Use of IT</i>	
- Although management uses system-generated reports in its controls, it does not rely on the IT application to produce complete and accurate reports. Instead, it reconciles the reports back to the hard copy documentation and verify the calculations in the reports. - The auditor will directly test information produced by the entity used as audit evidence.	

Other Aspects of the IT Environment That Are Subject to Risks Arising From the Use of IT

16. When the auditor identifies IT applications that are subject to risks arising from the use of IT, other aspects of the IT environment are also typically subject to risks arising from the use of IT. The IT infrastructure includes databases, the operating system, and the network. Databases store the data used by IT applications and may consist of many interrelated data tables. Data in databases may also be accessed directly through database management systems by IT or other personnel with database administration privileges. The operating system is responsible for managing communications between hardware, IT applications, and other software used in the network. As such, IT applications and databases may be directly accessed through the operating system. A network is used in the IT infrastructure to transmit data and to share information, resources, and services through a common communications link. The network also typically establishes a layer of logical security (enabled through the operating system) for access to the underlying resources.

17. When IT applications are identified by the auditor to be subject to risks arising from the use of IT, the databases that store the data processed by an identified IT application are typically also identified. Similarly, because an IT application's ability to operate is often dependent on the operating system and IT applications, and databases may be directly accessed from the operating system, the operating system is typically subject to risks arising from the use of IT. The network may be identified when it is a central point of access to the identified IT applications and related databases, when an IT application interacts with vendors or external parties through the internet, or when web-facing IT applications are identified by the auditor.

Identifying Risks Arising From the Use of IT and General IT Controls

18. Examples of risks arising from the use of IT include risks related to inappropriate reliance on IT applications that are inaccurately processing data, processing inaccurate data, or both, as follows:

- Unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or nonexistent transactions or inaccurate recording of transactions. Particular risks may arise when multiple users access a common database.

- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorized changes to data in master files.
- Unauthorized changes to IT applications or other aspects of the IT environment.
- Failure to make necessary changes to IT applications or other aspects of the IT environment.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.

19. The auditor's consideration of unauthorized access may include risks related to unauthorized access by internal or external parties. Such risks (for example, cybersecurity risks) may not necessarily affect financial reporting because an entity's IT environment may also include IT applications and related data that address operational or compliance needs. It is important to note that cyber incidents usually first occur through the perimeter and internal network layers, which tend to be further removed from the IT application, database, and operating systems that affect the preparation of the financial statements. Accordingly, if information about a security breach has been identified, the auditor ordinarily considers the extent to which such a breach had the potential to affect financial reporting. If financial reporting may be affected, the auditor may decide to understand and test the related controls to determine the possible impact or scope of potential misstatements in the financial statements or may determine that the entity has provided adequate disclosures in relation to such security breach.

20. In addition, laws and regulations that may have a direct or indirect effect on the entity's financial statements may include data protection legislation. Considering an entity's compliance with such laws or regulations, in accordance with section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, may involve understanding the entity's IT processes and general IT controls that the entity has implemented to address the relevant laws or regulations.

21. General IT controls are implemented to address risks arising from the use of IT. Accordingly, the auditor uses the understanding obtained about the identified IT applications and other aspects of the IT environment and the applicable risks arising from the use of IT in determining the general IT controls to identify. In some cases, an entity may use common IT processes across its IT environment or across certain IT applications, in which case, common risks arising from the use of IT and common general IT controls may be identified.

22. In general, a greater number of general IT controls related to IT applications and databases are likely to be identified than for other aspects of the IT environment. This is because these aspects are the most closely concerned with the information processing and storage of information in the entity's information system. In identifying general IT controls, the auditor may consider controls over actions of both end users and of the entity's IT personnel or IT service providers.

23. Appendix F, "Considerations for Understanding General IT Controls," provides further explanation of the nature of the general IT controls that may be implemented for different aspects of the IT environment.

.A279

Appendix F — Considerations for Understanding General IT Controls (Ref: par. .29 and .A190–.A200)

This appendix provides further explanation of the nature of the general IT controls that may be implemented for different aspects of the IT environment.

1. The nature of the general IT controls that may be implemented for different aspects of the IT environment include the following:

- a. *Applications.* General IT controls at the IT application layer will correlate to the nature and extent of application functionality and the access paths allowed in the technology. For example, different controls may be identified for highly integrated IT applications with complex security options than for an IT application supporting account balances with access methods only through transactions.
- b. *Database.* General IT controls at the database layer typically address risks arising from the use of IT related to unauthorized updates to financial reporting information in the database through direct database access or execution of a script or program.
- c. *Operating system.* General IT controls at the operating system layer typically address risks arising from the use of IT related to administrative access, which can facilitate the override of other controls. This includes actions such as compromising other user's credentials; adding new, unauthorized users; installing software that is not adequately tested, software containing an issue not yet fixed, or malware; or executing scripts or other unauthorized programs.
- d. *Network.* General IT controls at the network layer typically address risks arising from the use of IT related to network segmentation, remote access, and authentication. Network controls may be relevant when an entity has web-facing applications used in financial reporting. Network controls may be relevant when the entity has significant business partner relationships or third-party outsourcing, which may increase data transmissions and the need for remote access.

2. Examples of general IT controls that may exist, organized by IT process, include the following:

- a. Process to manage access:
 - i. *Authentication.* Controls that validate that a user accessing the IT application or other aspect of the IT environment is using the user's own log-in credentials (that is, the user is not using another user's credentials).
 - ii. *Authorization.* Controls that allow users to access the information necessary for their job responsibilities and nothing further, which facilitates appropriate segregation of duties.
 - iii. *Provisioning.* Controls to authorize new users and modifications to existing users' access privileges.
 - iv. *Deprovisioning.* Controls to remove user access upon termination or transfer.

- v. *Privileged access*. Controls over administrative or powerful users' access.
 - vi. *User-access reviews*. Controls to recertify or evaluate user access for ongoing authorization over time.
 - vii. *Security configuration controls*. Each technology generally has key configuration settings that help restrict access to the environment.
 - viii. *Physical access*. Controls over physical access to the data center and hardware because such access may be used to override other controls.
- b. Process to manage program or other changes to the IT environment:
 - i. *Change-management process*. Controls over the process to design, program, test, and migrate changes to a production (that is, end user) environment.
 - ii. *Segregation of duties over change migration*. Controls that segregate access to make and migrate changes to a production environment.
 - iii. *Systems development or acquisition or implementation*. Controls over initial IT application development or implementation (or in relation to other aspects of the IT environment).
 - iv. *Data conversion*. Controls over the conversion of data during development, implementation, or upgrades to the IT environment.
- c. Process to manage IT operations:
 - i. *Job scheduling*. Controls over access to schedule and initiate jobs or programs that may affect financial reporting.
 - ii. *Job monitoring*. Controls to monitor financial reporting jobs or programs for successful execution.
 - iii. *Backup and recovery*. Controls to ensure backups of financial reporting data occur as planned and that such data is available and able to be accessed for timely recovery in the event of an outage or attack.
 - iv. *Intrusion detection*. Controls to monitor for vulnerabilities or intrusions in the IT environment.

3. General IT controls need not be identified for every IT process. General IT controls are identified based on the risks arising from the use of IT. See paragraph 15 of appendix E, "Considerations for Understanding IT," for examples of considerations that may assist the auditor in determining whether IT applications are subject to risks arising from the use of IT.

.A280

Appendix G — Amendments to Various Statements on Auditing Standards (SAS), as Amended, and to Various Sections in SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as Amended

(***Boldface italics*** denotes new language. Deleted text is shown in ~~strikethrough~~.)

Amendments to Various Sections in SAS No. 122, as Amended (AICPA, *Professional Standards*, AU-C secs. 200, 210, 230, 240, 250, 260, 265, 330, 402, 501, 505, 530, 550, 600, 620, 805, and 930)

AU-C Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

1. The amendment to AU-C section 200 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.07.]

An Audit of Financial Statements

...

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

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

[No amendment to paragraphs .09–.13.]

Definitions

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

...

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

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

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

[No further amendment to paragraph .14; no amendment to paragraphs .15–.A14.]

Definitions

Risk of Material Misstatement

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

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

[No amendment to former paragraphs .A15–.A45, which are renumbered as paragraphs .A16–.A46.]

Sufficient Appropriate Audit Evidence and Audit Risk

...

Audit Risk

...

Risks of Material Misstatement

...

.A43A44 Inherent risk is ***influenced by inherent risk factors***. higher for some assertions and related classes of transactions, account balances, and disclosures than for others. ***Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, the level of inherent risk varies on a scale that is referred to as the spectrum of inherent risk. The auditor determines significant classes of transactions, account balances, and disclosures, and their relevant assertions, as part of the process of identifying and assessing the risks of material misstatement.*** For example, it may be higher for complex calculations or for accounts ***balances*** consisting of amounts derived from accounting estimates that are subject to significant estimation uncertainty ***may be identified as significant account balances, and the auditor's assessment of inherent risk for the related risks at the assertion level may be higher because of the high estimation uncertainty.*** External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. Factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may also influence the inherent risk related to a specific assertion. Such factors may include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.

.A44A45 Control risk is a function of the effectiveness of the design, implementation, and maintenance of ~~internal~~ controls by management to address

identified risks that threaten the achievement of the entity's objectives relevant to preparation and fair presentation of the entity's financial statements. However, internal control, no matter how well designed and operated, can only reduce, but not eliminate, risks of material misstatement in the financial statements, because of the inherent limitations of internal controls. These include, for example, the possibility of human errors or mistakes, or of controls being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. GAAS provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures to be performed. ^{fn 15}

^{fn 15} [Footnote omitted for purposes of this SAS.]

A45 A46 The assessment of the risks of material misstatement may be expressed in quantitative terms or in nonquantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. GAAS *typically* do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the risks of material misstatement, *rather than inherent risk and control risk separately*. However, **SAS No. 145** section 540, *Auditing Accounting Estimates and Related Disclosures*, ^{fn 16} requires a separate assessment of inherent risk *to be assessed separately and from* control risk to provide a basis for designing and performing audit procedures to respond to the assessed risks of material misstatement at the relevant assertion level in accordance with AU-C section 330. ^{fn 17, fn 18} ~~In identifying and assessing risks of material misstatement for significant classes of transactions, account balances, or disclosures other than accounting estimates, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.~~

^{fn 16} Paragraph 15 of section 540, *Auditing Accounting Estimates and Related Disclosures*.

^{fn 17} [Footnote omitted for purposes of this SAS.]

^{fn 18} **Paragraphs A227–A239 of SAS No. 145 address assessing risk, and paragraphs A248–A252 of SAS No. 145 address assessing control risk.**

A47 *Risks of material misstatement are assessed at the assertion level in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence.* ^{fn 19}

^{fn 19} **Paragraph .06 of AU-C section 330.**

[Subsequent footnotes renumbered. No amendment to former paragraphs .A46–.A64, which are renumbered as paragraphs .A48–.A66.]

Conduct of an Audit in Accordance With GAAS

...

Contents of GAAS

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A65A67 When necessary, the application and other explanatory material provides further explanation of the requirements of an AU-C section and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover, *including, in some AU-C sections, such as AU-C section 315 [SAS No. 145], why a procedure is required.*

- include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AU-C section. The auditor is required by paragraph .21 to understand the application and other explanatory material; how the auditor applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AU-C section. The words "may," "might," and "could" are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AU-C section.

[No amendment to renumbered paragraphs .A68–.A71.]

Considerations Specific to Smaller, Less Complex Entities Scalability Considerations

.A72 Scalability considerations have been included in some AU-C sections (for example, AU-C section 315 [SAS No. 145]) to illustrate the application of the requirements to all entities, regardless of whether their nature and circumstances are less complex or more complex. Less complex entities are entities for which the characteristics in paragraph .A73 apply.

.A70A73 For purposes of specifying additional considerations to audits of smaller, less complex entities, a *smaller, less complex entity* refers to an entity that typically possesses qualitative characteristics, such as the following:

- a. Concentration of ownership and management in a small number of individuals; and
- b. One or more of the following:
 - i. Straightforward or uncomplicated transactions
 - ii. Simple record keeping
 - iii. Few lines of business and few products within business lines
 - iv. **Simpler systems of** Few internal controls
 - v. Few levels of management with responsibility for a broad range of controls
 - vi. Few personnel, many having a wide range of duties

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

Considerations Specific to Automated Tools and Techniques

.A74 The considerations specific to "automated tools and techniques" included in some AU-C sections (for example, AU-C section 315 [SAS No. 145]) have been developed to explain how the auditor may apply certain requirements when using automated tools and techniques in performing audit procedures.

[Former paragraphs .A71–.A87 are renumbered as paragraphs .A75–.A91.]

[No further amendment to AU-C section 200.]

AU-C Section 210, Terms of Engagement

2. The amendment to AU-C section 210 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A15.]

Preconditions for an Audit

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Agreement of the Responsibilities of Management

...

Internal Control

...

.A16 Management has the responsibility to determine what internal control is necessary to enable the preparation and fair presentation of the financial statements. The term *internal control* encompasses a wide range of activities within components **of the system of internal control** that may be described as the control environment; the entity's risk assessment process; **the entity's process to monitor the system of internal control**; the information system, including the related business processes relevant to financial reporting; and communication; **and** control activities; **and** monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement, and maintain its internal control or how it may classify any particular component.^{fn 9} An entity's internal control will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulations.

^{fn 9} [Footnote omitted for purposes of this SAS.]

[No further amendment to AU-C section 210.]

AU-C Section 230, Audit Documentation

3. The amendment to AU-C section 230 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A19.]

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

...

Identification of Specific Items or Matters Tested and of the Preparer and the Reviewer

...

Considerations Specific to Smaller, Less Complex Entities

...

.A20 When preparing audit documentation, the auditor of a smaller, less complex entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller, less complex entity include the understanding of the entity and its **environment, the applicable financial reporting framework, and the entity's system of internal control**; the overall audit strategy and audit plan; materiality; assessed risks, significant findings or issues noted during the audit; and conclusions reached.

[No further amendment to AU-C section 230.]

AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit*

4. The amendment to AU-C section 240 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.06.]

Responsibility for the Prevention and Detection of Fraud

...

Responsibilities of the Auditor

...

.07 Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information, or override controls procedures designed to prevent similar frauds by other employees.

[No amendment to paragraphs .08–.15.]

Risk Assessment Procedures and Related Activities

.16 When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, ***the applicable financial reporting framework and*** including the entity's ***system of*** internal control, required by ***SAS No. 145*** section 315, the auditor should perform the procedures in paragraphs .17–.24 to obtain information for use in identifying the risks of material misstatement due to fraud. ^{fn 5}

^{fn 5} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .17–.19.]

Those Charged With Governance

.20 Unless all of those charged with governance are involved in managing the entity,^{fn 7} the auditor should obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal controls that management has established to mitigate these risks. (Ref: par. .A21–.A23)

^{fn 7} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .21–.26.]

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

...

.27 The auditor should treat those assessed risks of material misstatement due to fraud as significant risks and, accordingly, to the extent not already done so, the auditor should obtain an understanding of the entity's related ***identify the entity's*** controls, including control activities, relevant to ***that address*** such risks ***and evaluate their design and determine whether they have been implemented.*** ^{fn 10} including the evaluation of whether such controls have been suitably designed and implemented to mitigate such fraud risks.

^{fn 10} ***Paragraphs 26a(i) and d of SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.***

[Subsequent footnotes renumbered. No amendment to paragraphs .28–.31.]

Responses to the Assessed Risks of Material Misstatement Due to Fraud

...

Audit Procedures Responsive to Risks Related to Management Override of Controls

...

.32 Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor should address the risk of management override of controls apart from any conclusions regarding the existence of more specifically identifiable risks by designing and performing audit procedures to

- a. test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including entries posted directly to financial statement drafts. In designing and performing audit procedures for such tests, the auditor should (Ref: par. .A47–.A50 and .A56)
 - i. obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, ^{fn 12} and, ***in accordance with SAS No. 145, evaluate the suitability of design and determine whether the controls have been implemented*** ^{implementation of such controls; fn13}
 - ii. make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
 - iii. consider fraud risk indicators, the nature and complexity of accounts, and unusual entries processed;
 - iv. select journal entries and other adjustments made at the end of a reporting period; and
 - v. consider the need to test journal entries and other adjustments throughout the period.
- b. review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor should
 - i. evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor should reevaluate the accounting estimates taken as a whole, and
 - ii. perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. Estimates selected for review should include those that are based on highly sensitive assumptions or are otherwise significantly affected by judgments made by management. (Ref: par. .A51–.A53)
- c. evaluate, given the auditor's understanding of the entity and its environment and other information obtained during the audit,

whether the business purpose (or the lack thereof) of significant unusual transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. The procedures should include the following: (Ref: par. .A54–.A55)

- i. Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction
- ii. Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures
- iii. Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

^{fn 1213} Paragraph ~~.19~~ **26a and c** of **SAS No. 145** ~~section 315~~.

[No amendment to paragraphs .33–.42.]

Documentation

.43 The auditor should include in the audit documentation ^{fn 1314} ~~of the auditor's understanding of the entity and its environment~~ **the identification** and the assessment of the risks of material misstatement required by **SAS No. 145** AU-C ~~section 315~~, **which includes** the following: ^{fn 1415}

- a. The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud, and how and when the discussion occurred and the audit team members who participated
- b. The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level (See paragraphs .16–.27.)
- c. **Identified controls in the control activities component that address assessed risks of material misstatement due to fraud**

^{fns 1314–1415} [Footnotes omitted for purposes of this SAS.]

[No amendment to paragraphs .44–.A8.]

Professional Skepticism

.A9 Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and **the identified controls in the control activities, if any**, over its preparation and maintenance ~~when relevant~~. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

[No amendment to paragraphs .A10–.A20.]

Risk Assessment Procedures and Related Activities

...

Obtaining an Understanding of Oversight Exercised by Those Charged With Governance

.A21 Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control, and compliance with the law. In some circumstances, governance practices are well-developed, and those charged with governance play an active role in oversight of the entity's assessment of the risks of fraud and of the relevant internal control ***the controls that address such risks***. Because the responsibilities of those charged with governance and management may vary by entity, it is important that the auditor understands the respective responsibilities of those charged with governance and management to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals.^{fn 1819}

^{fn 1819} [Footnote omitted for purposes of this SAS.]

.A22 An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of internal controls ***that address*** over risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings during which such discussions take place, reading the minutes from such meetings, or making inquiries of those charged with governance.

[No amendment to paragraphs .A23–.A26.]

Other Information

.A27 In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment, ***the applicable financial reporting framework, and the entity's system of internal control*** may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example, engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud.

[No amendment to paragraphs .A28–.A29.]

Evaluation of Fraud Risk Factors

...

.A30 Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in appendix A, "Examples of Fraud Risk Factors." These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud
- A perceived opportunity to commit fraud
- An ability to rationalize the fraudulent action

The inability to observe one or more of these conditions does not necessarily mean that no risk of material misstatement due to fraud exists.

Fraud risk factors may relate to incentives, pressures, or opportunities that arise from conditions that create susceptibility to misstatement before consideration of controls. Fraud risk factors, which include intentional management bias, are inherent risk factors insofar as they affect inherent risk. Fraud risk factors may also relate to conditions within

the entity's system of internal control that provide opportunity to commit fraud or that may affect management's attitude or ability to rationalize fraudulent actions. Fraud Risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information *through, for example, the required understanding of the entity's control environment.*^{fn20} Although the fraud risk factors described in appendix A cover a broad range of situations that may be faced by auditors, they are only examples, and other risk factors may exist.

^{fn 20} **Paragraph 21 of SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.**

[Subsequent footnotes renumbered. No amendment to paragraphs .A31–.A36.]

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

...

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls

...

.A37 It is, therefore, important for the auditor to obtain an understanding of the controls that management has designed, implemented, and maintained to prevent and detect fraud. ~~In doing so,~~ *In identifying the controls that address the risks of material misstatement due to fraud,* the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from ~~obtaining this understanding~~ *identifying these controls and evaluating their design and determining whether they have been implemented* may also be useful in identifying fraud risk factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud.

[No amendment to paragraphs .A38–.A47.]

Responses to the Assessed Risks of Material Misstatement Due to Fraud

...

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments

...

.A48 The auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries^{fn22} is important because automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, when IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

^{fn 22} **Paragraph 27b of SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.**

[Subsequent footnotes further renumbered.]

.A49 When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters may be relevant:

- *The **identification and** assessment of the risks of material misstatement due to fraud.* The presence of fraud risk factors and other information obtained during the auditor's **identification and** assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.
- *Controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.
- *The entity's financial reporting process and the nature of evidence that can be obtained.* For many entities, routine processing of transactions involves a combination of manual and automated ~~steps and~~ procedures **and controls**. Similarly, the processing of journal entries and other adjustments may involve both manual and automated procedures and controls. When IT is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.
- *The characteristics of fraudulent journal entries or other adjustments.* Inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts; (b) made by individuals who typically do not make journal entries; (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description; (d) made either before or during the preparation of the financial statements that do not have account numbers; or (e) containing round numbers or consistent ending numbers.
- *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to misstatements in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified risk of material misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.
- *Journal entries or other adjustments processed outside the normal course of business.* Nonstandard journal entries, and other entries such as consolidating adjustments, may not be subject to the same ~~level of internal~~ **nature and extent of** controls as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements.

[No amendment to paragraphs .A50–.A75.]

Appendix A — Examples of Fraud Risk Factors

A76 The fraud risk factors identified in this appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration — that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives and pressures, (b) opportunities, and (c) attitudes and rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Fraud risk factors may relate to incentives or pressures, or opportunities that arise from conditions that create susceptibility to misstatement before consideration of controls (that is, the determination is based on inherent risk). Such factors are inherent risk factors and may be due to susceptibility to management bias. Fraud risk factors related to opportunities may also arise from other identified inherent risk factors (for example, complexity or uncertainty may create opportunities that result in susceptibility to misstatement due to fraud). Fraud risk factors related to opportunities may also relate to conditions within the entity's system of internal control, such as limitations or deficiencies in internal control that create such opportunities. Fraud risk factors related to attitudes or rationalizations may arise, in particular, from limitations or control deficiencies in the entity's control environment.

Risk Factors Relating to Misstatements Arising From Fraudulent Financial Reporting

...

Opportunities

...

Internal control components are deficient *Deficiencies in internal control areas* as a result of the following:

- Inadequate ~~monitoring of controls~~ *process to monitor the entity's system of internal control*, including automated controls and controls over interim financial reporting (when external reporting is required)
- High turnover rates or employment of staff in accounting, IT, or the internal audit function who are not effective
- Accounting and information systems that are not effective, including situations involving significant deficiencies or material weaknesses in internal control
- Weak controls over budget preparation and development and compliance with law or regulation

...

Risk Factors Arising From Misstatements Arising From Misappropriation of Assets

...

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when the following exist:

- Large amounts of cash on hand or processed
- Inventory items that are small in size, of high value, or in high demand
- Easily convertible assets, such as bearer bonds, diamonds, or computer chips
- Fixed assets that are small in size, marketable, or lack observable identification of ownership

Inadequate **internal controls** over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because the following exist:

- Inadequate segregation of duties or independent checks
- Inadequate oversight of senior management expenditures, such as travel and other reimbursements
- Inadequate management oversight of employees responsible for assets (for example, inadequate supervision or monitoring of remote locations)
- Inadequate job applicant screening of employees with access to assets
- Inadequate record keeping with respect to assets
- Inadequate system of authorization and approval of transactions (for example, in purchasing)
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets
- Lack of complete and timely reconciliations of assets
- Lack of timely and appropriate documentation of transactions (for example, credits for merchandise returns)
- Lack of mandatory vacations for employees performing key control functions
- Inadequate management understanding of IT, which enables IT employees to perpetrate a misappropriation
- Inadequate access controls over automated records, including controls over and review of computer systems event logs

Attitudes and Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets
- Disregard for **internal controls** over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee
- Changes in behavior or lifestyle that may indicate assets have been misappropriated

- The belief by some government or other officials that their level of authority justifies a certain level of compensation and personal privileges
- Tolerance of petty theft

Appendix B — Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

.A77 The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly, they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

...

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of **material** misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods, or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose

...

[No further amendment to appendix B. No further amendment to AU-C section 240.]

AU-C Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

5. The amendment to AU-C section 250 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A23.]

Audit Procedures When Noncompliance Is Identified or Suspected

...

Evaluating the Implications of Noncompliance

.A24 As required by paragraph .20, the auditor evaluates the implications of noncompliance with regard to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations. The implications of particular instances of noncompliance identified by the auditor will depend on the relationship of the perpetration and concealment, if any, of the act to specific controls activities and the level of management or employees involved, especially implications arising from the involvement of the highest authority within the entity.

[No further amendment to AU-C section 250.]

AU-C Section 260, *The Auditor's Communication With Those Charged With Governance*

6. The amendment to AU-C section 260 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A19.]

Matters to Be Communicated

...

Planned Scope and Timing of the Audit

...

.A20 Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they **were determined to be significant risks** require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.

.A21 Other matters regarding the planned scope and timing of the audit may include the following:

- How the auditor plans to address the significant risks of material misstatement, whether due to fraud or error.
- How the auditor plans to address areas of higher assessed risks of material misstatement.
- The auditor's approach to **the system of** internal control, relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.

...

[No further amendment to AU-C section 260.]

AU-C Section 265, *Communicating Internal Control Related Matters Identified in an Audit*

7. The amendment to AU-C section 265 is effective for audits of financial statements for periods ending on or after December 15, 2023.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. This section does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control or designing and performing tests of controls over and above the requirements of **SAS No. 145** *section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. Section 260, *The Auditor's Communication With Those Charged With Governance*, establishes further requirements and provides guidance regarding the auditor's responsibility to communicate with those charged with governance regarding the audit.

.02 The auditor is required to obtain an understanding of **the entity's system of** internal control relevant to the audit when identifying and assessing the risks of material misstatement.^{fn 1} In making those risk assessments, the auditor considers **the entity's system of** internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control. The auditor may identify deficiencies in internal control (**commonly referred to as control deficiencies**) not only during this risk assessment process but also at any other stage of the audit. This section specifies which identified deficiencies the

auditor is required to communicate to those charged with governance and management.

^{fn 1} *Paragraphs 21-22 and 24-26 of SAS No. 145, section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement. Paragraphs A61-A67 of section 315 provide guidance on obtaining and evaluating the components an understanding of internal control relevant to the audit.*

[No amendment to paragraphs .03-.06.]

Definitions

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Deficiency in internal control. A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively. (*Ref: par. A1*)

...

[No further amendment to paragraph .07. No amendment to paragraphs .08-.16.]

Determination of Whether Deficiencies in Internal Control Have Been Identified

.A1 *SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, defines the term system of internal control and recognizes that internal control frameworks may use different terms that are similar to the concept of the system of internal control. This section defines the term deficiency in internal control in the context of a system of internal control over financial reporting to more clearly define the auditor's communication responsibilities in this section.*

[Paragraphs .A1-.A39 are renumbered as paragraphs .A2-.A40. No amendment to renumbered paragraphs .A2-.A3.]

Considerations Specific to Smaller, Less Complex Entities

~~.A3A4~~ Although the concepts underlying **controls in the control activities component** in smaller entities are likely to be similar to those in larger entities, the formality with which controls operate will vary. Further, smaller entities may find that certain types of controls ~~activities~~ are not necessary because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide effective control over important account balances and transactions, lessening or removing the need for more detailed controls ~~activities~~.

[No amendment to renumbered paragraphs .A5-.A10.]

Evaluating Identified Deficiencies in Internal Control

...

~~.A10A11~~ Controls may be designed to operate individually, or in combination, to effectively prevent, or detect and correct, misstatements. ^{fn 3} For example,

controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance. A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency or a material weakness. However, a combination of deficiencies affecting the same class of transactions, account balance, or disclosure, **relevant** assertion, or component of **the entity's system of** internal control may increase the risks of misstatement to such an extent to give rise to a significant deficiency or material weakness.

^{fn 3} [Footnote omitted for purposes of this SAS.]

[No further amendment to AU-C section 265.]

AU-C Section 300, *Planning an Audit*

8. The amendment to AU-C section 300 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A25.]

Documentation

Considerations Specific to Smaller, Less Complex Entities

.A26 As discussed in paragraph .A12, a suitable, brief memorandum may serve as the documented strategy for the audit of a smaller entity. For the audit plan, standard audit programs or checklists (see paragraph .A24) drawn up on the assumption of few **relevant** controls activities, which is likely to be the case in a smaller entity, may be used, provided that they are tailored to the circumstances of the engagement, including the auditor's risk assessments.

[No further amendment to AU-C section 300.]

AU-C Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

9. The amendment to AU-C section 330 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.06.]

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level

...

.07 In designing the further audit procedures to be performed, the auditor should

- a. consider the reasons for the assessed risk of material misstatement at the relevant assertion level for each **significant** class of transactions, account balance, and disclosure, including
 - i. the likelihood **and magnitude** of material misstatement due to the particular characteristics of the **relevant significant** class of transactions, account balance, or disclosure (the inherent risk) and
 - ii. whether the risk assessment takes account of **relevant** controls **that address the risk of material misstatement** (the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor ~~intends to rely~~ **plans to test on** the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures), and (Ref: par. .A10–.A19)

- b. obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: par. .A20)

Tests of Controls

.08 The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of ~~relevant~~ controls if

- a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively (that is, the auditor ~~intends to rely on~~ **plans to test** the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures) or
- b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level. (Ref: par. .A21–.A26)

[No amendment to paragraph .09.]

Nature and Extent of Tests of Controls

.10 In designing and performing tests of controls, the auditor should

- a. perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including
 - i. how the controls were applied at relevant times during the period under audit;
 - ii. the consistency with which they were applied; and
 - iii. by whom or by what means they were applied, including, when applicable, whether the person performing the control possesses the necessary authority and competence to perform the control effectively, and (Ref: par. .A28–.A32)
- b. ***to the extent not already addressed***, determine whether the controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain audit evidence supporting the operating effectiveness of those indirect controls. (Ref: par. .A33–.A34)

[No amendment to paragraphs .11–.12.]

Timing of Tests of Controls

...

Using Audit Evidence Obtained in Previous Audits

.13 In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits and, if so, the length of the time period that may elapse before retesting a control, the auditor should consider

- a. the effectiveness of other ~~elements~~ **components of the entity's system of internal control**, including the control environment, the entity's ~~process to monitoring of the system of internal~~ controls, and the entity's risk assessment process;
- b. the risks arising from the characteristics of the control, including whether the control is manual or automated;
- c. the effectiveness of general IT controls;
- d. the effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits and whether there have been

personnel changes that significantly affect the application of the control;

- e. whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- f. the risks of material misstatement and the extent of reliance on the control. (Ref: par. .A38)

[No amendment to paragraph .14.]

Controls Over Significant Risks

.15 If the auditor ~~plans~~ **intends** to rely on controls over a risk the auditor has determined to be a significant risk, ^{fn 1} the auditor should test the operating effectiveness of those controls in the current period.

^{fn 1} [Footnote omitted for purposes of this SAS.]

Evaluating the Operating Effectiveness of Controls

.16 When evaluating the operating effectiveness of ~~relevant~~ controls **upon which the auditor intends to rely**, the auditor should evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the relevant assertion being tested are effective. (Ref: par. .A43)

.17 If deviations from controls upon which the auditor intends to rely are detected, the auditor should make specific inquiries to understand these matters and their potential consequences and should determine whether

- a. the tests of controls that have been performed provide an appropriate basis for reliance on the controls,
- b. additional tests of controls are necessary, or
- c. the ~~potential~~ risks of **material** misstatement need to be addressed using substantive procedures. (Ref: par. .A44)

Substantive Procedures

.18 ~~Irrespective of the assessed risks of material misstatement, T~~the auditor should design and perform substantive procedures for **each** all relevant assertions related to **of** each material **significant** class of transactions, account balance, and disclosure, **regardless of the assessed level of control risk**. (Ref: par. .A45–.A50)

[No amendment to paragraphs .19–.28.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence ^{fn 3}

...

.29 If the auditor has not obtained sufficient appropriate audit evidence ~~about~~ **related to** a relevant assertion **about a significant class of transactions, account balance, or disclosure**, the auditor should attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should express a qualified opinion or disclaim an opinion on the financial statements. ^{fn 4}

^{fns 3–4} [Footnotes omitted for purposes of this SAS.]

[No amendment to paragraphs .30–.33.]

Overall Responses

.A1 Overall responses to address the assessed risks of material misstatement at the financial statement level may include ^{fn 6}

- emphasizing to the audit team the need to maintain professional skepticism.

- assigning more experienced staff or those with specialized skills or using specialists.
- providing ~~more supervision~~ **changes to the nature, timing, and extent of direction and supervision of members of the engagement team and the review of the work performed.**
- incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- **changes to the overall audit strategy as required by section 300, Planning an Audit, or planned audit procedures, and may include changes to the following:**
 - **The auditor's determination of performance materiality in accordance with section 320.**
 - **The auditor's plans to test the operating effectiveness of controls, and the persuasiveness of audit evidence needed to support the planned reliance on the operating effectiveness of the controls, particularly when control deficiencies in the control environment or the entity's monitoring activities are identified.**
 - **The nature, timing, and extent of substantive procedures. For example, it may be appropriate to perform substantive procedures at or near the date of the financial statements when the risk of material misstatement is assessed as higher.**
- making general changes to the nature, timing, or extent of audit procedures (for example, performing substantive procedures at period-end instead of at an interim date or modifying the nature of audit procedures to obtain more persuasive audit evidence).

^{fn 6} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A2–.A3.]

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level

The Nature, Timing, and Extent of Further Audit Procedures

.A4 The auditor's assessment of the identified risks **of material misstatement** at the relevant assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that

- a. in addition to the substantive procedures that are required for all relevant assertions, in accordance with paragraph .18, an effective response to the assessed risk of material misstatement for a particular assertion can be achieved only by also performing tests of controls.
- b. performing only substantive procedures is appropriate for particular assertions, and therefore, the auditor excludes the effect of controls from the relevant risk assessment **of the risk of material misstatement**. This may be because the auditor's risk assessment procedures have not identified any effective controls relevant to the assertion or because **auditor has not identified a risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence and, as a result, is not required to test the operating effectiveness of controls.** ~~testing controls would be inefficient, and t~~Therefore, the

auditor ~~does not intend to rely on~~ **may not plan to test** the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures.

- c. a combined approach using both tests of controls and substantive procedures is an effective approach.

[No amendment to paragraphs .A5–.A6.]

.A7 Extent of an audit procedure refers to the quantity to be performed (for example, a sample size or the number of observations of a control activity).

[No amendment to paragraphs .A8–.A9.]

Responding to the Assessed Risks at the Assertion Level

.A10 Nature. SAS No. 145 requires that the auditor's assessment of the risks of material misstatement at the assertion level is performed by assessing inherent risk and control risk. The auditor assesses inherent risk by assessing the likelihood and magnitude of a misstatement, taking into account how and the degree to which the inherent risk factors affect the susceptibility of assertions to misstatement.^{fn 9} The auditor's assessed risks, **including the reasons for those assessed risks**, may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, regarding revenue, tests of controls may be most responsive to the assessed risk of **material** misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of **material** misstatement of the occurrence assertion.

^{fn 9} **Paragraph 48 of SAS No. 145.**

[Subsequent footnotes renumbered.]

.A11 The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because of ~~internal control~~ **the auditor plans to test the operating effectiveness of controls that are appropriately designed and implemented** and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph .08a. This may be the case, for example, for a class of transactions of reasonably uniform, noncomplex characteristics that are routinely processed and controlled by the entity's information system.

[No amendment to paragraphs .A12–.A18.]

.A19 Considerations specific to smaller, less complex entities. In the case of smaller entities, the auditor may not identify controls activities, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of controls activities or other components of **the system of internal** control may make it impossible to obtain sufficient appropriate audit evidence.

[No amendment to paragraph .A20.]

Tests of Controls

Designing and Performing Tests of Controls

.A21 Tests of controls are performed only on those controls that the auditor **plans to test and** has determined are suitably designed to prevent, or detect and correct, a material misstatement in a relevant assertion. If substantially different controls were used at different times during the period under audit, each is considered separately.

[No amendment to paragraphs .A22–.A24.]

.A25 In some cases, the auditor may find it impossible to design effective substantive procedures that, by themselves, provide sufficient appropriate audit evidence at the relevant assertion level.^{fn 910} This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph .08b requires the auditor to perform tests of relevant controls **that address the risk for which substantive procedures alone cannot provide sufficient appropriate audit evidence.**

^{fn 910} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A26–.A28.]

Nature and Extent of Tests of Controls

...

.A29 The nature of the particular control influences the type of audit procedure necessary to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect such documentation to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of controls activities, such as **automated controls activities performed by a computer.** In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures, such as observation or the use of CAATs.

[No amendment to paragraphs .A30–.A31.]

.A32 Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated control can be expected to function consistently unless the ~~program~~ **IT application** (including the tables, files, or other permanent data used by the ~~program~~ **IT application**) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests ~~might~~ **may** include **testing the general IT controls related to the IT application.** determining that

- ~~changes to the program are not made without being subject to the appropriate program change controls,~~
- ~~the authorized version of the program is used for processing transactions, and~~
- ~~other relevant general controls are effective.~~

~~Such tests also might include determining that changes to the programs have not been made, which may be the case when the entity uses packaged~~

software applications without modifying or maintaining them. For example, the auditor may inspect the record of the administration of IT security to obtain audit evidence that unauthorized access has not occurred during the period.

.A33 Similarly, the auditor may perform tests of controls that address risks of material misstatement related to the integrity of the entity's data, or the accuracy and completeness of the entity's system-generated reports, or may determine they are necessary to address risks of material misstatement because substantive procedures alone cannot provide sufficient appropriate audit evidence. These tests of controls may include tests of general IT controls that address the matters in paragraph .10a. When this is the case, the auditor may not need to perform any further testing to obtain audit evidence about the matters in paragraph .10a.

.A34 When the auditor determines that a general IT control is deficient, the auditor may consider the nature of the related risks arising from the use of IT that were identified in accordance with SAS No. 145^{fn 12} to provide the basis for the design of the auditor's additional procedures to address the assessed risk of material misstatement. Such procedures may address determining the following:

- ***Whether the related risks arising from the use of IT have occurred. For example, if users have unauthorized access to an IT application (but cannot access or modify the system logs that track access), the auditor may decide to inspect the system logs to obtain audit evidence that those users did not access the IT application during the period.***
- ***Whether there are any alternate or redundant general IT controls, or any other controls, that address the related risks arising from the use of IT. If so, the auditor may identify such controls (if not already identified) and, therefore, evaluate their design, determine that they have been implemented, and perform tests of their operating effectiveness. For example, if a general IT control related to user access is deficient, the entity may have an alternate control whereby IT management reviews end-user access reports on a timely basis. Circumstances in which an application control may address a risk arising from the use of IT may include when the information that may be affected by the general IT control deficiency can be reconciled to external sources (for example, a bank statement) or internal sources not affected by the general IT control deficiency (for example, a separate IT application or data source).***

^{fn 12} ***Paragraph 41 of SAS No. 145.***

[Subsequent footnotes further renumbered.]

.A33A35 Testing of indirect controls (Ref: par. .10b). In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls (for example, general IT controls). As explained in paragraphs .A33-.A34, general IT controls may have been identified in accordance with SAS No. 145 because of their support of the operating effectiveness of automated controls or due to their support in maintaining the integrity of information used in the entity's financial reporting, including system-generated reports. The requirement in paragraph .10b acknowledges that the auditor may have already tested certain indirect controls to address the matters in paragraph .10a. For example,

when the auditor decides to test the effectiveness of a user review of exception reports detailing sales in excess of authorized credit limits, the user review and related follow up is the control that is of direct relevance to the auditor. Controls over the accuracy of the information in the reports (for example, the general IT controls) are described as indirect controls.

~~A34~~ Because of the inherent consistency of IT processing, audit evidence about the implementation of an automated application control, when considered in combination with audit evidence about the operating effectiveness of the entity's general IT controls (in particular, change controls), also may provide substantial audit evidence about its operating effectiveness.

Timing of Tests of Controls

~~A35~~**A37** *Intended period of reliance (Ref: par. .11).* Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose (for example, when testing controls over the entity's physical inventory counting at the period-end). If, on the other hand, the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of **controls in** the entity's **process to** monitoring **the system of internal** of controls.

[Former paragraphs .A36–.A78 renumbered as paragraphs .A38–.A80. No amendment to renumbered paragraphs .A38–.A39.]

~~A38~~**A40** *Using audit evidence obtained in previous audits (Ref: par. .13).* In certain circumstances, audit evidence obtained from previous audits may provide audit evidence, provided that the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit **and its reliability**. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls.

~~A39~~**A41** *Controls that have changed from previous audits (Ref: par. .14a).* Changes may affect the relevance **and reliability** of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

[No amendment to renumbered paragraph .A42.]

~~A41~~**A43** In general, the higher the risk of material misstatement or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control or result in not relying on audit evidence obtained in previous audits at all include the following:

- A deficient control environment
- **A control** Deficient **deficiency in the entity's process to** monitoring **the system of internal** controls
- A significant manual element to the relevant **the identified** controls

- Personnel changes that significantly affect the application of the control
- Changing circumstances that indicate the need for changes in the control
- Deficient general IT controls

[No amendment to renumbered paragraphs .A44–.A46.]

Substantive Procedures

.A45A47 Paragraph .18 requires the auditor to design and perform substantive procedures for all relevant assertions related to each material **significant** class of transactions, account balance, and disclosure, ~~irrespective of the assessed risks of material misstatement.~~ ***For such classes of transactions, account balances, and disclosures, substantive procedures may have already been performed because paragraph .06 requires the auditor to design and perform further audit procedures that are responsive to the assessed risks of material misstatement at the relevant assertion level. Accordingly, substantive procedures are required to be designed and performed in accordance with paragraph .18 when the further audit procedures designed and performed in accordance with paragraph .06 for significant classes of transactions, account balances, or disclosures, designed and performed in accordance with paragraph .06, did not include substantive procedures.*** This requirement reflects the facts that (i) the auditor's assessment of risk is judgmental and may not identify all risks of material misstatement and (ii) inherent limitations to internal control exist, including management override.

[No amendment to renumbered paragraphs .A48–.A49.]

Nature and Extent of Substantive Procedures

...

.A48A50 The ~~nature~~ **assessment** of the risk and ***or the nature of the*** assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. For example, the auditor might inspect subsequent cash disbursements and compare them with the recorded accounts payable to determine whether any purchases had been omitted from accounts payable.

.A49A51 Because the assessment of the risks of material misstatement takes account of internal controls ***which the auditor plans to test***, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.

[No amendment to renumbered paragraphs .A52–.A63.]

Timing of Substantive Procedures

...

.A62A64 Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period-end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The effectiveness of the control environment and other relevant controls
- The availability at a later date of information necessary for the auditor's procedures
- The purpose of the substantive procedure
- The assessed risk of material misstatement
- The nature of the class of transactions or account balance and relevant assertions
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period-end will not be detected

[No amendment to renumbered paragraph .A65.]

~~A64~~A66 Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period-end:

- Whether the period-end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition
- Whether the entity's procedures for analyzing and adjusting such classes of transactions or account balances at interim dates and establishing proper accounting cutoffs are appropriate
- Whether the information system ~~relevant to financial reporting~~ will provide information concerning the balances at the period-end and the transactions in the remaining period that is sufficient to permit investigation of the following:
 - Significant unusual transactions or entries (including those at or near the period-end)
 - Other causes of significant fluctuations or expected fluctuations that did not occur
 - Changes in the composition of the classes of transactions or account balances

[No amendment to renumbered paragraphs .A67–.A75.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence

~~A74~~A76 An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessments were based. For example

- the extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's professional judgment about the risk assessments and indicate a significant deficiency or material weakness in internal control.
- the auditor may become aware of discrepancies in accounting records or conflicting or missing evidence.

- analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks **of material misstatement** for all or some **and the effect on the** of **significant** classes of transactions, account balances, or disclosures and related **their relevant** assertions. **SAS No. 145** ^{fn 1315} contains further guidance on revising the auditor's risk assessment.

^{fn 1315}

[Footnote omitted for purposes of this SAS.]

[No amendment to renumbered paragraphs .A77–.A78.]

.A77A79 The auditor's conclusion of whether sufficient appropriate audit evidence has been obtained is both at the relevant assertion level as well as the financial statement level. Section 500 enables the auditor to evaluate the results of audit procedures to inform the auditor's overall conclusion about whether sufficient appropriate audit evidence has been obtained as required by paragraph .28. The auditor's professional judgment about what constitutes sufficient appropriate audit evidence is influenced by the following additional factors:

- Significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements (see section 450, *Evaluation of Misstatements Identified During the Audit*)
- Effectiveness of management's responses and controls to address the risks
- Experience gained during previous audits with respect to similar potential misstatements
- Whether the audit procedures that were performed identified specific instances of fraud or error
- Understanding of the entity and its environment, ~~including it's~~ **the applicable financial reporting framework, and the entity's system of** internal control

Documentation

.A78A80 The form and extent of audit documentation is a matter of professional judgment and is influenced by the nature, size, and complexity of the entity; **system of** internal control of the entity; availability of information from the entity; and the audit methodology and technology used in the audit.

[No further amendment to AU-C section 330.]

AU-C Section 402, Audit Considerations Relating to an Entity Using a Service Organization

10. The amendment to AU-C section 402 is effective for audits of financial statements for periods ending on or after December 15, 2023.

Introduction

Scope of This Section

.01 This section addresses the user auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of a user entity that uses one or more service organizations. Specifically, it expands

on how the user auditor applies **SAS No. 145** section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, in obtaining an understanding of the user entity, including **the entity's system of internal control relevant to the preparation of the financial statements** the audit, sufficient to identify and assess the risks of material misstatement and in designing and performing further audit procedures responsive to those risks.

[No amendment to paragraph .02.]

.03 Services provided by a service organization are relevant to the audit of a user entity's financial statements when those services and the controls over them affect the user entity's information system, ~~including related business processes, relevant to financial reporting~~ **the preparation of the financial statements**. Although ~~in~~ Most controls at the service organization are likely to relate to financial reporting **be part of the user entity's information system relevant to the preparation of the financial statements** or other related controls also may be relevant to the audit, such as controls over the safeguarding of assets. A service organization's services are part of a user entity's information system, ~~including related business processes, relevant to financial reporting~~ if these services affect any of the following:

- a. **How information relating to significant classes of transactions, account balances, and disclosures flows through the user entity's information system, whether manually or using IT, and whether obtained from within or outside the general ledger and subsidiary ledgers.** The classes of transactions in the user entity's operations that are significant to the user entity's financial statements; **This includes when the service organization affects the following:**
 - bi. The ~~procedures within both IT and manual systems by which the user entity's transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements;~~ **How transactions of the user entity are initiated and how information about them is recorded, processed, corrected as necessary, and incorporated in the general ledger and reported in the financial statements**
 - ii. **How information about events or conditions, other than transactions, is captured, processed, and disclosed by the user entity in the financial statements**
- eb. The related accounting records, supporting information, and specific accounts in the user entity's financial statements, **and other supporting records relating to the flows of information in paragraph .03a.** that are used to initiate, authorize, record, process, and report the user entity's transactions. This includes the correction of incorrect information and how information is transferred to the general ledger; the records may be in either manual or electronic form;
- d. ~~How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;~~
- ec. The financial reporting process used to prepare the user entity's financial statements **from the records described in**

paragraph .03b, including *as it relates to disclosures and accounting estimates relating to significant classes of transactions, account balances, and disclosures*—accounting estimates and disclosures; and

- d. **The entity's IT environment relevant to preceding subparagraphs (a)–(c)**
- f. ~~Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments.~~

[No amendment to paragraph .04–.06.]

Objectives

.07 The objectives of the user auditor, when the user entity uses the services of a service organization, are to

- a. obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's **system of** internal control relevant to the audit, sufficient to **provide an appropriate basis for the identification and assessment of** identify and assess the risks of material misstatement.
- b. design and perform audit procedures responsive to those risks.

[No amendment to paragraph .08–.09.]

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

...

.10 When obtaining an understanding of *the entity's system of* internal control in accordance with **SAS No. 145**^{fn 2} section 315, the user auditor should **identify controls in the control activities component** evaluate the design and implementation of relevant controls at the user entity *from those* that relate to the services provided by the service organization, including those that are applied to the transactions processed by the service organization, **and evaluate their design and determine whether they have been implemented.**

^{fn 23}

^{fn 2} **Paragraph 27 of SAS No. 145.**

^{fn 23} Paragraph **.13 29 of** section 315 **SAS No. 145.**

.11 The user auditor should determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's **system of** internal control relevant to the audit has been obtained to provide an **appropriate** basis for the identification and assessment of *the* risks of material misstatement.

.12 If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor should obtain that understanding from one or more of the following procedures:

- a. Obtaining and reading a type 1 or type 2 report, if available
- b. Contacting the service organization, through the user entity, to obtain specific information
- c. Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization **that address risks of material misstatement at the assertion level in accordance with SAS No. 145**^{fn 4}

- d. Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization **that address risks of material misstatement at the assertion level in accordance with SAS No. 145^{fn 5}** (Ref: par. .A15–.A20)

^{fn 4} **Paragraphs 27 and 29b of SAS No. 145.**

^{fn 5} **Paragraphs 35–37 of SAS No. 145.**

[Subsequent footnotes renumbered. No amendment to paragraph .13.]

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization

...

.14 If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of **identified** controls at the service organization, the user auditor should

- a. evaluate whether the type 1 report is as of a date, or in the case of a type 2 report, is for a period that is appropriate for the user auditor's purposes;
- b. evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's ~~internal control~~ **the identified controls at the service organization** relevant to the audit; and
- c. determine whether complementary user entity controls identified by the service organization ~~are relevant in addressing the~~ **address the** risks of material misstatement relating to the relevant assertions in the user entity's financial statements and, if so, obtain an understanding of whether the user entity has designed and implemented such controls. (Ref: par. .A23–.A24)

[No amendment to paragraphs .15–.16.]

Responding to the Assessed Risks of Material Misstatement

...

Tests of Controls

...

Using a Type 2 Report as Audit Evidence That Controls at the Service Organization Are Operating Effectively

.17 If, in accordance with paragraph .16a, the user auditor plans to use a type 2 report as audit evidence that **identified** controls at the service organization are operating effectively, the user auditor should determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by

- a. evaluating whether the type 2 report is for a period that is appropriate for the user auditor's purposes;
- b. determining whether complementary user entity controls identified by the service organization ~~are relevant in addressing~~ **address** the risks of material misstatement relating to the relevant assertions in the user entity's financial statements and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;

- c. evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
- d. evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment. (Ref: par. .A32–.A40)

[No amendment to paragraphs .18–.A13.]

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

...

Understanding the Controls Relating to Services Provided by the Service Organization

...

.A14 As noted in **SAS No. 145** section 315, for some risks the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.^{fn 58} Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances that may involve highly automated processing with little or no manual intervention. Risks related to such automated processing may be particularly present when the user entity uses a service organization. In such cases, the user **auditor is required to identify** entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of and to evaluate **the design of** such controls **and determine whether they have been implemented** in accordance with paragraphs .09 .10 of this section.

^{fn 58} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraph .A15–.A18.]

Further Procedures When a Sufficient Understanding Cannot Be Obtained From the User Entity

...

.A19 Another auditor may be used to perform procedures that will provide the necessary information about the relevant controls at the service organization **related to services provided to the user entity**. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organization. The user auditor using the work of another auditor may find the guidance in section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, useful as it relates to understanding another auditor (including that auditor's independence and professional competence); involvement in the work of another auditor in planning the nature, extent, and timing of such work; and in evaluating the sufficiency and appropriateness of the audit evidence obtained.^{fn 69}

^{fn 69} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A20–.A23.]

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization

...

.A24 A type 1 or type 2 report, along with information about the user entity, may assist the user auditor in obtaining an understanding of the following:

- a. The controls at the service organization that may affect the processing of the user entity's transactions, including the use of sub-service organizations
- b. The flow of significant transactions through the service organization's system to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur
- c. The control objectives stated in the description of the service organization's system that are relevant to the user entity's financial statement assertions
- d. Whether controls at the service organization are suitably designed and implemented to prevent, or detect and correct, processing errors that could result in material misstatements in the user entity's financial statements

A type 1 or type 2 report may assist the user auditor in obtaining a sufficient understanding to identify and assess the risks of material misstatement of the user entity's financial statements. A type 1 report, however, does not provide any evidence of the operating effectiveness of the relevant controls.

[No amendment to paragraphs .A25–.A30.]

Responding to the Assessed Risks of Material Misstatement

...

Tests of Controls

.A31 The user auditor is required by section 330 to design and perform tests of controls to obtain sufficient appropriate audit evidence concerning the operating effectiveness of relevant controls in certain circumstances.^{fn §11} In the context of a service organization, this requirement applies when

- a. the user auditor's assessment of risks of material misstatement includes an expectation that the controls at the service organization are operating effectively (that is, the user auditor intends to rely on the operating effectiveness of controls at the service organization in determining the nature, timing, and extent of substantive procedures); or
- b. substantive procedures alone, or in combination with tests of the operating effectiveness of controls at the user entity, cannot provide sufficient appropriate audit evidence at the assertion level.

fn §11

[Footnote omitted for purposes of this SAS.]

.A32 If a type 2 report is not available, a user auditor may contact the service organization through the user entity to request that a service auditor be engaged to perform a type 2 engagement that includes tests of the operating effectiveness of the relevant controls or the user auditor may use another auditor to perform agreed-upon procedures at the service organization that test the operating effectiveness of those controls. A user auditor may also visit the service organization and perform tests of relevant controls if the service organization agrees to it. The user auditor's risk assessments are based on the combined

evidence provided by the service auditor's report and the user auditor's own procedures.

[No amendment to paragraphs .A33–.A34.]

Using a Type 2 Report as Audit Evidence That Controls at the Service Organization Are Operating Effectively

...

.A35 It may also be necessary for the user auditor to obtain additional evidence about significant changes in the relevant controls at the service organization during a period outside the period covered by the type 2 report, or to determine what additional audit procedures need to be performed (for example, when little or no overlap exists between the period covered by the type 2 report and the period covered by the user entity's financial statements). Relevant factors in determining what additional audit evidence to obtain about controls at the service organization that were operating outside the period covered by the service auditor's report may include the following:

- The significance of the assessed risks of material misstatement at the assertion level
- The specific controls that were tested during the interim period and significant changes to them since they were tested, including changes in the information systems, processes, and personnel
- The degree to which audit evidence about the operating effectiveness of those controls was obtained
- The length of the remaining period
- The extent to which the user auditor intends to reduce further substantive procedures based on the reliance on controls
- The effectiveness of the control environment and ***the user entity's process to monitoring the system of internal*** controls ~~at the user entity~~

.A36 Additional audit evidence may be obtained, for example, by performing tests of controls that operated during the remaining period or testing the user entity's ***process to monitoring the system of internal*** controls.

[No amendment to paragraphs .A37–.A40.]

.A41 *Communication of significant deficiencies and material weaknesses in internal control identified during the audit.* The user auditor is required by section 265, *Communicating Internal Control Related Matters Identified in an Audit*, to communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the audit.^{fn 912}

Matters related to the use of a service organization that the user auditor may identify during the audit and may communicate to management and those charged with governance of the user entity include the following:

- Any ***controls within the entity's process to monitor the system of internal control*** ~~needed monitoring controls~~ that could be implemented by the user entity, including those identified as a result of obtaining a type 1 or type 2 report
- Instances when complementary user entity controls identified in the type 1 or type 2 report are not implemented at the user entity
- Controls that may be needed at the service organization that do not appear to have been implemented or that were implemented, but are not operating effectively

The auditor also may communicate other control related matters, including deficiencies that are not significant deficiencies or material weaknesses.

fn 912

[Footnote omitted for purposes of this SAS.]

[No further amendment to AU-C section 402.]

AU-C Section 501, *Audit Evidence — Specific Considerations for Selected Items*

11. The amendment to AU-C section 501 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A23.]

Inventory

Attendance at Physical Inventory Counting

...

Evaluate Management's Instructions and Procedures

.A24 Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example, the following:

- The application of appropriate controls ~~activities~~ (for example, the collection of used physical inventory count records, accounting for unused physical inventory count records, and count and recount procedures)
- The accurate identification of the stage of completion of work in progress; slow moving, obsolete, or damaged items; and inventory owned by a third party (for example, on consignment)
- The procedures used to estimate physical quantities, when applicable, such as may be needed in estimating the physical quantity of a coal pile
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cut-off date

[No further amendment to AU-C section 501.]

AU-C Section 505, *External Confirmations*

12. The amendment to AU-C section 505 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.02.]

Introduction

...

External Confirmation Procedures to Obtain Audit Evidence

...

.03 Other AU-C sections recognize the importance of external confirmations as audit evidence; for example

- section 330 discusses the auditor's responsibility (a) to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level and (b) to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion

level.^{fn 3} ~~In addition, section 330 requires that, irrespective of the assessed risks of material misstatement, the auditor design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.~~^{fn 4} The auditor is required to consider whether external confirmation procedures are to be performed as substantive audit procedures and is required to use external confirmation procedures for accounts receivable unless

- the overall account balance is immaterial,
 - external confirmation procedures would be ineffective, or
 - the auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk.^{fn 5}
- section 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk.^{fn 6} To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. Section 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.^{fn 7}
 - section 240, Consideration of Fraud in a Financial Statement Audit, indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.^{fn 8}
 - section 500A indicates that corroborating information obtained from a source independent of the entity (such as external confirmations) may increase the assurance the auditor obtains from evidence existing within the accounting records or representations made by management.^{fn 9}

^{fn 3} [Footnote omitted for purposes of this SAS.]

^{fn 4} ~~Paragraph 18 of section 330.~~

^{fns 5–9} [Footnotes omitted for purposes of this SAS.]

[No further amendment to AU-C section 505.]

AU-C Section 530, *Audit Sampling*

13. The amendment to AU-C section 530 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A9.]

Sample Design, Size, and Selection of Items for Testing

Sample Design

.A10 In considering the test objective and characteristics of a population for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls. This assessment is made in order to design an audit sample and determine sample

size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100 percent examination or increasing the sample size may be appropriate when performing tests of details.

[No further amendment to AU-C section 530.]

AU-C Section 550, *Related Parties*

14. The amendment to AU-C section 550 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A6.]

Risk Assessment Procedures and Related Activities

Understanding the Entity's Related Party Relationships and Transactions

Discussion Among the Engagement Team

.A7 Matters that may be addressed in the discussion among the engagement team include the following:

- The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit)
- An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions
- The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (for example, a complex organizational structure, use of entities formed to accomplish specific purposes,^{fn 22} or an inadequate information system)
- The records or documents that may indicate the existence of related party relationships or transactions
- The importance that management and those charged with governance attach to the identification of, appropriate accounting for, and disclosure of related party relationships and transactions and the related risk of management override of relevant controls

^{fn 22} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A8–.A9.]

The Identity of the Entity's Related Parties

...

.A10 However, if the entity does not have such information systems in place, management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the inquiries specified by paragraph .14 still applies because management may be aware of parties that meet the related party definition set out in GAAP. In such a case, however, the auditor's inquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with **SAS No. 145**section 315 to obtain information regarding the

following: ***the entity's organizational structure, ownership, governance, and business model.***^{fn 23}

- The entity's ownership and governance structures
- The types of investments that the entity is making and plans to make
- The way the entity is structured and how it is financed

In the particular case of common control relationships, because management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions or shares resources to a significant degree are related parties.

^{fn 23} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A11–.A20.]

The Entity's Controls Over Related Party Relationships and Transactions

...

.A21 *Considerations specific to smaller entities.* Controls activities in smaller entities are likely to be less formal, and smaller entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions or potentially increase those risks through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities and inspection of available relevant documentation.

[No amendment to paragraphs .A22–.A29.]

Sharing Related Party Information With the Engagement Team

.A30 Relevant related party information shared with the engagement team members may include the following:

- The nature of the related party relationships and transactions
- Significant or complex related party relationships or transactions that may ***be associated with significant risks*** require special audit consideration, particularly transactions in which management or those charged with governance are financially involved

The exchange of information is most useful if made at an early stage of the audit.

[No amendment to paragraphs .A31–.A37.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

...

.A38 Depending upon the results of the auditor's risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity's controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone, regarding the risks of material misstatement associated with related party relationships and transactions. For example, when intragroup transactions between the entity and its components are numerous and a significant amount of information

regarding these transactions is initiated, authorized, recorded, processed, or reported electronically in an integrated system, the auditor may determine that it is not possible to design effective substantive audit procedures that by themselves would reduce the risks of material misstatement associated with these transactions to an acceptably low level. In such a case, in meeting the requirement of section 330 to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls, the auditor is required to test the entity's controls over the completeness and accuracy of the recording of the related party relationships and transactions. ^{fn 31}

^{fn 31} [Footnote omitted for purposes of this SAS.]

[No further amendment to AU-C section 550.]

AU-C Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*

15. The amendment to AU-C section 600 is effective for audits of group financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.19.]

Understanding the Group, Its Components, and Their Environments

.20 The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment, ***the applicable reporting framework, and the system of internal control.*** ^{fn 7} The group engagement team should

- a. enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage.
- b. obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: par. .A31–.A37)

^{fn 7} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .21–.A6.]

Definitions

...

Significant Component

...

.A7 The group engagement team also may identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances ~~(that is, risks that require special audit consideration ^{fn14})~~. For example, a component could be responsible for foreign exchange trading and, thus, expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

^{fn 14} ~~Paragraphs .28–.30 of section 315.~~

[No amendment to paragraphs .A7–.A93.]

Appendix A — Understanding the Group, Its Components, and Their Environments — Examples of Matters About Which the Group Engagement Team Obtains an Understanding

.A94 The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement, and the list of examples is not necessarily complete.

Group-Wide Controls

Group-wide controls may include a combination of the following:

- Regular meetings between group and component management to discuss business developments and review performance
- Monitoring of components' operations and their financial results, including regular reporting routines, which enables group management to monitor components' performance against budgets and take appropriate action
- Group management's risk assessment process (that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements)
- Monitoring, controlling, reconciling, and eliminating intragroup account balances, transactions, and unrealized profits or losses at group level
- A process for monitoring the timeliness and assessing the accuracy and completeness of financial information received from components
- A central IT system controlled by the same general IT controls for all or part of the group
- Controls activities within an IT system that are common for all or some components
- ***Controls within the group's process to Mmonitoring the system of internal controls***, including activities of the internal audit function and self-assessment programs
- Consistent policies and procedures, including a group financial reporting procedures manual
- Group-wide programs, such as codes of conduct and fraud prevention programs
- Arrangements for assigning authority and responsibility to component management

The internal audit function may be regarded as part of group-wide controls, for example, when the function is centralized. Section 610, *Using the Work of Internal Auditors*, addresses the group engagement team's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the function applies a systematic and disciplined approach when the group engagement team expects to use the function's work.^{fn 1}

^{fn 1} [Footnote omitted for purposes of this SAS.]

...

[No further amendment to appendix A. No amendment to paragraph .A95.]

Appendix C — Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction

.A96 The following matters are relevant to the planning of the work of a component auditor:

...

The following matters are relevant to the conduct of the work of the component auditor:

- The findings of the group engagement team's tests of controls activities of a processing system that is common for all or some components and tests of controls to be performed by the component auditor

...

[No further amendment to appendix C. No further amendment to AU-C section 600.]

AU-C Section 620, *Using the Work of an Auditor's Specialist*

16. The amendment to AU-C section 620 is effective for audits of financial statements for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A4.]

Determining the Need for an Auditor's Specialist

.A5 An auditor's specialist may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, **including its *the applicable financial reporting framework, and the entity's system of* internal control**
- Identifying and assessing the risks of material misstatement
- Determining and implementing overall responses to assessed risks at the financial statement level
- Designing and performing additional audit procedures to respond to assessed risks at the relevant assertion level, which may comprise tests of controls or substantive procedures
- Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements

[No further amendment to AU-C section 620.]

AU-C Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*

17. The amendment to AU-C section 805 is effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2023.

[No amendment to paragraphs .01–.A6.]

Considerations When Accepting the Engagement

Application of GAAS

...

Complying With Relevant Requirements

.A7 Compliance with the requirements of AU-C sections relevant to the audit of a single financial statement or a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, ***the applicable financial reporting framework, and*** including its internal control, as an auditor who also audits the entity's complete set of financial statements. The

auditor also does not have the audit evidence about the general quality of the accounting records or other accounting information that would be acquired in an audit of the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records. Also see paragraph .A18.

[No further amendment to AU-C section 805.]

AU-C Section 930, *Interim Financial Information*

18. The amendment to AU-C section 930 is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2023.

[No amendment to paragraphs .01–.10.]

Procedures for a Review of Interim Financial Information

Understanding the Entity and Its Environment, Including Its the Applicable Financial Reporting Framework, and the Entity's System of Internal Control

.11 To plan and conduct the engagement, the auditor should have an understanding of the entity and its environment, ~~including its~~ **the applicable financial reporting framework, and the entity's system of** internal control as it relates to the preparation and fair presentation of both annual and interim financial information, sufficient to be able to

- a. identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.
- b. select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework.

[No amendment to paragraphs .12–.A6.]

Procedures for a Review of Interim Financial Information

Understanding the Entity and Its Environment, Including Its the Applicable Financial Reporting Framework, and the Entity's System of Internal Control

.A7 As required by ~~SAS No. 145~~ **section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***, the auditor who has audited the entity's financial statements for one or more annual periods would have obtained an understanding of the entity and its environment, ~~including its~~ **the applicable financial reporting framework, and the entity's system of** internal control as it relates to the preparation and fair presentation of annual financial information, that was sufficient to conduct the audit. Internal control over the preparation and fair presentation of interim financial information may differ from internal control over the preparation and fair presentation of annual financial statements because certain accounting principles and practices used for interim financial information may differ from those used for the preparation of annual financial statements (for example, the use of estimated effective income tax rates for the preparation of interim financial information).

[No amendment to paragraphs .A8–.A10.]

Analytical Procedures, Inquiries, and Other Review Procedures*Analytical Procedures*

.A11 Procedures for conducting a review of interim financial information generally are limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim financial information. The auditor's understanding of the entity and its environment, including its ***the applicable financial reporting framework, the entity's system of*** internal control, the results of the risk assessments relating to the preceding audit, and the auditor's consideration of materiality as it relates to the interim financial information, influences the nature and extent of the inquiries made and analytical procedures performed. For example, if the auditor becomes aware of a significant change in the entity's controls at a particular location, the auditor may consider the following procedures:

- Making additional inquiries, such as whether management monitored the changes and considered whether they were operating as intended
- Employing analytical procedures with a more precise expectation

[No further amendment to AU-C section 930.]

Amendment to SAS No. 128, Using the Work of Internal Auditors (AICPA, Professional Standards, AU-C sec. 610)

19. The amendment to AU-C section 610 is effective for audits of financial statements for periods ending on or after December 15, 2023.

AU-C Section 610, Using the Work of Internal Auditors

[No amendment to paragraphs .01–.04.]

Relationship Between Section 315 and This Section

.05 Many entities establish internal audit functions as part of their internal control and governance structures. The objectives and scope of an internal audit function, the nature of its responsibilities, and its organizational status, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. ~~Section 315~~ **SAS No. 145** addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its environment, ***the applicable financial reporting framework and the entity's system of internal control***, and identification and assessment of risks of material misstatement. ~~Section 315~~ **SAS No. 145**^{fn 1} also explains how effective communication between the internal and external auditors creates an environment in which the external auditor can be informed by the internal auditor of significant matters that may affect the external auditor's work.

^{fn 1} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .06–.A2.]

Definition of Internal Audit Function

...

.A3 However, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this section, although they may

perform controls activities that can be tested in accordance with section 330.
^{fn 7} For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.

^{fn 7} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A4–.A11.]

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence
Evaluating the Internal Audit Function

...

Application of a Systematic and Disciplined Approach, Including Quality Control

.A12 The application of a systematic and disciplined approach to planning, performing, supervising, reviewing, and documenting its activities distinguishes the activities of the internal audit function from other monitoring controls activities that may be performed within the entity.

[No amendment to paragraphs .A13–.A25.]

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

...

Assessed Risk of Material Misstatement

...

.A26 As explained in section ~~315~~**SAS No. 145**, ^{fn 11} significant risks require special audit consideration ***are risks assessed close to the upper end of the spectrum of inherent risk*** and, therefore, the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgment. In addition, when the risks of material misstatement is other than low, the use of the work of the internal audit function in obtaining audit evidence alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly.

^{fn 11} [Footnote omitted for purposes of this SAS.]

[No further amendment to AU-C section 610.]

Amendment to SAS No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements, as Amended (AICPA, Professional Standards, AU-C sec. 940)

20. The amendment to AU-C section 940 is effective for integrated audits for periods ending on or after December 15, 2023.

AU-C Section 940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

[No amendment to paragraphs .01–.25.]

Using a Top-Down Approach

...

Identifying Significant Classes of Transactions, Account Balances, and Disclosures, and Their Relative Assertions

.26 The auditor should identify significant classes of transactions, account balances, and disclosures, and their relevant assertions. To identify significant

classes of transactions, account balances, and disclosures, and their relevant assertions, the auditor should evaluate the qualitative and quantitative **inherent** risk factors^{fn 6} related to the financial statement line items and disclosures. (Ref: par. .A50–.A52)

^{fn 6} See paragraph 12 of SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[Subsequent footnotes renumbered. No amendment to paragraphs .27–.30.]

Understanding Likely Sources of Misstatement

...

.31 The auditor should understand how IT affects the entity's flow of transactions and, as required by section 315 **SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***, how the entity has responded to **the entity's general IT controls that address the** risks arising from **the use of** IT.^{fn 67} (Ref: par. .A58)

^{fn 67} Paragraph 22 **26c** of section 315 **SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***.

[No amendment to paragraphs .32–.56.]

Concluding Procedures

...

Obtaining Written Representations

.57 In an audit of ICFR, the auditor should obtain written representations from management

- a. acknowledging management's responsibility for establishing **designing, implementing**, and maintaining effective ICFR;
- b. stating that management has performed an assessment of the effectiveness of the entity's ICFR and specifying the criteria;
- c. stating that management did not use the auditor's procedures performed during the integrated audit as part of the basis for management's assessment about ICFR;
- d. stating management's assessment about the effectiveness of the entity's ICFR based on the criteria as of a specified date;
- e. stating that management has disclosed to the auditor all deficiencies in the design or operation of ICFR, including separately disclosing to the auditor all such deficiencies that it believes to be significant deficiencies or material weaknesses;
- f. describing any fraud resulting in a material misstatement to the entity's financial statements and any other fraud that does not result in a material misstatement to the entity's financial statements, but involves senior management or management or other employees who have a significant role in the entity's ICFR;
- g. stating whether the significant deficiencies and material weaknesses identified and communicated to management and those charged with governance during previous engagements pursuant to paragraph .59 have been resolved and specifically identifying any that have not; and
- h. stating whether there were, subsequent to the date being reported on, any changes in ICFR or other conditions that might significantly affect ICFR, including any corrective actions taken by

management with regard to significant deficiencies and material weaknesses (Ref: par. .A103)

[No amendment to paragraphs .58–.A5.]

Definitions

...

Internal Control Over Financial Reporting

.A6 *For purposes of a financial statement audit, SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, defines the term system of internal control and recognizes that internal control frameworks may use different terms that are similar to the concept of the system of internal control. This section defines the term internal control over financial reporting, which is a system of internal control that supports the preparation of reliable financial statements, to more clearly define ICFR for purposes of expressing an opinion on the effectiveness of ICFR, based on suitable and available criteria.*

[Former paragraphs .A6–.A158 are renumbered as paragraphs .A7–.A159. No amendment to renumbered paragraphs .A7–.A21.]

Planning the Audit of ICFR

.A21A22 Evaluating whether the following matters are important to the entity's financial statements and ICFR and, if so, how they may affect the auditor's procedures may assist the auditor in planning the audit of ICFR:

- Knowledge of the entity's ICFR obtained during other engagements performed by the auditor or, if applicable, during a review of a predecessor auditor's working papers
- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, and capital structure
- The extent of recent changes, if any, in the entity, its operations, or its ICFR
- The auditor's preliminary judgments about financial statement materiality, risk, and other factors relating to the determination of material weaknesses
- Deficiencies previously communicated to those charged with governance or management
- Legal or regulatory matters of which the entity is aware
- The type and extent of available evidence related to the effectiveness of the entity's ICFR
- Preliminary judgments about the effectiveness of ICFR
- Public information about the entity relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the entity's ICFR
- Knowledge about risks related to the entity evaluated as part of the auditor's ***procedures regarding acceptance or continuance of the client relationship or the integrated audit engagement*** acceptance and retention evaluation.

- The relative complexity of the entity's operations

[No amendment to renumbered paragraphs .A23–.A25.]

Addressing the Risk of Fraud

~~A25~~A26 Section 240 addresses the auditor's identification and assessment of the risks of material misstatement due to fraud.^{fn 1415} Controls that might address these risks include

- controls over significant unusual transactions, particularly those that result in late or unusual journal entries;
- controls over journal entries and adjustments made in the period-end financial reporting process;
- controls over related party transactions;
- controls related to significant ~~management~~ **accounting** estimates; and
- controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results.

^{fn 1415} [Footnote omitted for purposes of this SAS.]

Using the Work of Internal Auditors or Others

~~A26~~A27 The extent of the procedures necessary to obtain the understanding required by paragraph .18 will vary, depending on the nature of those activities. In performing risk assessment procedures, the auditor is required to inquire of appropriate individuals within the internal audit function (if such function exists).^{fn 1516} ~~Section 315~~ **SAS No. 145** provides guidance with respect to such inquiries and certain additional procedures based on the responses to such inquiries.^{fn 1617}

^{fn 1516} Paragraph ~~.06a~~ **14** of section ~~315~~ **SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.**

^{fn 1617} Paragraph ~~A9–A13~~ **A25 and appendix D** of section ~~315~~ **SAS No. 145.**

[No amendment to renumbered paragraphs .A28–.A33.]

Using a Top-Down Approach

...

~~A33~~A34 A top-down approach involves

- beginning at the financial statement level;
- using the auditor's understanding of the overall risks to ICFR;
- focusing on entity-level controls, ***which may be indirect***^{fn 19} ***as described in SAS No. 145;***
- working down to significant classes of transactions, account balances, and disclosures, and their relevant assertions, ***which directs attention to classes of transactions, accounts, disclosures, and assertions that present a reasonable possibility of material misstatement of the financial statements;***
- ~~directing attention to classes of transactions, accounts, disclosures, and assertions that present a reasonable possibility of material misstatement of the financial statements;~~

- verifying the auditor's understanding of the risks in the entity's processes; and
- selecting controls for testing that sufficiently address the assessed risk of material misstatement to each relevant assertion.

fn 19 See paragraph A113 of SAS No. 145.

fn 20 See paragraph A141 of SAS No. 145.

[Subsequent footnotes further renumbered. No amendment to renumbered paragraphs .A35–.A50.]

Identifying Significant Classes of Transactions, Account Balances, and Disclosures, and Their Relative Assertions

A50A51 *Inherent* risk factors **are** relevant to the identification of significant classes of transactions, account balances, and disclosures, and their relevant assertions include. ***Inherent risk factors may be qualitative or quantitative and affect the susceptibility of assertions to misstatement. Inherent risk factors are described in SAS No. 145.***

- size and composition of the account;
- susceptibility to misstatement due to errors or fraud;
- volume of activity, complexity, and homogeneity of the individual transactions processed through the account or reflected in the disclosure;
- nature of the account, class of transactions, or disclosure;
- accounting and reporting complexities associated with the account, class of transactions, or disclosure;
- exposure to losses in the account;
- possibility of significant contingent liabilities arising from the activities reflected in the account or disclosure;
- existence of related party transactions in the account; and
- changes from the prior period in the account, class of transactions, or disclosure characteristics.

A51A52 The ***inherent*** risk factors in paragraph 26 that the auditor is required to evaluate in the identification of significant classes of transactions, account balances, and disclosures, and their relevant assertions, are the same in the audit of ICFR as in the audit of the financial statements; accordingly, significant classes of transactions, account balances, and disclosures, and their relevant assertions, are the same in an integrated audit.

[No further amendment to AU-C section 940.]

Amendment to SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as Amended, Section 701, Communicating Key Audit Matters in the Independent Auditor's Report (AICPA, Professional Standards, AU-C sec. 701)

21. The amendment to AU-C section 701 is effective for audits of financial statements for periods ending on or after December 15, 2023.

AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor's Report

[No amendment to paragraphs .01–.A17.]

Determining Key Audit Matters

...

Considerations in Determining Those Matters That Required Significant Auditor Attention

...

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance With Section 315

...

.A18 Section 315 SAS No. 145 defines a *significant risk* as an identified and assessed risk of material misstatement ***for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which the inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur*** that, in the auditor's judgment, requires special audit consideration.^{fn13} Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

^{fn 13} **See paragraph 13 of SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.**

[Subsequent footnotes renumbered.]

[No further amendment to AU-C section 701.]

Amendment to SAS No. 136, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as Amended (AICPA, Professional Standards, AU-C sec. 703)

22. The amendment to AU-C section 703 is effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2023.

AU-C Section 703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA

[No amendment to paragraphs .01–.17.]

Audit Risk Assessment and Response in an Audit of ERISA Plan Financial Statements

.18 Section 315 SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, ***the applicable financial reporting framework, and including its*** the entity's internal control. The plan instrument is essential to understanding the plan and identifying and performing audit procedures that are responsive to assessed risks. (Ref: par. .A18–.A21)

[No amendment to paragraph .19.]

.20 When designing and performing audit procedures, the auditor should consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for ***significant*** classes of transactions, account balances, and disclosures. (Ref: par. .A25–.A28)

[No amendment to paragraphs .21–.A18.]

Audit Risk Assessment and Response in an Audit of ERISA Plan Financial Statements

...

.A19 Obtaining an understanding of the plan and its environment, *the applicable financial reporting framework, and* including its internal control, is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The auditor's understanding of the plan establishes a frame of reference for planning the audit and exercising professional judgment throughout the audit when the auditor does the following:

- Assesses the risks of material misstatement of the financial statements, including the related disclosures
- Determines materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*
- Considers the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures
- Identifies areas for which special audit consideration may be necessary
- Develops expectations for use when performing analytical procedures
- Responds to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence
- Evaluates the sufficiency and appropriateness of audit evidence obtained ^{fn 22}

^{fn 22} [Footnote text omitted for purposes of this SAS.]

.A20 ~~Section 315~~**SAS No. 145** requires the auditor to perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and relevant assertion levels. ^{fn 23} The consideration of risks of material misstatement at the relevant assertion level for *significant* classes of transactions, account balances, and disclosures directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence.

^{fn 23} [Footnote text omitted for purposes of this SAS.]

[No amendment to paragraphs .A21–.A152.]

Appendix A — Examples of Plan Provisions by Audit Area (Not All-Inclusive)

.A153 Paragraph .20 of this section requires the auditor to consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for *significant* classes of transactions, account balances, and disclosures when designing and performing audit procedures. The relevant plan provisions will vary for each type of plan and the circumstances of each engagement. When designing audit procedures, the testing of relevant plan provisions may be coordinated among the various audit areas to which they relate.

...

[No further amendment to appendix A. No further amendment to AU-C section 703.]

Amendment to SAS No. 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, as Amended (AICPA, Professional Standards, AU-C sec. 720)

23. The amendment to AU-C section 720 is effective for audits of financial statements for periods ending on or after December 15, 2023.

AU-C Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

[No amendment to paragraphs .01–.A33.]

Reading and Considering the Other Information

...

.A34 The auditor's knowledge obtained in the audit includes the auditor's understanding of the entity and its environment, ***the applicable financial reporting framework, and*** including the entity's ***system of*** internal control, obtained in accordance with section ~~315~~**SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***^{fn 9} Section ~~315~~**SAS No. 145** sets out the auditor's required understanding, which includes such matters as obtaining an understanding of the following:

- a. ***The entity's organizational structure, ownership and governance, and its business model, including the extent to which the business model integrates the use of IT***
- ~~a~~b. The relevant industry, regulatory, and other external factors
- ~~b~~. The nature of the entity
- ~~c~~. The entity's selection and application of accounting policies
- ~~d~~. The entity's objectives and strategies
- ec. The ***relevant measures used, internally and externally, to assess*** measurement and review of the entity's financial performance
- ~~f~~d. The entity's internal control

^{fn 9} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A35–.A54.]

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated

.A55 In reading the other information, the auditor may become aware of new information that has implications for the following:

- The auditor's understanding of the entity and its environment, ***the financial reporting framework, and the entity's system of internal control***, which may indicate the need to revise the auditor's risk assessment^{fn 12}
- The auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements^{fn 13}
- The auditor's responsibilities relating to subsequent events^{fn 14}

^{fn 12} Paragraphs .11, .31, and .A1 of section ~~315~~**SAS No. 145**.

^{fns 13–14} [Footnotes omitted for purposes of this SAS.]

[No further amendment to AU-C section 720.]

Amendment to SAS No. 142, *Audit Evidence* (AICPA, *Professional Standards*, AU-C sec. 500)

24. The amendment to AU-C section 500 is effective for audits of financial statements for periods ending on or after December 15, 2023.

AU-C Section 500, *Audit Evidence*

[No amendment to paragraphs .01–.A66.]

Appendix A — Considerations Regarding the Use of External Information Sources

.A67

[No amendment to paragraphs 1–7.]

8. The nature and extent of the auditor's consideration takes into account the assessed risks of material misstatement at the assertion level to which the use of the external information is relevant, the degree to which the use of that information is relevant to the reasons for the assessed risks of material misstatement, and the possibility that the information from the external information source may not be reliable (for example, whether it is from a credible source). Based on the auditor's consideration of the matters described in paragraph 5 of this appendix, the auditor may determine that

- a. further understanding of the entity and its environment, ~~including its~~ ***the applicable financial reporting framework, and the entity's system of internal control***, is needed, in accordance with ~~section 315~~ ***SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***, or
- b. further audit procedures, in accordance with section 330 ^{fn 2} and section 540, ^{fn 3} when applicable, are appropriate in the circumstances, to respond to the assessed risks of material misstatement at the assertion level related to the use of information from an external information source. Such audit procedures may include the following:
 - i. Performing a comparison of information obtained from the external information source with information obtained from an alternative independent information source
 - ii. When relevant to considering management's use of an external information source, obtaining an understanding of controls management has in place to consider the reliability of the information from external information sources and potentially testing the operating effectiveness of such controls
 - iii. Performing procedures to obtain information from the external information source to understand its processes, techniques, and assumptions, for the purposes of identifying, understanding, and when relevant, testing the operating effectiveness of its controls

fns 2–3 [Footnotes omitted for purposes of this SAS.]

...

[No further amendment to appendix A. No further amendment to AU-C section 500.]

Amendment to SAS No. 143, *Auditing Accounting Estimates and Related Disclosures* (AICPA, Professional Standards, AU-C sec. 540)

25. The amendment to AU-C section 540 is effective for audits of financial statements for periods ending on or after December 15, 2023.

AU-C Section 540, *Auditing Accounting Estimates and Related Disclosures*

[No amendment to paragraphs .01–.03.]

Key Concepts of This Section

.04 ~~Section 315~~**SAS No. 145** requires *inherent risk and control risk to be assessed separately for identified risks of material misstatement* the auditor to assess the risk of material misstatement at the relevant assertion level. For this purpose, this section requires inherent risk and control risk to be assessed separately for accounting estimates. *In the context of this section and* Depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, and the interrelationship among them. As explained in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,^{fn 2} inherent risk is *influenced by inherent risk factors*, higher for some assertions and related classes of transactions, account balances, and disclosures than for others. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the *susceptibility of an assertion to misstatement, and the level of inherent risk* likelihood or magnitude of misstatement and varies on a scale that is referred to in this section as the *spectrum of inherent risk*. In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not *intend to test and rely on the operating effectiveness of controls* perform tests of controls, the auditor's assessment of *control risk is such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk* the risk of material misstatement at the relevant assertion level cannot be reduced for the effective operation of controls with respect to the particular assertion. (Ref: par. .A8–.A10, .A65–.A66, and app. A)

^{fn 2} [Footnote omitted for purposes of this SAS.]

.05 This section refers to relevant requirements in ~~AU-C sections 315~~**SAS No. 145** and *section 330* and provides related guidance to emphasize the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether

- there are controls *required to be identified in accordance with SAS No. 145* relevant to the audit,^{fn 3} for which the auditor is required to evaluate their design and determine whether they have been implemented.
- to test the operating effectiveness of relevant controls.

^{fn 3} See *paragraphs 27 and 29b of SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[Subsequent footnotes renumbered. No amendment to paragraph .06.]

.07 The exercise of professional skepticism in relation to accounting estimates is affected by the auditor's consideration of inherent risk factors, and its importance increases when accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity, or other inherent risk factors. Similarly, the exercise of professional skepticism is important when there is greater susceptibility to misstatement due to management bias or **other fraud risk factors insofar as they affect inherent risk**. (Ref: par. .A11)

[No amendment to paragraphs .08–.11.]

Risk Assessment Procedures and Related Activities

.12 When obtaining an understanding of the entity and its environment, **the applicable financial reporting framework, and** including the entity's **system of** internal control, as required by section ~~315~~**SAS No. 145**, the auditor should obtain an understanding of the following matters related to the entity's accounting estimates. The auditor's procedures to obtain the understanding should be performed to the extent necessary to **obtain audit evidence that** provides an appropriate basis for the identification and assessment of risks of material misstatement at the financial statement and relevant assertion levels.
^{fn 45} (Ref: par. .A19–.A23)

Obtaining an Understanding of the The Entity and Its Environment and the Applicable Financial Reporting Framework

- a. The entity's transactions and other events **or** and conditions that may give rise to the need for or changes in accounting estimates to be recognized or disclosed in the financial statements (Ref: par. .A24)
- b. The requirements of the applicable financial reporting framework related to accounting estimates (including the recognition criteria, measurement bases, and the related presentation and disclosure requirements) and how they apply in the context of the nature and circumstances of the entity and its environment, including how ~~transactions and other events or conditions are subject to or affected by~~ **the** inherent risk factors **affect susceptibility of assertions to misstatement**. (Ref: par. .A25–.A26)
- c. Regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks (Ref: par. .A27)
- d. The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements, based on the auditor's understanding of the matters in paragraph .12a–c of this section (Ref: par. .A28)

Obtaining an Understanding of the The Entity's System of Internal Control

- e. The nature and extent of oversight and governance that the entity has in place over management's financial reporting process relevant to accounting estimates (Ref: par. .A29–.A31)
- f. How management identifies the need for and applies specialized skills or knowledge related to accounting estimates, including with respect to the use of a management's specialist (Ref: par. .A32)
- g. How the entity's risk assessment process identifies and addresses risks relating to accounting estimates (Ref: par. .A33–.A34)

- h. The entity's information system as it relates to accounting estimates, including the following:
 - i. ***How information relating to accounting estimates and related disclosures for significant classes of transactions, account balances, or disclosures flows through the entity's information system*** ~~The classes of transactions, events, and conditions that are significant to the financial statements and that give rise to the need for or changes in accounting estimates and related disclosures (Ref: par. .A20 and .A35)~~
 - ii. For such accounting estimates and related disclosures, how management
 - (1) identifies the relevant methods, assumptions, or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework, including how management (Ref: par. .A36–.A37)
 - (a) selects or designs, and applies, the methods used, including the use of models (Ref: par. .A38–.A39)
 - (b) selects the assumptions to be used, including consideration of alternatives, and identifies significant assumptions (Ref: par. .A40–.A43)
 - (c) selects the data to be used (Ref: par. .A44)
 - (2) understands the degree of estimation uncertainty, including by considering the range of possible measurement outcomes (Ref: par. .A45)
 - (3) addresses the estimation uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements (Ref: par. .A46–.A49)
- i. ***Identified controls in the control activities component*** ^{fn 6} ~~Control activities relevant to the audit over management's process for making accounting estimates as described in paragraph .12h(ii) of this section (Ref: par. .A50–.A54)~~
- j. How management reviews the outcomes of previous accounting estimates and responds to the results of that review

^{fn 45} [Footnote omitted for purposes of this SAS.]

^{fn 6} ***Paragraphs 27 and 29b of SAS No. 145.***

[Subsequent footnotes further renumbered. No amendment to paragraphs .13–.14.]

Identifying and Assessing the Risks of Material Misstatement

.15 In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the relevant assertion level, ***including separately assessing inherent risk and control risk***, as required by ~~section 315~~ **SAS No. 145**, ^{fn 57} the auditor should ~~separately assess inherent risk and control risk. The auditor should take the following into account in identifying the risks of material misstatement and assessing inherent risk: (Ref: par. .A64–.A71)~~

- a. The degree to which the accounting estimate is subject to estimation uncertainty (Ref: par. .A72–.A75)
- b. The degree to which one or both of the following are affected by complexity, subjectivity, or other inherent risk factors: (Ref: par. .A76–.A79)
 - i. The selection and application of the method, assumptions, and data in making the accounting estimate
 - ii. The selection of management's point estimate and related disclosures for inclusion in the financial statements

^{fn 57}

Paragraphs ~~2631–2734~~ of section 315 **SAS No. 145.**

.16 The auditor should determine whether any of the risks of material misstatement identified and assessed in accordance with paragraph .15 are, in the auditor's **professional** judgment, a significant risk.^{fn 68} If the auditor has determined that a significant risk exists, the auditor should **identify controls that address** obtain an understanding of the entity's controls, including control activities, relevant to that risk^{fn 9} and, based on that understanding, evaluate whether such controls have been suitably designed and implemented to mitigate such risks.^{fn 710} (Ref: par. .A80)

^{fn 68}

Paragraph 32.28 of AU-C section 315 **SAS No. 145.**

^{fn 9}

Paragraph 26a(i) of SAS No. 145.

^{fn 710}

Paragraph 26a.30 of AU-C section 315 **SAS No. 145.**

[Subsequent footnotes further renumbered. No amendment to paragraph .17.]

Responses to the Assessed Risks of Material Misstatement

...

.18 As required by section 330,^{fn 1114} the auditor should design and perform tests to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls, if

- a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively, or
- b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level.

In relation to accounting estimates, the auditor's tests of such controls should be responsive to the reasons for the assessment given to the risks of material misstatement. In designing and performing tests of controls, the auditor should obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.^{fn 1215} (Ref: par. .A85–.A89)

^{fn 1114–fn 1215} [Footnotes omitted for purposes of this SAS.]

[No amendment to paragraphs .19–.A7.]

Key Concepts of This Section

Inherent Risk Factors

.A8 *Inherent risk factors* are characteristics of conditions and events **or conditions** that may affect the susceptibility of an assertion to misstatement, **whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure**, before consideration of controls.^{fn 27}

Appendix A, "Inherent Risk Factors," further explains the nature of these inherent risk factors, and their interrelationships, in the context of making accounting estimates and their presentation in the financial statements.

^{fn 27} **Paragraph 12 of SAS No. 145.**

~~.A9 In addition to the inherent risk factors of estimation uncertainty, complexity, or subjectivity, other inherent risk factors that the auditor may consider in identifying and~~ **When** assessing the risks of material misstatement **at the assertion level** ^{fn 28} **in addition to estimation uncertainty, complexity, and subjectivity, the auditor also takes into account the degree** may include the extent to which **other inherent risk factors included in SAS No. 145 affect susceptibility of assertions to misstatement about the accounting estimate. Such additional inherent risk factors include the following:** is subject to or affected by

- ~~a~~ **A** change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework, which may give rise to the need for changes in the method, assumptions, or data used to make the accounting estimate.
- ~~s~~ **S**usceptibility to misstatement due to management bias or **other** fraud **risk factors insofar as they affect inherent risk**, in making the accounting estimate.
- **Uncertainty, other than estimation uncertainty**

^{fn 28} **Paragraph 31 of SAS No. 145.**

[Subsequent footnotes further renumbered.]

Control Risk

~~.A10 An important consideration for the auditor in~~ **In** assessing control risk at the relevant assertion level **in accordance with SAS No. 145, the auditor takes into account** is the effectiveness of the design of the controls that **whether** the auditor intends **plans** to rely on **test the operating effectiveness of controls.** and the extent to which the controls address the assessed inherent risks at the relevant assertion level. **When the auditor is considering whether to test the operating effectiveness of controls, the** The auditor's evaluation that controls are effectively designed and have been implemented supports an expectation, **by the auditor**, about the operating effectiveness of the controls in determining whether **establishing the plan** to test them.

[No amendment to paragraphs .A11–.A18.]

Risk Assessment Procedures and Related Activities

Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework, and the Entity's System of Internal Control

~~.A19 Section 315~~ **SAS No. 145** ^{fn 2429} requires the auditor to obtain an understanding of certain matters about the entity and its environment, **the applicable financial reporting framework, and** including the entity's **system of** internal control. The requirements in paragraph .12 of this section relate more specifically to accounting estimates and build on the broader requirements in section 315 **SAS No. 145.**

^{fn 2429} [Footnote omitted for purposes of this SAS.]

.A20 The classes of transactions, events, and conditions within the scope of paragraph .12h of this section are the same as the classes of transactions,

events, and conditions relating to accounting estimates and related disclosures that are subject to ~~section 315~~ **SAS No. 145**.^{fn 2530} In obtaining the understanding of the entity's information system as it relates to accounting estimates, the auditor may consider

- whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions.
- how the information system addresses the completeness of accounting estimates and related disclosures, in particular, for accounting estimates related to liabilities.

^{fn 2530} [Footnote omitted for purposes of this SAS.]

Scalability

.A21 The nature, timing, and extent of the auditor's procedures to obtain the understanding of the entity and its environment, ~~including the applicable financial reporting framework, and~~ the entity's **system of** internal control, related to the entity's accounting estimates, may depend, to a greater or lesser degree, on the extent to which the individual matters apply in the circumstances. For example, the entity may have few transactions or other events **or** and conditions that give rise to the need for accounting estimates; the applicable financial reporting requirements may be simple to apply; and there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgments, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors to a lesser degree, and there may be fewer **identified controls in the control activities component**. ~~relevant to the audit.~~ If so, the auditor's risk assessment procedures are likely to be less extensive and may be performed primarily through inquiries of management with appropriate responsibilities for the financial statements, **such as** and observation of management's process for making the accounting estimate **(including when evaluating whether identified controls in that process are designed effectively and when determining whether the control has been implemented)**.

[No amendment to paragraphs .A22–.A23.]

The Entity and Its Environment

.A24 ~~The entity's transactions and other events and~~ **or** conditions (Ref: par. .12a). Changes in circumstances that may give rise to the need for or changes in accounting estimates may include, for example, whether

- the entity has engaged in new types of transactions,
- terms of transactions have changed, or
- new events or conditions have occurred.

.A25 *The requirements of the applicable financial reporting framework* (Ref: par. .12b). Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, where applicable, those charged with governance about how management has applied ~~the~~ those requirements **of the applicable financial reporting framework** relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting

practice that is acceptable under the applicable financial reporting framework to not be the most appropriate in the circumstances of the entity.^{fn 2631}

^{fn 2631} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A26–.A28.]

The Entity's System of Internal Control Relevant to the Audit

.A29 *The nature and extent of oversight and governance (Ref: par. .12e).* In applying section 315 **SAS No. 145**,^{fn 2732} the auditor's understanding of the nature and extent of oversight and governance that the entity has in place over management's process for making accounting estimates may be important to the auditor's required evaluation **about** as it relates to whether

- management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior, and
- the strengths in the control environment elements collectively provide **provides** an appropriate foundation for the other components of **the system of** internal control **considering the nature and size of the entity**, and
- whether those other components are undermined by control deficiencies **identified** in the control environment **undermine the other components of the system of internal control**.

^{fn 2732} Paragraph **21a.15** of AU-C section 315 **SAS No. 145**.

[No amendment to paragraphs .A30–.A34.]

.A35 *The entity's information system relating to accounting estimates (Ref: par. .12h(i)).* During the audit, the auditor may identify classes of transactions, events, **or** and conditions that give rise to the need for accounting estimates and related disclosures that management failed to identify. AU-C section 315 **SAS No. 145** addresses circumstances in which the auditor identifies risks of material misstatement that management failed to identify, including **considering the implications for the auditor's evaluation of** determining whether there is a significant deficiency or material weakness in internal control with regard to the entity's risk assessment process.^{fn 3035}

^{fn 3035} [Footnote omitted for purposes of this SAS.]

[No amendment to paragraphs .A36–.A38.]

.A39 Models. Management may design and implement specific controls around models used for making accounting estimates, whether it's management's own model or an external model. When the model itself has an increased level of complexity or subjectivity, such as an expected credit loss model or a fair value model using level 3 inputs, controls that address **the risks of material misstatement related to** such complexity or subjectivity may be more likely to be identified as relevant to the audit **in accordance with SAS No. 145**.^{fn 36} When complexity in relation to models is present, controls over data integrity are also more likely to be **identified controls in accordance with SAS No. 145** relevant to the audit. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and **related identified controls** control activities relevant to the audit include the following:

- How management determines the relevance and accuracy of the model.

- The validation or back-testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's validation of the model may include evaluation of
 - the model's theoretical soundness,
 - the model's mathematical integrity, and
 - the accuracy and completeness of the data and the appropriateness of data and assumptions used in the model.
- How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model.
- Whether adjustments, also referred to as *overlays* in certain industries, are made to the output of the model and whether such adjustments are appropriate in the circumstances in accordance with the requirements of the applicable financial reporting framework. When the adjustments are not appropriate, such adjustments may be indicators of possible management bias.
- Whether the model is adequately documented, including its intended applications, limitations, key parameters, required data and assumptions, and the results of any validation performed on it and the nature of and basis for any adjustments made to its output.

Examples of valuation models may include the present value of expected future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis.

^{fn 36} **Paragraph 27 and 29b of SAS No. 145.**

[Subsequent footnotes further renumbered. No amendment to paragraphs .A40–.A43.]

.A44 Data (Ref: par. .12h(ii)(1)(c)). Matters that the auditor may consider in obtaining an understanding of how management selects the data on which the accounting estimates are based include the following:

- The nature and source of the data, including information obtained from an external information source
- How management evaluates whether the data is appropriate
- The accuracy and completeness of the data
- The consistency of the data used with data used in previous periods
- The complexity of the IT **applications or other aspects of the entity's IT environment** systems used to obtain and process the data, including when this involves handling large volumes of data
- How the data is obtained, transmitted, and processed and how its integrity is maintained

[No amendment to paragraphs .A45–.A49.]

.A50 Identified controls ~~Control activities relevant to the audit over management's process for making accounting estimates~~ (Ref: par. .12i). The auditor's judgment in identifying controls ~~relevant to the audit~~ **in the control activities component** and, therefore, the need to evaluate the design of those controls

and determine whether they have been implemented, relates to management's process described in paragraph .12h(ii). The auditor may not identify **controls** relevant control activities in relation to all the elements **aspects** of paragraph .12h(ii), depending on the complexity associated with the accounting estimate.

A51 As part of obtaining an understanding of **identifying controls, and evaluating their design and determining whether they have been implemented**,^{fn 39} the control activities relevant to the audit, the auditor may consider the following:

- How management determines the appropriateness of the data used to develop the accounting estimates, including when management uses an external information source or data from outside the general and subsidiary ledgers.
- The review and approval of accounting estimates, including the assumptions or data used in their development, by appropriate levels of management and, where appropriate, those charged with governance.
- The segregation of duties between those responsible for making the accounting estimates and those committing the entity to the related transactions, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for estimation and validation of fair value pricing of the entity's financial products staffed by individuals whose remuneration is not tied to such products.
- The effectiveness of the design of the **controls-control activities**. Generally, it may be more difficult for management to design controls that address subjectivity and estimation uncertainty in a manner that effectively prevents, or detects and corrects, material misstatements than it is to design controls that address complexity. Controls that address subjectivity and estimation uncertainty may need to include more manual elements, which may be less reliable than automated controls as they can be more easily bypassed, ignored, or overridden by management. The design effectiveness of controls addressing complexity may vary depending on the reason for and the nature of the complexity. For example, it may be easier to design more effective controls related to a method that is routinely used or over the integrity of data.

^{fn 39} **Paragraph 30 of SAS No. 145.**

[Subsequent footnotes further renumbered.]

A52 When management makes extensive use of IT in making an accounting estimate, **identified** controls relevant to the audit **in the control activities component** are likely to include general IT controls and **application information-processing** controls. Such controls may address risks related to the following:

- Whether the IT **application or other aspects of the IT environment** system ~~has~~ **have** the capability and is **are** appropriately configured to process large volumes of data.
- Complex calculations in applying a method. When diverse **IT applications** systems are required to process complex transactions, regular reconciliations between the **IT applications** systems are made, in particular, when the **IT applications** systems do

not have automated interfaces or may be subject to manual intervention.

- Whether the design and calibration of models is periodically evaluated.
- The complete and accurate extraction of data regarding accounting estimates from the entity's records or from external information sources.
- Data, including the complete and accurate flow of data through the entity's information system, the appropriateness of any modification to the data used in making accounting estimates, and the maintenance of the integrity and security of the data; ~~When~~ using external information sources, risks related to processing or recording the data.
- Whether management has controls around access, change, and maintenance of individual models to maintain a strong audit trail of the accredited versions of models and to prevent unauthorized access or amendments to those models.
- Whether there are appropriate controls over the transfer of information relating to accounting estimates into the general ledger, including appropriate controls over journal entries.

.A53 In some entities, the term *governance* may be used to describe activities within the control environment, ***the entity's process to monitor the system of internal control*** monitoring of controls, and other components of ***the system of internal control***, as described in AU-C section 315 **SAS No. 145**.^{fn 3340}

^{fn 3340} [Footnote omitted for purposes of this SAS.]

.A54 For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of the following:

- The nature and extent of management's use of accounting estimates
- The design and implementation of ***controls*** ~~control activities~~ that address the risks related to the data, assumptions, and models used to make the accounting estimates
- The aspects of the entity's information system that generate the data on which the accounting estimates are based
- How new risks relating to accounting estimates are identified, assessed, and managed

[No amendment to paragraphs .A55–.A63.]

Identifying and Assessing the Risks of Material Misstatement

.A64 Identifying and assessing risks of material misstatement at the relevant assertion level relating to accounting estimates includes not only accounting estimates that are recognized in the financial statements but also those that are included in the notes to the financial statements.

[Paragraph .A67, .A69, and .A71 included for contextual purposes only.]

.A65 Section 200^{fn 38} states that GAAS do not ordinarily refer to inherent risk and control risk separately. However, this section **SAS No. 145** requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the risks of material misstatement **at the assertion level**,^{fn 46} including significant risks, at

the relevant assertion level for accounting estimates in accordance with section 330. ^{fn 39} See paragraphs .A148–.A149 of this section for discussion about documentation of inherent risk factors.

^{fn 38} Paragraph .A44 of section 200.

^{fn 3946} Paragraph .07b of AU-C section 330. ***Paragraphs 31 and 34 of SAS No. 145.***

[Subsequent footnotes further renumbered.]

.A66: As discussed in paragraph .04 of this section, section 200 ^{fn 4047} explains that inherent risk is ***influenced by inherent risk factors***. higher for some assertions and related classes of transactions, account balances, and disclosures than for others. In identifying the risks of material misstatement and in assessing inherent risk ***for accounting estimates in accordance with SAS No. 145***, the auditor is required to take into account ***the inherent risk factors that affect the susceptibility of assertions to misstatement and how they do so***. the degree to which the accounting estimate is subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors. The auditor's consideration of the inherent risk factors may also provide information to be used in determining the following:

- ***Assessing the likelihood and magnitude of misstatement (such as, where*** Where inherent risk is assessed on the spectrum of inherent risk)
- ***Determining the*** The reasons for the assessment given to the risks of material misstatement at the relevant assertion level, and that the auditor's further audit procedures in accordance with paragraph .18 of this section are responsive to those reasons

The interrelationships between the inherent risk factors are further explained in appendix A.

^{fn 4047} [Footnote omitted for purposes of this SAS.]

.A67 The reasons for the auditor's assessment of inherent risk at the relevant assertion level may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity, or other inherent risk factors. Examples follow:

- Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity-specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities.
- An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes but may involve little subjectivity, and the degree of estimation uncertainty may be low, depending on the nature of the inventory.
- Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single

critical judgment about a liability, the amount of which is contingent on the outcome of the litigation.

.A68 The relevance and significance of inherent risk factors may vary from one estimate to another. Accordingly, the inherent risk factors may, either individually or in combination, affect simple accounting estimates to a lesser degree, and the auditor may identify fewer risks or assess inherent risk *close to* at the lower end of the spectrum of inherent risk.

.A69 Conversely, the inherent risk factors may, either individually or in combination, affect complex accounting estimates to a greater degree and may lead the auditor to assess inherent risk at the higher end of the spectrum of inherent risk. For these accounting estimates, the auditor's consideration of the effects of the inherent risk factors is likely to directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately, the persuasiveness of the audit evidence needed in responding to the assessed risks. Also, for these accounting estimates, the auditor's application of professional skepticism may be particularly important.

.A70 Events occurring after the date of the financial statements may provide additional information relevant to the auditor's assessment of the risks of material misstatement at the relevant assertion level. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise the assessment of the risks of material misstatement at the relevant assertion level, ^{fn 4148} regardless of *how the inherent risk factors affect susceptibility of assertions to misstatement relating to* degree to which the accounting estimate was subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors. Events occurring after the date of the financial statements also may influence the auditor's selection of the approach to testing the accounting estimate in accordance with paragraph .18. For example, for a simple bonus accrual that is based on a straightforward percentage of compensation for selected employees, the auditor may conclude that there is relatively little complexity or subjectivity in making the accounting estimate and, therefore, may assess inherent risk at the relevant assertion level *close to* at the lower end of the spectrum of inherent risk. The payment of the bonuses subsequent to period-end may provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level.

fn 4148

Paragraph 37-32 of AU-C section 315 **SAS No. 145.**

.A71 The auditor's assessment of control risk may be done in different ways depending on preferred audit techniques or methodologies. The control risk assessment may be expressed using qualitative categories (for example, control risk assessed as maximum, moderate, or minimum) or in terms of the auditor's expectation of how effective the controls are in addressing the identified risk, that is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls.

[No amendment to paragraphs .A72–.A78.]

Other Inherent Risk Factors

.A79 The degree of subjectivity associated with an accounting estimate influences the susceptibility of the accounting estimate to misstatement due to management bias or fraud *other fraud risk factors insofar as they affect inherent risk*. For example, when an accounting estimate is subject to a high degree of subjectivity, the accounting estimate is likely to be more

susceptible to misstatement due to management bias or fraud, and this may result in a wide range of possible measurement outcomes. Management may select a point estimate from that range that is inappropriate in the circumstances, or that is inappropriately influenced by unintentional or intentional management bias, and that is, therefore, misstated. For continuing audits, indicators of possible management bias identified during the audit of preceding periods may influence the planning and risk assessment procedures in the current period.

[No amendment to paragraphs .A80–.A84.]

When the Auditor Intends to Rely on the Operating Effectiveness of Relevant Controls

.A85 Testing the operating effectiveness of ~~relevant~~ controls may be appropriate when inherent risk is assessed as higher on the spectrum of inherent risk, including for significant risks. This may be the case when the accounting estimate is subject to or affected by a high degree of complexity. When the accounting estimate is affected by a high degree of subjectivity and, therefore, requires significant judgment by management, inherent limitations in the effectiveness of the design of controls may lead the auditor to focus more on substantive procedures than on testing the operating effectiveness of controls.

[No further amendment to AU-C section 540.]

AU-C Section 315A

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

Source: SAS No. 122; SAS No. 128; SAS No. 130; SAS No. 134; SAS No. 135.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 142, *Audit Evidence*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, including the entity's internal control.

Effective Date

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

Objective

.03 The objective of the auditor is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement.

Definitions

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

Assertions. Representations by management, explicit or otherwise, that are embodied in the financial statements as used by the auditor to consider the different types of potential misstatements that may occur.

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

Internal control. A process effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to financial reporting and operations objectives.¹

Relevant assertion. A financial statement assertion that has a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated. The determination of whether an assertion is a relevant assertion is made without regard to the effect of internal controls. (Ref: par. .A136)

Risk assessment procedures. The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels.

Significant risk. An identified and assessed risk of material misstatement that, in the auditor's professional judgment, requires special audit consideration.

Requirements

Risk Assessment Procedures and Related Activities

.05 The auditor should perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and relevant assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion. (Ref: par. .A1–.A5)

.06 The risk assessment procedures should include the following:

- a. Inquiries of management, appropriate individuals within the internal audit function (if such function exists), others within the entity who, in the auditor's professional judgment, may have information that is likely to assist in identifying risks of material misstatement due to fraud or error (Ref: par. .A6–.A13)
- b. Analytical procedures (Ref: par. .A14–.A17)
- c. Observation and inspection (Ref: par. .A18)

¹ This section recognizes the definition and description of *internal control* contained in *Internal Control—Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.07 The auditor should consider whether information obtained from the auditor's client acceptance or continuance process is relevant to identifying risks of material misstatement.

.08 If the engagement partner has performed other engagements for the entity, the engagement partner should consider whether information obtained is relevant to identifying risks of material misstatement.

.09 During planning, the auditor should consider the results of the assessment of the risk of material misstatement due to fraud² along with other information gathered in the process of identifying the risks of material misstatements.

.10 When the auditor intends to use information obtained from the auditor's previous experience with the entity and from audit procedures performed in previous audits, the auditor should determine whether changes have occurred since the previous audit that may affect its relevance to the current audit. (Ref: par. .A19–.A21)

.11 The engagement partner and other key engagement team members should discuss the susceptibility of the entity's financial statements to material misstatement and the application of the applicable financial reporting framework to the entity's facts and circumstances. The engagement partner should determine which matters are to be communicated to engagement team members not involved in the discussion. (Ref: par. .A22–.A24)

Understanding the Entity and Its Environment, Including the Entity's Internal Control

The Entity and Its Environment (Ref: par. .A25)

.12 The auditor should obtain an understanding of the following:

- a. Relevant industry, regulatory, and other external factors, including the applicable financial reporting framework. (Ref: par. .A26–.A30)
- b. The nature of the entity, including
 - i. its operations;
 - ii. its ownership and governance structures;
 - iii. the types of investments that the entity is making and plans to make, including investments in entities formed to accomplish specific objectives; and
 - iv. the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: par. .A31–.A35)
- c. The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor should evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting

² See section 240, *Consideration of Fraud in a Financial Statement Audit*.

framework and accounting policies used in the relevant industry. (Ref: par. .A36)

- d. The entity's objectives and strategies and those related business risks that may result in risks of material misstatement. (Ref: par. .A37–.A43)
- e. The measurement and review of the entity's financial performance. (Ref: par. .A44–.A49)

The Entity's Internal Control

.13 The auditor should obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit. (Ref: par. .A50–.A75)

Nature and Extent of the Understanding of Relevant Controls

.14 When obtaining an understanding of controls that are relevant to the audit, the auditor should evaluate the design of those controls and determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel. (Ref: par. .A76–.A78)

Components of Internal Control

.15 *Control environment.* The auditor should obtain an understanding of the control environment. As part of obtaining this understanding, the auditor should evaluate whether

- a. management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior and
- b. the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control and whether those other components are not undermined by deficiencies in the control environment. (Ref: par. .A79–.A89)

.16 *The entity's risk assessment process.* The auditor should obtain an understanding of whether the entity has a process for

- a. identifying business risks relevant to financial reporting objectives,
- b. estimating the significance of the risks,
- c. assessing the likelihood of their occurrence, and
- d. deciding about actions to address those risks. (Ref: par. .A90–.A91)

.17 If the entity has established a risk assessment process (referred to hereafter as the *entity's risk assessment process*), the auditor should obtain an understanding of it and the results thereof. If the auditor identifies risks of material misstatement that management failed to identify, the auditor should evaluate whether an underlying risk existed that the auditor expects would have been identified by the entity's risk assessment process. If such a risk exists, the auditor should obtain an understanding of why that process failed to identify it and evaluate whether the process is appropriate to its circumstances or determine if a significant deficiency or material weakness exists in internal control regarding the entity's risk assessment process.

.18 If the entity has not established such a process or has an ad hoc process, the auditor should discuss with management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed. The auditor should evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances or determine whether it represents a significant deficiency or material weakness in the entity's internal control. (Ref: par. .A92)

.19 *The information system, including the related business processes relevant to financial reporting and communication.* The auditor should obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:

- a. The classes of transactions in the entity's operations that are significant to the financial statements.
- b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements.
- c. The related accounting records supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process, and report transactions. This includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form.
- d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.
- e. The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures.
- f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments.

This understanding of the information system relevant to financial reporting should include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers. (Ref: par. .A93–.A99) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.20 The auditor should obtain an understanding of how the entity communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including

- a. communications between management and those charged with governance and
- b. external communications, such as those with regulatory authorities. (Ref: par. .A100–.A101)

.21 *Control activities relevant to the audit.* The auditor should obtain an understanding of control activities relevant to the audit, which are those control activities the auditor judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further audit procedures responsive to assessed risks. An audit does not require an understanding of all the control activities related to each significant class of transactions, account balance, and disclosure in the financial statements or to

every assertion relevant to them. However, the auditor should obtain an understanding of the process of reconciling detailed records to the general ledger for material account balances. (Ref: par. .A102–.A109)

.22 In understanding the entity's control activities, the auditor should obtain an understanding of how the entity has responded to risks arising from IT. (Ref: par. .A110–.A113)

.23 *Monitoring of controls.* The auditor should obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates remedial actions to deficiencies in its controls. (Ref: par. .A114–.A115)

.24 If the entity has an internal audit function,³ the auditor should obtain an understanding of the nature of the internal audit function's responsibilities how the internal audit function fits in the entity's organizational structure, and the activities performed or to be performed. (Ref: par. .A117–.A124) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.25 The auditor should obtain an understanding of the sources of the information used in the entity's monitoring activities and the basis upon which management considers the information to be sufficiently reliable for the purpose. (Ref: par. .A125)

Identifying and Assessing the Risks of Material Misstatement

.26 To provide a basis for designing and performing further audit procedures, the auditor should identify and assess the risks of material misstatement at

- a. the financial statement level and (Ref: par. .A126–.A129)
- b. the relevant assertion level for classes of transactions, account balances, and disclosures. (Ref: par. .A130–.A138)

.27 For this purpose, the auditor should

- a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, by considering the classes of transactions, account balances, and disclosures (including the quantitative and qualitative aspects of such disclosures) in the financial statements; (Ref: par. .A139–.A143)
- b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: par. .A144–.A146)
- d. consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement could result in a material misstatement. (Ref: par. .A147)

³ Paragraph .13 of section 610, *Using the Work of Internal Auditors*, defines the term *internal audit function* for purposes of GAAS. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

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

Risks That Require Special Audit Consideration

.28 As part of the risk assessment described in paragraph .26, the auditor should determine whether any of the risks identified are, in the auditor's professional judgment, a significant risk. In exercising this judgment, the auditor should exclude the effects of identified controls related to the risk.

.29 In exercising professional judgment about which risks are significant risks, the auditor should consider at least

- a. whether the risk is a risk of fraud;
- b. whether the risk is related to recent significant economic, accounting, or other developments and, therefore, requires specific attention;
- c. the complexity of transactions;
- d. whether the risk involves significant transactions with related parties;
- e. the degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- f. whether the risk involves significant unusual transactions. (Ref: par. .A148–.A152)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.30 If the auditor has determined that a significant risk exists, the auditor should obtain an understanding of the entity's controls, including control activities, relevant to that risk and, based on that understanding, evaluate whether such controls have been suitably designed and implemented to mitigate such risks. (Ref: par. .A153–.A155)

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence

.31 In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit, and the auditor should obtain an understanding of them. (Ref: par. .A156–.A159)

Revision of Risk Assessment

.32 The auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances in which the auditor obtains audit evidence from performing further audit procedures or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment, the auditor should revise the assessment and modify the further planned audit procedures accordingly. (Ref: par. .A160)

Documentation

.33 The auditor should include in the audit documentation⁴ the

- a. discussion among the engagement team required by paragraph .11, the significant decisions reached, how and when the discussion occurred, and the audit team members who participated;
- b. key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph .12 and each of the internal control components specified in paragraphs .15–.25, the sources of information from which the understanding was obtained, and the risk assessment procedures performed;
- c. identified and assessed risks of material misstatement at the financial statement level and at the relevant assertion level, as required by paragraph .26; and
- d. risks identified and related controls about which the auditor has obtained an understanding as a result of the requirements in paragraphs .28–.31. (Ref: par. .A161–.A164)

Application and Other Explanatory Material

Risk Assessment Procedures and Related Activities (Ref: par. .05)

.A1 Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an *understanding of the entity*), is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The understanding of the entity establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit when, for example

- assessing risks of material misstatement of the financial statements;
- determining materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*;
- considering the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures;
- identifying areas relating to amounts or disclosures in the financial statements for which special audit consideration may be necessary (for example, related party transactions or management's evaluation of the entity's ability to continue as a going concern, or when considering the business purpose of transactions);
- developing expectations for use when performing analytical procedures;
- responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and

⁴ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

- evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and management's oral and written representations.

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

.A2 Information obtained by performing risk assessment procedures and related activities may be used by the auditor as audit evidence to support assessments of the risks of material misstatement. In addition, the auditor may obtain audit evidence about classes of transactions, account balances, or disclosures and relevant assertions and about the operating effectiveness of controls, even though such procedures were not specifically planned as substantive procedures or tests of controls. The auditor also may choose to perform substantive procedures or tests of controls concurrently with risk assessment procedures because it is efficient to do so.

.A3 The auditor is required to exercise professional judgment⁵ to determine the extent of the required understanding of the entity. The auditor's primary consideration is whether the understanding of the entity that has been obtained is sufficient to meet the objective stated in this section. The depth of the overall understanding that is required by the auditor is less than that possessed by management in managing the entity.

.A4 The risks to be assessed include both those due to fraud and those due to error, and both are covered by this section. However, the significance of fraud is such that further requirements and guidance are included in section 240, *Consideration of Fraud in a Financial Statement Audit*, regarding risk assessment procedures and related activities to obtain information that is used to identify the risks of material misstatement due to fraud.

.A5 Although the auditor is required to perform all the risk assessment procedures described in paragraph .06 in the course of obtaining the required understanding of the entity (see paragraphs .12–.25), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed when the information to be obtained therefrom may be helpful in identifying risks of material misstatement. Examples of such procedures include the following:

- Reviewing information obtained from external sources, such as trade and economic journals; reports by analysts, banks, or rating agencies; or regulatory or financial publications
- Making inquiries of the entity's external legal counsel or valuation specialists whom the entity has used

Inquiries of Management and Others Within the Entity (Ref: par. .06a)

.A6 Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. Information may also be obtained by the auditor through inquiries with the internal audit function, if the entity has such a function, and others within the entity. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

⁵ Paragraph .18 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to exercise professional judgment in planning and performing an audit. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

.A7 The auditor also may obtain information or a different perspective in identifying risks of material misstatement through inquiries of others within the entity and other employees with different levels of authority. For example

- inquiries directed toward those charged with governance may help the auditor understand the environment in which the financial statements are prepared. Section 260⁶ identifies the importance of effective two-way communication in assisting the auditor to obtain information from those charged with governance in this regard.
- inquiries of employees involved in initiating, authorizing, processing, or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
- inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, postsales obligations, arrangements (such as joint ventures) with business partners, and the meaning of contract terms.
- inquiries directed toward marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system-related risks.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A8 Because obtaining an understanding of the entity and its environment is a continual, dynamic process, the auditor's inquiries may occur throughout the audit engagement. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Inquiries of the Internal Audit Function (Ref: par. .06a)

.A9 If an entity has an internal audit function, inquiries of the appropriate individuals within the function may provide information that is useful to the external auditor in obtaining an understanding of the entity and its environment and in identifying and assessing risks of material misstatement at the financial statement and assertion levels. In performing its work, the internal audit function is likely to have obtained insight into the entity's operations and business risks and may have findings based on its work, such as identified control deficiencies or risks, that may provide valuable input into the external auditor's understanding of the entity, the external auditor's risk assessments, or other aspects of the audit. The external auditor's inquiries, therefore, are made regardless of whether the external auditor expects to use the work of the internal audit function to modify the nature or timing or reduce the extent

⁶ Paragraph .05d of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

of audit procedures to be performed.⁷ Inquiries of particular relevance may be about matters the internal audit function has raised with those charged with governance and the outcomes of the function's own risk assessment process. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A10 If, based on responses to the external auditor's inquiries, it appears that there are findings that may be relevant to the entity's financial reporting and the audit, the external auditor may consider it appropriate to read related reports of the internal audit function. Examples of reports of the internal audit function that may be relevant include the function's strategy and planning documents and reports that have been prepared for management or those charged with governance describing the findings of the internal audit function's examinations. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A11 In addition, in accordance with section 240,⁸ if the internal audit function provides information to the external auditor regarding any actual, suspected, or alleged fraud, the auditor takes this into account in the external auditor's identification of risk of material misstatement due to fraud. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A12 Appropriate individuals within the internal audit function with whom inquiries are made are those who, in the external auditor's judgment, have the appropriate knowledge, experience, and authority (such as the chief internal audit executive or, depending on the circumstances, other personnel within the function). The external auditor may also consider it appropriate to have periodic meetings with these individuals. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Considerations Specific to Governmental Entities (Ref: par. .06a)

.A13 External auditors of governmental entities often have additional responsibilities with regard to internal control and compliance with applicable laws and regulations. Inquiries of appropriate individuals in the internal audit function can assist the external auditors in identifying the risk of material non-compliance with applicable laws and regulations and the risk of deficiencies in internal control over financial reporting. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Analytical Procedures (Ref: par. .06b)

.A14 Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and nonfinancial information (for example, the relationship between sales and square footage of selling space or volume of goods sold). [Paragraph renumbered by the issuance of SAS No. 128, January 2015.]

⁷ The relevant requirements are contained in section 610, *Using the Work of Internal Auditors*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

⁸ Paragraph .19 of section 240. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A15 Analytical procedures may enhance the auditor's understanding of the client's business and the significant transactions and events that have occurred since the prior audit and also may help to identify the existence of unusual transactions or events and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud. [Paragraph renumbered by the issuance of SAS No. 128, January 2015.]

.A16 However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures provide only a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures. [Paragraph renumbered by the issuance of SAS No. 128, January 2015.]

Considerations Specific to Smaller, Less Complex Entities

.A17 Some smaller entities may not have interim or monthly financial information that can be used for purposes of analytical procedures. In these circumstances, although the auditor may be able to perform limited analytical procedures for purposes of planning the audit or obtain some information through inquiry, the auditor may need to plan to perform analytical procedures to identify and assess the risks of material misstatement when an early draft of the entity's financial statements is available. [Paragraph renumbered by the issuance of SAS No. 128, January 2015.]

Observation and Inspection (Ref: par. .06c)

.A18 Observation and inspection may support inquiries of management and others and also may provide information about the entity and its environment. Examples of such audit procedures include observation or inspection of the following:

- The entity's operations
- Documents (such as business plans and strategies), records, and internal control manuals
- Reports prepared by management (such as quarterly management reports and interim financial statements), those charged with governance (such as minutes of board of directors' meetings), and internal audit
- The entity's premises and plant facilities

[Paragraph renumbered by the issuance of SAS No. 128, January 2015.]

Information Obtained in Prior Periods (Ref: par. .10)

.A19 The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as

- past misstatements and whether they were corrected on a timely basis.
- the nature of the entity and its environment and the entity's internal control (including deficiencies in internal control).

- significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.
- those particular types of transactions and other events or account balances (and related disclosures) that, for example, due to their complexity, resulted in the auditor having difficulty in performing the necessary audit procedures.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A20 As part of the discussion among the engagement team required by paragraph .11, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement related to disclosures. Examples of matters the engagement team may discuss include the following:

- Changes in financial reporting requirements that may result in significant new or revised disclosures
- Changes in the entity's environment, financial condition, or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit
- Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past
- Disclosures about complex matters, including those involving significant management judgment regarding what information to disclose

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

.A21 Paragraph .10 requires the auditor to determine whether information obtained in prior periods remains relevant if the auditor intends to use that information for the purposes of the current audit. For example, changes in the control environment may affect the relevance of information obtained in the prior year. To determine whether changes have occurred that may affect the relevance of such information, the auditor may make inquiries and perform other appropriate audit procedures, such as walk-throughs of relevant systems. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Discussion Among the Engagement Team (Ref: par. .11)

.A22 The discussion among the engagement team about the susceptibility of the entity's financial statements to material misstatement

- provides an opportunity for more experienced engagement team members, including the engagement partner, to share their insights based on their knowledge of the entity.
- allows the engagement team members to exchange information about the business risks to which the entity is subject and about how and where the financial statements might be susceptible to material misstatement due to fraud or error.
- assists the engagement team members to gain a better understanding of the potential for material misstatement of the

financial statements in the specific areas assigned to them and to understand how the results of the audit procedures that they perform may affect other aspects of the audit, including the decisions about the nature, timing, and extent of further audit procedures.

- provides a basis upon which engagement team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks.

This discussion may be held concurrently with the discussion among the engagement team that is required by section 240 to discuss the susceptibility of the entity's financial statements to fraud.⁹ Section 240 further addresses the discussion among the engagement team about the risks of fraud. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A23 It is not always necessary or practical for the discussion to include all members in a single discussion (as in group audits), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team, including, if considered appropriate, those with specific skills or knowledge, and those responsible for the audits of components, while delegating discussion with others, taking account of the extent of communication considered necessary throughout the engagement team. A communications plan, agreed by the engagement partner, may be useful. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A24 Many small audits are carried out entirely by the engagement partner (who may be a sole practitioner). In such situations, it is the engagement partner who, having personally conducted the planning of the audit, would be responsible for considering the susceptibility of the entity's financial statements to material misstatement due to fraud or error. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

The Required Understanding of the Entity and Its Environment, Including the Entity's Internal Control

.A25 Appendix A, "Understanding the Entity and Its Environment," contains examples of matters that the auditor may consider in obtaining an understanding of the entity and its environment. Appendix B, "Internal Control Components," contains a detailed explanation of the internal control components. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

The Entity and Its Environment

Industry, Regulatory, and Other External Factors (Ref: par. .12a)

.A26 *Industry factors.* Relevant industry factors include industry conditions such as the competitive environment, supplier and customer relationships, and technological developments. Examples of matters the auditor may consider include

⁹ Paragraph .15 of section 240. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

- the market and competition, including demand, capacity, and price competition.
- cyclical or seasonal activity.
- product technology relating to the entity's products.
- energy supply and cost.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A27 The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation. For example, long term contracts may involve significant estimates of revenues and expenses that give rise to risks of material misstatement. In such cases, it is important that the engagement team includes members with sufficient, relevant knowledge and experience, as required by section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A28 *Regulatory factors*. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include the following:

- Accounting principles and industry-specific practices
- Regulatory framework for a regulated industry, including requirements for disclosures
- Laws and regulations that significantly affect the entity's operations, including direct supervisory activities
- Taxation (corporate and other)
- Government policies currently affecting the conduct of the entity's business, such as monetary (including foreign exchange controls), fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies
- Environmental requirements affecting the industry and the entity's business

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A29 Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A30 *Other external factors*. Examples of other external factors affecting the entity that the auditor may consider include the general economic conditions, interest rates and availability of financing, and inflation or currency revaluation. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Nature of the Entity (Ref: par. .12b)

.A31 An understanding of the nature of an entity enables the auditor to understand such matters as

- whether the entity has a complex structure (for example, with subsidiaries or other components in multiple locations). Complex structures often introduce issues that may give rise to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or investments in entities formed to accomplish specific objectives are accounted for and disclosed appropriately.
- the ownership and relationships between owners and other people or entities. This understanding assists in determining whether related party transactions and balances have been appropriately identified, accounted for, and adequately disclosed in the financial statements. Section 550, *Related Parties*, addresses the auditor's considerations relevant to related parties.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A32 Examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity include

- business operations such as
 - the nature of revenue sources, products or services, and markets, including involvement in electronic commerce, such as Internet sales and marketing activities.
 - the conduct of operations (for example, stages and methods of production or activities exposed to environmental risks).
 - alliances, joint ventures, and outsourcing activities.
 - geographic dispersion and industry segmentation.
 - the location of production facilities, warehouses, and offices and the location and quantities of inventories.
 - key customers and important suppliers of goods and services.
 - employment arrangements (including the existence of union contracts, pension and other postemployment benefits, stock option or incentive bonus arrangements, and government regulation related to employment matters).
 - research and development activities and expenditures.
 - transactions with related parties.
- investments and investment activities such as
 - planned or recently executed acquisitions or divestitures.
 - investments and dispositions of securities and loans.
 - capital investment activities.
 - investments in nonconsolidated entities, including partnerships, joint ventures, and investments in entities formed to accomplish specific objectives.
- financing and financing activities such as

- major subsidiaries and associated entities, including consolidated and nonconsolidated structures.
- debt structure and related terms, including off balance sheet financing arrangements and leasing arrangements.
- beneficial owners (local and foreign and their business reputation and experience) and related parties.
- the use of derivative financial instruments.
- financial reporting practices such as
 - accounting principles and industry-specific practices, including for industry-specific significant classes of transactions, account balances, and related disclosures in the financial statements (for example, loans and investments for banks or research and development for pharmaceuticals).
 - revenue recognition.
 - accounting for fair values.
 - foreign currency assets, liabilities, and transactions.
 - accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for stock-based compensation).

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A33 Significant changes in the entity from prior periods may give rise to, or change risks of, material misstatement. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A34 *Entities formed to accomplish specific purposes.* An entity may form an entity that is intended to accomplish a narrow and well-defined purpose (for example, a variable interest entity), such as to effect a lease or a securitization of financial assets or to carry out research and development activities. It may take the form of a corporation, trust, partnership, or unincorporated entity. The entity on behalf of which an entity has been created may often transfer assets to the latter (for example, as part of a derecognition transaction involving financial assets), obtain the right to use the latter's assets, or perform services for the latter, and other parties may provide the funding to the latter. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A35 Financial reporting frameworks often specify detailed conditions that are deemed to amount to control or circumstances under which an entity should be considered for consolidation. The financial reporting frameworks also may specify different bases for recognition of income related to transactions with these entities. The interpretation of the requirements of such frameworks often involves a detailed knowledge of the relevant agreements involving an entity formed for a specific purpose. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

The Entity's Selection and Application of Accounting Policies (Ref: par. .12c)

.A36 An understanding of the entity's selection and application of accounting policies may encompass such matters as

- the methods the entity uses to account for significant unusual transactions.
- the effect of significant accounting policies in controversial or emerging areas for which a lack of authoritative guidance or consensus exists.
- significant changes in the entity's accounting policies and disclosures and the reasons for such changes.
- financial reporting standards, and laws and regulations that are new to the entity and when and how the entity will adopt such requirements.
- the financial reporting competencies of personnel involved in selecting and applying significant new or complex accounting standards.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Objectives and Strategies and Related Business Risks (Ref: par. .12d)

.A37 The entity conducts its business in the context of industry, regulatory, and other internal and external factors. To respond to these factors, the entity's management or those charged with governance define objectives, which are the overall plans for the entity. Strategies are the approaches by which management intends to achieve its objectives. The entity's objectives and strategies may change over time. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A38 Business risk is broader than the risk of material misstatement of the financial statements, though it includes the latter. Business risk may arise from change or complexity. A failure to recognize the need for change also may give rise to business risk. Business risk may arise, for example, from

- the development of new products or services that may fail;
- a market that, even if successfully developed, is inadequate to support a product or service; or
- flaws in a product or service that may result in liabilities and reputational risk.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A39 An understanding of the business risks facing the entity increases the likelihood of identifying risks of material misstatement. This is because most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. However, the auditor does not have a responsibility to identify or assess all business risks because not all business risks give rise to risks of material misstatement. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A40 Examples of matters that the auditor may consider when obtaining an understanding of the entity's objectives, strategies, and related business risks that may result in a risk of material misstatement of the financial statements include

- industry developments (a potential related business risk might be, for example, that the entity does not have the personnel or expertise to deal with the changes in the industry).
- new products and services (a potential related business risk might be, for example, product liability is increased).
- expansion of the business (a potential related business risk might be, for example, that the demand has not been accurately estimated).
- new accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation or a cost increase).
- regulatory requirements (a potential related business risk might be, for example, that legal exposure is increased).
- current and prospective financing requirements (a potential related business risk might be, for example, financing is lost due to the entity's inability to meet requirements).
- use of IT (a potential related business risk might be, for example, systems and processes are incompatible).
- the effects of implementing a strategy, particularly any effects that will lead to new accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation).

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A41 A business risk may have an immediate consequence for the risk of material misstatement for classes of transactions, account balances, and disclosures at the assertion level or the financial statement level. For example, the business risk arising from a contracting customer base may increase the risk of material misstatement associated with the valuation of receivables. However, the same risk, particularly in combination with a contracting economy, also may have a longer term consequence, which may lead the auditor to consider whether those conditions, in the aggregate, indicate that substantial doubt could exist about the entity's ability to continue as a going concern.¹⁰ Whether a business risk may result in a risk of material misstatement is, therefore, considered in light of the entity's circumstances. Examples of conditions and events that may indicate risks of material misstatement are provided in appendix C, "Conditions and Events That May Indicate Risks of Material Misstatement." [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A42 Usually, management identifies business risks and develops approaches to address them. Such a risk assessment process is part of internal control and is discussed in paragraphs .16 and .A90–.A92. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A43 *Considerations specific to governmental entities.* For the audits of governmental entities, management objectives may be influenced by concerns regarding public accountability and may include objectives that have their source

¹⁰ See section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Footnote renumbered by the issuance of SAS No. 128, January 2015.]

in law or regulation. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Measurement and Review of the Entity's Financial Performance (Ref: par. .12e)

.A44 Management and others will measure and review those things they regard as important. Performance measures, whether external or internal, create pressures on the entity. These pressures, in turn, may motivate management or others to take action to improve the business performance or to misstate the financial statements. Accordingly, an understanding of the entity's performance measures assists the auditor in considering whether pressures to achieve performance targets may result in management actions that increase the risks of material misstatement, including those due to fraud. Section 240 addresses the risks of fraud. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A45 The measurement and review of financial performance are not the same as the monitoring of controls (discussed as a component of internal control in paragraphs .23–.25 and .A114–.A125), though their purposes may overlap as follows:

- The measurement and review of performance is directed at whether business performance is meeting the objectives set by management (or third parties).
- Monitoring of controls is specifically concerned with the effective operation of internal control.

In some cases, however, performance indicators also provide information that enables management to identify deficiencies in internal control. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A46 Examples of internally generated information used by management for measuring and reviewing financial performance, and which the auditor may consider, include

- key performance indicators (financial and nonfinancial) and key ratios, trends, and operating statistics.
- period-on-period financial performance analyses.
- budgets; forecasts; variance analyses; segment information; and divisional, departmental, or other-level performance reports.
- employee performance measures and incentive compensation policies.
- comparisons of an entity's performance with that of competitors.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A47 External parties also may measure and review the entity's financial performance. For example, external information, such as analysts' reports and credit rating agency reports, may represent useful information for the auditor. Such reports often can be obtained from the entity being audited. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A48 Internal measures may highlight unexpected results or trends requiring management to determine their cause and take corrective action (including, in some cases, the detection and correction of misstatements on a

timely basis). Performance measures also may indicate to the auditor that risks of misstatement of related financial statement information do exist. For example, performance measures may indicate that the entity has unusually rapid growth or profitability when compared with that of other entities in the same industry. Such information, particularly if combined with other factors, such as performance-based bonus or incentive remuneration, may indicate the potential risk of management bias in the preparation of the financial statements. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A49 Considerations specific to smaller, less complex entities. Smaller entities often do not have processes to measure and review financial performance. Inquiry of management may reveal that management relies on certain key indicators for evaluating financial performance and taking appropriate action. If such inquiry indicates an absence of performance measurement or review, an increased risk of misstatements not being detected and corrected may exist. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

The Entity's Internal Control

.A50 An understanding of internal control assists the auditor in identifying types of potential misstatements and factors that affect the risks of material misstatement and in designing the nature, timing, and extent of further audit procedures. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A51 The following application material on internal control is presented in four sections:

- "General Nature and Characteristics of Internal Control"
- "Controls Relevant to the Audit"
- "Nature and Extent of the Understanding of Relevant Controls"
- "Components of Internal Control — Control Environment"

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

General Nature and Characteristics of Internal Control (Ref: par. .13)

.A52 *Purpose of internal control.* Internal control is designed, implemented, and maintained to address identified business risks that threaten the achievement of any of the entity's objectives that concern

- the reliability of the entity's financial reporting,
- the effectiveness and efficiency of its operations, and
- its compliance with applicable laws and regulations.

The way in which internal control is designed, implemented, and maintained varies with an entity's size and complexity. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A53 *Considerations specific to smaller, less complex entities.* Smaller entities may use less structured means and simpler processes and procedures to achieve their objectives. For example, smaller entities with active management involvement in the financial reporting process may not have extensive descriptions of accounting procedures or detailed written policies. For some entities, in

particular very small entities, the owner-manager (the proprietor of an entity who is involved in running the entity on a day-to-day basis) may perform functions that in a larger entity would be regarded as belonging to several of the components of internal control. Therefore, the components of internal control may not be clearly distinguished within smaller entities, but their underlying purposes are equally valid. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A54 *Limitations of internal control.* Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by the inherent limitations of internal control. These include the realities that human judgment in decision making can be faulty and that breakdowns in internal control can occur because of human error. For example, an error in the design of, or in the change to, a control may exist. Equally, the operation of a control may not be effective, such as when information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A55 Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into undisclosed agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A56 Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement and the nature and extent of the risks it chooses to assume. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A57 *Considerations specific to smaller, less complex entities.* Smaller entities often have fewer employees, which may limit the extent to which segregation of duties is practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A58 *Division of internal control into components.* The division of internal control into the following five components, for purposes of GAAS, provides a useful framework for auditors when considering how different aspects of an entity's internal control may affect the audit:

- a. The control environment
- b. The entity's risk assessment process
- c. The information system, including the related business processes relevant to financial reporting and communication

- d. Control activities
- e. Monitoring of controls

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A59 The division does not necessarily reflect how an entity designs, implements, and maintains internal control or how it may classify any particular component. Auditors may use different terminology or frameworks to describe the various aspects of internal control and their effect on the audit other than those used in this section, provided that all the components described in this section are addressed. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A60 Application material relating to the five components of internal control as they relate to a financial statement audit is set out in paragraphs .A79–.A125. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A61 *Characteristics of manual and automated elements of internal control relevant to the auditor's risk assessment.* An entity's system of internal control contains manual elements and often contains automated elements. The characteristics of manual or automated elements are relevant to the auditor's risk assessment and further audit procedures based thereon. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A62 An entity's use of IT may affect any of the five components of internal control relevant to the achievement of the entity's financial reporting, operations, or compliance objectives and its operating units or business functions. For example, an entity may use IT as part of discrete systems that support only particular business units, functions, or activities, such as a unique accounts receivable system for a particular business unit or a system that controls the operation of factory equipment. Alternatively, an entity may have complex, highly integrated systems that share data and that are used to support all aspects of the entity's financial reporting, operations, and compliance objectives. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A63 The following use of manual or automated elements in internal control also affects the manner in which transactions are initiated, authorized, recorded, processed, and reported:

- Controls in a manual system may include such procedures as approvals and reviews of transactions and reconciliations and follow-up of reconciling items. Alternatively, an entity may use automated procedures to initiate, authorize, record, process, and report transactions, in which case records in electronic format replace paper documents.
- Controls in IT systems consist of a combination of automated controls (for example, controls embedded in computer programs) and manual controls. Further, manual controls may be independent of IT or may use information produced by IT. They also may be limited to monitoring the effective functioning of IT and automated controls and to handling exceptions. When IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in financial statements, the systems and

programs may include controls related to the corresponding assertions for material accounts or may be critical to the effective functioning of manual controls that depend on IT.

An entity's mix of manual and automated elements in internal control varies with the nature and complexity of the entity's use of IT. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A64 Generally, IT benefits an entity's internal control by enabling an entity to

- consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
- enhance the timeliness, availability, and accuracy of information;
- facilitate the additional analysis of information;
- enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- reduce the risk that controls will be circumvented; and
- enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A65 IT also poses specific risks to an entity's internal control, including, for example

- reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- unauthorized access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or nonexistent transactions or inaccurate recording of transactions. Particular risks may arise when multiple users access a common database.
- the possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby breaking down segregation of duties.
- unauthorized changes to data in master files.
- unauthorized changes to systems or programs.
- failure to make necessary changes to systems or programs.
- inappropriate manual intervention.
- potential loss of data or inability to access data as required.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A66 Manual elements in internal control may be more suitable when judgment and discretion are required, such as for the following circumstances:

- Large, unusual, or nonrecurring transactions
- Circumstances in which errors are difficult to define, anticipate, or predict

- Changing circumstances that require a control response outside the scope of an existing automated control
- Monitoring of the effectiveness of automated controls

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A67 Manual elements in internal control may be less reliable than automated elements because they can be more easily bypassed, ignored, or overridden, and they also are more prone to simple errors and mistakes. Consistency of application of a manual control element cannot, therefore, be assumed. Manual control elements may be less suitable for the following circumstances:

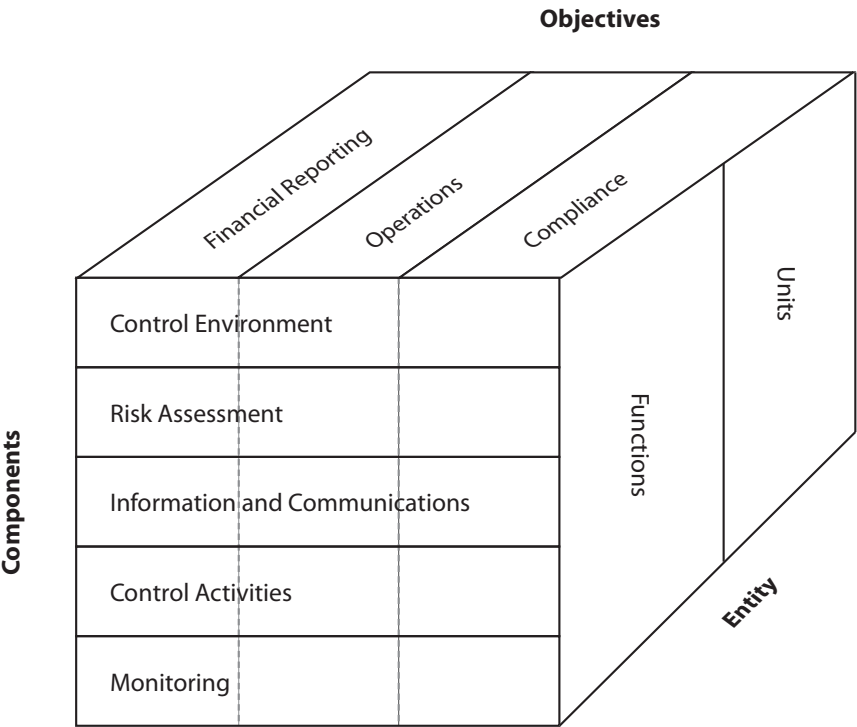
- High volume or recurring transactions or in situations in which errors that can be anticipated or predicted can be prevented, or detected and corrected, by control parameters that are automated
- Control activities in which the specific ways to perform the control can be adequately designed and automated

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A68 The extent and nature of the risks to internal control vary depending on the nature and characteristics of the entity's information system. For example, multiple users, either external or internal, may access a common database of information that affects financial reporting. In such circumstances, a lack of control at a single user entry point might compromise the security of the entire database, potentially resulting in improper changes to, or destruction of, data. When IT personnel or users are given, or can gain, access privileges beyond those necessary to perform their assigned duties, a breakdown in segregation of duties can occur. This could result in unauthorized transactions or changes to programs or data that affect the financial statements. The entity responds to the risks arising from the use of IT or the use of manual elements in internal control by establishing effective controls in light of the characteristics of the entity's information system. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Controls Relevant to the Audit

.A69 A direct relationship exists between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement. The entity's objectives and, therefore, controls relate to financial reporting, operations, and compliance; however, not all of these objectives and controls are relevant to the auditor's risk assessment. This relationship is depicted as follows:



Although internal control applies to the entire entity or any of its operating units or business functions, an understanding of internal control relating to each of the entity's operating units and business functions may not be necessary to the performance of the audit. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A70 Factors relevant to the auditor's professional judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- Materiality
- The significance of the related risk
- The size of the entity
- The nature of the entity's business, including its organization and ownership characteristics
- The diversity and complexity of the entity's operations
- Applicable legal and regulatory requirements
- The circumstances and the applicable component of internal control
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organizations
- Whether and how a specific control, individually or in combination with other controls, prevents, or detects and corrects, material misstatements

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A71 Controls over the completeness and accuracy of information produced by the entity may be relevant to the audit if the auditor intends to make use of the information in designing and performing further audit procedures. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A72 Controls relating to operations and compliance objectives also may be relevant to an audit if they relate to data the auditor evaluates or uses in applying audit procedures. For example, controls pertaining to nonfinancial data that the auditor may use in analytical procedures, such as production statistics, or controls pertaining to detecting noncompliance with laws and regulations that may have a direct effect on the determination of material amounts and disclosures in the financial statements,¹¹ such as controls over compliance with income tax laws and regulations used to determine the income tax provision, may be relevant to an audit. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A73 Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A74 An entity generally has controls relating to objectives that are not relevant to an audit and, therefore, need not be considered. For example, an entity may rely on a sophisticated system of automated controls to provide efficient and effective operations (such as an airline's system of automated controls to maintain flight schedules), but these controls ordinarily would not be relevant to the audit. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A75 *Considerations specific to governmental entities.* Governmental entity auditors often have additional responsibilities with respect to internal control (for example, to report on internal control over financial reporting and on internal control over compliance with law, regulation, and provisions of contracts or grant agreements, violations of which could have a direct effect on the determination of material amounts and disclosures in the financial statements). Governmental entity auditors also may have responsibilities to report on the compliance with law or regulation. As a result, their review of internal control may be broader and more detailed. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

¹¹ See section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

Nature and Extent of the Understanding of Relevant Controls (Ref: par. .14)

.A76 Evaluating the design of a control involves considering whether the control, individually or in combination with other controls, is capable of effectively preventing, or detecting and correcting, material misstatements. Implementation of a control means that the control exists and that the entity is using it. Assessing the implementation of a control that is not effectively designed is of little use, and so the design of a control is considered first. An improperly designed control may represent a significant deficiency or material weakness in the entity's internal control. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A77 Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include

- inquiring of entity personnel.
- observing the application of specific controls.
- inspecting documents and reports.
- tracing transactions through the information system relevant to financial reporting.

Inquiry alone, however, is not sufficient for such purposes. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A78 Obtaining an understanding of an entity's controls is not sufficient to test their operating effectiveness, unless some automation provides for the consistent operation of the controls. For example, obtaining audit evidence about the implementation of a manual control at a point in time does not provide audit evidence about the operating effectiveness of the control at other times during the period under audit. However, because of the inherent consistency of IT processing (see paragraph .A64), performing audit procedures to determine whether an automated control has been implemented may serve as a test of that control's operating effectiveness, depending on the auditor's assessment and testing of controls, such as those over program changes. Tests of the operating effectiveness of controls are further described in section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.¹² [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Components of Internal Control — Control Environment (Ref: par. .15)

.A79 The control environment includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A80 Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

¹² Paragraphs .08–.17 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

- a. *Communication and enforcement of integrity and ethical values.* Essential elements that influence the effectiveness of the design, administration, and monitoring of controls.
- b. *Commitment to competence.* Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
- c. *Participation by those charged with governance.* Attributes of those charged with governance, such as
 - i. their independence from management.
 - ii. their experience and stature.
 - iii. the extent of their involvement and the information they receive and the scrutiny of activities.
 - iv. the appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management.
 - v. their interaction with internal and external auditors.
- d. *Management's philosophy and operating style.* Characteristics such as management's
 - i. approach to taking and managing business risks.
 - ii. attitudes and actions toward financial reporting.
 - iii. attitudes toward information processing and accounting functions and personnel.
- e. *Organizational structure.* The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
- f. *Assignment of authority and responsibility.* Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.
- g. *Human resource policies and practices.* Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counseling, promotion, compensation, and remedial actions.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A81 *Audit evidence for elements of the control environment.* Relevant audit evidence may be obtained through a combination of inquiries and other risk assessment procedures, such as corroborating inquiries through observation or inspection of documents. For example, through inquiries of management and employees, the auditor may obtain an understanding of how management communicates to employees management's views on business practices and ethical behavior. The auditor may then determine whether relevant controls have been implemented by considering, for example, whether management has a written code of conduct and whether it acts in a manner that supports the code. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A82 The auditor may also consider how management has responded to the findings and recommendations of the internal audit function regarding identified deficiencies in internal control relevant to the audit, including whether and how such responses have been implemented and whether they have been subsequently evaluated by the internal audit function. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15,

2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

A83 *Effect of the control environment on the assessment of the risks of material misstatement.* Some elements of an entity's control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity's control consciousness is influenced significantly by those charged with governance because one of their roles is to counterbalance pressures on management regarding financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment with regard to participation by those charged with governance is therefore influenced by such matters as

- their independence from management and their ability to evaluate the actions of management.
- whether they understand the entity's business transactions.
- the extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, including whether the financial statements include adequate disclosures.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

A84 An active and independent board of directors may influence the philosophy and operating style of senior management. However, other elements may be more limited in their effect. For example, although human resource policies and practices directed toward hiring competent financial, accounting, and IT personnel may reduce the risk of errors in processing financial information, they may not mitigate a strong bias by top management to overstate earnings. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

A85 The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud. Conversely, deficiencies in the control environment may undermine the effectiveness of controls, particularly with regard to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or data or unauthorized transactions to be processed. As explained in section 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.¹³ [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

A86 The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and, thereby, the auditor's assessment of the risks of material misstatement. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

¹³ Paragraph .A2 of section 330. [Footnote renumbered by the issuance of SAS No. 128, January 2015.]

.A87 *Considerations specific to smaller, less complex entities.* The control environment within smaller entities is likely to differ from larger entities. For example, those charged with governance in smaller entities may not include an independent or outside member, and the role of governance may be undertaken directly by the owner-manager when no other owners exist. The nature of the control environment also may influence the significance of other controls or their absence. For example, the active involvement of an owner-manager may mitigate certain risks arising from a lack of segregation of duties in a small entity; however, it may increase other risks (for example, the risk of override of controls). [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A88 In addition, audit evidence for elements of the control environment in smaller entities may not be available in documentary form, in particular when communication between management and other personnel may be informal, yet effective. For example, smaller entities might not have a written code of conduct but, instead, develop a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A89 Consequently, the attitudes, awareness, and actions of management or the owner-manager are of particular importance to the auditor's understanding of a smaller entity's control environment. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Components of Internal Control — The Entity's Risk Assessment Process (Ref: par. 16)

.A90 An entity's risk assessment process for financial reporting purposes is its identification, analysis, and management of risks relevant to the preparation and fair presentation of financial statements. If that process is appropriate to the circumstances, including the nature, size, and complexity of the entity, it assists the auditor in identifying risks of material misstatement. For example, risk assessment may address how the entity considers the possibility of unrecorded transactions or identifies and analyzes significant estimates recorded in the financial statements. Risks relevant to reliable financial reporting also relate to specific events or transactions. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of professional judgment. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A91 Risks relevant to financial reporting include external and internal events and circumstances that may occur and adversely affect an entity's ability to initiate, authorize, record, process, and report financial data consistent with the assertions of management in the financial statements. Risks can arise or change due to circumstances such as the following:

- Changes in operating environment
- New personnel
- New or revamped information systems
- Rapid growth
- New technology
- New business models, products, or activities

- Corporate restructurings
- Expanded foreign operations
- New accounting pronouncements
- Changes in economic conditions

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A92 *Considerations specific to smaller, less complex entities (Ref: par. 18).* A smaller entity is unlikely to have an established risk assessment process in place. In such cases, it is likely that management will identify risks through direct personal involvement in the business. Irrespective of the circumstances, however, inquiry about identified risks and how they are addressed by management is still necessary. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Components of Internal Control — The Information System, Including Related Business Processes Relevant to Financial Reporting and Communication

.A93 *The information system, including related business processes relevant to financial reporting (Ref: par. 19).* The information system relevant to financial reporting objectives, which includes the accounting system, consists of the procedures and records designed and established to

- initiate, authorize, record, process, and report entity transactions (as well as events and conditions) and maintain accountability for the related assets, liabilities, and equity;
- resolve incorrect processing of transactions (for example, automated suspense files and procedures followed to clear suspense items out on a timely basis);
- process and account for system overrides or bypasses to controls;
- transfer information from transaction processing systems to the general ledger;
- capture information relevant to financial reporting for events and conditions other than transactions, such as the depreciation and amortization of assets and changes in the recoverability of accounts receivables; and
- ensure information required to be disclosed by the applicable financial reporting framework is accumulated, recorded, processed, summarized, and appropriately reported in the financial statements.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A94 Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information may include the following:

- Information obtained from lease agreements disclosed in the financial statements, such as renewal options or future lease payments
- Information disclosed in the financial statements that is produced by an entity's risk management system
- Fair value information produced by management's experts and disclosed in the financial statements

- Information disclosed in the financial statements that has been obtained from models or from other calculations used to develop estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as the following:
 - Assumptions developed internally that may affect an asset's useful life
 - Data, such as interest rates, that are affected by factors outside the control of the entity
- Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions
- Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records
- Information disclosed in the financial statements that has been obtained from analyses prepared to support management's evaluation of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that raise substantial doubt about the entity's ability to continue as a going concern¹⁴

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

.A95 The understanding of the information system relevant to financial reporting required by paragraph .19 of this section (including the understanding of relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers) is a matter of the auditor's professional judgment. For example, certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system and uses professional judgment in determining the necessary understanding. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A96 *Journal entries.* An entity's information system typically includes the use of standard journal entries that are required on a recurring basis to record transactions. Examples might be journal entries to record sales, purchases, and cash disbursements in the general ledger or to record accounting estimates that are periodically made by management, such as changes in the estimate of uncollectible accounts receivable. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A97 An entity's financial reporting process also includes the use of non-standard journal entries to record nonrecurring, unusual transactions or adjustments. Examples of such entries include consolidating adjustments and entries for a business combination or disposal or nonrecurring estimates, such as the impairment of an asset. In manual general ledger systems, nonstandard journal entries may be identified through inspection of ledgers, journals, and supporting documentation. When automated procedures are used to maintain

¹⁴ See paragraphs .21–.22 of section 570. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

the general ledger and prepare financial statements, such entries may exist only in electronic form and may, therefore, be more easily identified through the use of computer assisted audit techniques. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A98 *Related business processes.* An entity's business processes are the activities designed to

- develop, purchase, produce, sell, and distribute an entity's products and services;
- ensure compliance with laws and regulations; and
- record information, including accounting and financial reporting information.

Business processes result in the transactions that are recorded, processed, and reported by the information system. Obtaining an understanding of the entity's business processes, which includes how transactions are originated, assists the auditor to obtain an understanding of the entity's information system relevant to financial reporting in a manner that is appropriate to the entity's circumstances. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A99 *Considerations specific to smaller, less complex entities (Ref: par. .19).* The information system, and related business processes, relevant to financial reporting in smaller entities, including relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers, is likely to be less sophisticated than in larger entities, but its role is just as significant. Smaller entities with active management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity's information system relevant to financial reporting may therefore be easier in an audit of smaller entities and may be more dependent on inquiry than on review of documentation. The need to obtain an understanding, however, remains important. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A100 *Communication (Ref: par. .20).* Communication by the entity of the financial reporting roles and responsibilities and significant matters relating to financial reporting involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting. It includes such matters as the extent to which personnel understand how their activities in the financial reporting information system relate to the work of others and the means of reporting exceptions to an appropriate higher level within the entity. Communication may take such forms as policy manuals and financial reporting manuals. Open communication channels help ensure that exceptions are reported and acted on. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A101 *Considerations specific to smaller, less complex entities.* Communication may be less structured and easier to achieve in a smaller entity than in a larger entity due to fewer levels of responsibility and management's greater visibility and availability. [Paragraph renumbered by the issuance of SAS

No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Components of Internal Control — Control Activities (Ref: par. .21)

.A102 Control activities are the policies and procedures that help ensure that management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organizational and functional levels. Examples of specific control activities include those relating to the following:

- Authorization
- Performance reviews
- Information processing
- Physical controls
- Segregation of duties

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A103 Control activities that are relevant to the audit are those that are

- required to be treated as such, being control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, as required by paragraphs .30–.31, respectively, or
- considered to be relevant in the professional judgment of the auditor.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A104 The auditor's professional judgment about whether a control activity is relevant to the audit is influenced by the risk that the auditor has identified that may give rise to a material misstatement and whether the auditor thinks it is likely to be appropriate to test the operating effectiveness of the control in determining the extent of substantive testing. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A105 The auditor's emphasis may be on identifying and obtaining an understanding of control activities that address the areas in which the auditor considers that risks of material misstatement are likely to be higher. When multiple control activities each achieve the same objective, it is unnecessary to obtain an understanding of each of the control activities related to such objective. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Components of Internal Control — Control Activities (Ref: par. .21)

.A106 Control activities relevant to the audit may include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework, in addition to controls that address risks related to account balances and transactions. Such control activities may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A107 The auditor's knowledge about the presence or absence of control activities obtained from the understanding of the other components of internal control assists the auditor in determining whether it is necessary to devote additional attention to obtaining an understanding of control activities. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A108 *Considerations specific to smaller, less complex entities.* The concepts underlying control activities in smaller entities are likely to be similar to those in larger entities, but the formality with which they operate may vary. Further, smaller entities may find that certain types of control activities are not relevant because of controls applied by management. For example, management's sole authority for granting credit to customers and approving significant purchases can provide strong control over important account balances and transactions, lessening or removing the need for more detailed control activities. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A109 Control activities relevant to the audit of a smaller entity are likely to relate to the main transaction cycles, such as revenues, purchases, and employment expenses. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A110 *Risks arising from IT (Ref: par. .22).* The use of IT affects the way that control activities are implemented. From the auditor's perspective, controls over IT systems are effective when they maintain the integrity of information and the security of the data such systems process and when they include effective general IT controls and application controls. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A111 *General IT controls* are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments. General IT controls that maintain the integrity of information and security of data commonly include controls over the following:

- Data center and network operations
- System software acquisition, change, and maintenance
- Program change
- Access security
- Application system acquisition, development, and maintenance

They are generally implemented to deal with the risks referred to in paragraph .A65. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A112 Although ineffective general IT controls do not by themselves cause misstatements, they may permit application controls to operate improperly and allow misstatements to occur and not be detected. For example, if deficiencies in the general IT controls over access security exist and applications are relying on these general controls to prevent unauthorized transactions from being processed, such general IT control deficiencies may have a more severe effect on the effective design and operation of the application control. General IT controls are assessed with regard to their effect on applications and data that become part of the financial statements. For example, if no new systems are implemented

during the period of the financial statements, deficiencies in the general IT controls over application system acquisition and development may not be relevant to the financial statements being audited. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A113 *Application controls* are manual or automated procedures that typically operate at a business process level and apply to the processing of transactions by individual applications. Application controls can be preventive or detective and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, authorize, record, process, and report transactions or other financial data. These controls help ensure that transactions occurred, are authorized, and are completely and accurately recorded and processed. Examples include edit checks of input data and numerical sequence checks with manual follow-up of exception reports or correction at the point of data entry. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Components of Internal Control — Monitoring of Controls (Ref: par. .23)

.A114 Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities often are built into the normal recurring activities of an entity and include regular management and supervisory activities. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A115 *Considerations specific to smaller, less complex entities.* Management's monitoring of controls often is accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A116 *Internal audit function (Ref: par. .24).* If the entity has an internal audit function, obtaining an understanding of that function contributes to the external auditor's understanding of the entity and its environment, including internal control; this also includes the role that the function plays in the entity's monitoring of internal control over financial reporting. This understanding, together with the information obtained from the external auditor's inquiries in paragraph .06a, may also provide information that is directly relevant to the external auditor's identification and assessment of the risks of material misstatement. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A117 The entity's internal audit function is likely to be relevant to the audit if the nature of the internal audit function's responsibilities and activities are related to the entity's financial reporting, and the auditor expects to use the work of the internal auditors to modify the nature or timing or reduce the extent of audit procedures to be performed. If the auditor determines that the internal audit function is likely to be relevant to the audit, section 610, *Using the Work of Internal Auditors*, applies. [Paragraph renumbered and amended, effective

for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A118 The objectives and scope of an internal audit function and therefore, the nature of its responsibilities and its status within the organization, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. These matters may be set out in an internal audit charter or terms of reference. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A119 The responsibilities of an internal audit function may include performing procedures and evaluating the results to provide assurance to management and those charged with governance regarding the design and effectiveness of risk management, internal control, and governance processes. The internal audit function may play an important role in the entity's monitoring of internal control over financial reporting. However, the responsibilities of the internal audit function may be focused on evaluating the economy, efficiency, and effectiveness of operations and, if so, the work of the function may not directly relate to the entity's financial reporting. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A120 The external auditor's inquiries of appropriate individuals within the internal audit function, in accordance with paragraph .06a, help the external auditor obtain an understanding of the nature of the internal audit function's responsibilities. If the external auditor determines that the function's responsibilities are related to the entity's financial reporting, the external auditor may obtain further understanding of the activities performed, or to be performed, by the internal audit function by reviewing the internal audit function's audit plan for the period, if any, and discussing that plan with the appropriate individuals within the function. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A121 If the nature of the internal audit function's responsibilities and assurance activities is related to the entity's financial reporting, the external auditor may be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor in obtaining audit evidence. External auditors may be more likely to use the work of an entity's internal audit function when it appears, for example, based on experience in previous audits or the external auditor's risk assessment procedures, that the entity has an internal audit function that is adequately and appropriately resourced relative to the size of the entity and the nature of its operations and has a direct reporting relationship to those charged with governance. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A122 If, based on the external auditor's preliminary understanding of the internal audit function, the external auditor expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed, section 610 applies. [Paragraph added,

effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A123 As is further discussed in section 610, the activities of an internal audit function are distinct from other monitoring controls that may be relevant to financial reporting, such as reviews of management accounting information that are designed to contribute to how the entity prevents or detects misstatements. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A124 Establishing communications with the appropriate individuals within an entity's internal audit function early in the engagement, and maintaining such communications throughout the engagement, can facilitate effective sharing of information. It creates an environment in which the external auditor can be informed of significant matters that may come to the attention of the internal audit function when such matters may affect the work of the external auditor. Section 200 addresses the importance of the external auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring such information to the external auditor's attention. The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A125 *Sources of information (Ref: par. .25).* Much of the information used in monitoring may be produced by the entity's information system. If management assumes that data used for monitoring are accurate without having a basis for that assumption, errors that may exist in the information could potentially lead management to incorrect conclusions from its monitoring activities. Accordingly, an understanding of the following is required as part of the auditor's understanding of the entity's monitoring activities component of internal control:

- The sources of the information related to the entity's monitoring activities
- The basis upon which management considers the information to be sufficiently reliable for the purpose

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Identifying and Assessing the Risks of Material Misstatement

Assessment of Risks of Material Misstatement at the Financial Statement Level (Ref: par. .26a)

.A126 Risks of material misstatement at the financial statement level refer to risks that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement at the assertion level (for example,

through management override of internal control). Financial statement level risks may be especially relevant to the auditor's consideration of the risks of material misstatement arising from fraud. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A127 Risks at the financial statement level may derive, in particular, from a deficient control environment (although these risks also may relate to factors such as declining economic conditions). For example, deficiencies such as a lack of management competence or a lack of oversight over the preparation and fair presentation of the financial statements may have a more pervasive effect on the financial statements and may require an overall response by the auditor. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A128 The auditor's understanding of internal control may raise doubts about the auditability of an entity's financial statements. For example

- concerns about the integrity of the entity's management may be so serious to cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted.
- concerns about the condition and reliability of an entity's records may cause the auditor to conclude that it is unlikely that sufficient appropriate audit evidence will be available to support an unmodified opinion on the financial statements.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A129 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, addresses the determination of whether a need exists for the auditor to express a qualified or adverse opinion or disclaim an opinion or, as may be required in some cases, to withdraw from the engagement when withdrawal is possible under applicable law or regulation. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Assessment of Risks of Material Misstatement at the Relevant Assertion Level (Ref: par. .26b)

.A130 Risks of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the relevant assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many relevant assertions. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

The Use of Assertions

.A131 In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding recognition, measurement, and presentation of classes of transactions and events, account balances, and disclosures. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph

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

.A132 The auditor may use the assertions as described in paragraph .A133a–b or may express them differently, provided that all aspects described in paragraph .A133 have been covered. For example, the auditor may choose to combine the assertions about classes of transactions and events, and related disclosures, with the assertions about account balances, and related disclosures. As another example, there may not be a separate assertion related to cutoff of transactions and events when the occurrence and completeness assertions include appropriate consideration of recording transactions in the correct accounting period. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Assertions About Classes of Transactions, Account Balances, and Related Disclosures

.A133 Assertions used by the auditor in considering the different types of potential misstatements that may occur may fall into the following categories:

- a. Assertions about classes of transactions and events, and related disclosures, for the period under audit, such as the following
 - i. *Occurrence*. Transactions and events that have been recorded or disclosed have occurred, and such transactions and events pertain to the entity.
 - ii. *Completeness*. All transactions and events that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.
 - iii. *Accuracy*. Amounts and other data relating to recorded transactions and events have been recorded appropriately, and related disclosures have been appropriately measured and described.
 - iv. *Cutoff*. Transactions and events have been recorded in the correct accounting period.
 - v. *Classification*. Transactions and events have been recorded in the proper accounts.
 - vi. *Presentation*. Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.
- b. Assertions about account balances, and related disclosures, at the period end, such as the following:
 - i. *Existence*. Assets, liabilities, and equity interests exist.
 - ii. *Rights and obligations*. The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - iii. *Completeness*. All assets, liabilities, and equity interests that should have been recorded have been recorded, and all related disclosures that should have been included in the financial statements have been included.

- iv. *Accuracy, valuation and allocation.* Assets, liabilities, and equity interests have been included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments have been appropriately recorded, and related disclosures have been appropriately measured and described.
- v. *Classification.* Assets, liabilities, and equity interests have been recorded in the proper accounts.
- vi. *Presentation.* Assets, liabilities, and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Assertions About Other Disclosures

.A134 The assertions described in paragraph .A133a–b, adapted as appropriate, may also be used by the auditor in considering the different types of potential misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. As an example of such a disclosure, the entity may be required to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies, and processes for managing the risks; and the methods used to measure the risks. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Relevant Assertions

.A135 The auditor is required by paragraph .26b to use relevant assertions for classes of transactions, account balances, and disclosures in sufficient detail to form a basis for the assessment of risks of material misstatement and the design and performance of further audit procedures. The auditor also is required to use relevant assertions in assessing risks by relating the identified risks to what can go wrong at the relevant assertion, taking account of relevant controls that the auditor intends to test, and designing further audit procedures that are responsive to the assessed risks. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A136 *Relevant assertions* are assertions that have a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated and, as such, are assertions that have a meaningful bearing on whether the account is fairly stated. Not all assertions pertaining to a particular account balance will always be relevant. For example, valuation may not be relevant to the cash account unless currency translation is involved; however, existence and completeness are always relevant. Similarly, valuation may not be relevant to the gross amount of the accounts receivable balance but is relevant to the related allowance accounts. Additionally, the auditor might, in some circumstances, focus on the presentation and disclosure assertions separately in connection with the period-end financial reporting process. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A137 For each significant class of transactions, account balance, and disclosure, the auditor is required to determine the relevance of each of the financial statement assertions. Identifying relevant assertions includes determining the source of likely potential misstatements in each significant class of transactions, account balance, and disclosure. Attributes indicating the potential relevance of an assertion include the

- a. nature of the assertion;
- b. volume of transactions or data related to the assertion; and
- c. nature and complexity of the systems, including the use of IT, by which the entity processes and controls information supporting the assertion.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities

.A138 When making assertions about the financial statements of governmental entities, in addition to those assertions set out in paragraph .A133, management asserts that transactions and events have been carried out in accordance with law or regulation. Such assertions may fall within the scope of the financial statement audit. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Process of Identifying Risks of Material Misstatement (Ref: par. .27a)

.A139 Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing, and extent of further audit procedures to be performed. In identifying the risks of material misstatement in the financial statements, the auditor exercises professional skepticism in accordance with section 200.¹⁵ [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A140 Appendix C provides examples of conditions and events that may indicate the existence of risks of material misstatement, including risks of material misstatement relating to disclosures. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A141 As explained in section 320,¹⁶ materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances, and disclosures. The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial reporting needs of users of the financial statements.¹⁷ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁵ Paragraph .17 of section 200. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁶ Paragraph .A1 of section 320. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁷ Paragraph .04 of section 320. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A142 The auditor's consideration of disclosures in the financial statements when identifying risks includes quantitative and qualitative disclosures, the misstatement of which could be material (in general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements). Depending on the circumstances of the entity and the engagement, examples of disclosures that will have qualitative aspects and that may be relevant when assessing the risks of material misstatement include disclosures about the following:

- Liquidity and debt covenants of an entity in financial distress
- Events or circumstances that have led to the recognition of an impairment loss
- Key sources of estimation uncertainty, including assumptions about the future
- The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, when, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity
- Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures
- Related parties and related party transactions
- Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Revised, October 2021, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

Considerations Specific to Smaller Entities

.A143 Disclosures in the financial statements of smaller entities may be less detailed or less complex (for example, some financial reporting frameworks allow smaller entities to provide fewer disclosures in the financial statements). However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment, including internal control, as it relates to disclosures. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Relating Controls to Assertions (Ref: par. .27c)

.A144 In making risk assessments, the auditor may identify the controls that are likely to prevent, or detect and correct, material misstatement in specific assertions. Generally, it is useful to obtain an understanding of controls and relate them to assertions in the context of processes and systems in which they exist because individual control activities often do not in themselves address a risk. Often, only multiple control activities, together with other components of internal control, will be sufficient to address a risk. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A145 Conversely, some control activities may have a specific effect on an individual assertion embodied in a particular class of transactions, account

balance, or disclosure. For example, the control activities that an entity established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the existence and completeness assertions for the inventory account balance. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A146 Controls can be either directly or indirectly related to an assertion. The more indirect the relationship, the less effective that control may be in preventing, or detecting and correcting, misstatements in that assertion. For example, a sales manager's review of a summary of sales activity for specific stores by region ordinarily is only indirectly related to the completeness assertion for sales revenue. Accordingly, it may be less effective in reducing risk for that assertion than controls more directly related to that assertion, such as matching shipping documents with billing documents. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Material Misstatements (Ref: par. .27d)

.A147 Potential misstatements in individual statements and disclosures may be judged to be material due to size, nature, or circumstances. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Significant Risks

Identifying Significant Risks (Ref: par. .28–.29)

.A148 Significant risks often relate to significant unusual transactions and matters that require significant judgment. Matters that require significant judgment may include the development of accounting estimates for which a significant measurement uncertainty exists. Routine, noncomplex transactions that are subject to systematic processing are less likely to give rise to significant risks. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A149 Risks of material misstatement may be greater for significant unusual transactions arising from matters such as the following:

- Greater management intervention to specify the accounting treatment
- Greater manual intervention for data collection and processing
- Complex calculations or accounting principles
- The nature of unusual transactions, which may make it difficult for the entity to implement effective controls over the risks
- Related party transactions

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A150 Risks of material misstatement may be greater for matters that require significant judgment, such as the development of accounting estimates, arising from matters such as the following:

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex or it may require assumptions about the effects of future events (for example, judgment about fair value).

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A151 Section 330 describes the consequences for further audit procedures of identifying a risk as significant.¹⁸ [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Significant Risks Relating to the Risks of Material Misstatement Due to Fraud

.A152 Section 240 further addresses the identification and assessment of the risks of material misstatement due to fraud. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Understanding Controls Related to Significant Risks (Ref: par. .30)

.A153 Although risks relating to significant unusual transactions or matters that require significant judgment are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from unusual transactions or matters that require significant judgment includes whether and how management responds to the risks. Such responses might include

- control activities, such as a review of assumptions by senior management or specialists.
- documented processes for estimations.
- approval by those charged with governance.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A154 For example, when nonrecurring events occur, such as the receipt of notice of a significant lawsuit, consideration of the entity's response may include such matters as whether it has been referred to appropriate specialists (for example, internal or external legal counsel), whether an assessment has been made of the potential effect, and how it is proposed that the circumstances are to be disclosed in the financial statements. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A155 In some cases, management may not have appropriately responded to significant risks of material misstatement by implementing controls over these significant risks. Failure by management to implement such controls may be a significant deficiency or a material weakness. In these circumstances, the auditor also may consider the implications for the auditor's risk assessment. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

¹⁸ Paragraphs .15 and .22 of section 330. [Footnote renumbered by the issuance of SAS No. 128, January 2015. Footnote subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Risks for Which Substantive Procedures Alone Do Not Provide Sufficient Appropriate Audit Evidence (Ref: par. .31)

.A156 Risks of material misstatement may relate directly to the recording of routine classes of transactions or account balances and the preparation of reliable financial statements. Such risks may include risks of inaccurate or incomplete processing for routine and significant classes of transactions, such as an entity's revenue; purchases; and cash receipts or cash payments. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A157 When such routine business transactions are subject to highly automated processing with little or no manual intervention, it may not be possible to perform only substantive procedures regarding the risk. For example, the auditor may consider this to be the case when a significant amount of an entity's information is initiated, authorized, recorded, processed, or reported only in electronic form, such as in an integrated system. In such cases

- audit evidence may be available only in electronic form, and its sufficiency and appropriateness usually depend on the effectiveness of controls over its accuracy and completeness.
- the potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A158 Examples of situations in which the auditor may find it impossible to design effective substantive procedures that, by themselves, provide sufficient appropriate audit evidence that certain relevant assertions are not materially misstated include the following:

- An entity that conducts its business using IT to initiate orders for the purchase and delivery of goods based on predetermined rules of what to order and in what quantities and to pay the related accounts payable based on system-generated decisions initiated upon the confirmed receipt of goods and terms of payment. No other documentation of orders placed or goods received is produced or maintained, other than through the IT system.
- An entity that provides services to customers via electronic media (for example, an Internet service provider or a telecommunications company) and uses IT to create a log of the services provided to its customers, initiate and process its billings for the services, and automatically record such amounts in electronic accounting records that are part of the system used to produce the entity's financial statements.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A159 The consequences for further audit procedures of identifying such risks are described in section 330.¹⁹ [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

¹⁹ Paragraph .08 of section 330. [Footnote renumbered by the issuance of SAS No. 128, January 2015. Footnote subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Revision of Risk Assessment (Ref: par. .32)

.A160 During the audit, information may come to the auditor's attention that differs significantly from the information on which the risk assessment was based. For example, the risk assessment may be based on an expectation that controls are operating effectively. In performing tests of controls, the auditor may obtain audit evidence that they were not operating effectively at relevant times during the audit. Similarly, in performing substantive procedures, the auditor may detect misstatements in amounts or frequency greater than is consistent with the auditor's risk assessment. In such circumstances, the risk assessment may not appropriately reflect the true circumstances of the entity, and the further planned audit procedures may not be effective in detecting material misstatements. See section 330 for further guidance. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .33)

.A161 The manner in which the requirements of paragraph .33 are documented is for the auditor to determine exercising professional judgment. For example, in audits of smaller entities, the documentation may be incorporated in the auditor's documentation of the overall strategy and audit plan.²⁰ Similarly, the results of the risk assessment may be documented separately, or they may be documented as part of the auditor's documentation of further audit procedures.²¹ The form and extent of the documentation is influenced by the nature, size, and complexity of the entity and its internal control; availability of information from the entity; and the audit methodology and technology used in the course of the audit. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A162 For entities that have uncomplicated businesses and processes relevant to financial reporting, the documentation may be simple and relatively brief. It is not necessary to document the entirety of the auditor's understanding of the entity and matters related to it. Key elements of the understanding documented by the auditor include those on which the auditor based the assessment of the risks of material misstatement. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A163 The extent of documentation also may reflect the experience and capabilities of the members of the audit engagement team. Provided that the requirements of section 230, *Audit Documentation*, are met, an audit undertaken by an engagement team comprising less experienced individuals may contain more detailed documentation to assist them to obtain an appropriate understanding of the entity than one that includes experienced individuals. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

²⁰ Paragraphs .07–.09 of section 300, *Planning an Audit*. [Footnote renumbered by the issuance of SAS No. 128, January 2015. Footnote subsequently renumbered by the issuance of SAS No. 134, May 2019.]

²¹ Paragraph .30 of section 330. [Footnote renumbered by the issuance of SAS No. 128, January 2015. Footnote subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A164 For recurring audits, certain documentation may be carried forward and updated as necessary to reflect changes in the entity's business or processes. [Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

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Appendix A—Understanding the Entity and Its Environment (Ref: par. .A25)

This appendix provides additional guidance on matters the auditor may consider when obtaining an understanding of the industry and regulatory and other external factors that affect the entity, the nature of the entity, objectives and strategies and related business risks, and the measurement and review of the entity's financial performance. The examples provided cover a broad range of matters applicable to many engagements; however, not all matters are relevant to every engagement, and the list of examples is not necessarily complete. Additional guidance on internal control is contained in appendix B, "Internal Control Components."

Industry, Regulatory, and Other External Factors

Examples of matters an auditor may consider include the following:

- Industry conditions, such as the following:
 - The market and competition, including demand, capacity, and price competition
 - Cyclical or seasonal activity
 - Product technology relating to the entity's products
 - Supply availability and cost
- Regulatory environment, such as the following:
 - Accounting principles and industry-specific practices
 - Regulatory framework for a regulated industry
 - Legislation and regulation that significantly affect the entity's operations, such as the following:
 - Regulatory requirements
 - Direct supervisory activities
 - Taxation (corporate and other)
 - Government policies currently affecting the conduct of the entity's business, such as the following:
 - Monetary, including foreign exchange controls
 - Fiscal
 - Financial incentives (for example, government aid programs)
 - Tariffs and trade restrictions
 - Environmental requirements affecting the industry and the entity's business
- Other external factors currently affecting the entity's business, such as the following:
 - General level of economic activity (for example, recession, growth, and so on)
 - Interest rates and availability of financing
 - Inflation and currency revaluation

Nature of the Entity

Examples of matters an auditor may consider include the following:

- Business operations, such as the following:
 - Nature of revenue sources (for example, manufacturer; wholesaler; banking, insurance, or other financial services; import-export trading; utility; transportation; and technology products and services)
 - Products or services and markets (for example, major customers and contracts, terms of payment, profit margins, market share, competitors, exports, pricing policies, reputation of products, warranties, backlog, trends, marketing strategy and objectives, and manufacturing processes)
 - Conduct of operations (for example, stages and methods of production, subsidiaries or divisions, delivery of products and services, and details of declining or expanding operations)
 - Alliances, joint ventures, and outsourcing activities
 - Involvement in e-commerce, including Internet sales and marketing activities
 - Geographic dispersion and industry segmentation
 - Location of production facilities, warehouses, and offices
 - Key customers
 - Important suppliers of goods and services (for example, long term contracts, stability of supply, terms of payment, imports, and methods of delivery, such as "just-in-time")
 - Employment (for example, by location, supply, wage levels, union contracts, pension and other postemployment benefits, stock option or incentive bonus arrangements, and government regulation related to employment matters)
 - Research and development activities and expenditures
 - Transactions with related parties
- Investments, such as the following:
 - Acquisitions, mergers, or disposals of business activities (planned or recently executed)
 - Investments and dispositions of securities and loans
 - Capital investment activities, including investments in plant and equipment and technology and any recent or planned changes
 - Investments in nonconsolidated entities, including partnerships, joint ventures, and investments in entities formed to accomplish specific objectives
 - Life cycle stage of enterprise (start-up, growing, mature, declining)

- Financing, such as the following:
 - Group structure of major subsidiaries and associated entities, including consolidated and nonconsolidated structures
 - Debt structure, including covenants, restrictions, guarantees, and off balance sheet financing arrangements
 - Leasing of property, plant, or equipment for use in the business
 - Beneficial owners (local and foreign business reputation and experience)
 - Related parties
 - Use of derivative financial instruments
- Financial reporting, such as the following:
 - Accounting principles and industry-specific practices
 - Revenue recognition practices
 - Accounting for fair values
 - Inventories (for example, locations and quantities)
 - Foreign currency assets, liabilities, and transactions
 - Industry-specific significant categories (for example, loans and investments for banks, accounts receivable and inventory for manufacturers, research and development for pharmaceuticals)
 - Accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for stock-based compensation)
 - Financial statement presentation and disclosure

Objectives and Strategies and Related Business Risks

Examples of matters an auditor may consider include the following:

- Existence of objectives (that is, how the entity addresses industry, regulatory, and other external factors) relating to, for example, the following matters:
 - Industry developments (a potential related business risk might be, for example, the entity does not have the personnel or expertise to deal with the changes in the industry)
 - New products and services (a potential related business risk might be, for example, product liability has increased)
 - Expansion of the business (a potential related business risk might be, for example, the demand has not been accurately estimated)
 - New accounting requirements (a potential related business risk might be, for example, incomplete or improper implementation or increased costs)
 - Regulatory requirements (a potential related business risk might be, for example, legal exposure has increased)

- Current and prospective financing requirements (a potential related business risk might be, for example, the entity's inability to meet requirements results in the loss of financing)
- IT (a potential related business risk might be, for example, systems and processes are not compatible)
- Risk appetite of managers and stakeholders
- Effects of implementing a strategy, particularly any effects that will lead to new accounting requirements (a potential related business risk might be, for example, implementation is incomplete or improper)

Measurement and Review of the Entity's Financial Performance

Examples of matters an auditor may consider include the following:

- Key ratios and operating statistics
- Key performance indicators
- Employee performance measures and incentive compensation policies
- Trends
- Use of forecasts, budgets, and variance analysis
- Analyst reports and credit rating reports
- Competitor analysis
- Period-on-period financial performance (revenue growth, profitability, and leverage)

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

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Appendix B—Internal Control Components (Ref: par. .04, .15–.25, and .A79–.A125)

This appendix further explains the components of internal control, as set out in paragraphs .04, .15–.25, and .A79–.A125, as they relate to a financial statement audit.

Control Environment

The control environment encompasses the following elements:

- a. *Communication and enforcement of integrity and ethical values.* The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behavior are the products of the entity's ethical and behavioral standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of behavioral standards to personnel through policy statements and codes of conduct and by example.
- b. *Commitment to competence.* *Competence* is the knowledge and skills necessary to accomplish tasks that define the individual's job.
- c. *Participation by those charged with governance.* An entity's control consciousness is influenced significantly by those charged with governance. The importance of the responsibilities of those charged with governance is recognized in codes of practice and other laws and regulations or guidance produced for the benefit of those charged with governance. Other responsibilities of those charged with governance include oversight of the design and effective operation of whistle-blower procedures and the process for reviewing the effectiveness of the entity's internal control.
- d. *Management's philosophy and operating style.* Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions toward financial reporting may manifest themselves through conservative or aggressive selection from available alternative accounting principles or conscientiousness and conservatism with which accounting estimates are developed.
- e. *Organizational structure.* Establishing a relevant organizational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organizational structure depends, in part, on its size and the nature of its activities.
- f. *Assignment of authority and responsibility.* The assignment of authority and responsibility may include policies relating to appropriate business practices, knowledge and experience of key personnel, and resources provided for carrying out duties. In addition, it may include policies and communications directed at

ensuring that all personnel understand the entity's objectives, know how their individual actions interrelate and contribute to those objectives, and recognize how and for what they will be held accountable.

- g. *Human resource policies and practices.* Human resource policies and practices often demonstrate important matters regarding the control consciousness of an entity. For example, standards for recruiting the most qualified individuals, with an emphasis on educational background, prior work experience, past accomplishments, and evidence of integrity and ethical behavior, demonstrate an entity's commitment to competent and trustworthy people. Training policies that communicate prospective roles and responsibilities and include practices such as training schools and seminars illustrate expected levels of performance and behavior. Promotions driven by periodic performance appraisals demonstrate the entity's commitment to the advancement of qualified personnel to higher levels of responsibility.

The Entity's Risk Assessment Process

For financial reporting purposes, the entity's risk assessment process includes how management identifies business risks relevant to the preparation and fair presentation of financial statements in accordance with the entity's applicable financial reporting framework, estimates their significance, assesses the likelihood of their occurrence, and decides upon actions to respond to and manage them and the results thereof. For example, the entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyzes significant estimates recorded in the financial statements.

Risks relevant to reliable financial reporting include external and internal events, as well as transactions or circumstances that may occur and adversely affect an entity's ability to initiate, authorize, record, process, and report financial data consistent with the assertions of management in the financial statements. Management may initiate plans, programs, or actions to address specific risks or it may decide to accept a risk because of cost or other considerations. Risks can arise or change due to circumstances such as the following:

- *Changes in operating environment.* Changes in the regulatory or operating environment can result in changes in competitive pressures and significantly different risks.
- *New personnel.* New personnel may have a different focus on, or understanding of, internal control.
- *New or revamped information systems.* Significant and rapid changes in information systems can change the risk relating to internal control.
- *Rapid growth.* Significant and rapid expansion of operations can strain controls and increase the risk of a breakdown in controls.
- *New technology.* Incorporating new technologies into production processes or information systems may change the risk associated with internal control.
- *New business models, products, or activities.* Entering into business areas or transactions with which an entity has little experience may introduce new risks associated with internal control.

- *Corporate restructurings.* Restructurings may be accompanied by staff reductions and changes in supervision and segregation of duties that may change the risk associated with internal control.
- *Expanded foreign operations.* The expansion or acquisition of foreign operations carries new and often unique risks that may affect internal control (for example, additional or changed risks from foreign currency transactions).
- *New accounting pronouncements.* Adoption of new accounting principles or changing accounting principles may affect risks in preparing financial statements.

The Information System, Including the Related Business Processes Relevant to Financial Reporting and Communication

An information system consists of infrastructure (physical and hardware components), software, people, procedures, and data. Many information systems make extensive use of IT.

The information system relevant to financial reporting objectives, which includes the financial reporting system, encompasses methods and records that

- identify and record all valid transactions.
- describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
- measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements.
- determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
- present properly the transactions and related disclosures in the financial statements.

The quality of system-generated information affects management's ability to make appropriate decisions in managing and controlling the entity's activities and to prepare reliable financial reports.

Communication, which involves providing an understanding of individual roles and responsibilities pertaining to internal control over financial reporting, may take such forms as policy manuals, accounting and financial reporting manuals, and memoranda. Communication also can be made electronically, orally, and through the actions of management.

Control Activities

Generally, control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the following:

- *Performance reviews.* These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior-period performance; relating different sets of data (operating or financial) to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.

- *Information processing.* The two broad groupings of information systems control activities are application controls, which apply to the processing of individual applications, and general IT controls, which are policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. Examples of application controls include checking the arithmetical accuracy of records; maintaining and reviewing accounts and trial balances; automated controls, such as edit checks of input data and numerical sequence checks; and manual follow-up of exception reports. Examples of general IT controls are program change controls; controls that restrict access to programs or data; controls over the implementation of new releases of packaged software applications; and controls over system software that restrict access to, or monitor the use of, system utilities that could change financial data or records without leaving an audit trail.
- *Physical controls.* This includes controls that encompass the
 - physical security of assets, including adequate safeguards, such as secured facilities over access to assets and records.
 - authorization for access to computer programs and data files.
 - periodic counting and comparison with amounts shown on control records (for example comparing the results of cash, security, and inventory counts with accounting records).

The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation and, therefore, the audit, depends on circumstances such as when assets are highly susceptible to misappropriation.

- *Segregation of duties.* Assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. Segregation of duties is intended to reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties.

Certain control activities may depend on the existence of appropriate higher level policies established by management or those charged with governance. For example, authorization controls may be delegated under established guidelines, such as investment criteria set by those charged with governance; alternatively, nonroutine transactions, such as major acquisitions or divestments, may require specific high level approval, including, in some cases, that of shareholders.

Monitoring of Controls

An important management responsibility is to establish and maintain internal control on an ongoing basis. Management's monitoring of controls includes considering whether they are operating as intended and that they are modified as appropriate for changes in conditions. Monitoring of controls may include activities such as management's review of whether bank reconciliations are being prepared on a timely basis, internal auditors' evaluation of sales personnel's compliance with the entity's policies on terms of sales contracts, and a legal department's oversight of compliance with the entity's ethical or business practice policies. Monitoring also is done to ensure that controls continue to

operate effectively over time. For example, if the timeliness and accuracy of bank reconciliations are not monitored, personnel are likely to stop preparing them.

Internal auditors or personnel performing similar functions may contribute to the monitoring of an entity's controls through separate evaluations. Ordinarily, they regularly provide information about the functioning of internal control, focusing considerable attention on evaluating the effectiveness of internal control; communicate information about strengths and deficiencies in internal control; and provide recommendations for improving internal control.

Monitoring activities may include using information from communications from external parties that may indicate problems or highlight areas in need of improvement. Customers implicitly corroborate billing data by paying their invoices or complaining about their charges. In addition, regulators may communicate with the entity concerning matters that affect the functioning of internal control (for example, communications concerning examinations by bank regulatory agencies). Also, management may consider communications relating to internal control from external auditors in performing monitoring activities.

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered by the issuance of SAS No. 134, May 2019.]

.A167

Appendix C—Conditions and Events That May Indicate Risks of Material Misstatement (Ref: par. .A41 and .A140)

The following are examples of conditions and events that may indicate the existence of risks of material misstatement in the financial statements. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement, and the list of examples is not necessarily complete.

- Operations in regions that are economically unstable (for example, countries with significant currency devaluation or highly inflationary economies)
- Operations exposed to volatile markets (for example, futures trading)
- Operations that are subject to a high degree of complex regulation
- Going concern and liquidity issues, including loss of significant customers
- Constraints on the availability of capital and credit
- Changes in the industry in which the entity operates
- Changes in the supply chain
- Developing or offering new products or services or moving into new lines of business
- Expanding into new locations
- Changes in the entity, such as large acquisitions or reorganizations or other unusual events
- Entities or business segments likely to be sold
- The existence of complex alliances and joint ventures
- Use of off balance sheet finance, investments in entities formed to accomplish specific objectives, and other complex financing arrangements
- Significant transactions with related parties
- Lack of personnel with appropriate accounting and financial reporting skills
- Changes in key personnel, including departure of key executives
- Deficiencies in internal control, especially those not addressed by management
- Incentives for management and employees to engage in fraudulent financial reporting
- Inconsistencies between the entity's IT strategy and its business strategies
- Changes in the IT environment
- Installation of significant new IT systems related to financial reporting

Risk Assessment and Response to Assessed Risks

- Inquiries into the entity's operations or financial results by regulatory or government bodies
- Past misstatements, history of errors, or a significant amount of adjustments at period-end
- Significant amount of nonroutine or nonsystematic transactions, including intercompany transactions and large revenue transactions at period-end
- Transactions that are recorded based on management's intent (for example, debt refinancing, assets to be sold, and classification of marketable securities)
- Application of new accounting pronouncements
- Accounting measurements that involve complex processes
- Events or transactions that involve significant measurement uncertainty, including accounting estimates, and related disclosures
- Omitting, or obscuring, significant information in disclosures
- Pending litigation and contingent liabilities (for example, sales warranties, financial guarantees, and environmental remediation)

[Paragraph renumbered by the issuance of SAS No. 128, January 2015. Paragraph subsequently renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

AU-C Section 320

Materiality in Planning and Performing an Audit

Source: SAS No. 122; SAS No. 134; SAS No. 138.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. Section 450, *Evaluation of Misstatements Identified During the Audit*, explains how materiality is applied in evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements.

Materiality in the Context of an Audit

.02 Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and fair presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.
- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both.
- judgments about materiality involve both qualitative and quantitative considerations.
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.03 Such a discussion about materiality provides a frame of reference to the auditor in determining materiality for the audit. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .02 provide the auditor with such a frame of reference.

.04 The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements. For purposes of determining materiality, the auditor may assume that reasonable users

- a. have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- b. understand that financial statements are prepared, presented, and audited to levels of materiality;
- c. recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- d. make reasonable judgments based on the information in the financial statements.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.05 The concept of materiality is applied by the auditor both in planning and performing the audit; evaluating the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements; and in forming the opinion in the auditor's report. (Ref: par. .A2)

.06 In planning the audit, the auditor makes judgments about misstatements that will be considered material. These judgments provide a basis for

- a. determining the nature and extent of risk assessment procedures;
- b. identifying and assessing the risks of material misstatement; and
- c. determining the nature, timing, and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. It is not practicable to design audit procedures to detect all misstatements that could be material solely because of their nature (that is, qualitative considerations). However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement.¹ In addition, when evaluating the effect on the financial statements of all uncorrected misstatements, the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence.² (Ref: par. .A1) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Effective Date

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

¹ See paragraphs .A141–.A142 of section 315A, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

² Paragraph .A23 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

Objective

.08 The objective of the auditor is to apply the concept of materiality appropriately in planning and performing the audit.

Definition

.09 For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

Performance materiality. The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, *performance materiality* also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement. (Ref: par. .A3)

Requirements

Determining Materiality and Performance Materiality When Planning the Audit

.10 When establishing the overall audit strategy, the auditor should determine materiality for the financial statements as a whole. If, in the specific circumstances of the entity, one or more particular classes of transactions, account balances, or disclosures exist for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment made by a reasonable user based on the financial statements, the auditor also should determine the materiality level or levels to be applied to those particular classes of transactions, account balances, or disclosures. (Ref: par. .A4–.A14) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.11 The auditor should determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing, and extent of further audit procedures. (Ref: par. .A15)

Revision as the Audit Progresses

.12 The auditor should revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially. (Ref: par. .A16–.A17)

.13 If the auditor concludes that a lower materiality than that initially determined for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) is appropriate, the auditor should determine whether it is necessary to revise performance materiality and whether the nature, timing, and extent of the further audit procedures remain appropriate.

Documentation

.14 The auditor should include in the audit documentation the following amounts and the factors considered in their determination:³

- a. Materiality for the financial statements as a whole (see paragraph .10)
- b. If applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures (see paragraph .10)
- c. Performance materiality (see paragraph .11)
- d. Any revision of (a)–(c) as the audit progressed (see paragraphs .12–.13)

Application and Other Explanatory Material

Materiality in the Context of an Audit (Ref: par. .06)

.A1 Identifying and assessing the risks of material misstatement⁴ involves the use of professional judgment to identify those classes of transactions, account balances, and disclosures, including qualitative disclosures, the misstatement of which could be material (in general, misstatements are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements). When considering whether misstatements in qualitative disclosures could be material, the auditor may identify relevant factors such as the following:

- The circumstances of the entity for the period (For example, the entity may have undertaken a significant business combination during the period.)
- The applicable financial reporting framework, including changes therein (For example, a new financial reporting standard may require new qualitative disclosures that are significant to the entity.)
- Qualitative disclosures that are important to users of the financial statements because of the nature of an entity (For example, liquidity risk disclosures may be important to users of the financial statements for a financial institution.)

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Revised, April 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

Materiality and Audit Risk (Ref: par. .05)

.A2 In conducting an audit of financial statements, the overall objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether

³ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

⁴ Paragraph .26 of section 315A requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion levels. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework and to report on the financial statements and communicate, as required by GAAS, in accordance with the auditor's findings.⁵ The auditor obtains reasonable assurance by obtaining sufficient appropriate audit evidence to reduce audit risk to an acceptably low level.⁶ *Audit risk* is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.⁷ Materiality and audit risk are considered throughout the audit, in particular, when

- a. determining the nature and extent of risk assessment procedures to be performed;
- b. identifying and assessing the risks of material misstatement;⁸
- c. determining the nature, timing, and extent of further audit procedures;⁹ and
- d. evaluating the effect of uncorrected misstatements, if any, on the financial statements¹⁰ and in forming the opinion in the auditor's report.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Definition (Ref: par. .09)

.A3 *Tolerable misstatement* is the application of performance materiality to a particular sampling procedure. Section 530, *Audit Sampling*, defines *tolerable misstatement* and provides further application guidance about the concept.¹¹ [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Determining Materiality and Performance Materiality When Planning the Audit

Considerations Specific to Governmental Entities (Ref: par. .10)

.A4 In the case of a governmental entity, legislators and regulators are often the primary users of its financial statements. Furthermore, the financial statements may be used to make decisions other than economic decisions. The determination of materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) in an audit of the financial statements of a governmental entity, therefore, may be influenced by law or regulation. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A5 For most state or local governments, a governmental entity's applicable financial reporting framework is based on multiple reporting units, and

⁵ Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

⁶ Paragraph .19 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

⁷ Paragraph .14 of section 200. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

⁸ See section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

⁹ See section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

¹⁰ Paragraph .11 of section 450. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

¹¹ Paragraph .A6 of section 530, *Audit Sampling*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

generally, the auditor expresses or disclaims an opinion on a government's financial statements as a whole by providing opinions or disclaimers of opinion on each opinion unit. That is, a state or local governmental entity's applicable financial reporting framework requires the presentation of financial statements for its varied activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. Accordingly, in these cases, materiality is established for each opinion unit. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole (Ref: par. .10)

.A6 Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, or expenses)
- Whether items exist on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance, users may tend to focus on profit, revenue, or net assets)
- The nature of the entity, where the entity is in its life cycle, and the industry and economic environment in which the entity operates
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings)
- The relative volatility of the benchmark

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A7 Examples of benchmarks that may be appropriate, depending on the circumstances of the entity, include categories of reported income, such as profit before tax, total revenue, gross profit, and total expenses; total equity; or net asset value. Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A8 With regard to the chosen benchmark, relevant financial data ordinarily includes prior periods' financial results and financial positions; the period-to-date financial results and financial position, budgets, or forecasts for the current period, adjusted for significant changes in the circumstances of the entity (for example, a significant business acquisition); and relevant changes of conditions in the industry or economic environment in which the entity operates. For example, when, as a starting point, materiality for the financial statements as a whole is determined for a particular entity based on a percentage of profit before tax from continuing operations, circumstances that give rise to an exceptional decrease or increase in such profit may lead the auditor to conclude that materiality for the financial statements as a whole is more appropriately determined using a normalized profit before tax from continuing operations figure

based on past results. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A9 Materiality relates to the financial statements that are being audited. When the financial statements are prepared for a financial reporting period of more or less than 12 months, such as may be the case for a new entity or a change in the financial reporting period, materiality relates to the financial statements prepared for that financial reporting period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A10 Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. A relationship exists between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue. For example, the auditor may consider a percentage of profit before tax from continuing operations to be appropriate for a profit-oriented entity in a manufacturing industry. Chapter 3 of the AICPA Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* provides further guidance about the use of benchmarks in determining materiality. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Smaller, Less Complex Entities

.A11 When an entity's profit before tax from continuing operations is consistently nominal, which might be the case for an owner-managed business in which the owner takes much of the profit before tax in the form of remuneration, a benchmark such as profit before remuneration and tax may be more relevant. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities

.A12 In an audit of a governmental entity, total cost or net cost (expenses less revenues or expenditures less receipts) may be appropriate benchmarks for program activities. When a governmental entity has custody of public assets, assets may be an appropriate benchmark. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Materiality Level or Levels for Particular Classes of Transactions, Account Balances, or Disclosures (Ref: par. .10)

.A13 Factors that may indicate the existence of one or more particular classes of transactions, account balances, or disclosures for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment made by a reasonable user based on the financial statements include the following:

- Whether law, regulation, or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions and the remuneration of management and those charged with governance, and sensitivity analysis for fair value accounting estimates with high estimation uncertainty)
- The key disclosures with regard to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company)
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements

(for example, disclosures about discontinued operations or a significant business combination)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A14 In considering whether, in the specific circumstances of the entity, such classes of transactions, account balances, or disclosures exist, the auditor may find it useful to obtain an understanding of the views and expectations of those charged with governance and management. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Performance Materiality (Ref: par. .11)

.A15 Planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and leaves no margin for possible undetected misstatements. *Performance materiality* (which, as defined, is one or more amounts) is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. Similarly, performance materiality relating to a materiality level determined for a particular class of transactions, account balance, or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance, or disclosure exceeds the materiality level for that particular class of transactions, account balance, or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and, thereby, the auditor's expectations regarding misstatements in the current period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Revision as the Audit Progresses (Ref: par. .12)

.A16 In some situations, the auditor may determine materiality for planning purposes before the financial statements to be audited are prepared. In those situations, the auditor's professional judgment about materiality might be based on the entity's annualized interim financial statements or financial statements of one or more prior annual periods. If it appears as though the actual financial results are likely to be substantially different from the anticipated results, such as when there are major changes in the entity's circumstances (for example, a significant merger) or relevant changes in the economy as a whole or the industry in which the entity operates, the auditor may be required, in accordance with paragraph .12, to revise materiality. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A17 Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures. For example, if, during the audit, it appears as though

actual financial results are likely to be substantially different from the anticipated period-end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor may be required, in accordance with paragraph .12, to revise materiality. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

AU-C Section 330

Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 136.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 142, *Audit Evidence*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.

In October 2021, the Auditing Standards board issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and to evaluate the audit evidence obtained in an audit of financial statements. Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, address the auditor's responsibility to form an opinion on the financial statements based on the evaluation of the audit evidence obtained. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

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

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement through designing and implementing appropriate responses to those risks.

Definitions

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

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

- a. tests of details (classes of transactions, account balances, and disclosures) and
- b. substantive analytical procedures.

Test of controls. An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Requirements

Overall Responses

.05 The auditor should design and implement overall responses to address the assessed risks of material misstatement at the financial statement level. (Ref: par. .A1–.A3)

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level

.06 The auditor should design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level. (Ref: par. .A4–.A9)

.07 In designing the further audit procedures to be performed, the auditor should

- a. consider the reasons for the assessed risk of material misstatement at the relevant assertion level for each class of transactions, account balance, and disclosure, including
 - i. the likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure (the inherent risk) and
 - ii. whether the risk assessment takes account of relevant controls (the control risk), thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures), and (Ref: par. .A10–.A19)
- b. obtain more persuasive audit evidence the higher the auditor's assessment of risk. (Ref: par. .A20)

Tests of Controls

.08 The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls if

- a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively (that is, the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures) or
- b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level. (Ref: par. .A21–.A26)

.09 In designing and performing tests of controls, the auditor should obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. (Ref: par. .A27)

Nature and Extent of Tests of Controls

.10 In designing and performing tests of controls, the auditor should

- a. perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including
 - i. how the controls were applied at relevant times during the period under audit;
 - ii. the consistency with which they were applied; and
 - iii. by whom or by what means they were applied, including, when applicable, whether the person performing the control possesses the necessary authority and competence to perform the control effectively, and (Ref: par. .A28–.A32)
- b. determine whether the controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain audit evidence supporting the operating effectiveness of those indirect controls. (Ref: par. .A33–.A34)

Timing of Tests of Controls

.11 The auditor should test controls for the particular time or throughout the period for which the auditor intends to rely on those controls, subject to paragraphs .12 and .15 that follow, in order to provide an appropriate basis for the auditor's intended reliance. (Ref: par. .A35)

Using Audit Evidence Obtained During an Interim Period

.12 If the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor should

- a. obtain audit evidence about significant changes to those controls subsequent to the interim period and
- b. determine the additional audit evidence to be obtained for the remaining period. (Ref: par. .A36–.A37)

Using Audit Evidence Obtained in Previous Audits

.13 In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits and, if so, the length of the time period that may elapse before retesting a control, the auditor should consider

- a. the effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;
- b. the risks arising from the characteristics of the control, including whether the control is manual or automated;
- c. the effectiveness of general IT controls;
- d. the effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits and whether there have been personnel changes that significantly affect the application of the control;
- e. whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- f. the risks of material misstatement and the extent of reliance on the control. (Ref: par. .A38)

.14 If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor should perform audit procedures to establish the continuing relevance of that information to the current audit. The auditor should obtain this evidence by performing inquiry, combined with observation or inspection, to confirm the understanding of those specific controls, and

- a. if there have been changes that affect the continuing relevance of the audit evidence from the previous audit, the auditor should test the controls in the current audit. (Ref: par. .A39)
- b. if there have not been such changes, the auditor should test the controls at least once in every third audit and should test some controls during each audit to avoid the possibility of testing all the controls on which the auditor intends to rely in a single audit period with no testing of controls in the subsequent two audit periods. (Ref: par. .A40–.A42)

Controls Over Significant Risks

.15 If the auditor plans to rely on controls over a risk the auditor has determined to be a significant risk,¹ the auditor should test the operating effectiveness of those controls in the current period.

Evaluating the Operating Effectiveness of Controls

.16 When evaluating the operating effectiveness of relevant controls, the auditor should evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the relevant assertion being tested are effective. (Ref: par. .A43)

.17 If deviations from controls upon which the auditor intends to rely are detected, the auditor should make specific inquiries to understand these matters and their potential consequences and should determine whether

- a. the tests of controls that have been performed provide an appropriate basis for reliance on the controls,
- b. additional tests of controls are necessary, or

¹ Paragraphs .28–.30 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

- c. the potential risks of misstatement need to be addressed using substantive procedures. (Ref: par. .A44)

Substantive Procedures

.18 Irrespective of the assessed risks of material misstatement, the auditor should design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure. (Ref: par. .A45–.A50)

.19 The auditor should consider whether external confirmation procedures are to be performed as substantive audit procedures. (Ref: par. .A51–.A56)

.20 The auditor should use external confirmation procedures for accounts receivable, except when one or more of the following is applicable: (Ref: par. .A55)

- a. The overall account balance is immaterial.
- b. External confirmation procedures for accounts receivable would be ineffective. (Ref: par. .A54 and .A56)
- c. The auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk. In many situations, the use of external confirmation procedures for accounts receivable and the performance of other substantive procedures are necessary to reduce the assessed risk of material misstatement to an acceptably low level.

Substantive Procedures Related to the Financial Statement Closing Process

.21 The auditor's substantive procedures should include audit procedures related to the financial statement closing process, such as

- a. agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers, and
- b. examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: par. .A57)

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

Substantive Procedures Responsive to Significant Risks

.22 If the auditor has determined that an assessed risk of material misstatement at the relevant assertion level is a significant risk, the auditor should perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details. (Ref: par. .A58–.A59)

Timing of Substantive Procedures

.23 If substantive procedures are performed at an interim date, the auditor should cover the remaining period by performing

- a. substantive procedures, combined with tests of controls for the intervening period, or
- b. if the auditor determines that it is sufficient, further substantive procedures only,

that provide a reasonable basis for extending the audit conclusions from the interim date to the period-end. (Ref: par. .A60–.A64)

.24 If misstatements that the auditor did not expect when assessing the risks of material misstatement are detected at an interim date, the auditor should evaluate whether the related assessment of risk and the planned nature, timing, or extent of substantive procedures covering the remaining period need to be modified. See section 240, *Consideration of Fraud in a Financial Statement Audit*.² (Ref: par. .A65)

Selecting Items for Testing to Obtain Audit Evidence

.25 When designing tests of controls and tests of details, the auditor should determine the means of selecting items for testing that are effective in meeting the purpose of the audit procedure. (Ref: par. .A66–.A72)

Adequacy of Presentation of the Financial Statements

.26 The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework. In making this evaluation, the auditor should consider whether the financial statements are presented in a manner that reflects the following:

- a. The appropriate classification and description of financial information and the underlying transactions, events, and conditions
- b. The appropriate presentation, structure, and content of the financial statements (Ref: par. .A73)

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

Evaluating the Sufficiency and Appropriateness of Audit Evidence³

.27 Based on the audit procedures performed and the audit evidence obtained, the auditor should evaluate, before the conclusion of the audit, whether the assessments of the risks of material misstatement at the relevant assertion level remain appropriate. (Ref: par. .A74–.A75)

.28 The auditor should conclude whether sufficient appropriate audit evidence has been obtained. In forming a conclusion, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements. (Ref: par. .A76)

.29 If the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor should attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should express a qualified opinion or disclaim an opinion on the financial statements.⁴

² Paragraphs .35–.36 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

³ See section 700, *Forming an Opinion and Reporting on Financial Statements*.

⁴ Paragraphs .08–.10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, address qualified, adverse, and disclaimer of opinions.

Documentation

.30 The auditor should include in the audit documentation⁵

- a. the overall responses to address the assessed risks of material misstatement at the financial statement level and the nature, timing, and extent of the further audit procedures performed;
- b. the linkage of those procedures with the assessed risks at the relevant assertion level; and
- c. the results of the audit procedures, including the conclusions when such conclusions are not otherwise clear. (Ref: par. .A77)

.31 If the auditor plans to use audit evidence about the operating effectiveness of controls obtained in previous audits, the auditor should include in the audit documentation the conclusions reached about relying on such controls that were tested in a previous audit.

.32 The auditor should include in the audit documentation the basis for any determination not to use external confirmation procedures for accounts receivable when the account balance is material.

.33 The auditor's documentation should demonstrate that information in the financial statements agrees or reconciles with the underlying accounting records, including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Application and Other Explanatory Material

Overall Responses (Ref: par. .05)

.A1 Overall responses to address the assessed risks of material misstatement at the financial statement level may include⁶

- emphasizing to the audit team the need to maintain professional skepticism.
- assigning more experienced staff or those with specialized skills or using specialists.
- providing more supervision.
- incorporating additional elements of unpredictability in the selection of further audit procedures to be performed.
- making general changes to the nature, timing, or extent of audit procedures (for example, performing substantive procedures at period-end instead of at an interim date or modifying the nature of audit procedures to obtain more persuasive audit evidence).

.A2 The assessment of the risks of material misstatement at the financial statement level and, thereby, the auditor's overall responses are affected by the auditor's understanding of the control environment. An effective control environment may allow the auditor to have more confidence in internal control and the reliability of audit evidence generated internally within the entity

⁵ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

⁶ Paragraphs .07–.08 of section 300, *Planning an Audit*, address the auditor's overall audit strategy.

and, thus, for example, allow the auditor to conduct some audit procedures at an interim date rather than at the period-end. Deficiencies in the control environment, however, have the opposite effect (for example, the auditor may respond to an ineffective control environment by

- conducting more audit procedures as of the period-end rather than at an interim date,
- obtaining more extensive audit evidence from substantive procedures, and
- increasing the number of locations to be included in the audit scope).

.A3 Such considerations, therefore, have a significant bearing on the auditor's general approach (for example, an emphasis on substantive procedures [substantive approach] or an approach that uses tests of controls as well as substantive procedures [combined approach]).

Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Relevant Assertion Level

The Nature, Timing, and Extent of Further Audit Procedures (Ref: par. .06)

.A4 The auditor's assessment of the identified risks at the relevant assertion level provides a basis for considering the appropriate audit approach for designing and performing further audit procedures. For example, the auditor may determine that

- a. in addition to the substantive procedures that are required for all relevant assertions, in accordance with paragraph .18, an effective response to the assessed risk of material misstatement for a particular assertion can be achieved only by also performing tests of controls.
- b. performing only substantive procedures is appropriate for particular assertions, and therefore, the auditor excludes the effect of controls from the relevant risk assessment. This may be because the auditor's risk assessment procedures have not identified any effective controls relevant to the assertion or because testing controls would be inefficient, and therefore, the auditor does not intend to rely on the operating effectiveness of controls in determining the nature, timing, and extent of substantive procedures.
- c. a combined approach using both tests of controls and substantive procedures is an effective approach.

.A5 The nature of an audit procedure refers to its purpose (test of controls or substantive procedure) and its type (inspection, observation, inquiry, confirmation, recalculation, reperformance, or analytical procedure). See section 500A, *Audit Evidence*, which provides further application guidance about audit procedures.⁷ The nature of the audit procedures is most important in responding to the assessed risks.

.A6 Timing of an audit procedure refers to when it is performed or the period or date to which the audit evidence applies.

.A7 Extent of an audit procedure refers to the quantity to be performed (for example, a sample size or the number of observations of a control activity).

⁷ Paragraphs .A10–.A26 of section 500A, *Audit Evidence*.

.A8 Designing and performing further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level provides a clear linkage between the auditor's further audit procedures and the risk assessment.

.A9 Because effective internal controls generally reduce but do not eliminate the risk of material misstatement, tests of controls reduce but do not eliminate the need for substantive procedures. In addition, analytical procedures alone may not be sufficient in some cases. For example, when auditing certain estimation processes, such as the allowance for doubtful accounts, the auditor may perform substantive procedures beyond analytical procedures (for example, examining cash collections subsequent to the period-end) due to the risk of management override of controls⁸ or the subjectivity of the account balance.

Responding to the Assessed Risks at the Assertion Level (Ref: par. .07a)

.A10 *Nature.* The auditor's assessed risks may affect both the types of audit procedures to be performed and their combination. For example, when an assessed risk is high, the auditor may confirm the completeness of the terms of a contract with the counterparty, in addition to inspecting the document. Further, certain audit procedures may be more appropriate for some assertions than others. For example, regarding revenue, tests of controls may be most responsive to the assessed risk of misstatement of the completeness assertion, whereas substantive procedures may be most responsive to the assessed risk of misstatement of the occurrence assertion.

.A11 The reasons for the assessment given to a risk are relevant in determining the nature of audit procedures. For example, if an assessed risk is lower because of the particular characteristics of a class of transactions without consideration of the related controls, then the auditor may determine that substantive analytical procedures alone provide sufficient appropriate audit evidence. On the other hand, if the assessed risk is lower because of internal controls and the auditor intends to base the substantive procedures on that low assessment, then the auditor performs tests of those controls, as required by paragraph .08a. This may be the case, for example, for a class of transactions of reasonably uniform, noncomplex characteristics that are routinely processed and controlled by the entity's information system.

.A12 *Timing.* The auditor may perform tests of controls or substantive procedures at an interim date or at the period-end. The higher the risk of material misstatement, the more likely it is that the auditor may decide it is more effective to perform substantive procedures nearer to or at the period-end rather than at an earlier date or to perform audit procedures unannounced or at unpredictable times (for example, performing audit procedures at selected locations on an unannounced basis). This is particularly relevant when considering the response to the risks of fraud. For example, the auditor may conclude that, when the risks of intentional misstatement or manipulation have been identified, audit procedures to extend audit conclusions from the interim date to the period-end would not be effective.

.A13 On the other hand, performing audit procedures before the period-end may assist the auditor in identifying significant issues at an early stage of the audit and consequently resolving them with the assistance of management or developing an effective audit approach to address such issues.

.A14 In addition, certain audit procedures can be performed only at or after the period-end, for example,

⁸ The auditor is required by paragraphs .31–.33 of section 240 to perform audit procedures responsive to risks related to management override of controls.

- agreeing or reconciling information in the financial statements, including classes of transactions, account balances, and disclosures, with the underlying accounting records including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers;
- examining adjustments made during the course of preparing the financial statements; and
- procedures to respond to a risk that at the period-end the entity may have entered into improper sales contracts or transactions may not have been finalized.

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

.A15 Further relevant factors that influence the auditor's consideration of when to perform audit procedures include

- the effectiveness of the control environment.
- when relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- the nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may examine contracts available on the date of the period-end).
- the period or date to which the audit evidence relates.
- the timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded in the financial statements.

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

.A16 Extent. The extent of an audit procedure judged necessary is determined after considering the materiality, assessed risk, and degree of assurance the auditor plans to obtain. When a single purpose is met by a combination of procedures, the extent of each procedure may be considered separately. In general, the extent of audit procedures increases as the risks of material misstatement increase. For example, in response to the assessed risks of material misstatement due to fraud, increasing sample sizes or performing substantive analytical procedures at a more detailed level may be appropriate. However, increasing the extent of an audit procedure is effective only if the audit procedure itself is relevant to the specific risk.

.A17 The use of computer assisted audit techniques (CAATs) may enable more extensive testing of electronic transactions and account files, which may be useful when the auditor decides to modify the extent of testing (for example, in responding to the risks of material misstatement due to fraud). Such techniques can be used to select sample transactions from key electronic files, sort transactions with specific characteristics, or test an entire population instead of a sample.

.A18 Considerations specific to governmental entities. For the audits of governmental entities, the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing, and extent of further audit procedures. For example, under some governmental audit requirements, the auditor is required to perform tests of controls, even if reliance is not planned.

.A19 *Considerations specific to smaller, less complex entities.* In the case of smaller entities, the auditor may not identify control activities, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the auditor to perform further audit procedures that are primarily substantive procedures. In some rare cases, however, the absence of control activities or other components of control may make it impossible to obtain sufficient appropriate audit evidence.

Higher Assessments of Risk (Ref: par. .07b)

.A20 When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable (for example by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources).

Tests of Controls

Designing and Performing Tests of Controls (Ref: par. .08)

.A21 Tests of controls are performed only on those controls that the auditor has determined are suitably designed to prevent, or detect and correct, a material misstatement in a relevant assertion. If substantially different controls were used at different times during the period under audit, each is considered separately.

.A22 Testing the operating effectiveness of controls is different from obtaining an understanding of and evaluating the design and implementation of controls. However, the same types of audit procedures are used. The auditor may, therefore, decide it is efficient to test the operating effectiveness of controls at the same time the auditor is evaluating their design and determining that they have been implemented.

.A23 Further, although some risk assessment procedures may not have been specifically designed as tests of controls, they may nevertheless provide audit evidence about the operating effectiveness of the controls and, consequently, serve as tests of controls. For example, the auditor's risk assessment procedures may have included the following:

- Inquiring about management's use of budgets
- Observing management's comparison of monthly budgeted and actual expenses
- Inspecting reports pertaining to the investigation of variances between budgeted and actual amounts

These audit procedures provide knowledge about the design of the entity's budgeting policies and whether they have been implemented but also may provide audit evidence about the effectiveness of the operation of budgeting policies in preventing, or detecting and correcting, material misstatements in the classification of expenses.

.A24 In addition, the auditor may design a test of controls to be performed concurrently with a test of details on the same transaction. Although the purpose of a test of controls is different from the purpose of a test of details, both may be accomplished concurrently by performing a test of controls and a test of details on the same transaction, which also is known as a *dual purpose test*. For example, the auditor may design and evaluate the results of a test to examine an invoice to determine whether it has been approved and to provide substantive audit evidence of a transaction. A dual purpose test is designed and evaluated by considering each purpose of the test separately.

.A25 In some cases, the auditor may find it impossible to design effective substantive procedures that, by themselves, provide sufficient appropriate audit evidence at the relevant assertion level.⁹ This may occur when an entity conducts its business using IT and no documentation of transactions is produced or maintained, other than through the IT system. In such cases, paragraph .08b requires the auditor to perform tests of relevant controls.

.A26 The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. See section 520, *Analytical Procedures*, for further guidance.¹⁰

Audit Evidence and Intended Reliance (Ref: par. .09)

.A27 A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular when it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Nature and Extent of Tests of Controls

.A28 *Other audit procedures in combination with inquiry (Ref: par. .10a).* Inquiry alone is not sufficient to test the operating effectiveness of controls. Accordingly, other audit procedures are performed in combination with inquiry. In this regard, inquiry combined with inspection, recalculation, or reperformance may provide more assurance than inquiry and observation because an observation is pertinent only at the point in time at which it is made.

.A29 The nature of the particular control influences the type of audit procedure necessary to obtain audit evidence about whether the control was operating effectively. For example, if operating effectiveness is evidenced by documentation, the auditor may decide to inspect such documentation to obtain audit evidence about operating effectiveness. For other controls, however, documentation may not be available or relevant. For example, documentation of operation may not exist for some factors in the control environment, such as assignment of authority and responsibility, or for some types of control activities, such as control activities performed by a computer. In such circumstances, audit evidence about operating effectiveness may be obtained through inquiry in combination with other audit procedures, such as observation or the use of CAATs.

.A30 In some situations, particularly in smaller, less complex entities, an entity might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for an entity's financial reporting and associated controls, the auditor may take into account the combined competence of entity personnel and other parties that assist with functions related to financial reporting.

.A31 *Extent of tests of controls.* When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. In addition to the degree of reliance on controls, matters the auditor may consider in determining the extent of tests of controls include the following:

- The frequency of the performance of the control by the entity during the period

⁹ Paragraph .31 of section 315A.

¹⁰ Paragraph .A19 of section 520, *Analytical Procedures*.

- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control
- The expected rate of deviation from a control
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the relevant assertion level
- The extent to which audit evidence is obtained from tests of other controls related to the relevant assertion

However, the rate of expected deviation may indicate that obtaining audit evidence from the performance of tests of controls will not be sufficient to reduce the control risk at the relevant assertion level. If the rate of expected deviation is expected to be high, tests of controls for a particular assertion may not provide sufficient appropriate audit evidence. Section 530, *Audit Sampling*, contains further guidance on the extent of testing.

.A32 Because of the inherent consistency of IT processing, it may not be necessary to increase the extent of testing of an automated control. An automated control can be expected to function consistently unless the program (including the tables, files, or other permanent data used by the program) is changed. Once the auditor determines that an automated control is functioning as intended (which could be done at the time the control is initially implemented or at some other date), the auditor may consider performing tests to determine that the control continues to function effectively. Such tests might include determining that

- changes to the program are not made without being subject to the appropriate program change controls,
- the authorized version of the program is used for processing transactions, and
- other relevant general controls are effective.

Such tests also might include determining that changes to the programs have not been made, which may be the case when the entity uses packaged software applications without modifying or maintaining them. For example, the auditor may inspect the record of the administration of IT security to obtain audit evidence that unauthorized access has not occurred during the period.

.A33 *Testing of indirect controls (Ref: par. .10b).* In some circumstances, it may be necessary to obtain audit evidence supporting the effective operation of indirect controls. For example, when the auditor decides to test the effectiveness of a user review of exception reports detailing sales in excess of authorized credit limits, the user review and related follow up is the control that is of direct relevance to the auditor. Controls over the accuracy of the information in the reports (for example, the general IT controls) are described as indirect controls.

.A34 Because of the inherent consistency of IT processing, audit evidence about the implementation of an automated application control, when considered in combination with audit evidence about the operating effectiveness of the entity's general IT controls (in particular, change controls), also may provide substantial audit evidence about its operating effectiveness.

Timing of Tests of Controls

.A35 *Intended period of reliance (Ref: par. .11).* Audit evidence pertaining only to a point in time may be sufficient for the auditor's purpose (for example, when testing controls over the entity's physical inventory counting at the period-end). If, on the other hand, the auditor intends to rely on a control over

a period, tests that are capable of providing audit evidence that the control operated effectively at relevant times during that period are appropriate. Such tests may include tests of the entity's monitoring of controls.

.A36 *Using audit evidence obtained during an interim period (Ref: par. .12).* Relevant factors in determining what additional audit evidence to obtain about controls that were operating during the period remaining after an interim period, include the following:

- The significance of the assessed risks of material misstatement at the relevant assertion level
- The specific controls that were tested during the interim period and the results of those tests
- Significant changes to the controls since they were tested, including changes in the information system, processes, and personnel
- The degree to which audit evidence about the operating effectiveness of those controls was obtained
- The length of the remaining period
- The extent to which the auditor intends to reduce further substantive procedures based on the reliance of controls
- The effectiveness of the control environment

.A37 Additional audit evidence may be obtained, for example, by extending the testing of the operating effectiveness of controls over the remaining period or testing the entity's monitoring of controls.

.A38 *Using audit evidence obtained in previous audits (Ref: par. .13).* In certain circumstances, audit evidence obtained from previous audits may provide audit evidence, provided that the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit. For example, in performing a previous audit, the auditor may have determined that an automated control was functioning as intended. The auditor may obtain audit evidence to determine whether changes to the automated control have been made that affect its continued effective functioning through, for example, inquiries of management and the inspection of logs to indicate what controls have been changed. Consideration of audit evidence about these changes may support either increasing or decreasing the expected audit evidence to be obtained in the current period about the operating effectiveness of the controls.

.A39 *Controls that have changed from previous audits (Ref: par. .14a).* Changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance. For example, changes in a system that enable an entity to receive a new report from the system probably do not affect the relevance of audit evidence from a previous audit; however, a change that causes data to be accumulated or calculated differently does affect it.

.A40 *Controls that have not changed from previous audits (Ref: par. .14b).* The auditor's decision on whether to rely on audit evidence obtained in previous audits for controls that

- have not changed since they were last tested and
- are not controls that mitigate a significant risk

is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment but is required

by paragraph .14b to be at least once in every third audit. (This guidance may not be appropriate for audits not performed at least on an annual basis.)

.A41 In general, the higher the risk of material misstatement or the greater the reliance on controls, the shorter the time period elapsed, if any, is likely to be. Factors that may decrease the period for retesting a control or result in not relying on audit evidence obtained in previous audits at all include the following:

- A deficient control environment
- Deficient monitoring of controls
- A significant manual element to the relevant controls
- Personnel changes that significantly affect the application of the control
- Changing circumstances that indicate the need for changes in the control
- Deficient general IT controls

.A42 When there are a number of controls for which the auditor intends to rely on audit evidence obtained in previous audits, testing some of those controls in each audit provides corroborating information about the continuing effectiveness of the control environment. This contributes to the auditor's decision about whether it is appropriate to rely on audit evidence obtained in previous audits.

Evaluating the Operating Effectiveness of Controls (Ref: par. .16–.17)

.A43 In accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*, the identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected by the entity's internal control is an indicator of a material weakness.¹¹

.A44 The concept of effectiveness of the operation of controls recognizes that some deviations in the way controls are applied by the entity may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions, and human error. The detected rate of deviation, in particular, in comparison with the expected rate, may indicate that the control cannot be relied on to reduce risk at the relevant assertion level to that assessed by the auditor.

Substantive Procedures (Ref: par. .18)

.A45 Paragraph .18 requires the auditor to design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement. This requirement reflects the facts that (i) the auditor's assessment of risk is judgmental and may not identify all risks of material misstatement and (ii) inherent limitations to internal control exist, including management override.

Nature and Extent of Substantive Procedures

.A46 Depending on the circumstances, the auditor may determine the following:

¹¹ Paragraph .A11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

- Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level, such as, for example, when the auditor's assessment of risk is supported by audit evidence from tests of controls.
- Only tests of details are appropriate.
- A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.

.A47 Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Section 520 addresses the application of analytical procedures during an audit.

.A48 The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. For example, the auditor might inspect subsequent cash disbursements and compare them with the recorded accounts payable to determine whether any purchases had been omitted from accounts payable.

.A49 Because the assessment of the risks of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory. However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk.

.A50 In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters also are relevant, including whether it is more effective to use other selective means of testing. See paragraphs .A66–.A72.

Considering Whether External Confirmation Procedures Are to Be Performed (Ref: par. .19–.20)

.A51 External confirmation procedures frequently may be relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cut-off assertion. Other situations in which external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include the following:

- Bank balances and other information relevant to banking relationships
- Inventories held by third parties at bonded warehouses for processing or on consignment
- Property title deeds held by lawyers or financiers for safe custody or as security
- Investments held for safekeeping by third parties or purchased from stockbrokers but not delivered at the balance sheet date

- Amounts due to lenders, including relevant terms of repayment and restrictive covenants
- Accounts payable balances and terms

.A52 Although external confirmations may provide relevant audit evidence relating to certain assertions, some assertions exist for which external confirmations provide less relevant audit evidence. For example, external confirmations provide less relevant audit evidence relating to the recoverability of accounts receivable balances than they do of their existence.

.A53 The auditor may determine that external confirmation procedures performed for one purpose provide an opportunity to obtain audit evidence about other matters. For example, confirmation requests for bank balances often include requests for information relevant to other financial statement assertions. Such considerations may influence the auditor's decision about whether to perform external confirmation procedures.

.A54 Factors that may assist the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include the following:

- The confirming party's knowledge of the subject matter. Responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- The ability or willingness of the intended confirming party to respond. For example, the confirming party
 - may not accept responsibility for responding to a confirmation request,
 - may consider responding too costly or time consuming,
 - may have concerns about the potential legal liability resulting from responding,
 - may account for transactions in different currencies, or
 - may operate in an environment in which responding to confirmation requests is not a significant aspect of day-to-day operations.

In such situations, confirming parties may not respond, may respond in a casual manner, or may attempt to restrict the reliance placed on the response.

- The objectivity of the intended confirming party. If the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

.A55 For purposes of this section, *accounts receivable* means

- a. the entity's claims against customers that have arisen from the sale of goods or services in the normal course of business; and
- b. a financial institution's loans.

.A56 External confirmation procedures may be ineffective when, based on prior years' audit experience or experience with similar entities

- response rates to properly designed confirmation requests will be inadequate; or
- responses are known or expected to be unreliable.

If the auditor has experienced poor response rates to properly designed confirmation requests in prior audits, the auditor may instead consider changing the manner in which the confirmation process is performed, with the objective of increasing the response rates, or may consider obtaining audit evidence from other sources.

Substantive Procedures Related to the Financial Statement Closing Process (Ref: par. .21b)

.A57 The nature and also the extent of the auditor's substantive procedures related to the financial statement closing process, including testing the appropriateness of journal entries and other adjustments, depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Substantive Procedures Responsive to Significant Risks (Ref: par. .22)

.A58 Paragraph .22 requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Because significant unusual transactions can affect the risks of material misstatement due to error or fraud, substantive procedures that take into account the types of potential misstatements that could result from significant unusual transactions may be necessary, including procedures performed pursuant to paragraph .32 of section 240. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Timing of Substantive Procedures (Ref: par. .23–.24)

.A59 Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, a risk may exist that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Timing of Substantive Procedures (Ref: par. .23–.24)

.A60 In most cases, audit evidence from a previous audit's substantive procedures provides little or no audit evidence for the current period. However, exceptions exist (for example, a legal opinion obtained in a previous audit related to the structure of a securitization to which no changes have occurred may be relevant in the current period). In such cases, it may be appropriate to use audit evidence from a previous audit's substantive procedures if that evidence and the related subject matter have not fundamentally changed and audit procedures have been performed during the current period to establish its continuing relevance. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A61 *Using audit evidence obtained during an interim period (Ref: par. .23).*

In some circumstances, the auditor may determine that it is effective to perform

substantive procedures at an interim date and compare and reconcile information concerning the balance at the period-end with the comparable information at the interim date to

- a. identify amounts that appear unusual,
- b. investigate any such amounts, and
- c. perform substantive analytical procedures or tests of details to test the intervening period.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A62 Performing substantive procedures at an interim date without undertaking additional procedures at a later date increases the risk that the auditor will not detect misstatements that may exist at the period-end. This risk increases as the remaining period is lengthened. Factors such as the following may influence whether to perform substantive procedures at an interim date:

- The effectiveness of the control environment and other relevant controls
- The availability at a later date of information necessary for the auditor's procedures
- The purpose of the substantive procedure
- The assessed risk of material misstatement
- The nature of the class of transactions or account balance and relevant assertions
- The ability of the auditor to perform appropriate substantive procedures or substantive procedures combined with tests of controls to cover the remaining period in order to reduce the risk that misstatements that may exist at the period-end will not be detected

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A63 In circumstances in which the auditor has identified risks of material misstatement due to fraud, the auditor's responses to address those risks may include changing the timing of audit procedures. For example, the auditor might conclude that, given the risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period-end reporting date would not be effective. In such circumstances, the auditor might conclude that substantive procedures performed at or near the end of the reporting period best address an identified risk of material misstatement due to fraud. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A64 Factors such as the following may influence whether to perform substantive analytical procedures with respect to the period between the interim date and the period-end:

- Whether the period-end balances of the particular classes of transactions or account balances are reasonably predictable with respect to amount, relative significance, and composition
- Whether the entity's procedures for analyzing and adjusting such classes of transactions or account balances at interim dates and establishing proper accounting cutoffs are appropriate
- Whether the information system relevant to financial reporting will provide information concerning the balances at the period-end and the transactions in the remaining period that is sufficient to permit investigation of the following:

- Significant unusual transactions or entries (including those at or near the period-end)
- Other causes of significant fluctuations or expected fluctuations that did not occur
- Changes in the composition of the classes of transactions or account balances

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

A65 *Misstatements detected at an interim date (Ref: par. .24).* When the auditor concludes that the planned nature, timing, or extent of substantive procedures covering the remaining period need to be modified as a result of unexpected misstatements detected at an interim date, such modification may include extending or repeating, at the period-end, the procedures performed at the interim date. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Selecting Items for Testing to Obtain Audit Evidence (Ref: par. .25)

A66 An effective test provides appropriate audit evidence to the extent that it will be sufficient for the auditor's purpose when taken with other audit evidence obtained or to be obtained. In selecting items for testing, the auditor is required by section 500A to determine the relevance and reliability of information to be used as audit evidence;¹² the other aspect of effectiveness (sufficiency) is an important consideration in selecting items to test. The means available to the auditor for selecting items for testing are

- a. selecting all items (100 percent examination),
- b. selecting specific items, and
- c. audit sampling.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

A67 The application of any one or combination of these means may be appropriate depending on the particular circumstances (for example, the risks of material misstatement related to the assertion being tested and the practicality and efficiency of the different means). [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Selecting All Items

A68 The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance (or a stratum within that population). A 100 percent examination is unlikely in the case of tests of controls; however, it may be more common for tests of details. A 100 percent examination may be appropriate when, for example

- the population constitutes a small number of large value items,
- a significant risk exists and other means do not provide sufficient appropriate audit evidence, or
- the repetitive nature of a calculation or other process performed automatically by an information system makes a 100 percent examination cost effective.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

¹² Paragraph .07 of section 500A.

Selecting Specific Items

.A69 The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include the auditor's understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population being tested. The judgmental selection of specific items is subject to nonsampling risk. Specific items selected may include

- high value or key items. The auditor may decide to select specific items within a population because they are of high value or exhibit some other characteristic (for example, items that are suspicious, unusual, particularly risk prone, or have a history of error).
- all items over a certain amount. The auditor may decide to examine items whose recorded values exceed a certain amount in order to verify a large proportion of the total amount of a class of transactions or account balance.
- items to obtain information. The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A70 Although selective examination of specific items from a class of transactions or account balance often will be an efficient means of obtaining audit evidence, it does not constitute audit sampling. Consequently, the results of audit procedures applied to items selected in this way cannot be projected to the entire population; furthermore, selective examination of specific items does not, by itself, provide sufficient appropriate audit evidence concerning the remainder of the population. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Audit Sampling

.A71 Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from the population. Audit sampling is discussed in section 530. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A72 Valid conclusions ordinarily may be drawn using sampling approaches. However, if the sample size is too small, the sampling approach or the method of selection is not appropriate to achieve the specific audit objective or exceptions are not appropriately followed up, an unacceptable risk will exist that the auditor's conclusion based on a sample may be different from the conclusion reached if the entire population was subjected to the same audit procedure. Section 530 addresses planning, performing, and evaluating audit samples. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Adequacy of Presentation of the Financial Statements
(Ref: par. .26)

.A73 Evaluating the appropriate presentation, structure, and content of the financial statements includes, for example, consideration of the terminology used as required by the applicable financial reporting framework, the level of detail provided, the aggregation and disaggregation of amounts, and the bases of amounts set forth. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence (Ref: par. .27–.29)

.A74 An audit of financial statements is a cumulative and iterative process. As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessments were based. For example

- the extent of misstatements that the auditor detects by performing substantive procedures may alter the auditor's professional judgment about the risk assessments and indicate a significant deficiency or material weakness in internal control.
- the auditor may become aware of discrepancies in accounting records or conflicting or missing evidence.
- analytical procedures performed at the overall review stage of the audit may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the classes of transactions, account balances, or disclosures and related assertions. Section 315A contains further guidance on revising the auditor's risk assessment.¹³ [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A75 The auditor cannot assume that an instance of fraud or error is an isolated occurrence. Therefore, the consideration of how the detection of a misstatement affects the assessed risks of material misstatement is important in determining whether the assessment remains appropriate. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A76 The auditor's professional judgment about what constitutes sufficient appropriate audit evidence is influenced by such factors as the

- significance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements (see section 450, *Evaluation of Misstatements Identified During the Audit*).
- effectiveness of management's responses and controls to address the risks.
- experience gained during previous audits with respect to similar potential misstatements.
- results of audit procedures performed, including whether such audit procedures identified specific instances of fraud or error.
- source and reliability of the available information.
- persuasiveness of the audit evidence.
- understanding of the entity and its environment, including its internal control.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

¹³ Paragraph .32 of section 315A.

Documentation (Ref: par. .30)

.A77 The form and extent of audit documentation is a matter of professional judgment and is influenced by the nature, size, and complexity of the entity; internal control of the entity; availability of information from the entity; and the audit methodology and technology used in the audit. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

AU-C Section 402

Audit Considerations Relating to an Entity Using a Service Organization

Source: SAS No. 122; SAS No. 128; SAS No. 130.

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

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the user auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of a user entity that uses one or more service organizations. Specifically, it expands on how the user auditor applies section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, in obtaining an understanding of the user entity, including internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement and in designing and performing further audit procedures responsive to those risks.

.02 Many entities outsource aspects of their business activities to organizations that provide services ranging from performing a specific task under the direction of the entity to replacing entire business units or functions of the entity. Many of the services provided by such organizations are integral to the entity's business operations; however, not all of those services are relevant to the audit.

.03 Services provided by a service organization are relevant to the audit of a user entity's financial statements when those services and the controls over them affect the user entity's information system, including related business processes, relevant to financial reporting. Although most controls at the service organization are likely to relate to financial reporting, other controls also may be relevant to the audit, such as controls over the safeguarding of assets. A service organization's services are part of a user entity's information system, including related business processes, relevant to financial reporting if these services affect any of the following:

- a. The classes of transactions in the user entity's operations that are significant to the user entity's financial statements;

- b. The procedures within both IT and manual systems by which the user entity's transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements;
- c. The related accounting records, supporting information, and specific accounts in the user entity's financial statements that are used to initiate, authorize, record, process, and report the user entity's transactions. This includes the correction of incorrect information and how information is transferred to the general ledger; the records may be in either manual or electronic form;
- d. How the user entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;
- e. The financial reporting process used to prepare the user entity's financial statements, including significant accounting estimates and disclosures; and
- f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments.

.04 The nature and extent of work to be performed by the user auditor regarding the services provided by a service organization depend on the nature and significance of those services to the user entity and the relevance of those services to the audit.

.05 This section does not apply to services that are limited to processing an entity's transactions that are specifically authorized by the entity, such as the processing of checking account transactions by a bank or the processing of securities transactions by a broker (that is, when the user entity retains responsibility for authorizing the transactions and maintaining the related accountability). In addition, this section does not apply to the audit of transactions arising from an entity that holds a proprietary financial interest in another entity, such as a partnership, corporation, or joint venture, when the partnership, corporation, or joint venture performs no processing on behalf of the entity.

Effective Date

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

Objectives

.07 The objectives of the user auditor, when the user entity uses the services of a service organization, are to

- a. obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit, sufficient to identify and assess the risks of material misstatement.
- b. design and perform audit procedures responsive to those risks.

Definitions

.08 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Complementary user entity controls. Controls that management of the service organization assumes, in the design of its

service, will be implemented by user entities and are necessary to achieve the control objectives stated in management's description of the service organization's system.

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls (referred to in this section as a *type 1 report*). A report that comprises the following:

- a. Management's description of the service organization's system
- b. A written assertion by management of the service organization about whether, in all material respects, and based on suitable criteria
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date
- c. A service auditor's report that expresses an opinion on the matters in b(i–ii)

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

- a. Management's description of the service organization's system
- b. A written assertion by management of the service organization about whether in all material respects and, based on suitable criteria
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period to achieve those control objectives
 - iii. the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period to achieve those control objectives
- c. A service auditor's report that
 - i. expresses an opinion on the matters in b(i–iii)
 - ii. includes a description of the service auditor's tests of controls and the results thereof

Service auditor. A practitioner who reports on controls at a service organization.

Service organization. An organization or segment of an organization that provides services to user entities that are relevant to those user entities' internal control over financial reporting.

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

Subservice organization. A service organization used by another service organization to perform some of the services provided to user entities that are relevant to those user entities' internal control over financial reporting. (Ref: par. .A20)

User auditor. An auditor who audits and reports on the financial statements of a user entity.

User entity. An entity that uses a service organization and whose financial statements are being audited.

[Revised, December 2016, to reflect conforming changes necessary to reflect the issuance of SSAE No. 18.]

Requirements

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

.09 When obtaining an understanding of the user entity in accordance with section 315A, the user auditor should obtain an understanding of how the user entity uses the services of a service organization in the user entity's operations, including the following¹ (Ref: par. .A1–.A2)

- a. The nature of the services provided by the service organization and the significance of those services to the user entity, including their effect on the user entity's internal control (Ref: par. .A3–.A5)
- b. The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization (Ref: par. .A6)
- c. The degree of interaction between the activities of the service organization and those of the user entity (Ref: par. .A7)
- d. The nature of the relationship between the user entity and the service organization, including the relevant contractual terms for the activities undertaken by the service organization (Ref: par. .A8–.A11)

.10 When obtaining an understanding of internal control relevant to the audit in accordance with section 315A, the user auditor should evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organization, including those that

¹ Paragraph .12 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

are applied to the transactions processed by the service organization.² (Ref: par. .A12–.A14)

.11 The user auditor should determine whether a sufficient understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement.

.12 If the user auditor is unable to obtain a sufficient understanding from the user entity, the user auditor should obtain that understanding from one or more of the following procedures:

- a. Obtaining and reading a type 1 or type 2 report, if available
- b. Contacting the service organization, through the user entity, to obtain specific information
- c. Visiting the service organization and performing procedures that will provide the necessary information about the relevant controls at the service organization
- d. Using another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organization (Ref: par. .A15–.A20)

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization

.13 In determining the sufficiency and appropriateness of the audit evidence provided by a type 1 or type 2 report, the user auditor should be satisfied regarding the following:

- a. The service auditor's professional competence and independence from the service organization
- b. The adequacy of the standards under which the type 1 or type 2 report was issued (Ref: par. .A21–.A23)

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

.14 If the user auditor plans to use a type 1 or type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organization, the user auditor should

- a. evaluate whether the type 1 report is as of a date, or in the case of a type 2 report, is for a period that is appropriate for the user auditor's purposes;
- b. evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal control relevant to the audit; and
- c. determine whether complementary user entity controls identified by the service organization are relevant in addressing the risks of material misstatement relating to the relevant assertions in the user entity's financial statements and, if so, obtain an understanding of whether the user entity has designed and implemented such controls. (Ref: par. .A24–.A25)

² Paragraph .13 of section 315A.

Responding to the Assessed Risks of Material Misstatement

.15 In responding to assessed risks in accordance with section 330, the user auditor should

- a. determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity and, if not,
- b. perform further audit procedures to obtain sufficient appropriate audit evidence or use another auditor to perform those procedures at the service organization on the user auditor's behalf. (Ref: par. .A26–.A30)

Tests of Controls

.16 When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively, the user auditor should obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures:

- a. Obtaining and reading a type 2 report, if available
- b. Performing appropriate tests of controls at the service organization
- c. Using another auditor to perform tests of controls at the service organization on behalf of the user auditor (Ref: par. .A31–.A32)

Using a Type 2 Report as Audit Evidence That Controls at the Service Organization Are Operating Effectively

.17 If, in accordance with paragraph .16a, the user auditor plans to use a type 2 report as audit evidence that controls at the service organization are operating effectively, the user auditor should determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by

- a. evaluating whether the type 2 report is for a period that is appropriate for the user auditor's purposes;
- b. determining whether complementary user entity controls identified by the service organization are relevant in addressing the risks of material misstatement relating to the relevant assertions in the user entity's financial statements and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;
- c. evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
- d. evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment. (Ref: par. .A33–.A41)

Type 1 and Type 2 Reports That Exclude the Services of a Subservice Organization

.18 If the user auditor plans to use a type 1 or a type 2 report that excludes the services provided by a subservice organization and those services are relevant to the audit of the user entity's financial statements, the user auditor should apply the requirements of this section with respect to the services provided by the subservice organization. (Ref: par. .A42)

Fraud, Noncompliance With Laws and Regulations, and Uncorrected Misstatements Related to Activities at the Service Organization

.19 The user auditor should inquire of management of the user entity about whether the service organization has reported to the user entity, or whether the user entity is otherwise aware of, any fraud, noncompliance with laws and regulations, or uncorrected misstatements affecting the financial statements of the user entity. The user auditor should evaluate how such matters, if any, affect the nature, timing, and extent of the user auditor's further audit procedures, including the effect on the user auditor's conclusions and user auditor's report. (Ref: par. .A43)

Reporting by the User Auditor

.20 The user auditor should modify the opinion in the user auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, if the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements. (Ref: par. .A44)

.21 The user auditor should not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion. (Ref: par. .A45)

.22 If reference to the work of a service auditor is relevant to an understanding of a modification of the user auditor's opinion, the user auditor's report should indicate that such reference does not diminish the user auditor's responsibility for that opinion. (Ref: par. .A45)

Application and Other Explanatory Material

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

Sources of Information (Ref: par. .09)

.A1 Information about the nature of the services provided by a service organization may be available from a wide variety of sources, such as the following:

- User manuals
- System overviews
- Technical manuals
- The contract or service level agreement between the user entity and the service organization

- Reports by service organizations, the internal audit function, or regulatory authorities on controls at the service organization
- Reports by the service auditor, if available

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A2 Knowledge obtained through the user auditor's experience with the service organization—for example, through experience with other audit engagements—may also be helpful in obtaining an understanding of the nature of the services provided by the service organization. This may be particularly helpful if the services and controls at the service organization over those services are highly standardized.

Nature of the Services Provided by the Service Organization (Ref: par. .09a)

.A3 A user entity may use a service organization, such as one that processes transactions and maintains the related accountability for the user entity or records transactions and processes related data. Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage servicers that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions.

.A4 Examples of services provided by service organizations that may be relevant to the audit include the following:

- Maintenance of the user entity's accounting records
- Management of the user entity's assets
- Initiating, authorizing, recording, or processing transactions as an agent of the user entity

Considerations Specific to Smaller Entities

.A5 Smaller entities may use external bookkeeping services ranging from the processing of certain transactions (for example, payment of payroll taxes) and maintenance of their accounting records to the preparation of their financial statements. The use of such a service organization for the preparation of its financial statements does not relieve management of the smaller entity and, when appropriate, those charged with governance of their responsibilities for the financial statements.³

Nature and Materiality of Transactions Processed by the Service Organization (Ref: par. .09b)

.A6 A service organization may establish policies and procedures (controls) that affect the user entity's internal control. These controls are at least in part physically and operationally separate from the user entity. The significance of the controls at the service organization to the user entity's internal control depends on the nature of the services provided by the service organization, including the nature and materiality of the transactions it processes for the user entity. In certain situations, the transactions processed and the accounts affected by the service organization may not appear to be material to the user entity's

³ Paragraph .05 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of controls over the processing of those transactions is necessary in the circumstances.

The Degree of Interaction Between the Activities of the Service Organization and the User Entity (Ref: par. .09c)

.A7 The significance of the controls at the service organization to the user entity's internal control also depends on the degree of interaction between the service organization's activities and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organization. For example, a high degree of interaction exists between the activities of the user entity and those at the service organization when the user entity authorizes transactions and the service organization processes and accounts for those transactions. In these circumstances, it may be practicable for the user entity to implement effective controls over those transactions. On the other hand, when the service organization initiates or initially records, processes, and accounts for the user entity's transactions, a lower degree of interaction exists between the two organizations. In these circumstances, the user entity may be unable to, or may elect not to, implement effective controls over these transactions at the user entity and may rely on controls at the service organization.

Nature of the Relationship Between the User Entity and the Service Organization (Ref: par. .09d)

.A8 The contract or service level agreement between the user entity and the service organization may provide for matters such as the following:

- The information to be provided to the user entity and the responsibilities for initiating transactions relating to the activities undertaken by the service organization
- Complying with the requirements of regulatory bodies concerning the form of records to be maintained or access to them
- The indemnification, if any, to be provided to the user entity in the event of a performance failure
- Whether the service organization will provide a report on its controls and, if so, whether such a report will be a type 1 or type 2 report
- Whether the user auditor has rights of access to the accounting records of the user entity maintained by the service organization and other information necessary for the conduct of the audit
- Whether the agreement allows for direct communication between the user auditor and the service auditor

.A9 A direct relationship exists between the service organization and the user entity when the user entity enters into an agreement with the service organization, and between the service organization and the service auditor when the service organization engages the service auditor. These relationships do not create a direct relationship between the user auditor and the service auditor.

.A10 Communications between the user auditor and the service auditor usually are conducted through the user entity and the service organization. A user auditor may request through the user entity that a service auditor perform procedures for the benefit of the user auditor. For example, a service

auditor may be engaged by the service organization to perform an agreed-upon procedures engagement related to testing controls at a service organization or performing procedures related to a user entity's transactions or balances maintained by the service organization. AT-C section 215, *Agreed-Upon Procedures Engagements*, establishes standards and provides guidance for agreed-upon procedures engagements. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Considerations Specific to Governmental Entities

.A11 For governmental entities, the auditor may be required to perform audit procedures with respect to the entity's compliance with laws and regulations. Such required procedures may include obtaining an understanding of internal control over compliance, performing tests of controls over compliance, and performing tests of compliance. Consequently, auditors of governmental entities that use a service organization may determine that it is appropriate to request, through the governmental entity, that the service auditor perform specified compliance-related audit procedures with respect to services provided by the service organization.⁴

Understanding the Controls Relating to Services Provided by the Service Organization (Ref: par. .10)

.A12 The user entity may establish controls over the service organization's services that may be tested by the user auditor and that may enable the user auditor to conclude that the user entity's controls are operating effectively for some or all of the related assertions, regardless of the controls in place at the service organization. If a user entity, for example, uses a service organization to process its payroll transactions, the user entity may establish controls over the submission and receipt of payroll information that could prevent, or detect and correct, material misstatements. These controls may include the following:

- Comparing the data submitted to the service organization with reports of information received from the service organization after the data has been processed
- Recomputing a sample of the payroll amounts for clerical accuracy and reviewing the total amount of the payroll for reasonableness

.A13 In this situation, the user auditor may perform tests of the user entity's controls over payroll processing that would provide a basis for the user auditor to conclude that the user entity's controls are operating effectively for the assertions related to payroll transactions.

.A14 As noted in section 315A, for some risks the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.⁵ Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances that may involve highly automated processing with little or no manual intervention. Risks related to such automated processing may be particularly present when the user entity uses a service organization. In such cases, the user entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of and to evaluate such controls in accordance with paragraphs .09–.10 of this section.

⁴ Section 935, *Compliance Audits*, addresses audits of an entity's compliance.

⁵ Paragraph .31 of section 315A.

Further Procedures When a Sufficient Understanding Cannot Be Obtained From the User Entity (Ref: par. .12)

.A15 The user auditor's decision regarding which procedure, individually or in combination, in paragraph .12 to undertake in order to obtain the information necessary to provide a basis for the identification and assessment of the risks of material misstatement regarding the user entity's use of the service organization, may be influenced by such matters as the following:

- The size of both the user entity and the service organization
- The complexity of the transactions at the user entity and the complexity of the services provided by the service organization
- The location of the service organization (for example, the user auditor may decide to use another auditor to perform procedures at the service organization on the user auditor's behalf if the service organization is in a remote location)
- Whether the procedure(s) is expected to effectively provide the user auditor with sufficient appropriate audit evidence
- The nature of the relationship between the user entity and the service organization

.A16 A service organization may engage a service auditor to report on the description and design of its controls (type 1 report) or on the description and design of its controls and their operating effectiveness (type 2 report). Type 1 or type 2 reports may be issued under AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*, or under standards promulgated by an authorized or recognized standards-setting organization (for example, the International Auditing and Assurance Standards Board). [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A17 The availability of a type 1 or type 2 report generally will depend on whether the contract between the service organization and the user entity includes the provision of such a report by the service organization. A service organization may also elect, for practical reasons, to make a type 1 or type 2 report available to the user entities. However, in some cases, a type 1 or type 2 report may not be available to user entities.

.A18 In some circumstances, a user entity may outsource one or more significant business units or functions, such as its entire tax planning and compliance functions, finance and accounting functions, or the controllership function to one or more service organizations. As a report on controls at the service organization may not be available in these circumstances, visiting the service organization may be the most effective procedure for the user auditor to gain an understanding of controls at the service organization because there is likely to be direct interaction of management of the user entity with management of the service organization.

.A19 Another auditor may be used to perform procedures that will provide the necessary information about the relevant controls at the service organization. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organization. The user auditor using the work of another auditor may find the guidance in section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, useful as it relates to understanding another auditor (including that auditor's independence and professional competence); involvement

in the work of another auditor in planning the nature, extent, and timing of such work; and in evaluating the sufficiency and appropriateness of the audit evidence obtained.⁶

.A20 A user entity may use a service organization that in turn uses a subservice organization to provide some of the services provided to a user entity that are relevant to those user entities' internal control over financial reporting. The subservice organization may be a separate entity from the service organization or may be related to the service organization. A user auditor may need to consider controls at the subservice organization. In situations in which one or more subservice organizations are used, the interaction between the activities of the user entity and those of the service organization is expanded to include the interaction between the user entity, the service organization, and the subservice organizations. The degree of this interaction as well as the nature and materiality of the transactions processed by the service organization and the subservice organizations are the most important factors for the user auditor to consider in determining the significance of the service organization's and subservice organization's controls to the user entity's controls. (Ref: par. .08)

Using a Type 1 or Type 2 Report to Support the User Auditor's Understanding of the Service Organization (Ref: par. .13–.14)

.A21 The user auditor may make inquiries about the service auditor to the service auditor's professional organization or other practitioners and inquire whether the service auditor is subject to regulatory oversight. The service auditor may be practicing in a jurisdiction in which different standards are followed with respect to reports on controls at a service organization. In such a situation, the user auditor may obtain information about the standards used by the service auditor from the standards-setting organization in that jurisdiction.

.A22 Unless evidence to the contrary comes to the user auditor's attention, a service auditor's report implies that the service auditor is independent of the service organization. However, a service auditor need not be independent of the user entities.

.A23 Standards promulgated by a body designated by Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct are presumed to be adequate. Although the International Auditing and Assurance Standards Board (IAASB) is not such a body, AT-C section 320 may be helpful when the service auditor's report is issued in accordance with International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*, promulgated by the IAASB.^[7] [Paragraph added, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A24 A type 1 or type 2 report, along with information about the user entity, may assist the user auditor in obtaining an understanding of the following:

- a. The controls at the service organization that may affect the processing of the user entity's transactions, including the use of subservice organizations

⁶ Paragraphs .02 and .22 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

^[7] [Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

- b. The flow of significant transactions through the service organization's system to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur
- c. The control objectives stated in the description of the service organization's system that are relevant to the user entity's financial statement assertions
- d. Whether controls at the service organization are suitably designed and implemented to prevent, or detect and correct, processing errors that could result in material misstatements in the user entity's financial statements

A type 1 or type 2 report may assist the user auditor in obtaining a sufficient understanding to identify and assess the risks of material misstatement of the user entity's financial statements. A type 1 report, however, does not provide any evidence of the operating effectiveness of the relevant controls. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A25 A type 1 report that is as of a date, or a type 2 report that is for a period outside of the reporting period of a user entity, may assist the user auditor in obtaining a preliminary understanding of the controls implemented at the service organization if the report is supplemented by additional current information from other sources. If the description of the service organization's system is as of a date or for a period that precedes the beginning of the period under audit, the user auditor may perform procedures to update the information in a type 1 or type 2 report, such as the following:

- Discussing changes at the service organization with user entity personnel who would be in a position to know of such changes
- Reviewing current documentation and correspondence issued by the service organization
- Discussing the changes with service organization personnel

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Responding to the Assessed Risks of Material Misstatement (Ref: par. .15)

.A26 Whether the use of a service organization increases a user entity's risk of material misstatement depends on the nature of the services provided and the controls over these services; in some cases, the use of a service organization may decrease a user entity's risk of material misstatement, particularly if the user entity itself does not possess the expertise necessary to undertake particular activities, such as initiating, processing, and recording transactions, or does not have adequate resources (for example, an IT system). [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A27 When the service organization maintains material elements of the accounting records of the user entity, direct access to those records may be necessary for the user auditor to obtain sufficient appropriate audit evidence relating to the operations of controls over those records, to substantiate transactions and balances recorded in them, or both. Such access may involve physical inspection of records at the service organization's premises or electronic interrogation of records, or both. When direct access is achieved electronically, the user auditor may also obtain evidence concerning the adequacy of the service organization's controls over the completeness and integrity of the user entity's

data for which the service organization is responsible. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A28 In determining the nature and extent of audit evidence to be obtained for financial statement balances representing assets held or transactions processed by a service organization for a user entity, the following procedures may be considered by the user auditor:

- a. *Inspecting records and documents held by the user entity.* The reliability of this source of evidence is determined by the nature and extent of the accounting records and supporting documentation retained by the user entity. In some cases, the user entity may not maintain independent detailed records or documentation of specific transactions undertaken on its behalf.
- b. *Inspecting records and documents held by the service organization.* The user auditor's access to the records of the service organization may be established as part of the contractual arrangements between the user entity and the service organization. The user auditor may also use another auditor, on its behalf, to gain access to the user entity's records maintained by the service organization, or ask the service organization through the user entity for access to the user entity's records maintained by the service organization.
- c. *Obtaining confirmations of balances and transactions from the service organization.* When the user entity maintains independent records of balances and transactions, confirmation from the service organization corroborating those records usually constitutes reliable audit evidence concerning the existence of the transactions and assets concerned. For example, when multiple service organizations are used, such as an investment manager and a custodian, and these service organizations maintain independent records, the user auditor may confirm balances with these organizations in order to compare this information with the independent records of the user entity. If the user entity does not maintain independent records, information obtained in confirmations from the service organization is merely a statement of what is reflected in the records maintained by the service organization. Therefore, such confirmations do not, taken alone, constitute reliable audit evidence. In these circumstances, the user auditor may consider whether an alternative source of independent evidence can be identified.
- d. *Performing analytical procedures on the records maintained by the user entity or on the reports received from the service organization.* The effectiveness of analytical procedures is likely to vary by assertion and will be affected by the extent and detail of information available.

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A29 As noted in paragraph .A10, a service auditor may perform procedures under AT-C section 215 that are substantive in nature for the benefit of user auditors. Such an engagement may involve the performance by the service auditor of procedures agreed upon by the user entity and its user auditor and by the service organization and its service auditor. The findings resulting from the procedures performed by the service auditor are reviewed by the user auditor to determine whether they constitute sufficient appropriate audit evidence. In addition, requirements may be imposed by governmental authorities or through

contractual arrangements whereby a service auditor performs designated procedures that are substantive in nature. The results of the application of the required procedures to balances and transactions processed by the service organization may be used by the user auditor as part of the evidence necessary to support the user auditor's audit opinion. In these circumstances, it may be useful for the user auditor and the service auditor to establish an understanding prior to the performance of the procedures concerning the audit documentation or means of accessing the audit documentation that will be provided to the user auditor. [Paragraph renumbered by the issuance of SAS No. 130, December 2016. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A30 In certain circumstances, in particular when a user entity outsources some or all of its finance function to a service organization, the user auditor may face a situation in which a significant portion of the audit evidence resides at the service organization. Substantive procedures may need to be performed at the service organization by the user auditor or the service auditor on behalf of the user auditor. A service auditor may provide a type 2 report and, in addition, may perform substantive procedures on behalf of the user auditor. As noted in paragraph .A44, the involvement of a service auditor does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Accordingly, relevant information for the user auditor to consider when determining whether sufficient appropriate audit evidence has been obtained and whether the user auditor needs to perform further substantive procedures includes the user auditor's involvement with, or evidence of, the direction, supervision, and performance of the substantive procedures performed by the service auditor. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Tests of Controls (Ref: par. .16)

.A31 The user auditor is required by section 330 to design and perform tests of controls to obtain sufficient appropriate audit evidence concerning the operating effectiveness of relevant controls in certain circumstances.⁸ In the context of a service organization, this requirement applies when

- a. the user auditor's assessment of risks of material misstatement includes an expectation that the controls at the service organization are operating effectively (that is, the user auditor intends to rely on the operating effectiveness of controls at the service organization in determining the nature, timing and extent of substantive procedures); or
- b. substantive procedures alone, or in combination with tests of the operating effectiveness of controls at the user entity, cannot provide sufficient appropriate audit evidence at the assertion level.

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A32 If a type 2 report is not available, a user auditor may contact the service organization through the user entity to request that a service auditor be engaged to perform a type 2 engagement that includes tests of the operating effectiveness of the relevant controls or the user auditor may use another auditor to perform agreed-upon procedures at the service organization that test the operating effectiveness of those controls. A user auditor may also visit the service

⁸ Paragraph .08 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 130, December 2016.]

organization and perform tests of relevant controls if the service organization agrees to it. The user auditor's risk assessments are based on the combined evidence provided by the service auditor's report and the user auditor's own procedures. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Using a Type 2 Report as Audit Evidence That Controls at the Service Organization Are Operating Effectively (Ref: par. .17)

.A33 A type 2 report may be intended to satisfy the needs of several different user auditors; therefore, specific tests of controls and results described in a type 2 report may not be relevant to assertions that are significant in the user entity's financial statements. The relevant tests of controls and results of the tests are evaluated to determine whether the type 2 report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment. In doing so, the user auditor may consider the following factors:

- a. The time period covered by the tests of controls and the time elapsed since the performance of the tests of controls
- b. The scope of the service auditor's work and the services and processes covered, the controls tested and the tests that were performed, and the way in which tested controls relate to the user entity's controls
- c. The results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A34 For certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less audit evidence the test may provide. In comparing the period covered by the type 2 report to the user entity's financial reporting period, the user auditor may conclude that the type 2 report offers less audit evidence if little overlap exists between the period covered by the type 2 report and the period for which the user auditor intends to rely on the report. When this is the case, an additional type 2 report covering a preceding or subsequent period may provide additional audit evidence. In other cases, the user auditor may determine it is necessary to perform, or use another auditor to perform, tests of controls at the service organization in order to obtain sufficient appropriate audit evidence about the operating effectiveness of those controls. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A35 It may also be necessary for the user auditor to obtain additional evidence about significant changes in the relevant controls at the service organization during a period outside the period covered by the type 2 report, or to determine what additional audit procedures need to be performed (for example, when little or no overlap exists between the period covered by the type 2 report and the period covered by the user entity's financial statements). Relevant factors in determining what additional audit evidence to obtain about controls at the service organization that were operating outside the period covered by the service auditor's report may include the following:

- The significance of the assessed risks of material misstatement at the assertion level
- The specific controls that were tested during the interim period and significant changes to them since they were tested, including changes in the information systems, processes, and personnel

- The degree to which audit evidence about the operating effectiveness of those controls was obtained
- The length of the remaining period
- The extent to which the user auditor intends to reduce further substantive procedures based on the reliance on controls
- The effectiveness of the control environment and monitoring controls at the user entity

[Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A36 Additional audit evidence may be obtained, for example, by performing tests of controls that operated during the remaining period or testing the user entity's monitoring controls. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A37 If the service auditor's testing period is completely outside the user entity's financial reporting period, the user auditor will be unable to rely on such tests to conclude that the user entity's controls are operating effectively because the tests do not provide current audit period evidence of the effectiveness of the controls, unless other procedures are performed. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A38 In certain circumstances, a service provided by the service organization may be designed with the assumption that certain controls will be implemented by the user entity. For example, the service may be designed with the assumption that the user entity will have controls in place for authorizing transactions before they are sent to the service organization for processing. In such a situation, the description of the service organization's system may include a description of those complementary user entity controls. The user auditor considers whether those complementary user entity controls are relevant to the service provided to the user entity. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A39 If the user auditor believes that the service auditor's report may not provide sufficient appropriate audit evidence (for example, if a service auditor's report does not contain a description of the service auditor's tests of controls and results thereof), the user auditor may supplement his or her understanding of the service auditor's procedures and conclusions by contacting the service organization through the user entity to request a discussion with the service auditor about the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, the user auditor may contact the service organization through the user entity to request that the service auditor perform procedures at the service organization, or the user auditor may perform such procedures. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A40 The service auditor's type 2 report identifies results of tests, including deviations, and other information that could affect the user auditor's conclusions. Deviations noted by the service auditor or a modified opinion in the service auditor's report do not automatically mean that the service auditor's report will not be useful for the audit of the user entity's financial statements in assessing the risks of material misstatement. Rather, the deviations and the matter giving rise to a modified opinion in the service auditor's type 2 report are considered in the user auditor's assessment of the tests of controls performed by the service auditor. In considering the deviations and matters giving rise to a modified opinion, the user auditor may discuss such matters with the service auditor. Such communication is dependent upon the user entity contacting the service organization, and obtaining the service organization's approval for the

communication to take place. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

.A41 *Communication of significant deficiencies and material weaknesses in internal control identified during the audit.* The user auditor is required by section 265, *Communicating Internal Control Related Matters Identified in an Audit*, to communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the audit.⁹ Matters related to the use of a service organization that the user auditor may identify during the audit and may communicate to management and those charged with governance of the user entity include the following:

- Any needed monitoring controls that could be implemented by the user entity, including those identified as a result of obtaining a type 1 or type 2 report
- Instances when complementary user entity controls identified in the type 1 or type 2 report are not implemented at the user entity
- Controls that may be needed at the service organization that do not appear to have been implemented or that were implemented, but are not operating effectively

The auditor also may communicate other control related matters, including deficiencies that are not significant deficiencies or material weaknesses. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Type 1 and Type 2 Reports That Exclude the Services of a Subservice Organization (Ref: par. .18)

.A42 If a service organization uses a subservice organization, the service auditor's report may either include or exclude the subservice organization's relevant control objectives and related controls in the service organization's description of its system and in the scope of the service auditor's engagement. These two methods of reporting are known as the *inclusive method* and the *carve-out method*, respectively. If the type 1 or type 2 report excludes the controls at a subservice organization and the services provided by the subservice organization are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of this section with respect to the subservice organization. The nature and extent of work to be performed by the user auditor regarding the services provided by a subservice organization depend on the nature and significance of those services to the user entity and the relevance of those services to the audit. The application of the requirement in paragraph .09 assists the user auditor in determining the effect of the subservice organization and the nature and extent of work to be performed. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Fraud, Noncompliance With Laws and Regulations, and Uncorrected Misstatements Related to Activities at the Service Organization (Ref: par. .19)

.A43 A service organization may be required under the terms of the contract with user entities to disclose to affected user entities any fraud, noncompliance with laws and regulations, or uncorrected misstatements attributable

⁹ Paragraphs .11–.12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote renumbered by the issuance of SAS No. 130, December 2016.]

to the service organization's management or employees. As required by paragraph .19, the user auditor makes inquiries of the user entity management regarding whether the service organization has reported any such matters and evaluates whether any matters reported by the service organization affect the nature, timing, and extent of the user auditor's further audit procedures. In certain circumstances, the user auditor may require additional information to perform this evaluation and may request that the user entity contact the service organization to obtain the necessary information. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Reporting by the User Auditor (Ref: par. .20)

.A44 When a user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organization relevant to the audit of the user entity's financial statements, a limitation on the scope of the audit exists. This may be the case when

- the user auditor is unable to obtain a sufficient understanding of the services provided by the service organization and does not have a basis for the identification and assessment of the risks of material misstatement;
- a user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively and the user auditor is unable to obtain sufficient appropriate audit evidence about the operating effectiveness of these controls; or
- sufficient appropriate audit evidence is only available from records held at the service organization, and the user auditor is unable to obtain direct access to these records.

Whether the user auditor expresses a qualified opinion or disclaims an opinion depends on the user auditor's conclusion regarding whether the possible effects on the financial statements are material, pervasive, or both.¹⁰ [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

Reference to the Work of the Service Auditor (Ref: par. .21–.22)

.A45 The fact that a user entity uses a service organization does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Therefore, the user auditor does not make reference to the service auditor's report as a basis, in part, for the user auditor's opinion on the user entity's financial statements. However, when the user auditor expresses a modified opinion because of a modified opinion in a service auditor's report, the user auditor is not precluded from referring to the service auditor's report if such reference assists in explaining the reason for the user auditor's modified opinion. In such circumstances, the user auditor need not identify the service auditor by name and may need the consent of the service auditor before making such a reference. [Paragraph renumbered by the issuance of SAS No. 130, December 2016.]

¹⁰ Paragraphs .07–.10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 130, December 2016.]

AU-C Section 450

Evaluation of Misstatements Identified During the Audit

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 136; SAS No. 137; SAS No. 138.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to evaluate the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements. Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, address the auditor's responsibility in forming an opinion on the financial statements based on the evaluation of the audit evidence obtained. The auditor's conclusion, required by section 700 or section 703, takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements, in accordance with this section. Section 320, *Materiality in Planning and Performing an Audit*, addresses the auditor's responsibility to appropriately apply the concept of materiality in planning and performing an audit of financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

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

Objective

- .03 The objective of the auditor is to evaluate the effect of
- identified misstatements on the audit and
 - uncorrected misstatements, if any, on the financial statements.

Definitions

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

Misstatement. A difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with

the applicable financial reporting framework. Misstatements can arise from fraud or error. (Ref: par. .A1)

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Uncorrected misstatements. Misstatements that the auditor has accumulated during the audit and that have not been corrected.

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

Requirements

Accumulation of Identified Misstatements

.05 The auditor should accumulate misstatements identified during the audit, other than those that are clearly trivial. (Ref: par. .A2–.A3)

Consideration of Identified Misstatements as the Audit Progresses

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

- a. the nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material or (Ref: par. .A7)
- b. the aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with section 320.¹ (Ref: par. .A8)

Communication and Correction of Misstatements

.07 The auditor should communicate on a timely basis with the appropriate level of management all misstatements accumulated during the audit. The auditor should request management to correct those misstatements. (Ref: par. .A9–.A11)

.08 If, at the auditor's request, management has examined a class of transactions, account balance, or disclosure and corrected misstatements that were detected, the auditor should perform additional audit procedures to determine whether misstatements remain. (Ref: par. .A12–.A14)

.09 If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor should obtain an understanding of management's reasons for not making the corrections and should take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.² (Ref: par. .A15–.A18)

¹ Paragraph .10 of section 320, *Materiality in Planning and Performing an Audit*.

² Paragraph .13 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraph .38 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Evaluating the Effect of Uncorrected Misstatements

.10 Prior to evaluating the effect of uncorrected misstatements, the auditor should reassess materiality³ to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: par. .A19–.A21)

.11 The auditor should determine whether uncorrected misstatements are material, individually or in the aggregate. In making this determination, the auditor should consider

- a. the size and nature of the misstatements, both in relation to particular classes of transactions, account balances, or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and (Ref: par. .A22–.A29 and .A31–.A32)
- b. the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances, or disclosures and the financial statements as a whole. (Ref: par. .A30)

Documentation

.12 The auditor should include in the audit documentation⁴ (Ref: par. .A33)

- a. the amount below which misstatements would be regarded as clearly trivial; (See paragraph .05)
- b. all misstatements accumulated during the audit and whether they have been corrected; and (See paragraphs .05–.07)
- c. the auditor's conclusion about whether uncorrected misstatements are material, individually or in the aggregate, and the basis for that conclusion. (See paragraph .11)

Application and Other Explanatory Material

Definitions

Misstatement (Ref: par. .04)

.A1 Misstatements may result from fraud or error, such as

- a. an inaccuracy in gathering or processing data from which the financial statements are prepared;
- b. an omission of an amount or disclosure, including inadequate or incomplete disclosures and omission of those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable;
- c. a financial statement disclosure that is not presented in accordance with the applicable financial reporting framework;
- d. an incorrect accounting estimate arising from overlooking or clear misinterpretation of facts;

³ Paragraph .12 of section 320.

⁴ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- e. judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate;
- f. an inappropriate classification, aggregation, or disaggregation of information; and
- g. the omission of a disclosure necessary for the financial statements to achieve fair presentation beyond disclosures specifically required by the framework.

Other examples of misstatements arising from fraud are provided in section 240, *Consideration of Fraud in a Financial Statement Audit*.⁵ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Accumulation of Identified Misstatements (Ref: par. .05)

"Clearly Trivial"

.A2 Paragraph .05 requires the auditor to accumulate misstatements identified during the audit other than those that are clearly trivial. "Clearly trivial" is not another expression for "not material." Misstatements that are clearly trivial will be of a wholly different (smaller) order of magnitude, or of a wholly different nature, than those that would be determined to be material and will be misstatements that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the misstatement is considered not to be clearly trivial. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Misstatements in Individual Statements

.A3 The auditor may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, misstatements of amounts that are above the designated amount would be accumulated as required by paragraph .05. In addition, misstatements relating to amounts may not be clearly trivial based on their nature or circumstances and, if not clearly trivial, would be accumulated as required by paragraph .05 of this section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Misstatements in Disclosures

.A4 Misstatements in disclosures may also be clearly trivial whether taken individually or in the aggregate and whether judged based on size, nature, or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating the effect of such misstatements on the relevant disclosures and the financial statements as a whole. Paragraph .A23 provides examples of when misstatements in qualitative disclosures may be material. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁵ Paragraphs .A1–.A8 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

Accumulation of Misstatements

.A5 Misstatements by nature or circumstances, accumulated as described in paragraphs .A3–.A4, cannot be added together as is possible in the case of misstatements of amounts. Nevertheless, the auditor is required by paragraph .11 to evaluate those misstatements individually and in the aggregate (that is, collectively with other misstatements) to determine whether they are material. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A6 To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, the auditor may find it useful to distinguish between factual misstatements, judgmental misstatements, and projected misstatements, described as follows:

- *Factual misstatements* are misstatements about which there is no doubt.
- *Judgmental misstatements* are differences arising from the judgments of management including those concerning recognition, measurement, presentation, and disclosure in the financial statements (including the selection or application of accounting policies) that the auditor considers unreasonable or inappropriate.
- *Projected misstatements* are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in section 530, *Audit Sampling*.⁶

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

Consideration of Identified Misstatements as the Audit Progresses (Ref: par. .06)

.A7 A misstatement may not be an isolated occurrence. Evidence that other misstatements may exist include, for example, when the auditor identifies that a misstatement arose from a breakdown in internal control or from inappropriate assumptions or valuation methods that have been widely applied by the entity. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A8 If the aggregate of misstatements accumulated during the audit approaches materiality,⁷ a greater than acceptably low level of risk may exist that possible undetected misstatements, when taken with the aggregate of uncorrected misstatements accumulated during the audit, could exceed materiality. Undetected misstatements could exist because of the presence of sampling risk and nonsampling risk.⁸ [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

⁶ Paragraphs .13–.14 of section 530, *Audit Sampling*.

⁷ Paragraph .12 of section 320.

⁸ Paragraph .05 of section 530.

Communication and Correction of Misstatements (Ref: par. .07–.09)

.A9 Timely communication of misstatements to the appropriate level of management is important because it enables management to evaluate whether the classes of transactions, account balances, and disclosures are misstated, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and take the necessary action. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A10 Law or regulation may restrict the auditor's communication of certain misstatements to management or others within the entity. For example, laws or regulations may specifically prohibit a communication or other action that might prejudice an investigation by an appropriate authority into an instance of noncompliance or suspected noncompliance with laws or regulations. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider seeking legal advice. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A11 The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A12 The auditor may request management to examine a class of transactions, account balance, or disclosure in order for management to understand the cause of a misstatement identified by the auditor; perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance, or disclosure; and make appropriate adjustments to the financial statements. Such a request may be made, for example, based on the auditor's projection of misstatements identified in an audit sample to the entire population from which it was drawn. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A13 The auditor may request management to record an adjustment needed to correct all factual misstatements, including the effect of prior period misstatements (see paragraph .08), other than those that the auditor believes are clearly trivial. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A14 When the auditor has identified a judgmental misstatement involving differences in estimates, such as a difference in a fair value estimate, the auditor may request management to review the assumptions and methods used in developing management's estimate. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A15 Sections 700 and 703 require the auditor to evaluate whether the financial statements are presented fairly, in all material respects, in accordance with the requirements of the applicable financial reporting framework.⁹ This

⁹ Paragraph .12 of section 700 and paragraph .37 of section 703, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

evaluation includes consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments, which may be affected by the auditor's understanding of management's reasons for not making the corrections (see section 700).¹⁰ [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A16 Section 580, *Written Representations*, addresses management representations, including representations with respect to uncorrected misstatements.¹¹ [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A17 In accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*, identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected by the entity's internal control is an indicator of a material weakness.¹² [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A18 Section 260, *The Auditor's Communication With Those Charged With Governance*, addresses matters to be communicated by the auditor to those charged with governance, including uncorrected misstatements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)

.A19 The auditor's determination of materiality in accordance with section 320 often is based on estimates of the entity's financial results because the actual financial results may not yet be known.¹³ Therefore, prior to the auditor's evaluation of the effect of uncorrected misstatements, it may be necessary to revise materiality determined in accordance with section 320 based on the actual financial results. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A20 Section 320 explains that, as the audit progresses, materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances, or disclosures) is revised in the event of the auditor becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.¹⁴ Thus, any significant revision is likely to have been made before the auditor evaluates the effect of uncorrected misstatements. However, if the auditor's reassessment of materiality determined in accordance with section 320 (see paragraph .10 of this section) gives rise to a lower amount (or amounts), then performance materiality and the appropriateness of the nature, timing, and extent of the further audit procedures are reconsidered in order to

¹⁰ Paragraph .14 of section 700 and paragraph .39 of section 703, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹¹ Paragraph .14 of section 580, *Written Representations*.

¹² Paragraph .A11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

¹³ Paragraph .10 of section 320.

¹⁴ Paragraph .12 of section 320.

obtain sufficient appropriate audit evidence on which to base the audit opinion. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A21 Materiality is determined based on the auditor's understanding of the user needs and expectations (see section 320).¹⁵ Although user expectations may differ based on inherent uncertainty associated with the measurement of particular items in the financial statements, these expectations have already been considered in the auditor's determination of materiality. For example, the fact that the financial statements include very large provisions with a high degree of estimation uncertainty (for example, provisions for insurance claims in the case of an insurance company; oil rig decommissioning costs in the case of an oil company; or, more generally, legal claims against an entity) may influence the auditor's assessment of what users might consider material. However, after materiality is reassessed, this section requires the auditor to evaluate any misstatements in accordance with that level of materiality, regardless of the degree of inherent uncertainty associated with the measurement of particular items in the financial statements. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A22 Each individual misstatement of an amount is considered to evaluate its effect on the relevant classes of transactions, account balances, or disclosures, including whether the materiality level for that particular class of transactions, account balance, or disclosure, if any, has been exceeded. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A23 In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosures, as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples of misstatements that may be material include the following:

- Inaccurate or incomplete descriptions of information about the objectives, policies, and processes for managing capital
- The omission of information about the events or circumstances that have led to an impairment loss (for example, a significant long-term decline in the demand for a metal or commodity)
- An incorrect description of an accounting policy relating to a significant item in any of the statements that the financial statements comprise
- An inadequate description of the sensitivity of an exchange rate

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

.A24 In determining whether uncorrected misstatements by nature are material as required by paragraph .11, the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually or in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider the following:

- Whether identified errors are recurring or pervasive

¹⁵ Paragraph .10 of section 320.

- Whether a number of identified misstatements are relevant to the same matter and, considered collectively, may affect the users' understanding of that matter

This consideration of accumulated misstatements is also helpful when evaluating the financial statements as discussed in paragraph .A15 of section 700, *Forming an Opinion and Reporting on Financial Statements*,¹⁶ or paragraph .A70 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*,¹⁷ which states that evaluating whether the financial statements achieve fair presentation may include discussions with management about whether the presentation of amounts or disclosures obscures useful information or results in misleading information. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A25 The auditor is required by section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, to evaluate the effect on the group audit opinion of any uncorrected misstatement identified by the group engagement team or communicated by the component auditors.¹⁸ [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A26 If an individual misstatement is judged to be material, it is unlikely that it can be offset by other misstatements. For example, if revenue has been materially overstated, the financial statements as a whole will be materially misstated, even if the effect of the misstatement on earnings is completely offset by an equivalent overstatement of expenses. It may be appropriate to offset misstatements within the same account balance or class of transactions; however, the risk that further undetected misstatements may exist is considered before concluding that offsetting even immaterial misstatements is appropriate. The auditor may need to reassess the risks of material misstatement for a specific account balance or class of transactions upon identification of a number of immaterial misstatements within that account balance or class of transactions. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A27 Determining whether a classification misstatement is material involves the evaluation of qualitative considerations, such as the effect of the classification misstatement on debt or other contractual covenants, the effect on individual line items or subtotals, or the effect on key ratios. Circumstances may exist in which the auditor concludes that a classification misstatement is not material in the context of the financial statements as a whole, even though it may exceed the materiality level or levels applied in evaluating other misstatements. For example, a misclassification between balance sheet line items may not be considered material in the context of the financial statements as a whole when the amount of the misclassification is small in relation to the size of the related balance sheet line items and the misclassification does not affect the income statement or any key ratios. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

¹⁶ Paragraph .16 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁷ Paragraph .41 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

¹⁸ Paragraph .44 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

.A28 The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than materiality for the financial statements as a whole. Circumstances that may affect the evaluation include the extent to which the misstatement

- affects compliance with regulatory requirements.
- affects compliance with debt covenants or other contractual requirements.
- relates to the incorrect selection or application of an accounting policy that has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements.
- masks a change in earnings or other trends, especially in the context of general economic and industry conditions.
- affects ratios used to evaluate the entity's financial position, results of operations, or cash flows.
- affects segment information presented in the financial statements (for example, the significance of the matter to a segment or other portion of the entity's business that has been identified as playing a significant role in the entity's operations or profitability).
- has the effect of increasing management compensation (for example, by ensuring that the requirements for the award of bonuses or other incentives are satisfied).
- is significant with regard to the auditor's understanding of known previous communications to users (for example, regarding forecast earnings).
- relates to items involving particular parties (for example, whether external parties to the transaction are related to members of the entity's management).
- is an omission of information not specifically required by the applicable financial reporting framework but that, in the professional judgment of the auditor, is important to the users' understanding of the financial position, financial performance, or cash flows of the entity.
- affects other information that will be communicated in documents containing the audited financial statements (for example, information to be included in a "Management Discussion and Analysis" or an "Operating and Financial Review") when there is substantial likelihood that the other information would influence the judgment made by a reasonable user based on the financial statements. Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, addresses the auditor's responsibilities relating to other information, whether financial or nonfinancial information (other than the financial statements and the auditor's report thereon), included in an entity's annual report.
- is a misclassification between certain account balances affecting items disclosed separately in the financial statements (for example, misclassification between operating and nonoperating income or recurring and nonrecurring income items or a misclassification

between restricted and unrestricted resources in a not-for-profit entity).

- offsets effects of individually significant but different misstatements.
- is currently immaterial and likely to have a material effect in future periods because of a cumulative effect, for example, that builds over several periods.
- is too costly to correct. It may not be cost beneficial for the client to develop a system to calculate a basis to record the effect of an immaterial misstatement. On the other hand, if management appears to have developed a system to calculate an amount that represents an immaterial misstatement, it may reflect a motivation of management.
- represents a risk that possible additional undetected misstatements would affect the auditor's evaluation.
- changes a loss into income or vice versa.
- heightens the sensitivity of the circumstances surrounding the misstatement (for example, the implications of misstatements involving fraud and possible instances of noncompliance with laws or regulations, violations of contractual provisions, and conflicts of interest).
- has a significant effect relative to reasonable user needs (for example,
 - earnings to investors and the equity amounts to creditors,
 - the magnifying effects of a misstatement on the calculation of purchase price in a transfer of interests [buy-sell agreement], and
 - the effect of misstatements of earnings when contrasted with expectations).
- relates to the definitive character of the misstatement (for example, the precision of an error that is objectively determinable as contrasted with a misstatement that unavoidably involves a degree of subjectivity through estimation, allocation, or uncertainty).
- indicates the motivation of management (for example, [i] an indication of a possible pattern of bias by management when developing and accumulating accounting estimates, [ii] a misstatement precipitated by management's continued unwillingness to correct weaknesses in the financial reporting process, or [iii] an intentional decision not to follow the applicable financial reporting framework).

These circumstances are only examples — not all are likely to be present in all audits nor is the list necessarily complete. The existence of any circumstances such as these does not necessarily lead to a conclusion that the misstatement is material. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A29 Section 240 explains how the implications of a misstatement that is, or may be, the result of fraud are required to be considered with regard to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements.¹⁹ Depending on the circumstances, misstatements in disclosures could also be indicative of fraud and, for example, may arise from the following:

- Misleading disclosures that have resulted from bias in management's judgments
- Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements

When considering the implications of misstatements in classes of transactions, account balances, and disclosures, the auditor exercises professional skepticism in accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.²⁰ [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A30 The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's financial statements. Different acceptable approaches to the auditor's evaluation of such uncorrected misstatements on the current period's financial statements are available. Using the same evaluation approach provides consistency from period to period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Considerations Specific to Governmental Entities

.A31 In the case of an audit of a governmental entity, the evaluation of whether a misstatement is material also may be affected by the auditor's responsibilities established by law or regulation to report specific matters, including, for example, fraud. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A32 Furthermore, issues such as public interest, accountability, integrity, and ensuring effective legislative oversight, in particular, may affect the assessment of whether an item is material by virtue of its nature. This is particularly so for items that relate to compliance with law or regulation. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .12)

.A33 The auditor's documentation of uncorrected misstatements may take into account the following:

- a. The consideration of the aggregate effect of uncorrected misstatements
- b. The evaluation of whether the materiality level or levels for particular classes of transactions, account balances, or disclosures, if any, have been exceeded

¹⁹ Paragraph .35 of section 240. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

²⁰ Paragraph .17 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

- c. The evaluation of the effect of uncorrected misstatements on key ratios or trends and compliance with legal, regulatory, and contractual requirements (for example, debt covenants)

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

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AU-C Section 500

Audit Evidence

(Supersedes SAS No. 122 section 500)

Source: SAS No. 142.

Effective for audits of financial statements for periods ending on or after December 15, 2022.

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section explains what constitutes audit evidence in an audit of financial statements and sets out attributes of information that are taken into account by the auditor when evaluating information to be used as audit evidence. Taking these attributes into account assists the auditor in maintaining professional skepticism. (Ref: par. .A1)

.02 The application of this section assists the auditor in fulfilling the auditor's responsibilities in other AU-C sections. This section should be read in conjunction with other AU-C sections, including those that address the auditor's responsibilities to identify and assess the risks of material misstatement,¹ design and implement responses to the risks of material misstatement identified and assessed by the auditor,² and form an opinion on the financial statements.³ In particular, section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained and thereby provides a basis for the auditor's opinion. (Ref: par. .A2)

.03 The auditor's overall conclusion in accordance with section 330 about whether sufficient appropriate audit evidence has been obtained is a matter of professional judgment. Evaluating information to be used as audit evidence in accordance with this section assists the auditor in making that conclusion. The auditor's evaluation of information to be used as audit evidence is not a

¹ See section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

² Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

³ Section 700, *Forming an Opinion and Reporting on Financial Statements*.

formulaic exercise and is dependent on the degree to which the attributes of information to be used as audit evidence influence the auditor's evaluation. (Ref: par. .A3–.A4)

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2022.

Objective

.05 The objective of the auditor is to evaluate information to be used as audit evidence, including the results of audit procedures, to inform the auditor's overall conclusion about whether sufficient appropriate audit evidence has been obtained.

Definitions

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

Appropriateness (of audit evidence). The measure of the quality of audit evidence, that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based. (Ref: par. .A9)

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence is information to which audit procedures have been applied and consists of information that corroborates or contradicts assertions in the financial statements. (Ref: par. .A5–.A10)

External information source. An external individual or organization that provides information that is used by the entity in preparing the financial statements or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users. When information has been provided by an individual or organization acting in the capacity of management's specialist, service organization,⁴ or auditor's specialist,⁵ the individual or organization is not considered an external information source with respect to that particular information.

Sufficiency (of audit evidence). The measure of the quantity of audit evidence. The quantity of audit evidence necessary is affected by the auditor's assessment of the risks of material misstatement and the quality of the audit evidence obtained (that is, its appropriateness). (Ref: par. .A9–.A10)

Requirements

Evaluating Information to Be Used as Audit Evidence

.07 The auditor should evaluate information to be used as audit evidence by taking into account (Ref: par. .A11)

⁴ See section 402, *Audit Considerations Relating to an Entity Using a Service Organization*.

⁵ See section 620, *Using the Work of an Auditor's Specialist*.

- a. the relevance and reliability of the information, including its source, and (Ref: par. .A12–.A34)
- b. whether such information corroborates or contradicts assertions in the financial statements. (Ref: par. .A35–.A38)

.08 The auditor's evaluation of the information to be used as audit evidence in accordance with paragraph .07 should include

- a. evaluating whether the information is sufficiently precise and detailed for the auditor's purposes and (Ref: par. .A39)
- b. obtaining audit evidence about the accuracy and completeness of the information, as necessary (Ref: par. .A40–.A42).

Audit Procedures as a Basis for Concluding on the Sufficiency and Appropriateness of Audit Evidence

.09 In evaluating information to be used as audit evidence, the auditor should consider whether the results of audit procedures provide a basis for concluding on the sufficiency and appropriateness of audit evidence obtained. (Ref: par. .A43–.A64)

Inconsistencies in, or Doubts About the Reliability of, Audit Evidence

.10 The auditor should determine whether modifications or additions to audit procedures are necessary to resolve inconsistencies in, or doubts about the reliability of, audit evidence, including when

- a. audit evidence obtained from one source is inconsistent with that obtained from another source.
- b. the results of an audit procedure are inconsistent with the results of another audit procedure.

(Ref: par. .A65–.A66)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.03)

.A1 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, defines *professional skepticism* and *professional judgment*.⁶ Section 200 and section 330 provide application material about maintaining professional skepticism and exercising professional judgment.⁷ The auditor's evaluation of information to be used as audit evidence in accordance with this section involves maintaining professional skepticism, including the consideration of whether unconscious or conscious auditor biases may affect the auditor's professional judgments.⁸ Paragraphs .A17, .A30–.A31, .A37–.A38, .A60, and .A63 of this section are examples of paragraphs that describe ways in which the auditor can maintain professional skepticism.

⁶ Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

⁷ Paragraphs .A22–.A31 of section 200.

⁸ See paragraph .A27 of section 200.

.A2 Paragraph .02 states that this section should be read in conjunction with other AU-C sections. For example, the objective of section 330 is for the auditor to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement through designing and implementing appropriate responses to those risks.⁹ Section 330 also states that the auditor is required to do the following:

- Design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.¹⁰
- Obtain more persuasive audit evidence the higher the auditor's assessment of risk.¹¹
- Conclude whether sufficient appropriate audit evidence has been obtained.¹²
- Attempt to obtain further audit evidence if the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion.¹³

In addition, section 700, *Forming an Opinion and Reporting on Financial Statements*, requires the auditor to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The conclusions required by section 700 take into account, among other things, whether sufficient appropriate audit evidence has been obtained in accordance with section 330.¹⁴

.A3 Audit evidence is cumulative in nature and is obtained through the performance of one or more audit procedures on information obtained during the course of the audit. The auditor's evaluation of information to be used as audit evidence may be enhanced by the use of automated tools and techniques, which may enable the auditor to aggregate or disaggregate information or consider information obtained from multiple sources.

.A4 For example, the auditor may use automated tools and techniques for the purpose of planning or performing the audit, such as audit data analytics. *Data analytics* is described as the analysis of patterns, identification of anomalies, or extraction of other useful information in data underlying or related to the subject matter of an audit through analysis, modeling, or visualization. Examples of other automated tools and techniques are artificial intelligence, machine learning, remote observation tools, and robotic process automation.

Definitions (Ref: par. .06)

Audit Evidence

.A5 *Audit evidence* is information to which audit procedures have been applied, ordinarily during the course of the current-year audit. Information to be used as audit evidence may also be obtained by the auditor as part of designing and performing risk assessment procedures in accordance with section 315A,

⁹ Paragraph .03 of section 330.

¹⁰ Paragraph .06 of section 330.

¹¹ Paragraph .07b of section 330.

¹² Paragraph .28 of section 330.

¹³ Paragraph .29 of section 330.

¹⁴ Paragraph .13a of section 700.

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, including from

- a. the auditor's previous experience with the entity and audit procedures performed in previous audits, when the auditor has evaluated whether such information remains relevant and reliable as audit evidence for the current audit,
- b. the auditor's procedures regarding acceptance or continuance of the client relationship or the audit engagement, and
- c. when applicable, other engagements performed by the engagement partner for the entity.

.A6 The nature of the audit procedures that the auditor performs to use information as audit evidence may depend on the source of the information and range from simple to extensive audit procedures. For example, when using information from an external information source, obtaining the information may be relatively straightforward, and the auditor's procedures to evaluate that information would be largely focused on the relevance and reliability of the information, including its source, in accordance with this section. On the other hand, audit procedures to obtain evidence about the accuracy and completeness of the information, such as tests of controls, may be necessary when the auditor intends to use information generated internally from the entity's general and subsidiary ledgers as audit evidence.

.A7 In some cases, the absence of information is used by the auditor and, therefore, also constitutes audit evidence.¹⁵ For example, when considering information regarding management's assertions related to the entity's recorded warranty provision, the absence of sales returns of the product in question may be audit evidence supporting management's assertion about the completeness of the warranty provision.

Sufficient Appropriate Audit Evidence

.A8 As explained in section 200, reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.¹⁶

.A9 As explained in section 200, the sufficiency and appropriateness of audit evidence are interrelated.¹⁷ Together they affect the persuasiveness of audit evidence. The auditor's conclusion about whether sufficient appropriate audit evidence has been obtained in accordance with section 330 is both at the financial statement level as well as the relevant assertion level. Section 330 requires the auditor to obtain more persuasive audit evidence the higher the assessment of risk.¹⁸ For example, ordinarily, more persuasive audit evidence is needed to respond to significant risks. *Persuasiveness*, therefore, relates to the auditor obtaining appropriate audit evidence that is sufficient for the auditor to draw reasonable conclusions.

.A10 The quantity of audit evidence, in and of itself, is not solely determinative of its persuasiveness. For example, obtaining more of the same type of audit evidence may not compensate for its lack of appropriateness. However, as the quality of audit evidence increases, the need for additional corroborating

¹⁵ Paragraph .A32 of section 200.

¹⁶ Paragraph .06 of section 200.

¹⁷ Paragraph .A33 of section 200.

¹⁸ See paragraph .07b of section 330.

audit evidence decreases. Depending on the auditor's consideration of relevance and reliability, information obtained from a single source may provide persuasive audit evidence.

Evaluating Information to Be Used as Audit Evidence (Ref: par. .07–.08)

.A11 Information to be used as audit evidence may take different forms, which influences the nature of audit procedures that may be necessary to obtain or evaluate the information. Different forms of information, individually or in combination, include

- *oral information* obtained through a verbal response to an inquiry of management or external information sources (for example, oral inquiries made during the course of the audit).
- *visual information* obtained through observation (for example, a message that appears on-screen for a control restricting access to an IT) system or observed by the auditor using remote observation tools).
- *paper documents*, which are obtained in documentary form (for example, an original executed sales contract or a written confirmation).
- *electronic information*, which includes
 - *documents* obtained in electronic documentary form (for example, a scanned version of an executed sales contract or an electronic confirmation).
 - *data* stored in the entity's IT system or obtained electronically from an external information source. Such data may be manually input into the system or may be electronically generated (for example, an electronic data interface between the entity and a service organization).

Relevance and Reliability of the Information, Including Its Source (Ref: par. .07a)

Sources of Information to Be Used as Audit Evidence

.A12 The source of the information to be used as audit evidence often affects the consideration of its relevance and reliability. Information to be used as audit evidence may be obtained directly or derived individually or in combination from different sources, including the following:

- a. *Management.* Management may provide the auditor with information obtained from the financial reporting process used to prepare the financial statements, including disclosures (for example, the entity's accounting records) as well as information obtained from outside of the general and subsidiary ledgers (for example, from the entity's risk management system or sales functions). This information may be stored by the entity within its IT systems or in a remote server. Management may also employ or engage a specialist who may provide information to be used as audit evidence.¹⁹

¹⁹ See section 501, *Audit Evidence — Specific Considerations for Selected Items*.

- b. *External information sources and other external parties.* Management or the auditor may use information obtained from external information sources and other external parties (for example, information used as inputs to forecasts or models used to prepare accounting estimates or accumulated by an auditor to analyze industry trends). The auditor may obtain external confirmations or make inquiries of external parties to corroborate management's assertions. See appendix A, "Considerations Regarding the Use of External Information Sources," for the auditor's considerations when using external information sources.
- c. *Auditor.* The auditor may develop information to be used as audit evidence. For example, an auditor may accumulate and analyze industry trends to be used in the audits of entities in that industry. The auditor may also employ or engage a specialist to assist the auditor in developing audit evidence, which could include developing an independent expectation to evaluate the reasonableness of an accounting estimate. The auditor may also use automated tools and techniques to analyze information provided by management or external parties, resulting in audit evidence.

.A13 Accounting records are an example of information provided by management that is obtained from the financial reporting process and may include the following:

- The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers; and journal entries
- Records, such as spreadsheets, cost allocations, computations, reconciliations, and disclosures

.A14 An example of information provided by management that is obtained from outside the general and subsidiary ledgers is internal marketing information developed by the entity's sales function as an assumption in making an accounting estimate for a warranty provision.

.A15 External confirmation²⁰ procedures may provide relevant information to be used as audit evidence when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to classes of transactions, account balances, or disclosures. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, the relevant details. External confirmation procedures are also used to obtain audit evidence about the absence of certain conditions (for example, the absence of a side agreement that may influence revenue recognition).

.A16 As indicated in paragraph .A12, information to be used as audit evidence by the auditor may be obtained directly or derived individually or in combination from different sources. For example, in making an accounting estimate for an accumulated pension obligation, management may use information that is obtained from the general and subsidiary ledgers; information obtained from outside the general and subsidiary ledgers; and information obtained from a management's specialist. Similarly, an auditor may obtain information to be used as audit evidence from multiple sources. For example, in performing a

²⁰ See section 505, *External Confirmations*.

regression analysis to test revenue recorded, the auditor may obtain information about square footage of retail space and sales prices (both management-generated) and changes in an index published by a government agency (an external information source).

A17 In some situations, there may be only one source of certain information external to the entity, for example, information from a central bank or government, such as an inflation rate, or single recognized industry body. In such cases, taking into account the reliability of such information is influenced by the nature and credibility of the source of the external information, the assessed risks of material misstatement to which that external information is relevant, and the degree to which the use of that external information is relevant to the reasons for the assessed risk of material misstatement. For example, when the information is from a credible authoritative source, the extent of the auditor's further audit procedures may be less extensive, such as corroborating the information with the source's website or published information. In other cases, when information is from a source not assessed as credible, the auditor may determine that more extensive audit procedures are appropriate. In the absence of an alternative independent information source against which to compare, the auditor may consider whether performing additional audit procedures to obtain information from the external information source is appropriate in order to obtain sufficient appropriate audit evidence (see paragraph 9 in appendix A).

A18 In certain circumstances, the source of information may be a combination of management and external parties. For example, if an entity develops a distributed ledger to capture its transactions, there may be few or many other external parties participating in the transactions and contributing to the information included in the distributed ledger. Therefore, the source of the information included in the distributed ledger is not solely management but also external parties. In such circumstances, professional judgment is exercised by the auditor to evaluate the relevance and reliability of the information obtained from the distributed ledger to be used as audit evidence.

Relevance and Reliability

A19 *Relevance.* The relevance of the information to be used as audit evidence relates to the logical connection with, or bearing upon, the auditor's purposes. Information from one source may be relevant when performing one or more audit procedures (for example, sales information provided by management may be used to perform procedures related to both the entity's warranty provision and evaluation of management's cash flows forecast related to the entity's warranty provision). The following are factors that, individually or in combination, may affect the relevance of information to be used as audit evidence:

- The classes of transactions, account balances, or disclosures or assertions to which the information relates. Information to be used as audit evidence may be relevant to multiple classes of transactions, account balances, or disclosures.
- The period of time to which the information relates.

A20 The following examples illustrate the relevance of information to be used as audit evidence:

- Recorded accounts payable may provide relevant information when the objective of the audit procedures is to test the existence or valuation pertaining to accounts payable.
- Employee salaries may provide relevant information regarding an accounting estimate for a bonus accrual.

- Commodity pricing data may be used in the performance of an audit data analytic to evaluate recorded revenue. The period of time used for the commodity pricing data has to be relevant to the time period revenue was recorded.

.A21 Certain information to be used as audit evidence may have direct relevance to one financial statement assertion but may not be relevant to all assertions:

- Inspection of a document constituting a financial instrument, such as a stock, bond, or a digital copy of a mortgage, may provide relevant audit evidence about existence but may not necessarily provide audit evidence about ownership or valuation.
- Inspection of tangible assets may provide relevant audit evidence with respect to their existence but not necessarily about the entity's rights and obligations.
- The collection of receivables after the period-end may provide relevant audit evidence regarding existence and valuation of receivables and occurrence and accuracy of revenue but not necessarily completeness of receivables and revenue.

.A22 Reliability. The reliability of audit evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias. Consideration of the sources of information to be used as audit evidence includes the possibility that the information source may not be reliable.

.A23 Information obtained directly by the auditor (for example, observation of the application of a control) may be more reliable than information obtained indirectly or by inference (for example, inquiry about the application of a control). When information has been obtained indirectly or by inference, the auditor may perform additional audit procedures to evaluate the reliability of that information, such as by reperforming the control activity.

.A24 Information in documentary form, whether paper or electronic, may be more reliable than evidence obtained through oral inquiries (for example, a contemporaneously written record of a meeting may be more reliable than a subsequent oral representation of the matters discussed).

.A25 Determining whether controls are effectively designed and implemented (including general IT controls, as appropriate) may help the auditor design appropriate audit procedures to evaluate the reliability of information.²¹ In some cases, the reliability of such information may only be established when the related controls, whether manual or automated, including those over the preparation and maintenance of the information, have been tested and determined to be operating effectively.²²

.A26 Using electronic information may require the auditor to perform additional audit procedures to establish its reliability. For example, when using a scanned version of an executed sales contract provided by the sales department, additional audit procedures, such as confirmation of the key terms with a third party, may be necessary if the auditor has not tested the operating effectiveness of the controls around execution of the original contract and the maintenance of the scanned version.

²¹ See paragraph .07 of this section.

²² See also paragraph .05b of section 520, *Analytical Procedures*.

.A27 The reliability of information to be used as audit evidence is affected to varying degrees by the following attributes, individually or in combination:

- Accuracy
- Completeness
- Authenticity
- Susceptibility to management bias

These attributes are also relevant when automated tools and techniques are used to obtain audit evidence.

.A28 *Controls Over Information to Be Used as Audit Evidence.* When information has been transformed from its original medium (for example, documents that have been filmed, digitized, or otherwise transformed to electronic form), the reliability of that information may depend on the controls over the information's transformation and maintenance. In some situations, the auditor may determine that additional audit procedures are necessary to address reliability (for example, inspecting underlying original documents to validate the authenticity of information in electronic form). In other situations, the auditor may determine that it is necessary to test controls over the transformation and maintenance of the information.

.A29 Similarly, when a significant amount of information is electronically initiated, recorded, processed, or reported, information to be used as audit evidence may be available only in electronic form. In such cases, the sufficiency and appropriateness of the audit evidence usually depends on the effectiveness of controls over their accuracy and completeness. Furthermore, the potential for improper initiation or alteration of information to occur and not be detected may be greater if information is initiated, recorded, processed, or reported only in electronic form, and appropriate controls are not operating effectively.

.A30 *Authenticity.* An audit performed in accordance with GAAS rarely involves the authentication of documents, nor is the auditor trained as, or expected to be, an expert in such authentication. When the auditor identifies conditions that cause the auditor to believe that a document may not be authentic, that terms in a document may have been modified but not disclosed to the auditor, or that undisclosed side agreements may exist, the auditor may determine that additional audit procedures are necessary, including audit procedures to evaluate authenticity. Such audit procedures may include

- confirming directly with the third party.
- using the work of a specialist to assess the document's authenticity.²³

.A31 *Susceptibility to Management Bias.* Information with a higher susceptibility to management bias is considered less reliable than information for which the susceptibility to management bias is lower unless audit procedures have been performed to address the higher susceptibility to management bias.

.A32 A susceptibility to management bias may exist in the development of information itself or may exist due to interpretation of the information by the entity. A greater susceptibility to management bias may exist when information is generated from internal sources.

.A33 In accordance with section 200, the auditor is required to exercise professional judgment.²⁴ This includes determining the impact of management

²³ Paragraph .A11 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

²⁴ Paragraph .18 of section 200.

bias in evaluating the reliability of information from external information sources to be used as audit evidence. Determining the effect of management bias involves considering the following:

- a. The ability of the entity to influence the external information source
- b. Management's selection of information from an external source known to be favorably biased toward corroborating management's assertions or information

.A34 External information is more likely to be suitable for use by a broad range of users and less likely to be subject to influence by any particular user if the external individual or organization provides it to the public for free or makes it available to a wide range of users in return for payment of a fee.

Corroborative or Contradictory Information (Ref: par. .07b)

.A35 Section 330 states that, in forming a conclusion about whether sufficient appropriate audit evidence has been obtained, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions being tested by the auditor or the amounts recorded in the financial statements.²⁵

.A36 Evaluating information to be used as audit evidence involves taking into account information that corroborates assertions or contradicts assertions in the financial statements. For example, audit evidence obtained through the inspection of an original document may corroborate a financial statement assertion, whereas audit evidence obtained from confirmation with an external party may contradict that financial statement assertion. In this example, additional audit evidence may be necessary to enable the auditor to conclude on the relevant assertion.

.A37 Contradictory information may be relevant even when the source of that information is less reliable than the source of corroborative information. For example, in the audit of a depository institution, reports of decreasing property values in a particular geographical area may have been obtained by the auditor that contradicted the report of an external appraisal provided by management to support its estimate of the values of collateral for a loan portfolio. In this case, given that contradictory information has been obtained, the auditor may determine that it is necessary to perform additional audit procedures to obtain audit evidence about the value of the property.

.A38 Contradictory information is not considered in isolation but, rather, as part of the auditor's consideration with respect to that management assertion taken as a whole. In such cases, professional skepticism and judgment is necessary to evaluate the persuasiveness of the audit evidence taken as a whole, rather than focusing on an individual piece of audit evidence. For example, the auditor may be aware of information on social media suggesting a company's product has major quality issues and that all buyers would be returning the product. The auditor may have obtained external confirmations regarding product sales and outstanding accounts receivable that do not indicate quality or return issues and may have scanned the sales returns subsidiary ledger, which contained only an immaterial amount of returns subsequent to year-end. In light of that, the auditor may conclude that the contradictory information does not suggest a reasonable possibility of a risk of material misstatement and that further audit procedures are not necessary.

²⁵ Paragraph .28 of section 330.

Evaluating Whether the Information Is Sufficiently Precise and Detailed for the Auditor's Purposes (Ref: par. 08a)

.A39 In some cases, the auditor may intend to use information obtained from management for other audit purposes. For example, the auditor may use the performance measures included in the entity's internal audit function reports, initially obtained for the purpose of evaluating monitoring activities, in a substantive analytical procedure. In such cases, the appropriateness of this information to be used as audit evidence is affected by whether the information is sufficiently precise or detailed for the auditor's purposes.

Accuracy and Completeness (Ref: par. .08b)

.A40 In accordance with paragraph 8, the auditor is required to determine whether it is necessary to obtain audit evidence about the accuracy and completeness of information to be used as audit evidence. Examples of this would be the reliability of

- the price and sales volume data produced by the entity used to develop an expectation of revenue is affected by the accuracy and completeness of the information being used.
- a population being tested for a certain characteristic, such as payment authorization, is affected by the completeness of the population from which items are selected.

.A41 The auditor may obtain audit evidence about the accuracy or completeness of information to be used as audit evidence through the performance of an audit procedure that was not primarily intended for that purpose. For example, in testing valuation, the auditor may reconcile the listing of investment purchases for completeness before selecting a sample. In other situations, the auditor may consider it necessary to obtain audit evidence about the accuracy and completeness of information by testing controls over the preparation and maintenance of the information (for example, in light of the nature, frequency, and volume of transactions).

.A42 In contrast to paragraph .A41, evaluating certain attributes related to the relevance and reliability of information obtained from external information sources, such as completeness, used by the auditor may not be practicable. Procedures regarding the reliability of external information may depend on how the external information will be used in the execution of an audit procedure because the auditor may not be able to evaluate the completeness and accuracy of information obtained from an external source to the same degree as the auditor would evaluate the completeness and accuracy of internal information obtained from management. For example, when using information from external information sources to perform an audit data analytic, the auditor's evaluation may focus more on the quality of that information (for example, that the information was from a reputable source), rather than its completeness.

Audit Procedures as a Basis for Concluding on the Sufficiency and Appropriateness of Audit Evidence (Ref: par. .09)

.A43 Audit procedures performed on information may include inspection, observation, confirmation, recalculation, reperformance, and analytical procedures, often in some combination, in addition to inquiry. These audit procedures may be performed either manually or using automated tools and techniques. The nature, timing, and extent of audit procedures performed on information influences the persuasiveness of the audit evidence obtained. For example, inspection or observation may provide more persuasive audit evidence than inquiry.

.A44 As explained further in section 315A and section 330, to draw reasonable conclusions on which to base the auditor's opinion, audit evidence is obtained by performing the following:^{26,27}

- a. Risk assessment procedures
- b. Further audit procedures, which comprise
 - i. tests of controls, when required by the AU-C sections or when the auditor has chosen to do so, and
 - ii. substantive procedures, which include tests of details and substantive analytical procedures

An audit procedure may have characteristics of one or more of the preceding categories and can be designed to accomplish more than one objective. The auditor's focus is on evaluating the results of the audit procedures performed.

.A45 The auditor may use automated tools and techniques to process, organize, structure, or present data in a given context in order to generate useful information that can be used as audit evidence.

.A46 An auditor may use automated tools and techniques to perform both a risk assessment procedure and a substantive procedure concurrently. As illustrated by the concepts in exhibit A, a properly designed audit data analytic may be used to perform risk assessment procedures and may also provide sufficient appropriate audit evidence to address a risk of material misstatement.

.A47 The auditor may also use automated tools and techniques to obtain audit evidence about the operation of the entity's internal control. For example, if management has controls over the sequential numbering of sales invoices, the auditor may be able to obtain corroborating audit evidence about the sequential numbering of sales invoices for the period by using automated tools and techniques to determine whether any gaps in numbering or duplicates exist, which may provide audit evidence about the controls over the completeness of invoices issued during the period.

.A48 Some information may be available only in electronic form or only at certain points or periods in time, which may affect the nature and timing of the audit procedures to be performed.

.A49 Certain electronic information may be destroyed or deleted after a specified period of time (for example, if files are changed and back-up files do not exist). Accordingly, as a result of the entity's data retention policies, the auditor may find it necessary to request retention of some information for the performance of audit procedures at a later point in time or to perform audit procedures at a time when the information is available.

.A50 Some electronic information (for example, records maintained on a distributed ledger, such as a blockchain) is available on a continuous basis during the audit. In such cases, auditors may develop audit procedures using automated tools and techniques to obtain information about transactions on a real-time basis.

Inspection

.A51 Inspection involves an examination (being physically present or using remote observation tools) of an asset or an examination of records or documents, whether internal or external or in paper form, electronic form, or other media. An example of inspection used as a test of controls is inspection

²⁶ Paragraphs .05–.06 of section 315A.

²⁷ Paragraphs .06–.07 of section 330.

of records, using manual or automated techniques, for evidence of authorization. An example of an automated technique for inspection is the use of text-recognition programs to examine large populations of documents, such as contracts, to identify items for further audit consideration.

Observation

A52 Observation includes looking at a process or procedure being performed by others (for example, the auditor's observation of inventory counting by the entity's personnel or the performance of control activities).

A53 Remote observation tools (for example, a camera mounted on a drone or a video transmission) may aid the auditor in performing an inspection or an observation procedure, such as management's physical inventory count.

A54 Audit evidence obtained through observation procedures is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed.

Confirmation

A55 An external confirmation is defined as audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium (for example, through the auditor's direct access to information held by a third party). See section 505, *External Confirmations*, for further guidance.

Recalculation

A56 Recalculation consists of testing the mathematical accuracy of information. Recalculation may be performed manually or using automated tools and techniques.

A57 By using automated tools and techniques, auditors may be able to perform recalculation procedures on 100% of a population, for example, recalculating the gross margin for each product sold for an entity's product line.

Reperformance

A58 Repformance involves the independent execution of procedures or controls by the auditor that were originally performed as part of the entity's internal control.

Analytical Procedures

A59 Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass investigation as necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. Audit data analytics are techniques that the auditor may use to perform risk assessment procedures or substantive procedures.

A60 Use of audit data analytics may enable auditors to identify areas that might represent specific risks relevant to the audit, including the existence of unusual transactions and events, and amounts, ratios, and trends that warrant investigation. An analytical procedure performed using audit data analytics may be used to produce a visualization of transactional detail to assist the auditor in performing risk assessment procedures. For example, a visualization depicting the composition of a population may be prepared to illustrate the volume and dollar value of items in the population. Although the auditor may find this technique useful in obtaining information in order to identify and assess

the risks of material misstatement, the information provided may not be sufficiently precise for the auditor's purpose of obtaining information to respond to the assessed risks of material misstatement at the assertion level.

.A61 Analytical procedures involve the auditor's exercise of professional judgment and may be performed manually or by using automated tools and techniques. For example, the auditor may manually scan data to identify significant or unusual items to test, which may include the identification of unusual individual items within account balances or other data through the reading or analysis of entries in transaction listings, subsidiary ledgers, general ledger control accounts, adjusting entries, suspense accounts, reconciliations, and other detailed reports for indications of misstatements that have occurred. The auditor also might use automated tools and techniques to scan an entire population of transactions and identify those transactions meeting the auditor's criteria for a transaction being unusual. The identification of items that exhibit characteristics of risk of material misstatement through analytical procedures provides the auditor with audit evidence about those items. Analytical procedures also provide audit evidence about the items not exhibiting characteristics of risks of material misstatements because the auditor has determined, exercising professional judgment, that the items not selected for further audit procedures are less likely to be materially misstated.

Inquiry

.A62 Inquiry consists of seeking information, both financial and nonfinancial, from knowledgeable persons within the entity or outside the entity. Inquiry is used extensively throughout the audit, in addition to other audit procedures.

.A63 Responses to inquiries may provide the auditor with information that corroborates other information or with new information. Alternatively, responses might provide information that contradicts other information that the auditor has obtained (for example, regarding the possibility of management override of controls). Responses to inquiries may provide a basis for the auditor to modify or perform additional audit procedures. Evaluating responses to inquiries is an integral part of the inquiry process.

.A64 Inquiries of knowledgeable persons outside the entity do not meet the definition of *external confirmations* in accordance with section 505. However, the responses to inquiries of persons outside of the entity are considered in accordance with this section and may constitute reliable information to be used as audit evidence.

Inconsistencies in, or Doubts About the Reliability of, Audit Evidence (Ref: par. .10)

.A65 Information obtained from different sources may indicate that an individual item of audit evidence is not reliable, such as when audit evidence obtained from one source is inconsistent with that obtained from another. This may be the case when, for example, an external confirmation is inconsistent with the terms of a debt obligation. Section 230, *Audit Documentation*, includes a specific documentation requirement if the auditor identifies information that is inconsistent with the auditor's final conclusion regarding a significant finding or issue.²⁸

.A66 In the case of inquiries about management's intent, the information available to support management's intent may be limited.²⁹ Section 580, *Written Representations*, provides guidance about obtaining written representations

²⁸ Paragraph .12 of section 230, *Audit Documentation*.

²⁹ Paragraph .A13 of section 580, *Written Representations*.

that address management's intent. Maintaining professional skepticism is particularly important when corroborative audit evidence is limited to inquiry. In such circumstances, it may be helpful to consider the consistency, or lack thereof, between the information obtained through inquiry and management's history of carrying out its stated intentions, management's stated reasons for choosing a course of action, and management's ability to pursue a specific course of action.

.A67

Appendix A — Considerations Regarding the Use of External Information Sources (Ref: par. .A12b)

1. As defined in paragraph 6 of this section, an *external information* source is an external individual or organization that provides information used by the entity in preparing the financial statements or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users.

2. External information sources may include pricing services, governmental organizations, central banks, recognized stock exchanges, media, or academic journals. Examples of information that may be obtained from external information sources include the following:

- Prices and pricing-related data
- Macroeconomic data, such as historical and forecast unemployment rates and economic growth rates, or census data
- Credit history data
- Industry-specific data, such as an index of reclamation costs for certain extractive industries or viewership information or ratings used to determine advertising revenue in the entertainment industry
- Mortality tables used to determine liabilities in the life insurance and pension sectors
- Documents or records on websites or in databases or distributed ledgers

3. As set forth in generally accepted auditing standards, an external individual or organization cannot, in respect of any particular set of information, be both an external information source and

- a management's specialist,
- a service organization, or
- an auditor's specialist.

4. However, an external individual or organization may, for example, be acting as a management's specialist when providing a particular set of information but acting as an external information source when providing a different set of information. Professional judgment may be needed to determine whether an external individual or organization is acting as an external information source or as a management's specialist with respect to a particular set of information. The following examples illustrate some of the considerations that may be used. Each situation may be influenced by individual facts and circumstances:

- An external individual or organization may be providing information about real estate prices that is suitable for use by a broad range of users, for example, information made generally available pertaining to a geographical region, and determined to be an external information source with respect to that set of information. The same external organization may also be acting as a management's or auditor's specialist in providing commissioned valuations, with respect to the entity's real estate portfolio specifically tailored for the entity's facts and circumstances.

- Some actuarial organizations publish mortality tables for general use that, when used by an entity, would generally be considered to be information from an external information source. The same actuarial organization may also be a management's specialist with respect to different information tailored to the specific circumstances of the entity to help management determine the pension liability for several of the entity's pension plans.
- An external individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the external individual or organization applies that expertise in making an estimate specifically for the entity and that work is used by management in preparing its financial statements, the external individual or organization is likely to be a management's specialist with respect to that information. If, on the other hand, that external individual or organization merely provides, to the public, prices or pricing-related data regarding private transactions, and the entity uses that information in its own estimation methods, the external individual or organization is likely to be an external information source with respect to such information.
- An external individual or organization may publish information, suitable for a broad range of users, about risks or conditions in an industry. If used by an entity in preparing its risk disclosures (for example, in compliance with FASB *Accounting Standards Codification* 275, *Risk and Uncertainties*), such information would ordinarily be considered to be information from an external information source. However, if the same type of information has been specifically commissioned by the entity to use its expertise to develop information about those risks, tailored to the entity's circumstances, the external individual or organization is likely to be acting as a management's specialist.
- An external individual or organization may apply its expertise in providing information about current and future market trends, which it makes available to, and is suitable for use by, a broad range of users. If used by the entity to help make decisions about assumptions to be used in making accounting estimates, such information is likely to be considered to be information from an external information source. If the same type of information has been commissioned by the entity to address current and future trends relevant to the entity's specific facts and circumstances, the external individual or organization is likely to be acting as a management's specialist.

5. The auditor is required by paragraph 7 of this section to take into account the relevance and reliability of information to be used as audit evidence regardless of whether that information has been used by the entity in preparing the financial statements or was obtained by the auditor. For information obtained from an external information source, that consideration may, in certain cases, include

- information about the external information source,
- details about the preparation of the information by the external information source, or
- audit evidence obtained through designing and performing further audit procedures in accordance with section 330, *Performing*

Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained, or, where applicable, section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

6. Obtaining an understanding of why management or, when applicable, a management's specialist uses an external information source, and how the relevance and reliability of the information was taken into account (including its accuracy and completeness), may help inform the auditor's consideration of relevance and reliability of that information.

7. The following factors may be important when taking into account the relevance and reliability of information obtained from an external information source, including its accuracy and completeness. Some of these factors may only be relevant when the information has been used by management in preparing the financial statements or has been obtained by the auditor:

- The nature and authority of the external information source (for example, a central bank or government statistics office with a legislative mandate to provide industry information to the public may be considered a reliable external information source for certain types of information.)
- The ability of management to influence the information obtained, through relationships between the entity and the external information source
- The competence and reputation of the external information source with respect to the information, including whether, in the auditor's professional judgment, the information is routinely provided by an external information source with a track record of providing reliable information
- Past experience of the auditor with the reliability of the information provided by the external information source
- Evidence of general market acceptance by users of the relevance or reliability of information from an external information source for a similar purpose to that for which the information has been used by management or the auditor
- Whether the entity has in place controls to address the relevance and reliability of the information obtained and used
- Whether the external information source accumulates overall market information or engages directly in "setting" market transactions
- Whether the information is suitable for use in the manner in which it is being used and, if applicable, was developed taking into account the applicable financial reporting framework
- Alternative information that may contradict the information used
- The nature and extent of disclaimers or other restrictive language relating to the information obtained¹
- Information about the methods used in preparing the information; how the methods are being applied including, where applicable,

¹ Paragraphs .A56–.A62 of section 501, *Audit Evidence — Specific Considerations for Selected Items*.

how models have been used in such application; and the controls over the methods

- When available, information relevant to considering the appropriateness of assumptions and other data applied by the external information sources in developing the information obtained

8. The nature and extent of the auditor's consideration takes into account the assessed risks of material misstatement at the assertion level to which the use of the external information is relevant, the degree to which the use of that information is relevant to the reasons for the assessed risks of material misstatement, and the possibility that the information from the external information source may not be reliable (for example, whether it is from a credible source). Based on the auditor's consideration of the matters described in paragraph 5 of this appendix, the auditor may determine that

- a. further understanding of the entity and its environment, including its internal control, is needed, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, or
- b. further audit procedures, in accordance with section 330² and section 540,³ when applicable, are appropriate in the circumstances, to respond to the assessed risks of material misstatement at the assertion level related to the use of information from an external information source. Such audit procedures may include the following:
 - i. Performing a comparison of information obtained from the external information source with information obtained from an alternative independent information source
 - ii. When relevant to considering management's use of an external information source, obtaining an understanding of controls management has in place to consider the reliability of the information from external information sources and potentially testing the operating effectiveness of such controls
 - iii. Performing procedures to obtain information from the external information source to understand its processes, techniques, and assumptions, for the purposes of identifying, understanding, and when relevant, testing the operating effectiveness of its controls

9. When the auditor does not have a sufficient basis upon which to consider the relevance and reliability of information from an external information source, the auditor may have a limitation on scope if sufficient appropriate audit evidence cannot be obtained through alternative procedures. Any imposed limitation on scope is evaluated in accordance with the requirements of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

² Paragraph .06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

³ Paragraphs .12–.14 of section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

.A68

Appendix B — Amendments to Various Sections in Statement on Auditing Standards No. 122, *Statements on Auditing Standards: Clarification and Recodification, as Amended*

(***Boldface italics*** denote new language. Deleted text is shown in ~~strikethrough~~.)

1. The amendment to each section in this appendix is effective for audits of financial statements for periods ending on or after December 15, 2022.

AU-C Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

[No amendment to paragraphs .01–.13.]

Definitions

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

...

~~**Audit evidence.** Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. *Sufficiency of audit evidence* is the measure of the quantity of audit evidence. The quantity of the audit evidence necessary needed is affected by the auditor's assessment of the risks of material misstatement, and also by the quality of such audit evidence. *Appropriateness of audit evidence* is the measure of that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based.~~

...

[No amendment to paragraphs .15–.18.]

Sufficient Appropriate Audit Evidence and Audit Risk

.19 To obtain reasonable assurance, the auditor should obtain sufficient appropriate audit evidence⁴ to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. (Ref: par. .A32–.A56)

⁴***See paragraph .06 of section 500, Audit Evidence, for the definition of audit evidence.***

[Subsequent footnotes renumbered.]

[No amendment to paragraphs .20–.A26. Paragraph .A26 included for contextual purposes only.]

...

.A26 The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be

satisfied with less than persuasive audit evidence when obtaining reasonable assurance.

NOTE

In June 2022, the Auditing Standards Board issued Statement on Auditing Standards No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains further amendments to paragraph .A27 of section 200.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of section 220 until the effective date, when they will be applied to section 200.

.A27 Unconscious or conscious auditor biases may affect the auditor's professional skepticism and professional judgment, including, for example, in the design and performance of audit procedures or the evaluation of audit evidence. Examples of unconscious auditor biases that may impede the maintenance of professional skepticism and, therefore, the reasonableness of the professional judgments made by the auditor in complying with the requirements of this section, may include the following:

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

[Paragraphs .A27–.A86 have been renumbered.]

[No amendment to paragraphs .A27–.A75.]

.A76 The auditor is required by paragraph .23b to use the objectives stated in the relevant AU-C sections to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If, as a result, the auditor concludes that **sufficient appropriate** the audit evidence **has not been obtained** ~~is not sufficient and appropriate~~, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph .23b:

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other AU-C sections, **in particular, section 330**.
- Extend the work performed in applying one or more requirements.

- Perform other procedures judged by the auditor to be necessary in the circumstances.

When none of the preceding is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by GAAS to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

[No further amendment to section 200.]

AU-C Section 230, *Audit Documentation*

[No amendment to paragraphs .01–.05.]

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

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

[No further amendment to section 230.]

AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

[No amendment to paragraphs .01–.A80.]

.A81 *Audit evidence for elements of the control environment.* ~~Relevant~~ **Audit evidence *related to elements of the control environment*** may be obtained through a combination of inquiries and other risk assessment procedures, such as corroborating inquiries through observation or inspection of documents. For example, through inquiries of management and employees, the auditor may obtain an understanding of how management communicates to employees management's views on business practices and ethical behavior. The auditor may then determine whether relevant controls have been implemented by considering, for example, whether management has a written code of conduct and whether it acts in a manner that supports the code.

[No further amendment to section 315.]

AU-C Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

[No amendment to paragraphs .01–.05.]

.06 The auditor should design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level ***and in a manner that is not biased towards obtaining audit evidence that may be corroborative or towards excluding audit evidence that may be contradictory. When evaluating audit evidence with respect to the assessed risks of material misstatement, the auditor maintains professional skepticism, including when considering information that may be used as audit evidence and what procedures would be appropriate in the circumstances.***

[No amendment to paragraphs .07–.27.]

.28 The auditor should conclude whether sufficient appropriate audit evidence has been obtained. In forming a conclusion, the auditor should consider all relevant audit evidence, regardless of whether it appears to corroborate or contradict the assertions in the financial statements.

[No amendment to paragraphs .29–.A47.]

.A48 The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included. For example, the auditor might inspect subsequent cash disbursements and compare them with the recorded accounts payable to determine whether any purchases had been omitted from accounts payable.

[No amendment to paragraphs .A49–.A50.]

.A51 External confirmation procedures frequently may be relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cut-off assertion. Other situations in which external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include the following:

- Bank balances and other information relevant to banking relationships
- Inventories held by third parties at bonded warehouses for processing or on consignment
- Property title deeds held by lawyers or financiers for safe custody or as security
- Investments held for safekeeping by third parties or purchased from stockbrokers but not delivered at the balance sheet date
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants
- Accounts payable balances and terms

.A52 Although external confirmations may provide relevant audit evidence relating to certain assertions, some assertions exist for which external confirmations provide *less persuasive* audit evidence, for example, *external confirmations provide less* persuasive audit evidence relating to the recoverability of accounts receivable balances than they do of their existence.

[No amendment to paragraphs .A53–.A58.]

.A59 Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence ~~with the high level of reliability~~ that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, a risk may exist that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts but also to confirm the details of the sales agreements, including date, any rights of return,

and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms.

[No amendment to paragraphs .A60–.A65.]

.A66 An effective test provides appropriate audit evidence to the extent that it will be sufficient for the auditor's purpose when taken with other audit evidence obtained or to be obtained. In selecting items for testing, the auditor is required by section 500 to **consider** ~~determine~~ the relevance and reliability of information to be used as audit evidence;¹² the other aspect of effectiveness (~~sufficiency~~**extent**) is an important consideration in selecting items to test. The means available to the auditor for selecting items for testing are

- a. selecting all items (100 percent examination),
- b. selecting specific items, and
- c. audit sampling.

¹² [Footnote omitted for purposes of this section.]

[No amendment to paragraphs .A67–.A74.]

.A75 *By performing audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements. However, accounting records alone do not provide sufficient appropriate audit evidence on which to base an audit opinion on the financial statements.*

[Paragraph .A75 is renumbered as .A76.]

~~.A76~~**.A77** *The auditor's conclusion of whether sufficient appropriate audit evidence has been obtained is both at the relevant assertion level as well as the financial statement level. AU-C section 500 enables the auditor to evaluate the results of audit procedures to inform the auditor's overall conclusion about whether sufficient appropriate audit evidence has been obtained as required by paragraph .28.* The auditor's professional judgment about what constitutes sufficient appropriate audit evidence is influenced by **the following additional** ~~such~~ factors: ~~as the~~

- ~~S~~**S**ignificance of the potential misstatement in the relevant assertion and the likelihood of its having a material effect, individually or aggregated with other potential misstatements, on the financial statements (see section 450, *Evaluation of Misstatements Identified During the Audit*);
- ~~E~~**E**ffectiveness of management's responses and controls to address the risks;
- ~~E~~**E**xperience gained during previous audits with respect to similar potential misstatements;
- ~~Whether~~ **the** audit procedures that were performed identified specific instances of fraud or error;
- ~~source and reliability of the available information;~~
- ~~persuasiveness of the audit evidence;~~
- ~~U~~**U**nderstanding of the entity and its environment, including its internal control;

[Paragraph .A76 is renumbered as .A77.]

[No further amendment to section 330.]

AU-C Section 501, Audit Evidence — Specific Considerations for Selected Items

NOTE

Although SAS No. 142 supersedes SAS No. 122, as amended, section 500 (codified as AU-C section 500A in AICPA *Professional Standards* until the effective date of SAS No. 142), SAS No. 142 transfers the management's specialist content from section 500A to section 501.

The following paragraphs have been transferred from section 500A to section 501 and revised, as necessary:

1. Paragraph .05, definition of *management's specialist*
2. Paragraph .08, under the "Information to Be Used as Audit Evidence" heading, and corresponding application paragraphs .A35–.A49

Scope of This Section

.01 This section addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 500, *Audit Evidence*; and other relevant AU-C sections, regarding certain aspects of (a) investments in securities and derivative instruments; (b) inventory; (c) litigation, claims, and assessments involving the entity; ~~and~~ (d) segment information in an audit of financial statements; **and (e) use of management's specialists.**

[No amendment to paragraph .02.]

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the

- a. valuation of investments in securities and derivative instruments;
- b. existence and condition of inventory;
- c. completeness of litigation, claims, and assessments involving the entity; ~~and~~
- d. presentation and disclosure of segment information, in accordance with the applicable financial reporting framework; **and**
- e. **use of management's specialists.**

Definition

.04 For purposes of GAAS, the following term has the meaning attributed as follows:

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

[Subsequent paragraphs renumbered. No amendment to paragraphs .05–.25.]

Use of Management's Specialists

.26 If information to be used as audit evidence has been prepared using the work of a management's specialist, the auditor should, to the extent

necessary, taking into account the significance of that specialist's work for the auditor's purposes (Ref: par. .A69–.A71)

- a. evaluate the competence, capabilities, and objectivity of that specialist; (Ref: par. .A72–.A78)*
- b. obtain an understanding of the work of that specialist; and (Ref: par. .A79–.A82)*
- c. evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion. (Ref: par. .A83)*

[No amendment to paragraphs .A1–.A68.]

Use of Management's Specialists (Ref: par. .26)

.A69 The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement and may be a significant deficiency or material weakness.¹²

¹² See section 265, *Communicating Internal Control Related Matters Identified in an Audit*, for further guidance.

.A70 When information to be used as audit evidence has been prepared using the work of a management's specialist, the requirement in paragraph .26 applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which no observable market exists. If the individual or organization applies that expertise in making an estimate, which the entity uses in preparing its financial statements, the individual or organization is a management's specialist, and paragraph .26 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity, which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph .07 of section 500, but it is not the use of a management's specialist by the entity.

.A71 The nature, timing, and extent of audit procedures with regard to the requirement in paragraph .26 may be affected by such matters as the following:

- The nature and complexity of the matter to which the management's specialist relates***
- The risks of material misstatement of the matter***
- The availability of alternative sources of audit evidence***
- The nature, scope, and objectives of the work of the management's specialist***
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services***
- The extent to which management can exercise control or influence over the work of the management's specialist***
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements***

- *The nature and extent of any controls within the entity over the work of the management's specialist*
- *The auditor's knowledge and experience of the field of expertise of management's specialist*
- *The auditor's previous experience of the work of that specialist*

The Competence, Capabilities, and Objectivity of a Management's Specialist (Ref: par. .26a)

.A72 Competence relates to the nature and level of expertise of the management's specialist. Capability relates to the ability of the management's specialist to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the management's specialist. The competence, capabilities, and objectivity of a management's specialist, and any controls within the entity over that specialist's work, are important factors with regard to the reliability of any information produced by a management's specialist.

.A73 Information regarding the competence, capabilities, and objectivity of a management's specialist may come from a variety of sources, such as the following:

- *Personal experience with previous work of that specialist*
- *Discussions with that specialist*
- *Discussions with others who are familiar with that specialist's work*
- *Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition*
- *Published papers or books written by that specialist*
- *An auditor's specialist, if any, that assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's specialist*

.A74 Matters relevant to evaluating the competence, capabilities, and objectivity of a management's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

.A75 Other matters that may be relevant include the following:

- *The relevance of the capabilities and competence of the management's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations*
- *The competence of the management's specialist with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models, when*

applicable, that are consistent with the applicable financial reporting framework

- *Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the management's specialist as the audit progresses*

.A76 A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the profession, legislation, or regulation of the management's specialist) or by the work of the management's specialist's environment (for example, quality control policies and procedures).

.A77 Although safeguards cannot eliminate all threats to the objectivity of a management's specialist, threats such as intimidation threats may be of less significance to a specialist engaged by the entity than to a specialist employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, a specialist employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

.A78 When evaluating the objectivity of a specialist engaged by the entity, it may be relevant to discuss with management and that specialist any interests and relationships that may create threats to the specialist's objectivity and any applicable safeguards, including any professional requirements that apply to the specialist, and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include the following:

- *Financial interests*
- *Business and personal relationships*
- *Provision of other services*

Obtaining an Understanding of the Work of the Management's Specialist (Ref: par. .26b)

.A79 An understanding of the work of the management's specialist includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's specialist or whether the auditor needs an auditor's specialist for this purpose.¹³

¹³ Paragraph .07 of section 620, *Using the Work of an Auditor's Specialist*.

.A80 Aspects of the field of the management's specialist relevant to the auditor's understanding may include

- *whether that specialist's field has areas of specialty within it that are relevant to the audit.*
- *whether any professional or other standards and regulatory or legal requirements apply.*

- *what assumptions and methods are used by the management's specialist and whether they are generally accepted within that specialist's field and appropriate for financial reporting purposes.*
- *the nature of internal and external data or information the management's specialist uses.*

.A81 *In the case of a management's specialist engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that specialist. Evaluating that agreement when obtaining an understanding of the work of the management's specialist may assist the auditor in determining for the auditor's purposes the appropriateness of*

- *the nature, scope, and objectives of that specialist's work;*
- *the respective roles and responsibilities of management and that specialist; and*
- *the nature, timing, and extent of communication between management and that specialist, including the form of any report to be provided by that specialist.*

.A82 *In the case of a management's specialist employed by the entity, it is less likely that there will be a written agreement of this kind. Inquiry of the specialist and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding.*

Evaluating the Appropriateness of the Work of the Management's Specialist (Ref: par. .26c)

.A83 *Considerations when evaluating the appropriateness of the work of the management's specialist as audit evidence for the relevant assertion may include*

- *the relevance and reasonableness of that specialist's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;*
- *if that specialist's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and*
- *if that specialist's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.*

AU-C Section 530, Audit Sampling

[No amendment to paragraph .01. Footnote intentionally omitted.]

.02 This section complements section 500, *Audit Evidence*, which addresses the auditor's responsibility to design and perform audit procedures to obtain **explains what constitutes** sufficient appropriate audit evidence **and addresses how an auditor evaluates information to be used as audit evidence**. to be able to draw reasonable conclusions as a basis for forming the auditor's opinion. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides guidance on the means available to the auditor for selecting items for testing, one of which is audit sampling.

[No further amendment to section 530.]

AU-C Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

[No amendment to paragraphs .01–.A27. Paragraph .A28 shown for contextual purposes.]

*Management's Use of Specialists*¹¹ (~~Ref. par. .08e(iii)~~)

.A28 Management may have, or the entity may employ individuals with, the experience and competence necessary to make estimates. In some cases, however, management may need to engage a specialist to make estimates or assist in making them. This need may arise because of, for example,

- the specialized nature of the matter requiring estimation (for example, the measurement of mineral or hydrocarbon reserves in extractive industries).
- the technical nature of the models required to meet the relevant requirements of the applicable financial reporting framework, as may be the case in certain measurements at fair value.
- the unusual or infrequent nature of the condition, transaction, or event requiring an accounting estimate.

¹¹ **See section 501, Audit Evidence — Specific Considerations for Selected Items.** See Paragraph .08 of section 500, *Audit Evidence*, which addresses management's specialists.

[No amendment to paragraphs .A29–.A69.]

.A70 In accordance with section 500, *Audit Evidence*, the auditor is required to ***evaluate information to be used as audit evidence by taking into account, among other things, the relevance and reliability of the information, including its source. The auditor's evaluation of such information to be used as audit evidence is required to include evaluating whether the information is sufficiently precise and detailed for the auditor's purposes and obtaining audit evidence about the accuracy and completeness of the information, as necessary.***¹⁸

evaluate whether the data on which the estimate is based is sufficiently reliable for the auditor's purposes, including, as necessary.

- a. obtaining audit evidence about the accuracy and completeness of the data.
- b. evaluating whether the data is sufficiently precise and detailed for the auditor's purposes.

¹⁸ Paragraphs **.09 .07 and .08** of section 500.

[No further amendment to section 540.]

.A69

Exhibit A — Using ADAs to Simultaneously Accomplish Multiple Audit Procedures (Ref: par. A46 and par. A61)

This exhibit illustrates the use of an audit data analytic (ADA) that simultaneously accomplishes the objectives of both risk assessment and substantive audit procedures.

Background

The fact pattern in this example, in which the auditor uses a revenue transaction scoring model, will focus on the audit of an entity that recognizes revenue when control of the product (or satisfaction of the performance obligation) transfers at a specific point in time,¹ such as a manufacturer of external data storage devices.

For purposes of this example, assume the following:

- Revenue was determined to be a material account during initial planning and scoping with the occurrence (including cut-off) and accuracy assertions being more susceptible to misstatement.
- The ADA was performed after initial planning and scoping as part of the ongoing and iterative risk assessment process.
- All transactions within the account were subject to the same processes and controls.
- The purpose of the ADA was to design the nature, timing, and extent of the audit procedures and to obtain audit evidence.
- Based on the understanding of controls, the auditor has concluded that the controls over revenue were effectively designed and have been implemented, the auditor has tested certain relevant controls and determined they are operating effectively, and the auditor is otherwise satisfied the entity has appropriately applied the requirements of the applicable financial reporting framework (for example, *FASB Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers*).
- Data used in the ADA are relevant and reliable and have been tested for accuracy and completeness.
- Customers tend to purchase consistent quantities throughout the year, with the exception of purchases just prior to major retail holidays, such as Memorial Day, Black Friday, and Christmas.
- Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month.
- The customer base does not fluctuate significantly from period to period.
- Revenue is recognized when control transfers at a free-on-board (FOB) shipping point.
- Invoicing occurs the day the product ships from the entity's warehouse.

¹ FASB *Accounting Standards Codification* 606-10-25-30.

- Warehouse personnel typically do not work weekends.
- The company does not sell product to any related parties.

All items that are determined to be individually material were excluded from the ADA and substantively tested separately. The remaining population that was subject to the ADA comprised routine, non-complex transactions with third parties. The processing and recording of transactions are highly automated and less likely to be susceptible to management override.

Description of the ADA

ADA Scoring Model — A complete population of transactions (at the individual item level) for one material account (excluding individually significant items) was subjected to an ADA designed to identify and assess risk and obtain audit evidence specific to a relevant assertion using different routines. The scoring of each routine is based on the evidence expected to be provided by that routine in relation to the auditor's assessment of the risks of material misstatement.

The routines were as follows:

<i>Routine</i>	<i>Description</i>	<i>Characteristic</i>	<i>Transaction Scoring Model</i>	<i>Risk Score</i>	<i>Relevant Fact Pattern</i>
1	Identify customers with infrequent revenue activity (less than X transactions)	Volume	Less than 6 transactions	2	Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month
			6–12 transactions	1	Some customers only purchase in bulk a few times a year, whereas others purchase smaller quantities one to two times a month.
			More than 12 transactions	0	
2	Identify customers with a significant fluctuation in volume of products purchased (item level) on a period-over-period basis	Volume	Greater than 70% variance	2	Customers tend to purchase consistent quantities throughout the year, with the exception of purchases just prior to major retail holidays, such as Memorial Day, Black Friday, and Christmas.
			30% to 70% variance	1	Some customers only purchase in bulk a few times a year, but most customers consistently purchase quantities one to two times a month.
			Less than 30% variance	0	
3	Identify activity for new customers	Volume	Customer for 6 months or less Customer for greater than 6 months	1 0	The customer base does not fluctuate significantly from period to period.
4	Identify all transactions recorded within X days of quarter-end.	Timing	Within 3 days of quarter end Greater than 3 days of quarter end	1 0	Revenue is recognized when control transfers at FOB shipping point.

<i>Routine</i>	<i>Description</i>	<i>Characteristic</i>	<i>Transaction Scoring Model</i>	<i>Risk Score</i>	<i>Relevant Fact Pattern</i>
5	Identify revenue transactions with an invoice date on an unusual date (for example, weekend or holiday)	Timing	Transaction on a weekend/holiday	2	Invoicing occurs the day the product ships from the company's warehouse.
			Transaction on a weekday	0	Warehouse personnel typically do not work weekends.
6	Identify instances in which the shipping document date and invoice date do not match.	Timing	Invoice and shipping document do not match, and invoice date is before shipping date.	4	Revenue is recognized when control transfers at FOB shipping point.
			Invoice and shipping document do not match, and shipping date is before invoice date.	2	Invoicing occurs the day the product ships from the company's warehouse.
			Invoice and shipping document match.	0	

Running the revenue transaction level detail through the ADA routines produces a total score for each transaction. The auditor then groups each transaction into a sub-population based on the individual transaction score. The number of sub-populations may differ depending upon the type of ADA developed, the scores produced by the ADA, and the auditor's assessment of those scores. For purposes of this example, the auditor grouped the population of the account into sub-populations as follows:

<i>Assessed Risk</i>	<i>Total Risk Score</i>	<i>Group</i>
High risk	8–12	A
Moderate risk	4–7	B
Low risk	0–3	C

- Group A – High risk — Comprises items with characteristics deemed to present a higher risk of material misstatement.

Approach — The auditor would perform additional substantive procedures to provide more persuasive audit evidence for the items identified by the ADA. For example, the nature of the substantive procedure may be confirmation as opposed to inspection; the extent of testing may be greater (larger proportionate sample size); or the timing of the procedure may be at or near the financial statement date as opposed to earlier in the period.

- Group B – Moderate risk — Comprises items that warrant further procedures but do not have characteristics of those in the higher risk group.

Approach — The auditor would perform substantive procedures appropriate for the items identified by the ADA in less depth relative to the higher risk population. For example, the nature of the substantive procedure may be limited to inspection of documents and records; the extent of testing may be less (smaller proportionate sample size); and the timing of the procedure may be earlier in the period.

- Group C – Low risk — Comprises items that demonstrate no unusual characteristics based on the procedure performed using the ADA.

Approach — The results of other audit procedures performed throughout the audit would be evaluated for contradictory information regarding the assessed risk of material misstatement. In the absence of contradictory information, as the routines of the ADA are sufficiently precise for the auditor to conclude that the risks of material misstatement have been addressed, no additional substantive procedures may be warranted for any reason other than to incorporate an element of unpredictability in the selection of auditing procedures to be performed from year to year.

As a result of the previous procedures, the auditor concluded

- Groups A, B, and C comprise a material account in the aggregate for which each group has differing risks.
- for Group C, the audit evidence provided over the transactions (within the population analyzed by the ADA in combination with the audit evidence provided by testing of certain key controls over revenue as determined by the auditor and the absence of contradictory audit evidence from the testing of related accounts) was

sufficiently persuasive for the auditor to conclude that the risk of material misstatement was addressed.

- for Groups A and B, the audit evidence provided by the ADA was not sufficiently persuasive, and further substantive procedures were required to address the risk of material misstatement.
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AU-C Section 9500***Audit Evidence: Auditing Interpretations of Section 500*****1. The Effect of an Inability to Obtain Audit Evidence Relating to Income Tax Accruals**

.01 Question—The IRS's audit manual instructs its examiners on how to secure from corporate officials "tax accrual workpapers" or the "tax liability contingency analysis," including "a memorandum discussing items reflected in the financial statements as income or expense where the ultimate tax treatment is unclear." The audit manual states that the examiner may question or summons a corporate officer or manager concerning the "knowledge of the items that make up the corporation's contingent reserve accounts." It also states that "in unusual circumstances, access may be had to the audit or tax workpapers" of an independent accountant or an accounting firm after attempting to obtain the information from the taxpayer. IRS policy also includes specific procedures to be followed in circumstances involving "listed transactions," to help address what the IRS considers to be abusive tax avoidance transactions (Internal Revenue Manual, section 4024.2-.5, 5/14/81, and Internal Revenue Service Announcement 2002-63, 6/17/02).

.02 Concern over IRS access to tax accrual working papers might cause some entities to not prepare or maintain appropriate documentation of the calculation or contents of the accrual for income taxes included in the financial statements or to deny the independent auditor access to such information.

.03 What effect does this situation have on the auditor's opinion on the financial statements?

.04 Interpretation—The entity is responsible for its tax accrual, the underlying support for the accrual, and the related disclosures. Limitations on the auditor's access to information considered necessary to audit the tax accrual will affect the auditor's ability to issue an unmodified opinion on the financial statements.

.05 The auditor is required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.¹

.06 If the entity does not have appropriate documentation of the calculation or contents of the accrual for income taxes and denies the auditor access to entity personnel responsible for making the judgments and estimates relating to the accrual, the auditor is required to conclude whether sufficient appropriate audit evidence has been obtained. If the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor is required to attempt to obtain further audit evidence.²

¹ Paragraph .06 of section 500, *Audit Evidence*.

² Paragraphs .28–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

.07 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor is required to express a qualified opinion or disclaim an opinion on the financial statements.³

.08 If the entity has appropriate documentation but denies the auditor access to it and to entity personnel who possess the information, the auditor is required to perform procedures to evaluate the consequence of an inability to obtain sufficient appropriate audit evidence due to a management-imposed limitation.⁴

.09 The auditor is required to request management to provide a written representation that it has provided the auditor with all relevant information and access, as agreed upon in the terms of the audit engagement.⁵ If management does not provide the written representations required by section 580, *Written Representations*, the auditor is required to disclaim an opinion on the financial statements in accordance section 705, *Modifications to the Opinion in the Independent Auditor's Report*, or withdraw from the engagement.⁶

.10 Question—An entity may allow the auditor to inspect its tax accrual workpapers but request that copies not be retained for audit documentation, particularly copies of the tax liability contingency analysis. The entity also may suggest that the auditor not prepare and maintain similar documentation of his or her own. What are the auditor's requirements in deciding a response to such a request?

.11 Interpretation—Section 230, *Audit Documentation*, defines *audit documentation* as the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.⁷ The auditor is required to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand

- a. the nature, timing, and extent of the audit procedures performed to comply with generally accepted auditing standards and applicable legal and regulatory requirements;
- b. the results of the audit procedures performed and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant judgments made in reaching those conclusions.⁸

Section 500, *Audit Evidence*, states that other information includes information obtained by the auditor from inquiry, observation, inspection, and physical examination. The quantity, type, and content of audit documentation are matters of the auditor's judgment.

.12 The audit documentation of the results of auditing procedures directed at the tax accounts and related disclosures also includes sufficient appropriate audit evidence about the significant elements of the entity's tax liability contingency analysis. This audit documentation includes copies of the entity's documents, schedules, or analyses (or auditor-prepared summaries thereof) to enable the auditor to support his or her conclusions regarding the appropriateness

³ Paragraphs .08 and .10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

⁴ Paragraphs .11–.14 of section 705.

⁵ Paragraph .11a of section 580, *Written Representations*.

⁶ Paragraph .25 of section 580.

⁷ Paragraph .06 of section 230, *Audit Documentation*.

⁸ Paragraph .08 of section 230.

of the entity's accounting and disclosure of significant tax-related contingency matters. The audit documentation reflects the procedures performed and conclusions reached by the auditor and, for significant matters, include the entity's documentary support for its financial statement amounts and disclosures.

.13 The audit documentation includes the significant elements of the entity's analysis of tax contingencies or reserves, including roll-forward of material changes to such reserves. In addition, the audit documentation provides the entity's position and support for income tax related disclosures, such as its effective tax rate reconciliation, and support for its intraperiod allocation of income tax expense or benefit to continuing operations and to items other than continuing operations. When applicable, the audit documentation also includes the entity's basis for assessing deferred tax assets and related valuation allowances and its support for applying the "indefinite reversal criteria" discussed in FASB ASC 740-30-25-17, including its specific plans for reinvestment of undistributed foreign earnings.

.14 Question—In some situations, an entity may furnish its external legal counsel or in-house legal or tax counsel with information concerning the tax contingencies covered by the accrual for income taxes included in the financial statements and ask counsel to provide the auditor an opinion on the adequacy of the accrual for those contingencies.

.15 In such circumstances, rather than inspecting and obtaining documentary evidence of the entity's tax liability contingency analysis and making inquiries of the entity, may the auditor consider the counsel as a management's specialist within the meaning of section 500 and rely solely on counsel's opinion as an appropriate procedure for obtaining audit evidence to support his or her opinion on the financial statements?

.16 Interpretation—No. The opinion of legal counsel in this situation does not provide sufficient appropriate audit evidence to afford a reasonable basis for an opinion on the financial statements. The opinion of legal counsel on specific tax issues that he or she is asked to address and to which he or she has devoted substantive attention, as contemplated by the legal counsel's response to an auditor's letter of inquiry, can be useful to the auditor in forming his or her own opinion.

.17 An opinion from an entity's legal or tax counsel, similar to other work products obtained from a management's specialist, is useful in situations in which the auditor does not have adequate technical training and proficiency. In this case, however, the auditor's education, training, and experience, on the other hand, do enable him or her to be knowledgeable concerning income tax matters and competent to assess their presentation in the financial statements.

.18 Therefore, while the opinion of legal counsel on specific tax issues can be useful to the auditor in forming his or her own opinion, the audit of income tax accounts requires a combination of tax expertise and knowledge about the entity's business that is accumulated during all aspects of an audit. Therefore, as previously stated, it is not appropriate for the auditor to rely solely on such legal opinion.

.19 Question—A entity may have obtained the advice or opinion of an outside tax adviser related to the tax accrual or matters affecting it, including tax contingencies, and further may attempt to limit the auditor's access to such advice or opinion, or limit the auditor's documentation of such advice or opinion. This limitation on the auditor's access may be proposed on the basis that such information is privileged. Can the auditor rely solely on the conclusions of third-party tax advisers? What audit evidence should the auditor obtain and include in the audit documentation?

.20 Interpretation—As discussed in paragraphs .16–.18 of this interpretation, the auditor cannot accept an entity's or a third party's analysis or opinion with respect to tax matters without careful consideration and application of the auditor's tax expertise and knowledge about the entity's business. As a result of applying such knowledge to the facts, the auditor may encounter situations in which the auditor either disagrees with the position taken by the entity, or its advisers, or does not have sufficient appropriate audit evidence to support his or her opinion.

.21 If the entity's support for the tax accrual or matters affecting it, including tax contingencies, is based upon an opinion issued by an outside adviser with respect to a potentially material matter, the auditor is required to obtain access to the opinion,⁹ notwithstanding potential concerns regarding attorney-client or other forms of privilege. The audit documentation includes either the actual advice or opinions rendered by an outside adviser or other sufficient documentation or abstracts supporting both the transactions or facts addressed as well as the analysis and conclusions reached by the entity and adviser. Alternatives such as redacted or modified opinions may be considered but must, nonetheless, include sufficient content to articulate and document the entity's position so that the auditor can formulate his or her conclusion. Similarly, it may be possible to accept an entity's analysis summarizing an outside adviser's opinion, but the entity's analysis must provide sufficient appropriate audit evidence for the auditor to formulate his or her conclusion. In addition, written representations may be obtained stating that the entity has not received any advice or opinions that are contradictory to the entity's support for the tax accrual.

.22 If the auditor is unable to accumulate sufficient appropriate audit evidence about whether there is a supported and reasonable basis for the entity's position, the auditor is required to consider the effect of this scope limitation on his or her opinion.¹⁰

[Issue Date: March 1981; Amended: April 9, 2003; Revised: December 2005; Revised: March 2006; Revised: March 2008; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012.]

New GASB Pension Standards

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

Interpretation No. 2, "Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan" (paragraphs .23–.29), Interpretation No. 3, "Auditor of Participating Employer in a Governmental Agent

⁹ Paragraph .11 of this interpretation.

¹⁰ Paragraphs .11–.14 of section 705.

Multiple-Employer Pension Plan" (paragraphs .30–.36), and Interpretation Nos. 1–2 of section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, are intended to assist both plan and employer auditors who are auditing entities that have implemented the new accounting standards.

2. Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan

.23 Question—GASB Statement No. 68 requires governmental entities (employers) participating in governmental cost-sharing multiple-employer pension plans (cost-sharing plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.24 Do the audited financial statements of the plan prepared in accordance with generally accepted accounting principles (GAAP) and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.25 Interpretation—No. GASB Statement No. 67 requires only the disclosure of the collective net pension liability for all participating employers in GAAP financial statements of cost-sharing plans, not each employer's proportionate share of the collective net pension liability. Further, GAAP does not require the plan to present deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's share of collective pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.

.26 Absent additional audit evidence from the cost-sharing plan (for example, auditor's opinions on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts), the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

.27 Question—A plan has engaged its auditor to audit and report on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. May an employer

auditor use the plan auditor's report as evidence for the audit of the employer's financial statements?

.28 Interpretation—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedules as evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated.

.29 Before using the report of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedules are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes. Further, the employer auditor has a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage (that is, the numerator of the calculation), to recalculate the allocation percentage for the employer, and to recalculate the pension amounts allocated to the employer based on the allocation percentage.

[Issue Date: April 2014.]

3. Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan

.30 Question—GASB Statement No. 68 requires governmental entities (employers) participating in governmental agent multiple-employer pension plans (agent plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.31 Do the audited financial statements of the plan prepared in accordance with GAAP and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.32 Interpretation—No. GASB Statement No. 67 does not require the plan to present net pension liability, deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's specific pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.

.33 Absent additional evidence obtained, for example, through the suggested best practices as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer*

Reporting, the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

.34 Question—A plan has engaged its auditor to audit and report on the schedule of changes in fiduciary net position by employer, as described in the AICPA's State and Local Governments Expert Panel white paper referenced in paragraph .33 of this interpretation. May an employer auditor use the plan auditor's report as evidence about the fiduciary net position and changes in fiduciary net position for the audit of the employer's financial statements?

.35 Interpretation—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedule as evidence about both the fiduciary net position and changes in fiduciary net position of the employer. However, the employer auditor should consider whether the opinion is on the schedule as a whole or on each employer column. If the opinion is on the schedule as a whole, it is likely that the employer auditor will need additional evidence to support these amounts in the employer's financial statements (examples of such audit evidence are included in the white paper referenced in paragraph .33 of this interpretation).

.36 Before using the work of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedule are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes.

[Issue Date: June 2014.]

AU-C Section 500A

Audit Evidence

Source: SAS No. 122; SAS No. 128.

See section 9500A for interpretations of this section.

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

Introduction

Scope of This Section

.01 This section explains what constitutes audit evidence in an audit of financial statements and addresses the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

.02 This section is applicable to all the audit evidence obtained during the course of the audit. Other AU-C sections address

- specific aspects of the audit (for example, section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*);
- the audit evidence to be obtained regarding a particular topic (for example, section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*);
- specific procedures to obtain audit evidence (for example, section 520, *Analytical Procedures*); and
- the evaluation of whether sufficient appropriate audit evidence has been obtained (for example, section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, and section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*).

[Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.]

Effective Date

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

Objective

.04 The objective of the auditor is to design and perform audit procedures that enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

Definitions

.05 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

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

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

Audit evidence. Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

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

Sufficiency (of audit evidence). The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

Requirements

Sufficient Appropriate Audit Evidence

.06 The auditor should design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. (Ref: par. .A1–.A26)

Information to Be Used as Audit Evidence

.07 When designing and performing audit procedures, the auditor should consider the relevance and reliability of the information to be used as audit evidence. (Ref: par. .A27–.A34)

.08 If information to be used as audit evidence has been prepared using the work of a management's specialist, the auditor should, to the extent necessary, taking into account the significance of that specialist's work for the auditor's purposes, (Ref: par. .A35–.A37)

- a. evaluate the competence, capabilities, and objectivity of that specialist; (Ref: par. .A38–.A44)
- b. obtain an understanding of the work of that specialist; and (Ref: par. .A45–.A48)
- c. evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion. (Ref: par. .A49)

.09 When using information produced by the entity, the auditor should evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary, in the following circumstances:

- a. Obtaining audit evidence about the accuracy and completeness of the information (Ref: par. .A50–.A51)
- b. Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes (Ref: par. .A52)

Inconsistency in, or Doubts Over Reliability of, Audit Evidence

.10 If

- a. audit evidence obtained from one source is inconsistent with that obtained from another or
- b. the auditor has doubts about the reliability of information to be used as audit evidence,

the auditor should determine what modifications or additions to audit procedures are necessary to resolve the matter and should consider the effect of the matter, if any, on other aspects of the audit. (Ref: par. .A53)

Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: par. .06)

.A1 Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources, such as previous audits (provided that the auditor has determined whether changes have occurred since the previous audits that may affect its relevance to the current audit¹), or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of management's specialist. Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such assertions. In addition, in some cases, the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor and, therefore, also constitutes audit evidence.²

.A2 Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance, and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor is inquiry alone sufficient to test the operating effectiveness of controls.

.A3 As explained in section 200, reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit

¹ Paragraph .10 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

² Paragraph .A32 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.³

.A4 The sufficiency and appropriateness of audit evidence are interrelated. *Sufficiency* is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). However, obtaining more audit evidence may not compensate for its poor quality.

.A5 *Appropriateness* is the measure of the quality of audit evidence (that is, its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based). The reliability of evidence is influenced by its source and nature and is dependent on the individual circumstances under which it is obtained.

.A6 Section 330B requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained.⁴ Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level and, thereby, enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. Section 200 contains discussion of relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.⁵

Sources of Audit Evidence

.A7 Some audit evidence is obtained by performing audit procedures to test the accounting records (for example, through analysis and review, by performing procedures followed in the financial reporting process, and by reconciling related types and applications of the same information). Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements. However, accounting records alone do not provide sufficient appropriate audit evidence on which to base an audit opinion on the financial statements.

.A8 More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance that the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.

.A9 Information from sources independent of the entity that the auditor may use as audit evidence include confirmations from third parties, analysts' reports, and comparable data about competitors (benchmarking data).

Audit Procedures for Obtaining Audit Evidence

.A10 As required by and explained further in section 315B and section 330B, audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing the following.^{6,7}

³ Paragraph .06 of section 200.

⁴ Paragraph .28 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

⁵ Paragraphs .A49–.A54 of section 200.

⁶ Paragraphs .05–.06 of section 315B.

⁷ Paragraphs .06–.07 of section 330B.

- a. Risk assessment procedures
- b. Further audit procedures, which comprise
 - i. tests of controls, when required by the AU-C sections or when the auditor has chosen to do so, and
 - ii. substantive procedures, which include tests of details and substantive analytical procedures.

.A11 The audit procedures described in paragraphs .A14–.A26 that follow may be used as risk assessment procedures, tests of controls, or substantive procedures, depending on the context in which they are applied by the auditor. As explained in section 330, audit evidence obtained from previous audits may, in certain circumstances, provide appropriate audit evidence, provided that the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit.⁸

.A12 The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

.A13 Certain electronic information may not be retrievable after a specified period of time (for example, if files are changed and if backup files do not exist). Accordingly, the auditor may find it necessary, as a result of an entity's data retention policies, to request retention of some information for the performance of audit procedures at a later point in time or to perform audit procedures at a time when the information is available.

Inspection

.A14 Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorization.

.A15 Some documents represent direct audit evidence of the existence of an asset (for example, a document constituting a financial instrument such as a stock or bond). Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

.A16 Inspection of tangible assets may provide reliable audit evidence with respect to their existence but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting. For example, when observing an inventory count, the auditor may inspect individual inventory items (such as opening containers included in the inventory count to determine whether they are full or empty) to verify their existence.

⁸ Paragraph .A38 of section 330.

Observation

A17 Observation consists of looking at a process or procedure being performed by others (for example, the auditor's observation of inventory counting by the entity's personnel or the performance of control activities). Observation provides audit evidence about the performance of a process or procedure but is limited to the point in time at which the observation takes place and by the fact that the act of being observed may affect how the process or procedure is performed. Section 501A, *Audit Evidence — Specific Considerations for Selected Items*, addresses the observation of the counting of inventory.⁹

External Confirmation

A18 An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party) in paper form or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, their relevant details. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions (for example, the absence of a side agreement that may influence revenue recognition). See section 505, *External Confirmations*, for further guidance.

Recalculation

A19 Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance

A20 Repformance involves the independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures

A21 Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations and relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. See section 520 for further guidance.

A22 *Scanning* is a type of analytical procedure involving the auditor's exercise of professional judgment to review accounting data to identify significant or unusual items to test. This may include the identification of unusual individual items within account balances or other data through the reading or analysis of, for example, entries in transaction listings, subsidiary ledgers, general ledger control accounts, adjusting entries, suspense accounts, reconciliations, and other detailed reports. Scanning may include searching for large or unusual items in the accounting records (for example, nonstandard journal entries), as well as in transaction data (for example, suspense accounts and adjusting journal entries) for indications of misstatements that have occurred. Electronic audit procedures may assist the auditor in identifying unusual items. When the auditor selects items for testing by scanning and those items are tested, the auditor obtains audit evidence about those items. The auditor's scanning

⁹ Paragraphs .11–.15 of section 501A, *Audit Evidence—Specific Considerations for Selected Items*.

also may provide some audit evidence about the items not selected for testing because the auditor has exercised professional judgment to determine that the items not selected are less likely to be misstated.

Inquiry

.A23 Inquiry consists of seeking information of knowledgeable persons, both financial and nonfinancial, within the entity or outside the entity. Inquiry is used extensively throughout the audit, in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

.A24 Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained (for example, information regarding the possibility of management override of controls). In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

.A25 Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

.A26 Regarding some matters, the auditor may consider it necessary to obtain written representations from management and, when appropriate, those charged with governance to confirm responses to oral inquiries. See section 580, *Written Representations*, for further guidance.

Information to Be Used as Audit Evidence

Relevance and Reliability (Ref: par. .07)

.A27 As noted in paragraph .A1, although audit evidence is primarily obtained from audit procedures performed during the course of the audit, it also may include information obtained from other sources (for example, previous audits, in certain circumstances, and a firm's quality control procedures for client acceptance and continuance). The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.

Relevance

.A28 Relevance relates to the logical connection with, or bearing upon, the purpose of the audit procedure and, when appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing. For example, if the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.

.A29 A given set of audit procedures may provide audit evidence that is relevant to certain assertions but not others. For example, inspection of documents related to the collection of receivables after the period-end may provide

audit evidence regarding existence and valuation but not necessarily cutoff. Similarly, obtaining audit evidence regarding a particular assertion (for example, the existence of inventory) is not a substitute for obtaining audit evidence regarding another assertion (for example, the valuation of that inventory). On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion.

A30 Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control and identifying deviation conditions that indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the auditor.

A31 Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.

Reliability

A32 The reliability of information to be used as audit evidence and, therefore, of the audit evidence itself is influenced by its source and nature and the circumstances under which it is obtained, including the controls over its preparation and maintenance, when relevant. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. Information obtained from an independent external source may not be reliable, for example, if the source is not knowledgeable or a management specialist lacks objectivity. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies, facsimiles, or documents that have been filmed, digitized, or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

.A33 Section 520 provides further guidance regarding the reliability of data used for purposes of designing analytical procedures as substantive procedures.¹⁰

.A34 Section 240, *Consideration of Fraud in a Financial Statement Audit*, addresses circumstances in which the auditor has reason to believe that a document may not be authentic or may have been modified without that modification having been disclosed to the auditor.¹¹

Reliability of Information Produced by a Management's Specialist
(Ref: par. .08)

.A35 The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement and may be a significant deficiency or material weakness.¹²

.A36 When information to be used as audit evidence has been prepared using the work of a management's specialist, the requirement in paragraph .08 applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which no observable market exists. If the individual or organization applies that expertise in making an estimate which the entity uses in preparing its financial statements, the individual or organization is a management's specialist and paragraph .08 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph .07, but it is not the use of a management's specialist by the entity.

.A37 The nature, timing, and extent of audit procedures with regard to the requirement in paragraph .08 may be affected by such matters as the following:

- The nature and complexity of the matter to which the management's specialist relates
- The risks of material misstatement of the matter
- The availability of alternative sources of audit evidence
- The nature, scope, and objectives of the work of the management's specialist
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services
- The extent to which management can exercise control or influence over the work of the management's specialist
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements

¹⁰ Paragraph .05 of section 520, *Analytical Procedures*.

¹¹ Paragraph .A11 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

¹² See section 265, *Communicating Internal Control Related Matters Identified in an Audit*, for further guidance.

- The nature and extent of any controls within the entity over the work of the management's specialist
- The auditor's knowledge and experience of the field of expertise management's specialist
- The auditor's previous experience of the work of that specialist

The Competence, Capabilities, and Objectivity of a Management's Specialist (Ref: par. .08a)

.A38 Competence relates to the nature and level of expertise of the management's specialist. Capability relates to the ability of the management's specialist to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the management's specialist. The competence, capabilities, and objectivity of a management's specialist, and any controls within the entity over that specialist's work, are important factors with regard to the reliability of any information produced by a management's specialist.

.A39 Information regarding the competence, capabilities, and objectivity of a management's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- An auditor's specialist, if any, that assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's specialist

.A40 Matters relevant to evaluating the competence, capabilities, and objectivity of a management's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

.A41 Other matters that may be relevant include

- the relevance of the capabilities and competence of the management's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations.
- the competence of the management's specialist with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework.

- whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the management's specialist as the audit progresses.

.A42 A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the profession, legislation, or regulation of the management's specialist) or by the work of the management's specialist environment (for example, quality control policies and procedures).

.A43 Although safeguards cannot eliminate all threats to the objectivity of a management's specialist, threats such as intimidation threats may be of less significance to a specialist engaged by the entity than to a specialist employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, a specialist employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

.A44 When evaluating the objectivity of a specialist engaged by the entity, it may be relevant to discuss with management and that specialist any interests and relationships that may create threats to the specialist's objectivity and any applicable safeguards, including any professional requirements that apply to the specialist, and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include the following:

- Financial interests
- Business and personal relationships
- Provision of other services

Obtaining an Understanding of the Work of the Management's Specialist (Ref: par. .08b)

.A45 An understanding of the work of the management's specialist includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's specialist, or whether the auditor needs an auditor's specialist for this purpose.¹³

.A46 Aspects of the field of the management's specialist relevant to the auditor's understanding may include

- whether that specialist's field has areas of specialty within it that are relevant to the audit.
- whether any professional or other standards and regulatory or legal requirements apply.
- what assumptions and methods are used by the management's specialist and whether they are generally accepted within that specialist's field and appropriate for financial reporting purposes.
- the nature of internal and external data or information the management's specialist uses.

¹³ Paragraph .07 of section 620, *Using the Work of an Auditor's Specialist*.

.A47 In the case of a management's specialist engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that specialist. Evaluating that agreement when obtaining an understanding of the work of the management's specialist may assist the auditor in determining for the auditor's purposes the appropriateness of

- the nature, scope, and objectives of that specialist's work;
- the respective roles and responsibilities of management and that specialist; and
- the nature, timing, and extent of communication between management and that specialist, including the form of any report to be provided by that specialist.

.A48 In the case of a management's specialist employed by the entity, it is less likely that there will be a written agreement of this kind. Inquiry of the specialist and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding.

Evaluating the Appropriateness of the Work of the Management's Specialist (Ref: par. .08c)

.A49 Considerations when evaluating the appropriateness of the work of the management's specialist as audit evidence for the relevant assertion may include

- the relevance and reasonableness of that specialist's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- if that specialist's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- if that specialist's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

Information Produced by the Entity and Used for the Auditor's Purposes (Ref: par. .09a–b)

.A50 In order for the auditor to obtain reliable audit evidence, information produced by the entity, including any management's specialist, that is used for performing audit procedures needs to be sufficiently complete and accurate. For example, the effectiveness of an audit procedure, such as applying standard prices to records of sales volume to develop an expectation of sales revenue, is affected by the accuracy of the price information and the completeness and accuracy of the sales volume data. Similarly, if the auditor intends to test a population (for example, payments) for a certain characteristic (for example, authorization), the results of the test will be less reliable if the population from which items are selected for testing is not complete.

.A51 Obtaining audit evidence about the accuracy and completeness of such information may be accomplished concurrently with the actual audit procedure applied to the information when obtaining such audit evidence is an integral part of the audit procedure itself. In other situations, the auditor may have obtained audit evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the auditor may determine that additional audit procedures are needed.

.A52 In some cases, the auditor may intend to use information produced by the entity for other audit purposes. For example, the auditor may intend to use the entity's performance measures for the purpose of analytical procedures or use the entity's information produced for monitoring activities such as reports of the internal audit function. In such cases, the appropriateness of the audit evidence obtained is affected by whether the information is sufficiently precise or detailed for the auditor's purposes. For example, performance measures used by management may not be precise enough to detect material misstatements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Inconsistency in, or Doubts Over Reliability of, Audit Evidence (Ref: par. .10)

.A53 Obtaining audit evidence from different sources or of a different nature may indicate that an individual item of audit evidence is not reliable, such as when audit evidence obtained from one source is inconsistent with that obtained from another. This may be the case when, for example, responses to inquiries of management, internal audit, and others are inconsistent or when responses to inquiries of those charged with governance made to corroborate the responses to inquiries of management are inconsistent with the response by management. Section 230, *Audit Documentation*, includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant finding or issue.¹⁴

¹⁴ Paragraph .12 of section 230, *Audit Documentation*.

AU-C Section 9500A

Audit Evidence: Auditing Interpretations of Section 500A

1. The Effect of an Inability to Obtain Audit Evidence Relating to Income Tax Accruals

.01 Question—The IRS's audit manual instructs its examiners on how to secure from corporate officials "tax accrual workpapers" or the "tax liability contingency analysis," including "a memorandum discussing items reflected in the financial statements as income or expense where the ultimate tax treatment is unclear." The audit manual states that the examiner may question or summons a corporate officer or manager concerning the "knowledge of the items that make up the corporation's contingent reserve accounts." It also states that "in unusual circumstances, access may be had to the audit or tax workpapers" of an independent accountant or an accounting firm after attempting to obtain the information from the taxpayer. IRS policy also includes specific procedures to be followed in circumstances involving "listed transactions," to help address what the IRS considers to be abusive tax avoidance transactions (Internal Revenue Manual, section 4024.2-5, 5/14/81, and Internal Revenue Service Announcement 2002-63, 6/17/02).

.02 Concern over IRS access to tax accrual working papers might cause some entities to not prepare or maintain appropriate documentation of the calculation or contents of the accrual for income taxes included in the financial statements or to deny the independent auditor access to such information.

.03 What effect does this situation have on the auditor's opinion on the financial statements?

.04 Interpretation—The entity is responsible for its tax accrual, the underlying support for the accrual, and the related disclosures. Limitations on the auditor's access to information considered necessary to audit the tax accrual will affect the auditor's ability to issue an unmodified opinion on the financial statements.

.05 The auditor is required to design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence.¹

.06 If the entity does not have appropriate documentation of the calculation or contents of the accrual for income taxes and denies the auditor access to entity personnel responsible for making the judgments and estimates relating to the accrual, the auditor is required to conclude whether sufficient appropriate audit evidence has been obtained. If the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion, the auditor is required to attempt to obtain further audit evidence.²

¹ Paragraph .06 of section 500A, *Audit Evidence*.

² Paragraphs .28–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

.07 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor is required to express a qualified opinion or disclaim an opinion on the financial statements.³

.08 If the entity has appropriate documentation but denies the auditor access to it and to entity personnel who possess the information, the auditor is required to perform procedures to evaluate the consequence of an inability to obtain sufficient appropriate audit evidence due to a management-imposed limitation.⁴

.09 The auditor is required to request management to provide a written representation that it has provided the auditor with all relevant information and access, as agreed upon in the terms of the audit engagement.⁵ If management does not provide the written representations required by section 580, *Written Representations*, the auditor is required to disclaim an opinion on the financial statements in accordance section 705, *Modifications to the Opinion in the Independent Auditor's Report*, or withdraw from the engagement.⁶

.10 Question—An entity may allow the auditor to inspect its tax accrual workpapers but request that copies not be retained for audit documentation, particularly copies of the tax liability contingency analysis. The entity also may suggest that the auditor not prepare and maintain similar documentation of his or her own. What are the auditor's requirements in deciding a response to such a request?

.11 Interpretation—Section 230, *Audit Documentation*, defines *audit documentation* as the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.⁷ The auditor is required to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand

- a. the nature, timing, and extent of the audit procedures performed to comply with generally accepted auditing standards and applicable legal and regulatory requirements;
- b. the results of the audit procedures performed and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant judgments made in reaching those conclusions.⁸

Section 500A, *Audit Evidence*, states that other information includes information obtained by the auditor from inquiry, observation, inspection, and physical examination. The quantity, type, and content of audit documentation are matters of the auditor's judgment.

.12 The audit documentation of the results of auditing procedures directed at the tax accounts and related disclosures also includes sufficient appropriate audit evidence about the significant elements of the entity's tax liability contingency analysis. This audit documentation includes copies of the entity's documents, schedules, or analyses (or auditor-prepared summaries thereof) to enable the auditor to support his or her conclusions regarding the appropriateness

³ Paragraphs .08 and .10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

⁴ Paragraphs .11–.14 of section 705.

⁵ Paragraph .11a of section 580, *Written Representations*.

⁶ Paragraph .25 of section 580.

⁷ Paragraph .06 of section 230, *Audit Documentation*.

⁸ Paragraph .08 of section 230.

of the entity's accounting and disclosure of significant tax-related contingency matters. The audit documentation reflects the procedures performed and conclusions reached by the auditor and, for significant matters, include the entity's documentary support for its financial statement amounts and disclosures.

.13 The audit documentation includes the significant elements of the entity's analysis of tax contingencies or reserves, including roll-forward of material changes to such reserves. In addition, the audit documentation provides the entity's position and support for income tax related disclosures, such as its effective tax rate reconciliation, and support for its intraperiod allocation of income tax expense or benefit to continuing operations and to items other than continuing operations. When applicable, the audit documentation also includes the entity's basis for assessing deferred tax assets and related valuation allowances and its support for applying the "indefinite reversal criteria" discussed in FASB ASC 740-30-25-17, including its specific plans for reinvestment of undistributed foreign earnings.

.14 Question—In some situations, an entity may furnish its external legal counsel or in-house legal or tax counsel with information concerning the tax contingencies covered by the accrual for income taxes included in the financial statements and ask counsel to provide the auditor an opinion on the adequacy of the accrual for those contingencies.

.15 In such circumstances, rather than inspecting and obtaining documentary evidence of the entity's tax liability contingency analysis and making inquiries of the entity, may the auditor consider the counsel as a management's specialist within the meaning of section 500A and rely solely on counsel's opinion as an appropriate procedure for obtaining audit evidence to support his or her opinion on the financial statements?

.16 Interpretation—No. The opinion of legal counsel in this situation does not provide sufficient appropriate audit evidence to afford a reasonable basis for an opinion on the financial statements. The opinion of legal counsel on specific tax issues that he or she is asked to address and to which he or she has devoted substantive attention, as contemplated by the legal counsel's response to an auditor's letter of inquiry, can be useful to the auditor in forming his or her own opinion.

.17 An opinion from an entity's legal or tax counsel, similar to other work products obtained from a management's specialist, is useful in situations in which the auditor does not have adequate technical training and proficiency. In this case, however, the auditor's education, training, and experience, on the other hand, do enable him or her to be knowledgeable concerning income tax matters and competent to assess their presentation in the financial statements.

.18 Therefore, while the opinion of legal counsel on specific tax issues can be useful to the auditor in forming his or her own opinion, the audit of income tax accounts requires a combination of tax expertise and knowledge about the entity's business that is accumulated during all aspects of an audit. Therefore, as previously stated, it is not appropriate for the auditor to rely solely on such legal opinion.

.19 Question—A entity may have obtained the advice or opinion of an outside tax adviser related to the tax accrual or matters affecting it, including tax contingencies, and further may attempt to limit the auditor's access to such advice or opinion, or limit the auditor's documentation of such advice or opinion. This limitation on the auditor's access may be proposed on the basis that such information is privileged. Can the auditor rely solely on the conclusions of third-party tax advisers? What audit evidence should the auditor obtain and include in the audit documentation?

.20 Interpretation—As discussed in paragraphs .16–.18 of this interpretation, the auditor cannot accept an entity's or a third party's analysis or opinion with respect to tax matters without careful consideration and application of the auditor's tax expertise and knowledge about the entity's business. As a result of applying such knowledge to the facts, the auditor may encounter situations in which the auditor either disagrees with the position taken by the entity, or its advisers, or does not have sufficient appropriate audit evidence to support his or her opinion.

.21 If the entity's support for the tax accrual or matters affecting it, including tax contingencies, is based upon an opinion issued by an outside adviser with respect to a potentially material matter, the auditor is required to obtain access to the opinion,⁹ notwithstanding potential concerns regarding attorney-client or other forms of privilege. The audit documentation includes either the actual advice or opinions rendered by an outside adviser or other sufficient documentation or abstracts supporting both the transactions or facts addressed as well as the analysis and conclusions reached by the entity and adviser. Alternatives such as redacted or modified opinions may be considered but must, nonetheless, include sufficient content to articulate and document the entity's position so that the auditor can formulate his or her conclusion. Similarly, it may be possible to accept an entity's analysis summarizing an outside adviser's opinion, but the entity's analysis must provide sufficient appropriate audit evidence for the auditor to formulate his or her conclusion. In addition, written representations may be obtained stating that the entity has not received any advice or opinions that are contradictory to the entity's support for the tax accrual.

.22 If the auditor is unable to accumulate sufficient appropriate audit evidence about whether there is a supported and reasonable basis for the entity's position, the auditor is required to consider the effect of this scope limitation on his or her opinion.¹⁰

[Issue Date: March 1981; Amended: April 9, 2003; Revised: December 2005; Revised: March 2006; Revised: March 2008; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012.]

⁹ Paragraph .11 of this interpretation.

¹⁰ Paragraphs .11–.14 of section 705.

New GASB Pension Standards

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

Interpretation No. 2, "Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan" (paragraphs .23–.29), Interpretation No. 3, "Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan" (paragraphs .30–.36), and Interpretation Nos. 1–2 of section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, are intended to assist both plan and employer auditors who are auditing entities that have implemented the new accounting standards.

2. Auditor of Participating Employer in a Governmental Cost-Sharing Multiple-Employer Pension Plan

.23 Question—GASB Statement No. 68 requires governmental entities (employers) participating in governmental cost-sharing multiple-employer pension plans (cost-sharing plan or plan) to present certain pension amounts in employer financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.24 Do the audited financial statements of the plan prepared in accordance with generally accepted accounting principles (GAAP) and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.25 Interpretation—No. GASB Statement No. 67 requires only the disclosure of the collective net pension liability for all participating employers in GAAP financial statements of cost-sharing plans, not each employer's proportionate share of the collective net pension liability. Further, GAAP does not require the plan to present deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's share of collective pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's

financial statements related to the pension amounts, including required disclosures.

.26 Absent additional audit evidence from the cost-sharing plan (for example, auditor's opinions on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts), the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

.27 Question—A plan has engaged its auditor to audit and report on the schedule of employer allocations and certain key elements including net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense in a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. May an employer auditor use the plan auditor's report as evidence for the audit of the employer's financial statements?

.28 Interpretation—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedules as evidence that the pension amounts allocated to the employer and included in the employer's financial statements are not materially misstated.

.29 Before using the report of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedules are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes. Further, the employer auditor has a responsibility to verify and recalculate amounts specific to the applicable employer, including the employer amount used in the allocation percentage (that is, the numerator of the calculation), to recalculate the allocation percentage for the employer, and to recalculate the pension amounts allocated to the employer based on the allocation percentage.

[Issue Date: April 2014.]

3. Auditor of Participating Employer in a Governmental Agent Multiple-Employer Pension Plan

.30 Question—GASB Statement No. 68 requires governmental entities (employers) participating in governmental agent multiple-employer pension plans (agent plan or plan) to present certain pension amounts in employer

financial statements that are calculated by the plan or its actuary. Such amounts are based, in part, on records maintained only by the plan.

.31 Do the audited financial statements of the plan prepared in accordance with GAAP and additional unaudited information provided by the plan's management necessary to calculate the employer's net pension liability provide the employer's auditor with sufficient appropriate audit evidence upon which to base the opinion on the affected opinion units of the governmental employer financial reporting entity?

.32 Interpretation—No. GASB Statement No. 67 does not require the plan to present net pension liability, deferred outflows of resources or deferred inflows of resources by category, pension expense, or each participating employer's specific pension amounts. Unaudited information provided by the plan's management to the employers to support allocations or pension amounts that has not been subjected to further audit procedures beyond those performed in the audit of the basic plan financial statements would not constitute sufficient appropriate audit evidence to support the relevant assertions in the employer's financial statements related to the pension amounts, including required disclosures.

.33 Absent additional evidence obtained, for example, through the suggested best practices as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting*, the employer auditor would not likely be able to accumulate sufficient appropriate audit evidence to support the pension amounts and disclosures in the employer's financial statements. When pension amounts are material to one or more applicable opinion units of the employer's financial statements and the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements of those opinion units are free from material misstatement, the auditor should modify the audit opinion pursuant to section 705.

.34 Question—A plan has engaged its auditor to audit and report on the schedule of changes in fiduciary net position by employer, as described in the AICPA's State and Local Governments Expert Panel white paper referenced in paragraph .33 of this interpretation. May an employer auditor use the plan auditor's report as evidence about the fiduciary net position and changes in fiduciary net position for the audit of the employer's financial statements?

.35 Interpretation—Yes. The employer auditor is solely responsible for the audit of the employer's financial statements and, therefore, is responsible for determining the sufficiency and appropriateness of audit evidence necessary to reduce audit risk to an appropriately low level. Nevertheless, the employer auditor may use the plan auditor's report on the schedule as evidence about both the fiduciary net position and changes in fiduciary net position of the employer. However, the employer auditor should consider whether the opinion is on the schedule as a whole or on each employer column. If the opinion is on the schedule as a whole, it is likely that the employer auditor will need additional evidence to support these amounts in the employer's financial statements (examples of such audit evidence are included in the white paper referenced in paragraph .33 of this interpretation).

.36 Before using the work of the plan auditor as evidence, the employer auditor should evaluate whether the plan auditor's report and accompanying schedule are adequate and appropriate for the employer auditor's purposes. For example, the employer auditor may review the plan auditor's report and any

related opinion modifications and assess other matters discussed in the report. Additionally, the employer auditor should evaluate whether the plan auditor has the necessary competence and independence for the employer auditor's purposes.

[Issue Date: June 2014.]

AU-C Section 501

Audit Evidence — Specific Considerations for Selected Items

Source: SAS No. 122; SAS No. 136; SAS No. 142; SAS No. 143; SAS No. 144; SAS No. 145.

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

Introduction

Scope of This Section

.01 This section addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 500, *Audit Evidence*; section 540, *Auditing Accounting Estimates and Related Disclosures*; and other relevant AU-C sections, regarding certain aspects of (a) investments in securities and derivative instruments; (b) inventory; (c) litigation, claims, and assessments involving the entity; (d) segment information in an audit of financial statements; and (e) use of management's specialists. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

Effective Date

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

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the

- a. valuation of investments in securities and derivative instruments;
- b. existence and condition of inventory;
- c. completeness of litigation, claims, and assessments involving the entity;
- d. presentation and disclosure of segment information, in accordance with the applicable financial reporting framework; and
- e. work of management's specialists.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Definition

.04 For purposes of GAAS, the following term has the meaning attributed as follows:

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

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

Requirements

Investments in Securities and Derivative Instruments (Ref: par. .A1–.A4)

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting)

.05 When investments in securities are valued based on an investee's financial results, excluding investments accounted for using the equity method of accounting, the auditor should obtain audit evidence regarding the investee's financial results, including as applicable in the circumstances, performing the following procedures: (Ref: par. .A5–.A9)

- a. Obtain and read available financial statements of the investee and the accompanying audit report, if any, including determining whether the report of the other auditor is satisfactory for this purpose.
- b. If the investee's financial statements are not audited, or if the audit report on such financial statements is not satisfactory to the auditor, apply, or request that the investor entity arrange with the investee to have another auditor apply, appropriate auditing procedures to such financial statements, considering the materiality of the investment in relation to the financial statements of the investor entity.
- c. If the carrying amount of the investment reflects factors that are not recognized in the investee's financial statements or fair values of assets that are materially different from the investee's carrying amounts, obtain sufficient appropriate audit evidence regarding such amounts.
- d. If the difference between the financial statement period of the entity and the investee has or could have a material effect on the entity's financial statements, determine whether the entity's management has properly considered the lack of comparability and determine the effect, if any, on the auditor's report. (Ref: par. .A10)

If the auditor is not able to obtain sufficient appropriate audit evidence in support of the investee's financial results because of an inability to perform appropriate procedures, the auditor should determine the effect on the auditor's opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Paragraph renumbered by the issuance of SAS

No. 142, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.06 With respect to subsequent events and transactions of the investee occurring after the date of the investee's financial statements but before the date of the auditor's report, the auditor should obtain and read available interim financial statements of the investee and make appropriate inquiries of management of the investor to identify such events and transactions that may be material to the investor's financial statements and that may need to be recognized or disclosed in the investor's financial statements. (Ref: par. .A11) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

[Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value]

[.07–.11] [Paragraphs deleted by the issuance of SAS No. 143, July 2020.]^[1]

Inventory

.12 If inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory² by

- a. attending physical inventory counting, unless impracticable, to (Ref: par. .A21–.A23)
 - i. evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting, (Ref: par. .A24)
 - ii. observe the performance of management's count procedures, (Ref: par. .A25)
 - iii. inspect the inventory, and (Ref: par. .A26)
 - iv. perform test counts and (Ref: par. .A27)
- b. performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. (Ref: par. .A28–.A31)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.13 If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor should, in addition to the procedures required by paragraph .12, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are recorded properly. (Ref: par. .A32–.A34) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.14 If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor should make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

^[1] [Footnote deleted by the issuance of SAS No. 143, July 2020.]

² Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the auditor's procedures to respond to the assessed risks of material misstatements at the relevant assertion level.

.15 If attendance at physical inventory counting is impracticable, the auditor should perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor should modify the opinion in the auditor's report, in accordance with section 705. (Ref: par. .A35–.A37) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.16 If inventory under the custody and control of a third party is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- a. Request confirmation from the third party regarding the quantities and condition of inventory held on behalf of the entity (Ref: par. .A38)
- b. Perform inspection or other audit procedures appropriate in the circumstances (Ref: par. .A39)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Litigation, Claims, and Assessments

.17 The auditor should design and perform audit procedures to identify litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement, including (Ref: par. .A40–.A46)

- a. inquiring of management and, when applicable, others within the entity, including in-house legal counsel;
- b. obtaining from management a description and evaluation of litigation, claims, and assessments that existed at the date of the financial statements being reported on and during the period from the date of the financial statements to the date the information is furnished, including an identification of those matters referred to legal counsel;³
- c. reviewing minutes of meetings of those charged with governance; documents obtained from management concerning litigation, claims, and assessments; and correspondence between the entity and its external legal counsel; and
- d. reviewing legal expense accounts and invoices from external legal counsel.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.18 For actual or potential litigation, claims, and assessments identified based on the audit procedures required in paragraph .17, the auditor should obtain audit evidence relevant to the following factors:

- a. The period in which the underlying cause for legal action occurred
- b. The degree of probability of an unfavorable outcome
- c. The amount or range of potential loss

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Communication With the Entity's Legal Counsel

.19 Unless the audit procedures required by paragraph .17 indicate that no actual or potential litigation, claims, or assessments that may give rise to

³ For purposes of this section, the term *legal counsel* refers to the entity's in-house legal counsel and external legal counsel.

a risk of material misstatement exist, the auditor should, in addition to the procedures required by other AU-C sections, seek direct communication with the entity's external legal counsel. The auditor should do so through a letter of inquiry prepared by management and sent by the auditor requesting the entity's external legal counsel to communicate directly with the auditor. (Ref: par. .A41 and .A47–.A64) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.20 In addition to the direct communications with the entity's external legal counsel referred to in paragraph .19, the auditor should, in cases when the entity's in-house legal counsel has the responsibility for the entity's litigation, claims, and assessments, seek direct communication with the entity's in-house legal counsel through a letter of inquiry similar to the letter referred to in paragraph .19. Audit evidence obtained from in-house legal counsel in this manner is not, however, a substitute for the auditor seeking direct communication with the entity's external legal counsel, as described in paragraph .19. (Ref: par. .A65) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.21 The auditor should document the basis for any determination not to seek direct communication with the entity's legal counsel, as required by paragraphs .19–.20. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.22 The auditor should request management to authorize the entity's legal counsel to discuss applicable matters with the auditor. [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.23 As described in paragraphs .19–.20, the auditor should request, through letter(s) of inquiry, the entity's legal counsel to inform the auditor of any litigation, claims, assessments, and unasserted claims that the counsel is aware of, together with an assessment of the outcome of the litigation, claims, and assessments, and an estimate of the financial implications, including costs involved. Each letter of inquiry should include, but not be limited to, the following matters: (Ref: par. .A89)

- a. Identification of the entity, including subsidiaries, and the date of the audit
- b. A list prepared by management (or a request by management that the legal counsel prepare a list) that describes and evaluates pending or threatened litigation, claims, and assessments with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the company in the form of legal consultation or representation
- c. A list prepared by management that describes and evaluates unasserted claims and assessments that management considers to be probable of assertion and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the entity in the form of legal consultation or representation
- d. Regarding each matter listed in item b, a request that the legal counsel either provide the following information or comment on those matters on which the legal counsel's views may differ from those stated by management, as appropriate:
 - i. A description of the nature of the matter, the progress of the case to date, and the action that the entity intends to take (for example, to contest the matter vigorously or to seek an out-of-court settlement)

- ii. An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss (Ref: par. .A66)
 - iii. With respect to a list prepared by management (or by the legal counsel at management's request), an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete
- e. Regarding each matter listed in item c, a request that the legal counsel comment on those matters on which the legal counsel's views concerning the description or evaluation of the matter may differ from those stated by management
- f. A statement that management understands that whenever, in the course of performing legal services for the entity with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, the legal counsel has formed a professional conclusion that the entity should disclose or consider disclosure concerning such possible claim or assessment, the legal counsel, as a matter of professional responsibility to the entity, will so advise the entity and will consult with the entity concerning the question of such disclosure and the requirements of the applicable financial reporting framework (for example, the requirements of Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 450, *Contingencies*)
- g. A request that the legal counsel confirm whether the understanding described in item f is correct
- h. A request that the legal counsel specifically identify the nature of, and reasons for, any limitation on the response
- i. A request that the legal counsel specify the effective date of the response

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.24 When the auditor is aware that an entity has changed legal counsel or that the legal counsel previously engaged by the entity has resigned, the auditor should consider making inquiries of management or others about the reasons such legal counsel is no longer associated with the entity. (Ref: par. .A56) [Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

.25 The auditor should modify the opinion in the auditor's report, in accordance with section 705, if (Ref: par. .A57–.A66)

- a. the entity's legal counsel refuses to respond appropriately to the letter of inquiry and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures or
- b. management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Segment Information

.26 The auditor should obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information, in accordance with the applicable financial reporting framework, by (Ref: par. .A67–.A68)

- a. obtaining an understanding of the methods used by management in determining segment information and (Ref: par. .A69)
 - i. evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and
 - ii. when appropriate, testing the application of such methods and
- b. performing analytical procedures or other audit procedures appropriate in the circumstances.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020.]

Management's Specialist

.27 If information to be used as audit evidence has been prepared using the work of a management's specialist, the auditor should, to the extent necessary, taking into account the significance of that specialist's work for the auditor's purposes, perform the following: (Ref: par. .A70–.A72)

- a. Evaluate the competence, capabilities, and objectivity of that specialist (Ref: par. .A73–.A79)
- b. Obtain an understanding of the work of that specialist (Ref: par. .A80–.A83)
- c. Evaluate the appropriateness of that specialist's work as audit evidence for the relevant assertion (Ref: par. .A84–.A88)

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Application and Other Explanatory Material

Investments in Securities and Derivative Instruments (Ref: par. .05–.06)

.A1 Section 540 addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. This section addresses aspects relating to auditing valuation of investments in securities and derivative instruments that are incremental to section 540. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A2 Evaluating audit evidence for assertions about investments in securities and derivative instruments often involves professional judgment because the assertions, especially those about valuation, are based on highly subjective assumptions or are particularly sensitive to changes in the underlying circumstances. Valuation assertions relating to investments in securities and derivative instruments may be based on assumptions about the occurrence of future events for which expectations are difficult to develop or on assumptions about conditions expected to exist over a long period (for example, default rates or prepayment rates). Accordingly, competent persons could reach different conclusions about estimates of fair values or estimates of ranges of fair values. Professional judgment also may be necessary when evaluating audit evidence

for assertions based on features of the security or derivative and the requirements of the applicable financial reporting framework, including underlying criteria for hedge accounting, which may be complex. For example, determining the fair value of a structured note may require consideration of a variety of features of the note that react differently to changes in economic conditions. In addition, one or more other derivatives may be designated to hedge changes in cash flows under the note. Evaluating audit evidence about the fair value of the note, the determination of whether the hedge is highly effective, and the allocation of changes in fair value to earnings and other comprehensive income requires professional judgment. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

[.A3] [Paragraph renumbered and deleted by issuance of SAS No. 143, July 2020]

Investments in Securities When Valuations Are Based on Cost

.A4 Procedures to obtain evidence about the valuation of securities that are recorded at cost may include inspection of documentation of the purchase price, confirmation with the issuer or holder of those securities, and testing discount or premium amortization either by recomputation or through the use of analytical procedures. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .05–.06)

.A5 Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, addresses auditing investments accounted for using the equity method of accounting. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A6 For valuations based on an investee's financial results (excluding investments accounted for using the equity method of accounting), obtaining and reading the financial statements of the investee that have been audited by an auditor whose report is satisfactory may be sufficient for the purpose of obtaining sufficient appropriate audit evidence of the amount used in the estimate. In determining whether the report of another auditor is satisfactory, the auditor may perform procedures such as making inquiries regarding the professional reputation and standing of the other auditor, visiting the other auditor, discussing the audit procedures followed and the results thereof, and reviewing the audit plan and audit documentation of the other auditor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A7 After obtaining and reading the audited financial statements of an investee, the auditor may conclude that additional audit procedures are necessary to obtain sufficient appropriate audit evidence, for example, when the date of the audited financial statements is different from the investor's measurement date. Further examples for when the auditor may conclude that additional audit evidence is needed include significant differences in accounting principles, changes in ownership, or the significance of the investment to the investor's financial position or results of operations. Examples of procedures that the auditor may perform are reviewing information in the investor's files that relates to the investee, such as investee minutes and budgets, and investee cash flow information and making inquiries of investor management about the investee's

financial results. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A8 The auditor may need to obtain evidence relating to transactions between the entity and investee to evaluate

- a. the propriety of the elimination of unrealized profits and losses on transactions between the entity and investee, if applicable, and
- b. the adequacy of disclosures about material related party transactions or relationships.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A9 Section 540 addresses auditing fair value accounting estimates. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 143.]

.A10 The date of the investor's financial statements and those of the investee may be different. If the difference between the date of the entity's financial statements and those of the investee has or could have a material effect on the entity's financial statements, the auditor is required, in accordance with paragraph .05d, to determine whether the entity's management has properly considered the lack of comparability. The effect may be material, for example, because the difference between the financial statement period ends of the entity and investee is not consistent with the prior period in comparative statements or because a significant transaction occurred during the time period between the financial statement period end of the entity and investee. If a change in the difference between the financial statement period end of the entity and investee has a material effect on the investor's financial statements, the auditor may be required, in accordance with section 708, *Consistency of Financial Statements*, to add an emphasis-of-matter paragraph to the auditor's report because the comparability of financial statements between periods has been materially affected by a change in reporting period. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A11 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

[Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value (Ref: par. .07–.09)]

[.A12–.A20] [Paragraphs renumbered and deleted by the issuance of SAS No. 143, July 2020.]^[4-6]

Inventory

Attendance at Physical Inventory Counting (Ref: par. .12a)

.A21 Management ordinarily establishes procedures under which inventory is physically counted at least once per year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

^[4-6] [Footnotes deleted by the issuance of SAS No. 143, July 2020.]

.A22 Attendance at physical inventory counting involves

- inspecting the inventory to ascertain its existence and evaluate its condition and performing test counts,
- observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count, and
- obtaining audit evidence about the reliability of management's count procedures.

These procedures may serve as tests of controls or substantive procedures, or both, depending on the auditor's risk assessment, planned approach, and the specific procedures carried out. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A23 Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs .12–.16) include, for example, the following:

- The risks of material misstatement related to inventory.
- The control risk related to inventory.
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- The timing of physical inventory counting.
- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. Section 600 addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor's specialist is needed. Section 620, *Using the Work of an Auditor's Specialist*, addresses the use of an auditor's specialist to assist the auditor in obtaining sufficient appropriate audit evidence.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluate Management's Instructions and Procedures (Ref: par. .12a(i))

.A24 Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example, the following:

- The application of appropriate controls (for example, the collection of used physical inventory count records, accounting for unused physical inventory count records, and count and recount procedures)
- The accurate identification of the stage of completion of work in progress; slow moving, obsolete, or damaged items; and inventory owned by a third party (for example, on consignment)
- The procedures used to estimate physical quantities, when applicable, such as may be needed in estimating the physical quantity of a coal pile

- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cut-off date

[Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Observe the Performance of Management's Count Procedures (Ref: par. .12a(ii))

.A25 Observing the performance of management's count procedures (for example, those relating to control over the movement of inventory before, during, and after the count) assists the auditor in obtaining audit evidence that management's instructions and count procedures are designed and implemented adequately. In addition, the auditor may obtain copies of cutoff information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Inspect the Inventory (Ref: par. .12a(iii))

.A26 Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying obsolete, damaged, or aging inventory. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Perform Test Counts (Ref: par. .12a(iv))

.A27 Performing test counts (for example, by tracing items selected from management's count records to the physical inventory and tracing items selected from the physical inventory to management's count records) provides audit evidence about the completeness and accuracy of those records. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A28 In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Using the Work of an External Inventory-Taking Firm

.A29 Management may engage external organizations that have expertise in the taking of physical inventories to count, list, price, and subsequently compute the total dollar amount of inventory on hand at the date of the physical count. For example, such external inventory-taking firms are often used by entities such as retail stores, hospitals, and automobile dealers. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A30 The report of an external inventory-taking firm about the work it performed does not, by itself, provide the auditor with sufficient appropriate audit evidence. Paragraph .12 requires the auditor, if inventory is material to the financial statements, to perform certain procedures regarding the existence and condition of inventory.^[7] The auditor may, for example, examine the external inventory-taking firm's program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis, and apply appropriate tests to the intervening transactions. [Paragraph renumbered by the issuance of SAS No. 143,

^[7] [Footnote deleted by the issuance of SAS No. 144, June 2021.]

July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A31 Although the auditor may adjust the extent of the work on the physical count of inventory because of the work of an external inventory-taking firm, any restriction imposed on the auditor such that the auditor is unable to perform the procedures that the auditor considers necessary is a scope limitation. In such cases, section 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. [Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Physical Inventory Counting Conducted Other Than at the Date of the Financial Statements (Ref: par. .13)

.A32 For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation, and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date (or dates) other than the date of the financial statements is appropriate for audit purposes. Section 330 addresses substantive procedures performed at an interim date.⁸ [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A33 When a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A34 Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are recorded properly include the following:

- Whether the perpetual inventory records are properly adjusted
- Reliability of the entity's perpetual inventory records
- Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Attendance at Physical Inventory Counting Is Impracticable (Ref: par. .15)

.A35 In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory (for example, when inventory is held in a location that may pose threats to the safety of the auditor). The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in section 200, *Overall Objectives of the*

⁸ Paragraphs .23–.24 of section 330.

Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards, the matter of difficulty, time, or cost involved is not, in itself, a valid basis for the auditor to omit an audit procedure for which no alternative exists or to be satisfied with audit evidence that is less than persuasive. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A36 In some cases, when attendance is impracticable, alternative audit procedures (for example, observing a current physical inventory count and reconciling it to the opening inventory quantities or inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting) may provide sufficient appropriate audit evidence about the existence and condition of inventory. If the audit covers the current period and one or more periods for which the auditor had not observed or made some physical counts of prior inventories, alternative audit procedures, such as tests of prior transactions or reviews of the records of prior counts, may provide sufficient appropriate audit evidence about the prior inventories. The effectiveness of the alternative procedures that an auditor may perform is affected by the length of the period that the alternative procedures cover. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A37 In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, section 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. In addition, section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's procedures regarding inventory opening balances in initial audit engagements.⁹ [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Inventory Under the Custody and Control of a Third Party

Confirmation (Ref: par. .16a)

.A38 Section 505, *External Confirmations*, addresses external confirmation procedures. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Other Audit Procedures (Ref: par. .16b)

.A39 Depending on the circumstances (for example, when information is obtained that raises doubt about the integrity and objectivity of the third party), the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include the following:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable
- Obtaining another auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded
- Inspecting documentation regarding inventory held by third parties (for example, warehouse receipts)
- Requesting confirmation from other parties when inventory has been pledged as collateral

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

⁹ Paragraph .A13 of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

Litigation, Claims, and Assessments

Completeness of Litigation, Claims, and Assessments (Ref: par. .17)

.A40 Litigation, claims, and assessments involving the entity may have a material effect on the financial statements and, thus, may be required to be recognized, measured, or disclosed in the financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A41 Other legal matters involving the entity may not have a material effect on the entity's financial statements and, accordingly, would not give rise to risks of material misstatement. Examples of such other legal matters may be

- matters unrelated to actual or potential litigation, claims, or assessments, such as consulting services related to real estate or potential merger and acquisition transactions;
- matters in which the entity records indicate that management or the legal counsel has not devoted substantive attention to the matter;
- matters in which the entity's insurance coverage exceeds the amount of the actual or potential litigation, claim, or assessment sought against the entity; or
- matters that are clearly trivial to the financial statements.

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A42 Management is responsible for adopting policies and procedures to identify, evaluate, and account for litigation, claims, and assessments as a basis for the preparation of financial statements, in accordance with the requirements of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A43 Management is the primary source of information about events or conditions considered in the financial accounting for, and reporting of, litigation, claims, and assessments because these matters are within the direct knowledge and, often, control of management. Accordingly, the auditor's procedures with respect to litigation, claims, and assessments include the following:

- Making inquiries of management as required by paragraph .17a, which may include a discussion about the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement
- Obtaining written representations from management, in accordance with section 580, *Written Representations*, that all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework¹⁰

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A44 In addition to the procedures identified in paragraph .17, other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the

¹⁰ Paragraph .15 of section 580, *Written Representations*.

entity and its environment to assist the auditor to become aware of litigation, claims, and assessments involving the entity. Examples of such procedures are as follows:

- Reading minutes of meetings of stockholders; directors; governing bodies of governmental entities; and appropriate committees held during, and subsequent to, the period being audited
- Reading contracts, loan agreements, leases, correspondence from taxing or other governmental agencies, and similar documents
- Obtaining information concerning guarantees from bank confirmation forms
- Inspecting other documents for possible guarantees by the entity

Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity and its environment.¹¹ In addition, section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, requires the auditor to obtain an understanding of the entity's legal and regulatory framework applicable to the entity and industry or sector in which the entity operates and how the entity is complying with that framework. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A45 Audit evidence obtained for purposes of identifying litigation, claims, and assessments that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation, claims, and assessments. Section 540 establishes requirements and provides guidance relevant to the auditor's consideration of litigation, claims, and assessments requiring accounting estimates or related disclosures in the financial statements. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A46 This section addresses inquiries of the entity's legal counsel with whom management has consulted. If management has not consulted legal counsel, the auditor would rely on the procedures required by paragraph .17 to identify litigation, claims, and assessments involving the entity, which may give rise to a risk of material misstatement, and the written representation of management regarding litigation, claims, and assessments, as required by section 580. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Communication With the Entity's Legal Counsel (Ref: par. .19–.25)

.A47 An auditor ordinarily does not possess legal skills and, therefore, cannot make legal judgments concerning information coming to the auditor's attention. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A48 Direct communication with the entity's legal counsel assists the auditor in obtaining sufficient appropriate audit evidence about whether potentially material litigation, claims, and assessments are known and management's estimates of the financial implications, including costs, are reasonable. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A49 The American Bar Association (ABA) has approved *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (the ABA statement), which explains the concerns of the legal counsel and the nature of the limitations that an auditor is likely to encounter in connection with

¹¹ Paragraph .12 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

seeking direct communication with the entity's legal counsel about litigation, claims, assessments, and unasserted claims.¹² [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A50 A letter of inquiry to the entity's legal counsel is the auditor's primary means of obtaining corroboration of the information provided by management concerning material litigation, claims, and assessments. Audit evidence obtained from the entity's in-house general counsel or legal department may provide the auditor with the necessary corroboration. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A51 In certain circumstances, the auditor also may judge it necessary to meet with the entity's legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, when

- the auditor determines that the matter is a significant risk.
- the matter is complex.
- a disagreement exists between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A52 An external legal counsel's response to a letter of inquiry and the procedures set forth in paragraphs .17–.18 provide the auditor with sufficient appropriate audit evidence concerning the accounting for, and reporting of, pending and threatened litigation, claims, and assessments. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A53 Audit evidence about the status of litigation, claims, and assessments up to the date of the auditor's report may be obtained by inquiry of management, including in-house legal counsel responsible for dealing with the relevant matters. The auditor may need to obtain updated information from the entity's legal counsel. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A54 In accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.¹³ Accordingly, it is preferable that the entity's legal counsel's response be as close to the date of the auditor's report as is practicable in the circumstances. Specifying the effective date of the entity's legal counsel's response to reasonably approximate the expected date of the auditor's report may obviate the need to obtain updated information from the entity's legal counsel. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

¹² The *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* is reprinted as exhibit A, "American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," for the convenience of readers but is not an integral part of this section.

¹³ Paragraph .43 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .82 and .126 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A55 Clearly specifying the earliest acceptable effective date of the response and the latest date by which it is to be sent to the auditor and informing the entity's legal counsel of these dates timely facilitates the entity's legal counsel's ability to respond timely and adequately. A two-week period between the specified effective date of the entity's legal counsel's response and the latest date by which the response is to be sent to the auditor is generally sufficient. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A56 In some circumstances, the legal counsel may be required by relevant ethical requirements to resign the engagement if the legal counsel's advice concerning financial accounting and reporting for litigation, claims, and assessments is disregarded by the entity. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A57 The legal counsel appropriately may limit the response to matters to which the legal counsel has given substantive attention in the form of legal consultation or representation. Also, the legal counsel's response may be limited to matters that are considered individually or collectively material to the financial statements, such as when the entity and auditor have reached an understanding on the limits of materiality for this purpose and management has communicated such understanding to the legal counsel. Such limitations are not limitations on the scope of the audit. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A58 The legal counsel may be unable to respond concerning the likelihood of an unfavorable outcome of litigation, claims, and assessments or the amount or range of potential loss because of inherent uncertainties. Factors influencing the likelihood of an unfavorable outcome sometimes may not be within the legal counsel's competence to judge; historical experience of the entity in similar litigation or the experience of other entities may not be relevant or available, and the amount of the possible loss frequently may vary widely at different stages of litigation. Consequently, the legal counsel may not be able to form a conclusion with respect to such matters. In such circumstances, the auditor may conclude that the financial statements are affected by an uncertainty concerning the outcome of a future event that cannot be reasonably estimated. If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, section 705 requires the auditor to modify the opinion in addressing the effect, if any, of the legal counsel's response on the auditor's report as a result of the scope limitation.¹⁴ [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A59 An external legal counsel's refusal to furnish the information requested in an inquiry letter either in writing or orally may cause a scope limitation of the audit sufficient to preclude an unmodified opinion. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A60 Although the auditor would consider the inability to review information that could have a significant bearing on the audit as a scope limitation, in recognition of the public interest in protecting the confidentiality of lawyer-client communications, such inability is not intended to require an auditor to examine documents that the client identifies as subject to the lawyer-client privilege. In the event of questions concerning the applicability of this privilege, the auditor may request confirmation from the entity's legal counsel that the information is subject to that privilege and that the information was considered by the legal counsel in responding to the letter of inquiry or, if the matters

¹⁴ Paragraph .07 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

are being handled by another legal counsel, an identification of such legal counsel for the purpose of sending a letter of inquiry. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A61 If management imposes a limitation on the scope of the audit and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor is required by section 705 to either disclaim an opinion on the financial statements or, when practicable, withdraw from the audit.¹⁵ [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A62 In some cases, in order to emphasize the preservation of the attorney-client privilege or the attorney work-product privilege, some entities may include the following or substantially similar language in the audit inquiry letter to legal counsel:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

For the same reason, some legal counsel may include the following or substantially similar language in their response letters to auditors:

The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

Explanatory language similar to the foregoing in the letters of the entity or legal counsel is not a limitation on the scope of the legal counsel's response. See exhibit B, "Report of the Subcommittee on Audit Inquiry Responses." [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A63 In order to emphasize the preservation of the attorney-client privilege with respect to unasserted possible claims or assessments, some legal counsel may include the following or substantially similar language in their responses to audit inquiry letters:

Please be advised that pursuant to clauses (b) and (c) of Paragraph 5 of the ABA Statement of Policy [*American Bar Association's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*] and related Commentary referred to in the last paragraph of this letter, it would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the Company. We can only furnish information concerning those unasserted possible claims or assessments upon which the Company has specifically requested in writing that we comment. We also cannot comment upon the adequacy of the Company's listing, if any, of unasserted possible claims or assessments or its assertions concerning the advice, if any, about the need to disclose same.

Additional language similar to the foregoing in a letter from legal counsel is not a limitation on the scope of the audit. However, the ABA statement and the understanding between the legal and accounting professions assumes that the

¹⁵ Paragraph .13 of section 705.

legal counsel, under certain circumstances, will advise and consult with the entity concerning the entity's obligation to make financial statement disclosure with respect to unasserted possible claims or assessments. Confirmation of this understanding is included in the legal counsel's response. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

A64 If the auditor believes that there may be actual or potential material litigation, claims, or assessments and the entity has not engaged external legal counsel relating to such matters, the auditor may discuss with the client the possible need to consult legal counsel to assist the client in determining the appropriate measurement, recognition, or disclosure of related liabilities or loss contingencies in the financial statements, in accordance with the applicable financial reporting framework. Depending on the significance of the matter(s), refusal by management to consult legal counsel in these circumstances may result in a scope limitation of the audit sufficient to preclude an unmodified opinion. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Direct Communication With the Entity's In-House Legal Counsel

A65 In-house legal counsel can range from one lawyer to a large staff, with responsibilities ranging from specific internal matters to a comprehensive coverage of all of the entity's legal needs, including litigation with outside parties. Because both in-house and external legal counsel are bound by an applicable code of ethics, there should be no significant difference in their professional obligations and responsibilities. In some circumstances, external legal counsel, if used at all, may be used only for limited purposes, such as data accumulation or account collection activity. In such circumstances, in-house legal counsel may have the primary responsibility for corporate legal matters and may be in the best position to know and precisely describe the status of all litigation, claims, and assessments or to corroborate information provided by management. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluation of the Outcome of Litigation, Claims, or Assessment (Ref: par .23d(ii))

A66 Although paragraph 5 of the ABA statement states that the legal counsel "may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is 'probable' or 'remote,'" the legal counsel is not required to use those terms in communicating the evaluation to the auditor. The auditor may find other wording sufficiently clear, as long as the terms can be used to classify the outcome of the uncertainty under one of the three probability classifications established in FASB ASC 450. Some examples of evaluations concerning litigation that may be considered to provide sufficient clarity that the likelihood of an unfavorable outcome is remote, even though they do not use that term, are the following:

- "We are of the opinion that this action will not result in any liability to the company."
- "It is our opinion that the possible liability to the company in this proceeding is nominal in amount."
- "We believe the company will be able to defend this action successfully."
- "We believe that the plaintiff's case against the company is without merit."
- "Based on the facts known to us, after a full investigation, it is our opinion that no liability will be established against the company in these suits."

Absent any contradictory information obtained by the auditor either in other parts of the legal counsel's letter or otherwise, the auditor need not obtain further clarification of evaluations such as the foregoing. Because of inherent uncertainties described in paragraph .A58 and the ABA statement, an evaluation furnished by the legal counsel may indicate significant uncertainties or stipulations about whether the client will prevail. The following are examples of the legal counsel's evaluations that are unclear about the likelihood of an unfavorable outcome:

- "This action involves unique characteristics wherein authoritative legal precedents do not seem to exist. We believe that the plaintiff will have serious problems establishing the company's liability under the act; nevertheless, if the plaintiff is successful, the award may be substantial."
- "It is our opinion that the company will be able to assert meritorious defenses to this action." (The term *meritorious defenses* indicates that the entity's defenses will not be summarily dismissed by the court; it does not necessarily indicate the legal counsel's opinion that the entity will prevail.)
- "We believe the action can be settled for less than the damages claimed."
- "We are unable to express an opinion as to the merits of the litigation at this time. The company believes there is absolutely no merit to the litigation." (If the entity's legal counsel, with the benefit of all relevant information, is unable to conclude that the likelihood of an unfavorable outcome is remote, it is unlikely that management would be able to form a judgment to that effect.)
- "In our opinion, the company has a substantial chance of prevailing in this action." (A *substantial chance*, a *reasonable opportunity*, and similar terms indicate more uncertainty than an opinion that the company will prevail.)

If the auditor is uncertain about the meaning of the legal counsel's evaluation, clarification either in a follow-up letter or conference with the legal counsel and entity, appropriately documented, may be appropriate. If the legal counsel is still unable to give an unequivocal evaluation of the likelihood of an unfavorable outcome in writing or orally, the auditor is required by section 700, or section 703, to determine the effect, if any, of the legal counsel's response on the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Segment Information (Ref: par. .26)

.A67 Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis. [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Considerations Specific to Governmental Entities

.A68 For governmental entities required by the applicable financial reporting framework to disclose segment information, the auditor's responsibility

regarding the presentation and disclosure of segment information is in relation to the financial statements of the opinion unit(s) on which the segment information is based.¹⁶ [Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Understanding of the Methods Used by Management (Ref: par. .26a)

.A69 Depending on the circumstances, examples of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include the following:

- Sales, transfers, and charges between segments and elimination of intersegment amounts
- Comparisons with budgets and other expected results (for example, operating profits as a percentage of sales)
- The allocation of assets and costs among segments
- Consistency with prior periods and the adequacy of the disclosures with respect to inconsistencies
- Management's process for identifying those segments that require disclosure in accordance with the entity's financial reporting framework

[Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Using the Work of a Management's Specialist (Ref: par. .27)

.A70 The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement and may be a significant deficiency or material weakness.¹⁷ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A71 When information to be used as audit evidence has been prepared using the work of a management's specialist, the requirement in paragraph .27 applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which no observable market exists. If the individual or organization applies that expertise in making an estimate, which the entity uses in preparing its financial statements, the individual or organization is a management's specialist, and paragraph .27 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity, which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to the evaluation required by

¹⁶ Paragraph .A14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

¹⁷ See section 265, *Communicating Internal Control Related Matters Identified in an Audit*, for further guidance. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142.]

section 500,¹⁸ but it is not the use of a management's specialist by the entity. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A72 The nature, timing, and extent of audit procedures with regard to the requirement in paragraph .27 may be affected by matters such as the following:

- The nature and complexity of the matter to which the management's specialist relates
- The risks of material misstatement of the matter
- The availability of alternative sources of audit evidence
- The nature, scope, and objectives of the work of the management's specialist
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services
- The extent to which management can exercise control or influence over the management's specialist (including, when applicable, the organization that employs the individual specialist), thereby influencing the work of the management's specialist
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements
- The nature and extent of any controls within the entity over the work of the management's specialist
- The auditor's knowledge and experience of the field of expertise of management's specialist
- The auditor's previous experience of the work of that specialist

More persuasive audit evidence is needed with regard to the requirement in paragraph .27 as the significance of the management's specialist's work, the risk of material misstatement at the relevant assertion level, or the ability of management to affect the specialist's judgments increases, or as the competence, capabilities, and objectivity possessed by the specialist in the particular field decreases. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

The Competence, Capabilities, and Objectivity of a Management's Specialist (Ref: par. .27a)

.A73 Competence relates to the nature and level of expertise of the management's specialist. Capability relates to the ability of the management's specialist to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business

¹⁸ See paragraph .07 of section 500, *Audit Evidence*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

judgment of the management's specialist. The competence, capabilities, and objectivity of a management's specialist, and any controls within the entity over that specialist's work, are important factors with regard to the reliability of any information produced by a management's specialist. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A74 Information regarding the competence, capabilities, and objectivity of a management's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- An auditor's specialist, if any, that assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's specialist

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A75 Matters relevant to evaluating the competence, capabilities, and objectivity of a management's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A76 Other matters that may be relevant include the following:

- The relevance of the capabilities and competence of the management's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations
- The competence of the management's specialist with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the management's specialist as the audit progresses

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A77 A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the profession, legislation, or regulation of the management's specialist) or by the work of the management's specialist's environment (for example, quality control policies and procedures). [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A78 Although safeguards cannot eliminate all threats to the objectivity of a management's specialist, threats such as intimidation threats may be of less significance to a specialist engaged by the entity than to a specialist employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, a specialist employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A79 When evaluating the objectivity of a specialist engaged by the entity, it may be relevant to discuss with management and that specialist any interests and relationships that may create threats to the specialist's objectivity and any applicable safeguards, including any professional requirements that apply to the specialist, and to evaluate whether the safeguards are adequate. Relevant information may be obtained by the auditor from procedures performed in accordance with section 550, *Related Parties*. Interests and relationships creating threats may include the following:

- Financial interests
- Business and personal relationships between the entity and the individual specialist and between the entity and the organization that employs the individual specialist
- Provision of other services

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Obtaining an Understanding of the Work of the Management's Specialist (Ref: par. .27b)

.A80 An understanding of the work of the management's specialist includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's specialist or whether the auditor needs an auditor's specialist for this purpose.¹⁹ [Paragraph added, effective for audits of financial

¹⁹ Paragraph .07 of section 620, *Using the Work of an Auditor's Specialist*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Footnote renumbered by the issuance of SAS No. 144, June 2021.]

statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A81 Aspects of the field of the management's specialist relevant to the auditor's understanding may include

- whether that specialist's field has areas of specialty within it that are relevant to the audit.
- whether any professional or other standards and regulatory or legal requirements apply.
- what assumptions and methods are used by the management's specialist and whether they are generally accepted within that specialist's field appropriately applied under the applicable financial reporting framework.
- the nature of internal and external data or information the management's specialist uses.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A82 In the case of a management's specialist engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that specialist. Evaluating that agreement when obtaining an understanding of the work of the management's specialist may assist the auditor in determining for the auditor's purposes the appropriateness of

- the nature, scope, and objectives of that specialist's work;
- the respective roles and responsibilities of management and that specialist; and
- the nature, timing, and extent of communication between management and that specialist, including the form of any report to be provided by that specialist.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

.A83 In the case of a management's specialist employed by the entity, it is less likely that there will be a written agreement of this kind. Inquiry of the specialist and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020.]

Evaluating the Appropriateness of the Work of the Management's Specialist (Ref: par. .27c)

.A84 Section 540 includes requirements and guidance related to accounting estimates, including the selection and application of the methods, significant assumptions, and data used in making the accounting estimate.²⁰ Considerations when evaluating the appropriateness of the work of the management's specialist as audit evidence for the relevant assertion may include

²⁰ Paragraph .21 of section 540, *Auditing Accounting Estimates and Related Disclosures*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

- if that specialist's work involves significant assumptions, the appropriateness of the assumptions, taking into account the consistency of those assumptions with relevant information
- if that specialist's work involves the use of methods, the appropriateness of the methods under the circumstances, taking into account the requirements of the applicable financial reporting framework;
- if that specialist's work involves significant use of source data, including entity-produced data, the relevance and reliability of that source data; and
- the relevance and reasonableness of that specialist's findings or conclusions, the consistency of the findings or conclusions with other audit evidence, and whether the findings or conclusions have been appropriately reflected in the financial statements.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2022, by SAS No. 142. Paragraph renumbered by the issuance of SAS No. 143, July 2020. As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A85 If the work of the management's specialist involves use of significant assumptions developed by the management's specialist, evaluating the appropriateness of those assumptions may include taking into account the consistency of those assumptions with relevant information such as the following:

- Assumptions generally accepted within the specialist's field
- Supporting information provided by the specialist
- Industry, regulatory, and other external factors, including economic conditions
- The entity's objectives, strategies, and related business risks
- Existing market information
- Historical or recent experience, along with changes in conditions and events affecting the entity
- Significant assumptions used in other estimates tested in the entity's financial statements

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A86 If the methods of the management's specialist include the use of a proprietary model, the auditor's procedures may include, for example

- obtaining an understanding of the model through
 - inquiry of the specialist, and
 - reading descriptions of the model in the specialist's report or equivalent communication;
- testing controls over the entity's evaluation of the specialist's work;
- testing mathematical accuracy of the calculations under the model, if practicable; or
- assessing the inputs to and output from the model, which may involve using an alternative model for comparison.

The extent of such procedures will depend on the type of model used (for example, commercially available versus internally developed) and the applicability of the factors described in paragraph .A72. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A87 Factors that affect the relevance and reliability of the work of the management's specialist include the following:

- The results of the auditor's procedures over internal or external data, significant assumptions, and methods
- The nature of any restrictions, disclaimers, or limitations in the specialist's report or equivalent communication
- The consistency of the management's specialist's work with other evidence obtained by the auditor and the auditor's understanding of the entity and its environment

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A88 Additional procedures may be necessary if the management's specialist's findings or conclusions appear to contradict the relevant assertion, or the management's specialist's work does not provide sufficient appropriate audit evidence. Examples of situations in which additional procedures may be necessary include the following:

- The findings and conclusions of the management's specialist are inconsistent with
 - other information, if any, in the specialist's report, or equivalent communication,
 - other evidence obtained by the auditor, or
 - the auditor's understanding of the entity and its environment.
- The management's specialist's report, or equivalent communication, contains restrictions, disclaimers, or limitations regarding the auditor's use of the report or communication.
- The auditor has identified exceptions in performing procedures related to data, significant assumptions, or methods.
- The auditor has doubts about the competence, capabilities, or objectivity of the management's specialist.
- The management's specialist has a conflict of interest relevant to the specialist's work.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A89

Appendix — Illustrative Audit Inquiry Letter to Legal Counsel (Ref: par. .23)

In connection with an audit of our financial statements at (balance sheet date) and for the (period) then ended, management of the Company has prepared, and furnished to our auditors (name and address of auditors), a description and evaluation of certain contingencies, including those set forth below involving matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. These contingencies are regarded by management of the Company as material for this purpose (management may indicate a materiality limit if an understanding has been reached with the auditor). Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

In connection with an audit of our financial statements as of (balance-sheet date) and for the (period) then ended, please furnish our auditors, (name and address of auditors), with the information requested below concerning certain contingencies involving matters with respect to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. *[When a materiality limit has been established based on an understanding between management and the auditor, the following sentence should be added: This request is limited to contingencies amounting to (amount) individually or items involving lesser amounts that exceed (amount) in the aggregate.]*

Pending or Threatened Litigation (Excluding Unasserted Claims)

[Ordinarily the information would include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3) how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.] This letter will serve as our consent for you to furnish to our auditor all the information requested herein. Accordingly, please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated and an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

Regarding pending or threatened litigation, claims, and assessments, please include in your response: (1) the nature of each matter, (2) the progress of each matter to date, (3) how the Company is responding or intends to respond (for example, to contest the case vigorously or seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

Unasserted Claims and Assessments (Considered by Management to be Probable of Assertion and That, if Asserted, Would Have at Least a Reasonable Possibility of an Unfavorable Outcome)

[Ordinarily management's information would include the following: (1) the nature of the matter; (2) how management intends to respond if the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.] Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*. Please specifically confirm to our auditors that our understanding is correct.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

We have represented to our auditors that there are no unasserted possible claims or assessments that you have advised us are probable of assertion and must be disclosed in accordance with FASB ASC 450. We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of FASB ASC 450. Please specifically confirm to our auditors that our understanding is correct.

Please specifically identify the nature of and reasons for any limitation on your response.

[The auditor may request the client to inquire about additional matters, for example, unpaid or unbilled charges or specified information on certain contractually assumed obligations of the Company, such as guarantees of indebtedness of others.]

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

Your response should include matters that existed as of (balance-sheet date) and during the period from that date to the effective date of your response. Please specifically identify the nature of and reasons for any limitations on your response. Our auditors expect to have the audit completed about (expected completion date). They would appreciate receiving your reply by that date with a specified effective date no earlier than (ordinarily two weeks before expected completion date).

[Wording that could be used in an audit inquiry letter, instead of the heading and first paragraph, when the client believes that there are no unasserted claims or assessments (to be specified to the lawyer for comment) that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome as specified by Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies, is as follows:]

Unasserted claims and assessments — We have represented to our auditors that there are no unasserted possible claims that you have advised us are probable of assertion and must be disclosed, in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*. (The second paragraph in the section relating to unasserted claims and assessments would not be altered.)

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

.A90

Exhibit A — American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (Ref: par. .A49)

NOTE

This document, in the form herein set forth, was approved by the Board of Governors of the American Bar Association (ABA) in December 1975, which official action permitted its release to lawyers and accountants as the standard recommended by the ABA for the lawyer's response to letters of audit inquiry.

Source: Statement on Auditing Standards No. 12 section 337C, *Exhibit II—American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information**

Preamble

The public interest in protecting the confidentiality of lawyer-client communications is fundamental. The American legal, political and economic systems depend heavily upon voluntary compliance with the law and upon ready access to a respected body of professionals able to interpret and advise on the law. The expanding complexity of our laws and governmental regulations increases the need for prompt, specific and unhampered lawyer-client communication. The benefits of such communication and early consultation underlie the strict statutory and ethical obligations of the lawyer to preserve the confidences and secrets of the client, as well as the long-recognized testimonial privilege for lawyer-client communication.

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would

* Statement on Auditing Standards No. 12 section 337C, *Exhibit II — American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, has been superseded by this section.

inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and encouraging its readiness to seek advice of counsel and to act in accordance with counsel's advice.

Consistent with the foregoing public policy considerations, it is believed appropriate to distinguish between, on the one hand, litigation which is pending or which a third party has manifested to the client a present intention to commence and, on the other hand, other contingencies of a legal nature or having legal aspects. As regards the former category, unquestionably the lawyer representing the client in a litigation matter may be the best source for a description of the claim or claims asserted, the client's position (e.g., denial, contest, etc.), and the client's possible exposure in the litigation (to the extent the lawyer is in a position to do so). As to the latter category, it is submitted that, for the reasons set forth above, it is not in the public interest for the lawyer to be required to respond to general inquiries from auditors concerning possible claims.

It is recognized that the disclosure requirements for enterprises subject to the reporting requirements of the Federal securities laws are a major concern of managements and counsel, as well as auditors. It is submitted that compliance therewith is best assured when clients are afforded maximum encouragement, by protecting lawyer-client confidentiality, freely to consult counsel. Likewise, lawyers must be keenly conscious of the importance of their clients being competently advised in these matters.

Statement of Policy

NOW, THEREFORE, BE IT RESOLVED that it is desirable and in the public interest that this Association adopt the following Statement of Policy regarding the appropriate scope of the lawyer's response to the auditor's request, made by the client at the request of the auditor, for information concerning matters referred to the lawyer during the course of his representation of the client:

1. *Client Consent to Response.* The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5,[†] promulgated by the Financial Accounting Standards Board in March 1975 and discussed in Paragraph 5.1 of the accompanying Commentary), to the extent hereinafter set forth, subject to the following:

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued *FASB Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

- a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.
 - b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.
 - c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.
 - d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.
2. *Limitation on Scope of Response.* It is appropriate for the lawyer to set forth in his response, by way of limitation, the scope of his engagement by the client. It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention. *Unless the lawyer's response indicates otherwise, (a) it is properly limited to matters which have been given substantive attention by the lawyer in the form of legal consultation and, where appropriate, legal representation since the beginning of the period or periods being reported upon, and (b) if a law firm or a law department, the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning those loss contingencies referred to in Paragraph 5(a) below but, beyond that, no review has been made of any of the client's transactions or other matters for the purpose of identifying loss contingencies to be described in the response.*[‡]
3. *Response may be Limited to Material Items.* In response to an auditor's request for disclosure of loss contingencies of a client, it is appropriate for the lawyer's response to indicate that the response is limited to items which are considered individually or collectively material to the presentation of the client's financial statements.
4. *Limited Responses.* Where the lawyer is limiting his response in accordance with the Statement of Policy, his response should so

[‡] As contemplated by Paragraph 8 of this Statement of Policy, this sentence is intended to be the subject of incorporation by reference as therein provided.

indicate (see Paragraph 8). If in any other respect the lawyer is not undertaking to respond to or comment on particular aspects of the inquiry when responding to the auditor, he should consider advising the auditor that his response is limited, in order to avoid any inference that the lawyer has responded to all aspects; otherwise, he may be assuming a responsibility which he does not intend.

5. *Loss Contingencies.* When properly requested by the client, it is appropriate for the lawyer to furnish to the auditor information concerning the following matters if the lawyer has been engaged by the client to represent or advise the client professionally with respect thereto and he has devoted substantive attention to them in the form of legal representation or consultation:
 - a. *overtly threatened or pending litigation*, whether or not specified by the client;
 - b. *a contractually assumed obligation* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor;
 - c. *an unasserted possible claim or assessment* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor.

With respect to clause (a), overtly threatened litigation means that a potential claimant has manifested to the client an awareness of and present intention to assert a possible claim or assessment unless the likelihood of litigation (or of settlement when litigation would normally be avoided) is considered remote. With respect to clause (c), where there has been no manifestation by a potential claimant of an awareness of and present intention to assert a possible claim or assessment, consistent with the considerations and concerns outlined in the Preamble and Paragraph 1 hereof, the client should request the lawyer to furnish information to the auditor only if the client has determined that it is probable that a possible claim will be asserted, that there is a reasonable possibility that the outcome (assuming such assertion) will be unfavorable, and that the resulting liability would be material to the financial condition of the client. Examples of such situations might (depending in each case upon the particular circumstances) include the following: (i) a catastrophe, accident or other similar physical occurrence in which the client's involvement is open and notorious, or (ii) an investigation by a government agency where enforcement proceedings have been instituted or where the likelihood that they will not be instituted is remote, under circumstances where assertion of one or more private claims for redress would normally be expected, or (iii) a public disclosure by the client acknowledging (and thus focusing attention upon) the existence of one or more probable claims arising out of an event or circumstance. In assessing whether or not the assertion of a possible claim is probable, it is expected that the client would normally employ, by reason of the inherent uncertainties involved and insufficiency of available data, concepts parallel to those used by the lawyer (discussed below) in assessing whether or not an unfavorable outcome is probable; thus,

assertion of a possible claim would be considered probable only when the prospects of its being asserted seem reasonably certain (i.e., supported by extrinsic evidence strong enough to establish a presumption that it will happen) and the prospects of nonassertion seem slight.

It would not be appropriate, however, for the lawyer to be requested to furnish information in response to an inquiry letter or supplement thereto if it appears that (a) the client has been required to specify unasserted possible claims without regard to the standard suggested in the preceding paragraph, or (b) the client has been required to specify all or substantially all unasserted possible claims as to which legal advice may have been obtained, since, in either case, such a request would be in substance a general inquiry and would be inconsistent with the intent of this Statement of Policy.

The information that lawyers may properly give to the auditor concerning the foregoing matters would include (to the extent appropriate) an identification of the proceedings or matter, the stage of proceedings, the claim(s) asserted, and the position taken by the client.

In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either "probable" or "remote"; for purposes of any such judgment it is appropriate to use the following meanings:

- i. *probable* — an unfavorable outcome for the client is probable if the prospects of the claimant not succeeding are judged to be extremely doubtful and the prospects for success by the client in its defense are judged to be slight.
- ii. *remote* — an unfavorable outcome is remote if the prospects for the client not succeeding in its defense are judged to be extremely doubtful and the prospects of success by the claimant are judged to be slight.

If, in the opinion of the lawyer, considerations within the province of his professional judgment bear on a particular loss contingency to the degree necessary to make an informed judgment, he may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is "probable" or "remote," applying the above meanings. No inference should be drawn, from the absence of such a judgment, that the client will not prevail.

The lawyer also may be asked to estimate, in dollar terms, the potential amount of loss or range of loss in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss (if the outcome should be unfavorable) only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight.

The considerations bearing upon the difficulty in estimating loss (or range of loss) where pending litigation is concerned are obviously even more compelling in the case of unasserted possible

claims. In most cases, the lawyer will not be able to provide any such estimate to the auditor.

As indicated in Paragraph 4 hereof, the auditor may assume that all loss contingencies specified by the client in the manner specified in clauses (b) and (c) above have received comment in the response, unless otherwise therein indicated. The lawyer should not be asked, nor need the lawyer undertake, to furnish information to the auditor concerning loss contingencies except as contemplated by this Paragraph 5.

6. *Lawyer's Professional Responsibility.* Independent of the scope of his response to the auditor's request for information, the lawyer, depending upon the nature of the matters as to which he is engaged, may have as part of his professional responsibility to his client an obligation to advise the client concerning the need for or advisability of public disclosure of a wide range of events and circumstances. The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. In appropriate circumstances, the lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosures is disregarded by the client. The auditor may properly assume that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, the lawyer has formed a professional conclusion that the client must disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure and the applicable requirements^{||} of FAS 5.
7. *Limitation on Use of Response.* Unless otherwise stated in the lawyer's response, it shall be solely for the auditor's information in connection with his audit of the financial condition of the client and is not to be quoted in whole or in part or otherwise referred to in any financial statements of the client or related documents, nor is it to be filed with any governmental agency or other person, without the lawyer's prior written consent.[‡] Notwithstanding such limitation, the response can properly be furnished to others in compliance with court process or when necessary in order to defend the auditor against a challenge of the audit by the client or a regulatory agency, provided that the lawyer is given written notice of the circumstances at least twenty days before the response is so to be furnished to others, or as long in advance as possible if the situation does not permit such period of notice.[‡]
8. *General.* This Statement of Policy, together with the accompanying Commentary (which is an integral part hereof), has been developed for the general guidance of the legal profession. In a

^{||} Under FAS 5, when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, disclosure of an unasserted possible claim is required only if the enterprise concludes that (i) it is probable that a claim will be asserted, (ii) there is a reasonable possibility, if the claim is in fact asserted, that the outcome will be unfavorable, and (iii) the liability resulting from such unfavorable outcome would be material to its financial condition.

[‡] As contemplated by Paragraph 8 of this Statement of Policy, this sentence is intended to be the subject of incorporation by reference as therein provided.

particular case, the lawyer may elect to supplement or modify the approach hereby set forth. If desired, this Statement of Policy may be incorporated by reference in the lawyer's response by the following statement: "This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any 'loss contingencies' is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement)."

The accompanying Commentary is an integral part of this Statement of Policy.

Commentary

Paragraph 1 (Client Consent to Response)

In responding to any aspect of an auditor's inquiry letter, the lawyer must be guided by his ethical obligations as set forth in the Code of Professional Responsibility. Under Canon 4 of the Code of Professional Responsibility a lawyer is enjoined to preserve the client's confidences (defined as information protected by the attorney-client privilege under applicable law) and the client's secrets (defined as other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client). The observance of this ethical obligation, in the context of public policy, "... not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance." (Ethical Consideration 4-1).

The lawyer's ethical obligation therefore includes a much broader range of information than that protected by the attorney-client privilege. As stated in Ethical Consideration 4-4: "The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge."

In recognition of this ethical obligation, the lawyer should be careful to disclose fully to his client any confidence, secret or evaluation that is to be revealed to another, including the client's auditor, and to satisfy himself that the officer or agent of a corporate client consenting to the disclosure understands the legal consequences thereof and has authority to provide the required consent.

The law in the area of attorney-client privilege and the impact of statements made in letters to auditors upon that privilege has not yet been developed. Based upon cases treating the attorney-client privilege in other contexts, however, certain generalizations can be made with respect to the possible impact of statements in letters to auditors.

It is now generally accepted that a corporation may claim the attorney-client privilege. Whether the privilege extends beyond the control group of the corporation (a concept found in the existing decisional authority), and if so, how far, is yet unresolved.

If a client discloses to a third party a part of any privileged communication he has made to his attorney, there may have been a waiver as to the whole communication; further, it has been suggested that giving accountants access

to privileged statements made to attorneys may waive any privilege as to those statements. Any disclosure of privileged communications relating to a particular subject matter may have the effect of waiving the privilege on other communications with respect to the same subject matter.

To the extent that the lawyer's knowledge of unasserted possible claims is obtained by means of confidential communications from the client, any disclosure thereof might constitute a waiver as fully as if the communication related to pending claims.

A further difficulty arises with respect to requests for evaluation of either pending or unasserted possible claims. It might be argued that any evaluation of a claim, to the extent based upon a confidential communication with the client, waives any privilege with respect to that claim.

Another danger inherent in a lawyer's placing a value on a claim, or estimating the likely result, is that such a statement might be treated as an admission or might be otherwise prejudicial to the client.

The Statement of Policy has been prepared in the expectation that judicial development of the law in the foregoing areas will be such that useful communication between lawyers and auditors in the manner envisaged in the Statement will not prove prejudicial to clients engaged in or threatened with adversary proceedings. If developments occur contrary to this expectation, appropriate review and revision of the Statement of Policy may be necessary.

Paragraph 2 (Limitation on Scope of Response)

In furnishing information to an auditor, the lawyer can properly limit himself to loss contingencies which he is handling on a substantive basis for the client in the form of legal consultation (advice and other attention to matters not in litigation by the lawyer in his professional capacity) or legal representation (counsel of record or other direct professional responsibility for a matter in litigation). Some auditors' inquiries go further and ask for information on matters of which the lawyer "has knowledge." Lawyers are concerned that such a broad request may be deemed to include information coming from a variety of sources including social contact and third party contacts as well as professional engagement and that the lawyer might be criticized or subjected to liability if some of this information is forgotten at the time of the auditor's request.

It is also believed appropriate to recognize that the lawyer will not necessarily have been authorized to investigate, or have investigated, all legal problems of the client, even when on notice of some facts which might conceivably constitute a legal problem upon exploration and development. Thus, consideration in the form of preliminary or passing advice, or regarding an incomplete or hypothetical state of facts, or where the lawyer has not been requested to give studied attention to the matter in question, would not come within the concept of "substantive attention" and would therefore be excluded. Similarly excluded are matters which may have been mentioned by the client but which are not actually being handled by the lawyer. Paragraph 2 undertakes to deal with these concerns.

Paragraph 2 is also intended to recognize the principle that the appropriate lawyer to respond as to a particular loss contingency is the lawyer having charge of the matter for the client (e.g., the lawyer representing the client in a litigation matter and/or the lawyer having overall charge and supervision of the matter), and that the lawyer not having that kind of role with respect to the matter should not be expected to respond merely because of having become aware of its existence in a general or incidental way.

The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the

complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.

As the lawyer's response is limited to matters involving his professional engagement as counsel, such response should not include information concerning the client which the lawyer receives in another role. In particular, a lawyer who is also a director or officer of the client would not include information which he received as a director or officer unless the information was also received (or, absent the dual role, would in the normal course be received) in his capacity as legal counsel in the context of his professional engagement. Where the auditor's request for information is addressed to a law firm as a firm, the law firm may properly assume that its response is not expected to include any information which may have been communicated to the particular individual by reason of his serving in the capacity of director or officer of the client. The question of the individual's duty, in his role as a director or officer, is not here addressed.

Paragraph 3 (Response May Cover only Material Items in Certain Cases)

Paragraph 3 makes it clear that the lawyer may optionally limit his responses to those items which are individually or collectively material to the auditor's inquiry. If the lawyer takes responsibility for making a determination that a matter is not material for the purposes of his response to the audit inquiry, he should make it clear that his response is so limited. The auditor, in such circumstance, should properly be entitled to rely upon the lawyer's response as providing him with the necessary corroboration. It should be emphasized that the employment of inside general counsel by the client should not detract from the acceptability of his response since inside general counsel is as fully bound by the professional obligations and responsibilities contained in the Code of Professional Responsibility as outside counsel. If the audit inquiry sets forth a definition of materiality but the lawyer utilizes a different test of materiality, he should specifically so state. The lawyer may wish to reach an understanding with the auditor concerning the test of materiality to be used in his response, but he need not do so if he assumes responsibility for the criteria used in making materiality determinations. Any such understanding with the auditor should be referred to or set forth in the lawyer's response. In this connection, it is assumed that the test of materiality so agreed upon would not be so low in amount as to result in a disservice to the client and an unreasonable burden on counsel.

Paragraph 4 (Limited Responses)

The Statement of Policy is designed to recognize the obligation of the auditor to complete the procedures considered necessary to satisfy himself as to the fair presentation of the company's financial condition and results, in order to render a report which includes an opinion not qualified because of a limitation on the scope of the audit. In this connection, reference is made to SEC Accounting Series Release No. 90 [*Financial Reporting Release No. 1, section 607.01(b)*], in which it is stated:

"A 'subject to' or 'except for' opinion paragraph in which these phrases refer to the scope of the audit, indicating that the accountant has not been able to satisfy himself on some significant element in the financial statements, is not acceptable in certificates filed with the Commission in connection with the

public offering of securities. The 'subject to' qualification is appropriate when the reference is to a middle paragraph or to footnotes explaining the status of matters which cannot be resolved at statement date."

Paragraph 5 (Loss Contingencies)

Paragraph 5 of the Statement of Policy summarizes the categories of "loss contingencies" about which the lawyer may furnish information to the auditor. The term loss contingencies and the categories relate to concepts of accounting accrual and disclosure specified for the accounting profession in Statement of Financial Accounting Standards No. 5[†] ("FAS 5") issued by the Financial Accounting Standards Board in March, 1975.

5.1 Accounting Requirements

To understand the significance of the auditor's inquiry and the implications of any response the lawyer may give, the lawyer should be aware of the following accounting concepts and requirements set out in FAS 5:[#]

- a. A "loss contingency" is an existing condition, situation or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more events occur or fail to occur. Resolutions of the uncertainty may confirm the loss or impairment of an asset or the incurrence of a liability. (Para. 1)
- b. When a "loss contingency" exists, the likelihood that a future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. There are three areas within that range, defined as follows:
 - i. Probable — "The future event or events are likely to occur."
 - ii. Reasonably possible — "The chance of the future event or events occurring is more than remote but less than likely."
 - iii. Remote — "The chance of the future event or events occurring is slight." (Para. 3)
- c. *Accrual* in a client's financial statements by a charge to income of the period will be required if both the following conditions are met:
 - i. "Information available prior to issuance of the financial statements indicates that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be *probable* that one or more future events will occur confirming the fact of the loss." (emphasis added; footnote omitted)
 - ii. "The amount of loss can be reasonably estimated." (Para. 8)
- d. If there is no *accrual* of the loss contingency in the client's financial statements because one of the two conditions outlined in (c)

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

[#] Citations are to paragraph numbers of FAS 5.

above are not met, disclosure may be required as provided in the following:

"If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, *disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.*" (emphasis added; footnote omitted) (Para. 10)

- e. The accounting requirements recognize or specify that (i) the opinions or views of counsel are not the sole source of audit evidence in making determinations about the accounting recognition or treatment to be given to litigation, and (ii) the fact that the lawyer is notable to express an opinion that the outcome will be favorable does not necessarily require an accrual of a loss. Paragraphs 36 and 37 of FAS 5 state as follows:

"If the underlying cause of the litigation, claim, or assessment is an event occurring before the date of an enterprise's financial statements, the probability of an outcome unfavorable to the enterprise must be assessed to determine whether the condition in paragraph 8(a) is met. Among the factors that should be considered are the nature of the litigation, claim, or assessment, the progress of the case (including progress after the date of the financial statements but before those statements are issued), the opinions or views of legal counsel and other advisers, the experience of the enterprise in similar cases, the experience of other enterprises, and any decision of the enterprise's management as to how the enterprise intends to respond to the lawsuit, claim, or assessment (for example, a decision to contest the case vigorously or a decision to seek an out-of-court settlement). The fact that legal counsel is unable to express an opinion that the outcome will be favorable to the enterprise should not necessarily be interpreted to mean that the condition for accrual of a loss in paragraph 8(a) is met.

"The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition for accrual in paragraph 8(a) would be met if an unfavorable outcome is determined to be probable. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, accrual would be inappropriate, but disclosure would be required by paragraph 10 of this Statement."

- f. Paragraph 38 of FAS 5 focuses on certain examples concerning the determination by the enterprise whether an assertion of an *unasserted possible claim* may be considered probable:

"With respect to unasserted claims and assessments, an enterprise must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. For example, a catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case. By way of further example, an enterprise may believe there is a possibility that it has infringed on another enterprise's patent rights, but the enterprise owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable. If the judgment is that assertion is not probable, no accrual or disclosure would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 8. If an unfavorable outcome is probable but the amount of loss cannot be reasonably estimated, accrual would not be appropriate, but disclosure would be required by paragraph 10. If an unfavorable outcome is reasonably possible but not probable, disclosure would be required by paragraph 10."

For a more complete presentation of FAS 5, reference is made to AU section 337B, *Exhibit I — Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies* [SAS No. 12 section 337B], ** in which are set forth excerpts selected by the AICPA as relevant to a Statement on Auditing Standards, issued by its Auditing Standards Executive Committee, captioned "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments."

5.2 Lawyer's Response

Concepts of probability inherent in the usage of terms like "probable" or "reasonably possible" or "remote" mean different things in different contexts. Generally, the outcome of, or the loss which may result from, litigation cannot be assessed in any way that is comparable to a statistically or empirically determined concept of "probability" that may be applicable when determining such matters as reserves for warranty obligations or accounts receivable or loan losses when there is a large number of transactions and a substantial body of known historical experience for the enterprise or comparable enterprises. While lawyers are accustomed to counseling clients during the progress of

** Statement on Auditing Standards No. 12 section 337B, *Exhibit I — Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies*, has been withdrawn by this section.

litigation as to the possible amount required for settlement purposes, the estimated risks of the proceedings at particular times and the possible application or establishment of points of law that may be relevant, such advice to the client is not possible at many stages of the litigation and may change dramatically depending upon the development of the proceedings. Lawyers do not generally quantify for clients the "odds" in numerical terms; if they do, the quantification is generally only undertaken in an effort to make meaningful, for limited purposes, a whole host of judgmental factors applicable at a particular time, without any intention to depict "probability" in any statistical, scientific or empirically-grounded sense. Thus, for example, statements that litigation is being defended vigorously and that the client has meritorious defenses do not, and do not purport to, make a statement about the probability of outcome in any measurable sense.

Likewise, the "amount" of loss — that is, the total of costs and damages that ultimately might be assessed against a client — will, in most litigation, be a subject of wide possible variance at most stages; it is the rare case where the amount is precise and where the question is whether the client against which claim is made is liable either for all of it or none of it.

In light of the foregoing considerations, it must be concluded that, as a general rule, it should not be anticipated that meaningful quantifications of "probability" of outcome or amount of damages can be given by lawyers in assessing litigation. To provide content to the definitions set forth in Paragraph 5 of the Statement of Policy, this Commentary amplifies the meanings of the terms under discussion, as follows:

"probable" — An unfavorable outcome is normally "probable" if, but only if, investigation, preparation (including development of the factual data and legal research) and progress of the matter have reached a stage where a judgment can be made, taking all relevant factors into account which may affect the outcome, that it is extremely doubtful that the client will prevail.

"remote" — The prospect for an unfavorable outcome appears, at the time, to be slight; i.e., it is extremely doubtful that the client will not prevail. Normally, this would entail the ability to make an unqualified judgment, taking into account all relevant factors which may affect the outcome, that the client may confidently expect to prevail on a motion for summary judgment on all issues due to the clarity of the facts and the law.

In other words, for purposes of the lawyer's response to the request to advise auditors about litigation, an unfavorable outcome will be "probable" only if the chances of the client prevailing appear slight and of the claimant losing appear extremely doubtful; it will be "remote" when the client's chances of losing appear slight and of not winning appear extremely doubtful. It is, therefore, to be anticipated that, in most situations, an unfavorable outcome will be neither "probable" nor "remote" as defined in the Statement of Policy.

The discussion above about the very limited basis for furnishing judgments about the outcome of litigation applies with even more force to a judgment concerning whether or not the assertion of a claim not yet asserted is "probable." That judgment will infrequently be one within the professional competence of lawyers and therefore the lawyer should not undertake such assessment except where such judgment may become meaningful because of the presence of special circumstances, such as catastrophes, investigations and previous public disclosure as cited in Paragraph 5 of the Statement of Policy, or similar extrinsic evidence relevant to such assessment. Moreover, it is unlikely, absent relevant extrinsic evidence, that the client or anyone else will be in a position to make an informed judgment that assertion of a possible claim is "probable" as

opposed to "reasonably possible" (in which event disclosure is not required). In light of the legitimate concern that the public interest would not be well served by resolving uncertainties in a way that invites the assertion of claims or otherwise causes unnecessary harm to the client and its stockholders, a decision to treat an unasserted claim as "probable" of assertion should be based only upon compelling judgment.

Consistent with these limitations believed appropriate for the lawyer, he should not represent to the auditor, nor should any inference from his response be drawn, that the unasserted possible claims identified by the client (as contemplated by Paragraph 5(c) of the Statement of Policy) represent all such claims of which the lawyer may be aware or that he necessarily concurs in his client's determination of which unasserted possible claims warrant specification by the client; within proper limits, this determination is one which the client is entitled to make — and should make — and it would be inconsistent with his professional obligations for the lawyer to volunteer information arising from his confidential relationship with his client.

As indicated in Paragraph 5, the lawyer also may be asked to estimate the potential loss (or range) in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the lawyer would provide an estimate only if he believes that the probability of inaccuracy of the estimate of the range or amount is slight. What is meant here is that the estimate of amount of loss presents the same difficulty as assessment of outcome and that the same formulation of "probability" should be used with respect to the determination of estimated loss amounts as should be used with respect to estimating the outcome of the matter.

In special circumstances, with the proper consent of the client, the lawyer may be better able to provide the auditor with information concerning loss contingencies through conferences where there is opportunity for more detailed discussion and interchange. However, the principles set forth in the Statement of Policy and this Commentary are fully applicable to such conferences.

Subsumed throughout this discussion is the ongoing responsibility of the lawyer to assist his client, at the client's request, in complying with the requirements of FAS 5 to the extent such assistance falls within his professional competence. This will continue to involve, to the extent appropriate, privileged discussions with the client to provide a better basis on which the client can make accrual and disclosure determinations in respect of its financial statements.

In addition to the considerations discussed above with respect to the making of any judgment or estimate by the lawyer in his response to the auditor, including with respect to a matter specifically identified by the client, the lawyer should also bear in mind the risk that the furnishing of such a judgment or estimate to any one other than the client might constitute an admission or be otherwise prejudicial to the client's position in its defense against such litigation or claim (see Paragraph 1 of the Statement of Policy and of this Commentary).

Paragraph 6 (Lawyer's Professional Responsibility)

The client must satisfy whatever duties it has relative to timely disclosure, including appropriate disclosure concerning material loss contingencies, and, to the extent such matters are given substantive attention in the form of legal consultation, the lawyer, when his engagement is to advise his client concerning a disclosure obligation, has a responsibility to advise his client concerning its obligations in this regard. Although lawyers who normally confine themselves to a legal specialty such as tax, antitrust, patent or admiralty law, unlike lawyers consulted about SEC or general corporate matters, would not be expected to advise generally concerning the client's disclosure obligations in respect of a

matter on which the lawyer is working, the legal specialist should counsel his client with respect to the client's obligations under FAS 5 to the extent contemplated herein. Without regard to legal specialty, the lawyer should be mindful of his professional responsibility to the client described in Paragraph 6 of the Statement of Policy concerning disclosure.

The lawyer's responsibilities with respect to his client's disclosure obligations have been a subject of considerable discussion and there may be, in due course, clarification and further guidance in this regard. In any event, where in the lawyer's view it is clear that (i) the matter is of material importance and seriousness, and (ii) there can be no reasonable doubt that its non-disclosure in the client's financial statements would be a violation of law giving rise to material claims, rejection by the client of his advice to call the matter to the attention of the auditor would almost certainly require the lawyer's withdrawal from employment in accordance with the Code of Professional Responsibility. (See, e.g., Disciplinary Rule 7-102 (A)(3) and (7), and Disciplinary Rule 2-110 (B)(2).) Withdrawal under such circumstances is obviously undesirable and might present serious problems for the client. Accordingly, in the context of financial accounting and reporting for loss contingencies arising from unasserted claims, the standards for which are contained in FAS 5, clients should be urged to disclose to the auditor information concerning an unasserted possible claim or assessment (not otherwise specifically identified by the client) where in the course of the services performed for the client it has become clear to the lawyer that (i) the client has no reasonable basis to conclude that assertion of the claim is not probable (employing the concepts hereby enunciated) and (ii) given the probability of assertion, disclosure of the loss contingency in the client's financial statements is beyond reasonable dispute required.

Paragraph 7 (Limitation on Use of Response)

Some inquiry letters make specific reference to, and one might infer from others, an intention to quote verbatim or include the substance of the lawyer's reply in footnotes to the client's financial statements. Because the client's prospects in pending litigation may shift as a result of interim developments, and because the lawyer should have an opportunity, if quotation is to be made, to review the footnote in full, it would seem prudent to limit the use of the lawyer's reply letter. Paragraph 7 sets out such a limitation.

Paragraph 7 also recognizes that it may be in the client's interest to protect information contained in the lawyer's response to the auditor, if and to the extent possible, against unnecessary further disclosure or use beyond its intended purpose of informing the auditor. For example, the response may contain information which could prejudice efforts to negotiate a favorable settlement of a pending litigation described in the response. The requirement of consent to further disclosure, or of reasonable advance notice where disclosure may be required by court process or necessary in defense of the audit, is designed to give the lawyer an opportunity to consult with the client as to whether consent should be refused or limited or, in the case of legal process or the auditor's defense of the audit, as to whether steps can and should be taken to challenge the necessity of further disclosure or to seek protective measures in connection therewith. It is believed that the suggested standard of twenty days advance notice would normally be a minimum reasonable time for this purpose.

Paragraph 8 (General)

It is reasonable to assume that the Statement of Policy will receive wide distribution and will be readily available to the accounting profession. Specifically, the Statement of Policy has been reprinted as Exhibit II to the Statement on

Auditing Standards, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments," issued by the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants. Accordingly, the mechanic for its incorporation by reference will facilitate lawyer-auditor communication. The incorporation is intended to include not only limitations, such as those provided by Paragraphs 2 and 7 of the Statement of Policy, but also the explanatory material set forth in this Commentary.

Annex A

[Illustrative forms of letters for full response by outside practitioner or law firm and inside general counsel to the auditor's inquiry letter. These illustrative forms, which are not part of the Statement of Policy, have been prepared by the Committee on Audit Inquiry Responses solely in order to assist those who may wish to have, for reference purposes, a form of response which incorporates the principles of the Statement of Policy and accompanying Commentary. Other forms of response letters will be appropriate depending on the circumstances.]

Illustrative Form of Letter for Use by Outside Practitioner or Law Firm:

[Name and Address of Accounting Firm]

Re: *[Name of Client]* *[and Subsidiaries]*

Dear Sirs:

By letter date *[insert date of request]* Mr. *[insert name and title of officer signing request]* of *[insert name of client]* *[(the "Company") or (together with its subsidiaries, the "Company")]* has requested us to furnish you with certain information in connection with your examination of the accounts of the Company as at *[insert fiscal year-end]*.

[Insert description of the scope of the lawyer's engagement; the following are sample descriptions:]

While this firm represents the Company on a regular basis, our engagement has been limited to specific matters as to which we were consulted by the Company.
[or]

We call your attention to the fact that this firm has during the past year represented the Company only in connection with certain *[Federal income tax matters]* *[litigation]* *[real estate transactions]* *[describe other specific matters, as appropriate]* and has not been engaged for any other purpose.

Subject to the foregoing and to the last paragraph of this letter, we advise you that since *[insert date of beginning of fiscal period under audit]* we have not been engaged to give substantive attention to, or represent the Company in connection with, *[material]* ^{††} loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[Describe litigation and claims which fit the foregoing criteria.]

[If the inquiry letter requests information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations:]

With respect to the matters specifically identified in the Company's letter and upon which comment has been specifically requested, as contemplated by clauses (b) or (c) of Paragraph 5 of the ABA Statement of Policy, we advise you, subject to the last paragraph of this letter, as follows:

^{††} **Note:** See Paragraph 3 of the Statement of Policy and the accompanying Commentary for guidance where the response is limited to material items.

[Insert information as appropriate]

The information set forth herein is *[as of the date of this letter]* *[as of (insert date), the date on which we commenced our internal review procedures for purposes of preparing this response]*, except as otherwise noted, and we disclaim any undertaking to advise you of changes which thereafter may be brought to our attention.

[Insert information with respect to outstanding bills for services and disbursements.]

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy and pursuant to the Company's request, this will confirm as correct the Company's understanding as set forth in its audit inquiry letter to us that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.[†] *[Describe any other or additional limitation as indicated by Paragraph 4 of the Statement]*

Very truly yours,

Illustrative Form of Letter for Use by Inside General Counsel:

[Name and Address of Accounting Firm]

Re: *[Name of Company]* *[and Subsidiaries]*

Dear Sirs:

As General Counsel^{††} of *[insert name of client]* *[(the "Company")]* *[(together with its subsidiaries, the "Company")]*, I advise you as follows in connection with your examination of the accounts of the Company as at *[insert fiscal year-end]*.

I call your attention to the fact that as General Counsel^{††} for the Company I have general supervision of the Company's legal affairs. *[If the general legal supervisory responsibilities of the person signing the letter are limited, set forth here a clear description of those legal matters over which such person exercises general supervision, indicating exceptions to such supervision and situations where primary reliance should be placed on other sources.]* In such capacity, I have reviewed litigation and claims threatened or asserted involving the Company and have consulted with outside legal counsel with respect thereto where I have deemed appropriate.

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

^{††} It may be appropriate in some cases for the response to be given by inside counsel other than inside general counsel, in which event this letter should be appropriately modified.

Subject to the foregoing and to the last paragraph of this letter, I advise you that since *[insert date of beginning of fiscal period under audit]* neither I, nor any of the lawyers over whom I exercise general legal supervision, have given substantive attention to, or represented the Company in connection with, *[material]* ^{††} loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[Describe litigation and claims which fit the foregoing criteria.]

[If information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations is to be supplied:]

With respect to matters which have been specifically identified as contemplated by clauses (b) or (c) of Paragraph 5 of the ABA Statement of Policy, I advise you, subject to the last paragraph of this letter, as follows:

[Insert information as appropriate]

The information set forth herein is *[as of the date of this letter]* as of *[insert date]*, the date on which we commenced our internal review procedures for purposes of preparing this response, except as otherwise noted, and I disclaim any undertaking to advise you of changes which thereafter may be brought to my attention or to the attention of the lawyers over whom I exercise general legal supervision.

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy, this will confirm as correct the Company's understanding that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, I, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5. [†] *[Describe any other or additional limitation as indicated by Paragraph 4 of the Statement.]*

Very truly yours,

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

^{††} **Note:** See Paragraph 3 of the Statement of Policy and the accompanying Commentary for guidance where the response is limited to material items.

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other non-grandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

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Exhibit B — Report of the Subcommittee on Audit Inquiry Responses¹

Because of a recent court case and other judicial decisions involving lawyers' responses to auditors' requests for information, an area of uncertainty or concern has been brought to the Subcommittee's attention and is the subject of the following comment:

This Committee's report does not modify the ABA Statement of Policy, nor does it constitute an interpretation thereof. The Preamble to the ABA Statement of Policy states as follows:

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political, and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and to act in accordance with counsel's advice.

Paragraph 1 of the ABA Statement of Policy provides as follows:

1. *Client Consent to Response.* The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5, promulgated by the Financial Accounting Standards Board in March 1975 and discussed in

¹ Excerpted from "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," *The Business Lawyer* 31, no. 3 (1976). Reprinted by permission of the American Bar Association.

Paragraph 5.1 of the accompanying commentary), to the extent hereinafter set forth, subject to the following:

- a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.
- b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.
- c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.
- d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

In order to preserve explicitly the evidentiary privileges, some lawyers have suggested that clients include language in the following or substantially similar form:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

If client's request letter does not contain language similar to that in the preceding paragraph, the lawyer's statement that the client has so advised him or her may be based upon the fact that the client has in fact so advised the lawyer, in writing or orally, in other communications or in discussions.

For the same reason, the response letter from some lawyers also includes language in the following or substantially similar form:

The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

We believe that language similar to the foregoing in letters of the client or the lawyer simply makes explicit what has always been implicit, namely, it expressly states clearly that neither the client nor the lawyer intended a waiver. It follows that non-inclusion of either or both of the foregoing statements by the client or the lawyer in their respective letters at any time in the past or the future would not constitute an expression of intent to waive the privileges.

On the other hand, the inclusion of such language does not necessarily assure the client that, depending on the facts and circumstances, a waiver may not be found by a court of law to have occurred.

We do not believe that the foregoing types of inclusions cause a negative impact upon the public policy considerations described in the Preamble to the ABA Statement of Policy nor do they intrude upon the arrangements between the legal profession and the accounting profession contemplated by the ABA Statement of Policy. Moreover, we do not believe that such language interferes in any way with the standards and procedures of the accounting profession in the auditing process nor should it be construed as a limitation upon the lawyer's reply to the auditors. We have been informed that the Auditing Standards Board of the AICPA has adopted an interpretation of SAS 12 recognizing the propriety of these statements.

Lawyers, in any case, should be encouraged to have their draft letters to auditors reviewed and approved by the client before releasing them to the auditors and may wish to explain to the client the legal consequences of the client's consent to lawyer's response as contemplated by subparagraph 1(d) of the Statement of Policy.

[Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

.A92

Exhibit C — Statement on Updates to Audit Response Letters *

By Audit Responses Committee, ABA Business Law Section

Requests for updates to lawyers' audit response letters have become more frequent in recent years. Typically, the client's audit inquiry letter to its lawyers calls for a response before the anticipated issuance date of the audited financial statements. An "update" or "bringdown" is an audit response letter provided to the auditor in which a lawyer provides information about loss contingencies as of a date after the date of the lawyer's initial response to the audit inquiry letter and any previous update.

The *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests*¹ does not specifically discuss updates to audit response letters. In view of the increased frequency of update requests and the lack of guidance regarding these requests, the ABA Business Law Section Audit Responses Committee has prepared this statement to outline the reasons auditors seek updates of audit response letters and to present the Committee's views on appropriate practices for responding to update requests under the *ABA Statement of Policy*. The Committee hopes that the guidance provided in this Statement will enhance the ability of lawyers to respond efficiently to update requests, thereby facilitating the audit process and contributing to audit quality.

The Reasons for Update Requests

The *ABA Statement of Policy*, including its reference to accounting and auditing standards, provides the framework for lawyers' audit response letters. The *ABA Statement of Policy* recognizes the fundamental importance to the American legal system of maintaining client confidences. It makes clear that lawyers may provide information to auditors only at the request, and with the express consent, of their clients.² In accordance with the *ABA Statement of Policy*, lawyers typically indicate in their audit response letters that the information they are furnishing is as of a specified date and disclaim any undertaking to advise the auditor of changes that may later be brought to the lawyer's attention.³ The *ABA Statement of Policy* also contemplates that "the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the

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¹ *American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976) [hereinafter *ABA Statement of Policy*], reprinted in ABA BUS. LAW SECTION AUDIT RESPONSES COMM., AUDITOR'S LETTER HANDBOOK 1 (2d ed. 2013).

² *Id.* at 2–3 (¶ 1).

³ *Id.* at 3 (¶ 2) ("It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention.").

fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning" loss contingencies.⁴

In recent years, requests for updates have become standard procedure for many auditors. This reflects changes in applicable accounting standards and auditing practices, as well as increased emphasis on loss contingencies by the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB"), which in turn has increased auditors' focus on loss contingencies. Requests for updates to audit response letters typically are made in three contexts:

- *Audit of annual financial statements.* Changes to financial reporting standards require the entity's management to evaluate "subsequent events," which can include changes in loss contingencies, through the date the financial statements are issued or are available to be issued.⁵

As a result of changes in auditing practices,⁶ most auditors' reports are now dated as of the date the financial statements are issued or are available to be issued, as opposed to the date on which fieldwork is completed. Accordingly, the auditor may seek to obtain audit evidence, in the form of audit letter updates, to corroborate management's identification of and accounting for loss contingencies as of the issuance date.

⁴ *Id.* Although a law firm's or law department's internal review procedure may include canvassing lawyers who performed services for a client from the beginning of the fiscal period under audit, many firms or departments limit their response to matters existing at the end of that period or arising after the end of the period. This approach is based upon the statement in the typical request letter to the effect that the response should include matters that existed at the end of the fiscal period under audit and during the period from that date to the date as of which the response is given. See INTERIM AUDITING STANDARDS, AU § 337A (Pub. Co. Accounting Oversight Bd. 2003) (illustrative audit inquiry letter); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 501.A69 (Am. Inst. of Certified Pub. Accountants 2011) (illustrative audit inquiry letter). Thus, under this approach, matters resolved during the fiscal period, which no longer comprise "loss contingencies" at or after the fiscal period end date, are not reported.

⁵ See SUBSEQUENT EVENTS, Accounting Standards Codification, Topic 855 (Fin. Accounting Standards Bd. 2010) [hereinafter ASC 855]. ASC 855 codifies a prior accounting standard on subsequent events. See SUBSEQUENT EVENTS, Statement of Fin. Accounting Standards, No. 165 (Fin. Accounting Standards Bd. 2009) [hereinafter SFAS 165]. Notably, SFAS 165 amended the accounting standard governing contingencies. See ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975), amended by SFAS 165, ¶ B3 (codified as CONTINGENCIES, Accounting Standards Codification, Topic 450 (Fin. Accounting Standards Bd. 2009)) [hereinafter ASC 450]. As amended, ASC 450 provides that, in assessing the accounting for a loss contingency, the reporting entity must consider information available through the date the financial statements were issued or available to be issued. See *id.* 450-20-25. Under ASC 855, for SEC filers, financial statements are "issued" on the date they are filed with the SEC; for non-SEC filers, they are "available to be issued" when they are complete and all internal approvals for issuance have occurred. ASC 855-10-25. ASC 855 also requires that entities disclose in the financial statements the date through which they evaluated subsequent events. See *id.* 855-10-50.

⁶ In connection with its adoption of Auditing Standard No. 5 in 2007, the Public Company Accounting Oversight Board amended Interim Auditing Standard AU 530 to provide that "the auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion." INTERIM AUDITING STANDARDS, AU § 530.01 (Pub. Co. Accounting Oversight Bd. 2007). Previously, AU 530 had provided that generally the date of completion of the field work should be used as the date of the report. See Proposed Auditing Standard — An Audit of Internal Control over Financial Reporting that Is Integrated with an Audit of Financial Statements and Related Other Proposals, PCAOB Release No. 2006-007, at 34 (Dec. 19, 2006), available at http://pcaobus.org/Rules/Documents/2006-12-19_Release_No._2006-007.pdf. The PCAOB also amended its Interim Auditing Standards to provide that "the latest date of the period covered by the lawyer's response (the 'effective date') should be as close to the date of the auditor's report as is practicable in the circumstances." INTERIM AUDITING STANDARDS, AU § 9337.05 (Pub. Co. Accounting Oversight Bd. 2007). Previously, the standard had said that the effective date should be "as close to the completion of field work" as practicable in the circumstances. INTERIM AUDITING STANDARDS, AU § 9337.05 (Pub. Co. Accounting Oversight Bd. 2003).

- *Review of quarterly financial statements.* As with annual financial statements, an entity is required to consider subsequent events, including loss contingencies, through the date of issuance of its quarterly financial statements. SEC rules require that quarterly financial statements be reviewed by the entity's external auditors in accordance with relevant auditing standards.⁷ Although they are not ordinarily required to do so,⁸ auditors may request confirmation from counsel about loss contingencies as part of their internal procedures before they will sign off on the filing of quarterly financial statements with the SEC.
- *Consents in connection with registered securities offerings.* Auditors must consent to the use of their audit reports in registration statements for public offerings of securities. Auditing standards require the auditors to perform certain procedures before consenting to the inclusion of a previously issued audit report in a registration statement or amendment to a registration statement.⁹ Although these standards do not require an auditor to make inquiries of lawyers, before issuing a consent, many auditors ask lawyers to update their audit response letters. In offerings involving shelf takedowns, the auditors may request one or more updates in connection with their delivery of "comfort letters" to underwriters.

The foregoing explains the increased frequency of auditors' requests for updates. However, the experience of many lawyers suggests that auditors (and sometimes clients) do not always appreciate the need for lawyers to perform internal procedures to be able to deliver an update.

Lawyers' Responses to Update Requests — A Framework

A lawyer's update to an audit response letter is subject to the *ABA Statement of Policy* and should be prepared and delivered in accordance with its terms. This has several implications.

Client Requests for Updates to Audit Response Letters. As with the initial response letter, a lawyer may only provide information to the auditor at the client's request, even if, as is often the case, the auditor requests the update directly. The lawyer should be satisfied that the client has provided the necessary authorization for the update. The Committee does not believe that any specific form of authorization is necessary, so long as it expresses the client's intent that the lawyer deliver an update to the lawyer's response letter to the auditor. A lawyer may rely on any form of written request, including electronic mail. The Committee believes that lawyers may also rely on oral requests for an update, though it may be advisable for them to document such requests.

Standing Requests. In some cases, a client's initial request letter may contain a standing request that the lawyer deliver updates to response letters upon request by the auditor. The inclusion of such a request can facilitate the audit response process. Many lawyers view a client request to provide information

⁷ Regulation S-X, Rule 10-01(d), 17 C.F.R. § 210.10-01(d) (2014).

⁸ See INTERIM AUDITING STANDARDS, AU § 722.20 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF AUDITING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 100, AU § 722.20 (Am. Inst. of Certified Pub. Accountants 2002), *superseded by* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 930.15 (Am. Inst. of Certified Pub. Accountants 2011).

⁹ See INTERIM AUDITING STANDARDS, AU § 711 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 925 (Am. Inst. of Certified Pub. Accountants 2011).

to the auditors in connection with the audit of the annual financial statements to include an implicit standing request to respond to update requests related to issuance of those financial statements. Other lawyers require a separate authorization for every update, absent a standing request.

The Committee believes that lawyers may provide an update on the basis of a standing request, but recognizes that in some circumstances they may want a specific request or consent from the client. Among those circumstances are (1) when significant time has elapsed since the initial request, and (2) when developments have occurred that would be required to be reported in the update, such as pending or threatened litigation that has arisen since the previous response or significant developments in previously described pending or threatened litigation, and the lawyer believes the client should be consulted before issuing the update response.

Preparation of Updates to Audit Response Letters. The Committee recognizes that circumstances may allow lawyers significantly less time to prepare an update than they had for the initial response letter. Still, clients and auditors should recognize that because, from the lawyers' standpoint, each update is tantamount to reissuance of the initial response letter, lawyers may have to perform internal review procedures similar to those performed for the initial response letter. Those may include inquiring again of lawyers in the law firm or law department who may have relevant information. Clients should be encouraged to communicate with their lawyers and the auditor when the client becomes aware of a filing or transaction that will require an update to an audit response letter, so that the lawyers have adequate time to perform sufficient internal review procedures to provide the update.¹⁰

The internal procedures lawyers perform to issue an update will depend on the particular circumstances and the professional judgment of the lawyers involved as to what is necessary. For example, some law firms or law departments may canvass the lawyers who provided information reflected in the earlier response to the audit inquiry letter, even if those lawyers have not subsequently recorded time for the client. Other firms or law departments may only canvass lawyers who have performed legal services for the client since the cutoff date for the last internal inquiry and any other lawyers they believe are likely to have relevant information. The Committee believes that either approach is acceptable. The Committee recognizes that the professional judgment of lawyers may lead to different procedures in particular cases, which might involve varying types and amount of inquiry and documentation.

Form of Updates to Audit Response Letters. Updates ordinarily should be delivered in writing, not communicated orally. Any update to an audit response letter should be made in accordance with the *ABA Statement of Policy*, including its conditions and limitations. Unlike lawyers' initial responses to audit inquiry letters, no illustrative form of update response has been established, and many different forms are in common use.

Some lawyers regularly use a "long form" response letter that employs the same form as the initial response letter but provides information about loss

¹⁰ See *ABA Statement of Policy*, *supra* note 1, at 9–10 (commentary ¶ 2) ("The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.").

contingencies as of an effective date after the effective date of the previous letter. Others use a "short form" letter that does not contain all the language of a long-form letter, but rather references the information in the previous letter and identifies any reportable developments with respect to previously reported loss contingencies or reportable loss contingencies that have arisen since the prior effective date. Finally, some lawyers have adopted a hybrid approach under which they use a short form in some circumstances and a long form in others; these lawyers may use a short form when they have no developments to report since the previous response letter and a long form when additional information about loss contingencies (whether previously reported or new) needs to be reported.

If a short form is used, the Committee suggests that it should (1) refer to the relevant client request(s), the entity or entities covered by the response, and the most recent long form response letter and previous update letters, if any, identifying them by date, and (2) state expressly that the response is subject to the same limitations and qualifications contained in the earlier letter. Nothing in this statement is intended to limit the professional judgment of a lawyer regarding the form the lawyer uses to update an audit response letter.

[Paragraph added, June 2015, to reflect *Statement on Updates to Audit Response Letter* by the Audit Responses Committee of the American Bar Association. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph renumbered by the issuance of SAS No. 142, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 143, July 2020. Paragraph subsequently renumbered by the issuance of SAS No. 144, July 2021.]

AU-C Section 501A

Audit Evidence—Specific Considerations for Selected Items

Source: SAS No. 122; SAS No. 136.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards (SAS) Nos. 142, *Audit Evidence*, and 143, *Auditing Accounting Estimates and Related Disclosures*, which contain amendments to this section.

- The amendments in SAS No. 142 are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.
- The amendments in SAS No. 143 are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix C of section 540 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 500A, *Audit Evidence*; and other relevant AU-C sections, regarding certain aspects of (a) investments in securities and derivative instruments; (b) inventory; (c) litigation, claims, and assessments involving the entity; and (d) segment information in an audit of financial statements.

Effective Date

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

Objective

.03 The objective of the auditor is to obtain sufficient appropriate audit evidence regarding the

- valuation of investments in securities and derivative instruments;
- existence and condition of inventory;

- c. completeness of litigation, claims, and assessments involving the entity; and
- d. presentation and disclosure of segment information, in accordance with the applicable financial reporting framework.

Requirements

Investments in Securities and Derivative Instruments (Ref: par. .A1–.A3)

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting)

.04 When investments in securities are valued based on an investee's financial results, excluding investments accounted for using the equity method of accounting, the auditor should obtain sufficient appropriate audit evidence in support of the investee's financial results, as follows: (Ref: par. .A4–.A8)

- a. Obtain and read available financial statements of the investee and the accompanying audit report, if any, including determining whether the report of the other auditor is satisfactory for this purpose.
- b. If the investee's financial statements are not audited, or if the audit report on such financial statements is not satisfactory to the auditor, apply, or request that the investor entity arrange with the investee to have another auditor apply, appropriate auditing procedures to such financial statements, considering the materiality of the investment in relation to the financial statements of the investor entity.
- c. If the carrying amount of the investment reflects factors that are not recognized in the investee's financial statements or fair values of assets that are materially different from the investee's carrying amounts, obtain sufficient appropriate audit evidence in support of such amounts.
- d. If the difference between the financial statement period of the entity and the investee has or could have a material effect on the entity's financial statements, determine whether the entity's management has properly considered the lack of comparability and determine the effect, if any, on the auditor's report. (Ref: par. .A9)

If the auditor is not able to obtain sufficient appropriate audit evidence because of an inability to perform one or more of these procedures, the auditor should determine the effect on the auditor's opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.05 With respect to subsequent events and transactions of the investee occurring after the date of the investee's financial statements but before the date of the auditor's report, the auditor should obtain and read available interim financial statements of the investee and make appropriate inquiries of management of the investor to identify such events and transactions that may be material to the investor's financial statements and that may need to be recognized or disclosed in the investor's financial statements. (Ref: par. .A10)

Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value

.06 With respect to investments in derivative instruments and securities measured or disclosed at fair value, the auditor should

- a. determine whether the applicable financial reporting framework specifies the method to be used to determine the fair value of the entity's derivative instruments and investments in securities and
- b. evaluate whether the determination of fair value is consistent with the specified valuation method. (Ref: par. .A11–.A13)

.07 If estimates of fair value of derivative instruments or securities are obtained from broker-dealers or other third-party sources based on valuation models, the auditor should understand the method used by the broker-dealer or other third-party source in developing the estimate and consider the applicability of section 500A.¹ (Ref: par. .A14–.A15)

.08 If derivative instruments or securities are valued by the entity using a valuation model, the auditor should obtain sufficient appropriate audit evidence supporting management's assertions about fair value determined using the model. (Ref: par. .A16)

Impairment Losses

.09 The auditor should

- a. evaluate management's conclusion (including the relevance of the information considered) about the need to recognize an impairment loss for a decline in a security's fair value below its cost or carrying amount and
- b. obtain sufficient appropriate audit evidence supporting the amount of any impairment adjustment recorded, including evaluating whether the requirements of the applicable financial reporting framework have been complied with. (Ref: par. .A17–.A18)

Unrealized Appreciation or Depreciation

.10 The auditor should obtain sufficient appropriate audit evidence about the amount of unrealized appreciation or depreciation in the fair value of a derivative that is recognized or that is disclosed because of the ineffectiveness of a hedge, including evaluating whether the requirements of the applicable financial reporting framework have been complied with. (Ref: par. .A19)

Inventory

.11 If inventory is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of inventory² by

- a. attending physical inventory counting, unless impracticable, to (Ref: par. .A20–.A22)

¹ Paragraph .08 of section 500A, *Audit Evidence*, addresses management's specialists.

² Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the auditor's procedures to respond to the assessed risks of material misstatements at the relevant assertion level.

- i. evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting, (Ref: par. .A23)
 - ii. observe the performance of management's count procedures, (Ref: par. .A24)
 - iii. inspect the inventory, and (Ref: par. .A25)
 - iv. perform test counts and (Ref: par. .A26)
- b. performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. (Ref: par. .A27–.A30)

.12 If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor should, in addition to the procedures required by paragraph .11, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are recorded properly. (Ref: par. .A31–.A33)

.13 If the auditor is unable to attend physical inventory counting due to unforeseen circumstances, the auditor should make or observe some physical counts on an alternative date and perform audit procedures on intervening transactions.

.14 If attendance at physical inventory counting is impracticable, the auditor should perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor should modify the opinion in the auditor's report, in accordance with section 705. (Ref: par. .A34–.A36)

.15 If inventory under the custody and control of a third party is material to the financial statements, the auditor should obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- a. Request confirmation from the third party regarding the quantities and condition of inventory held on behalf of the entity (Ref: par. .A37)
- b. Perform inspection or other audit procedures appropriate in the circumstances (Ref: par. .A38)

Litigation, Claims, and Assessments

.16 The auditor should design and perform audit procedures to identify litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement, including (Ref: par. .A39–.A45)

- a. inquiring of management and, when applicable, others within the entity, including in-house legal counsel;
- b. obtaining from management a description and evaluation of litigation, claims, and assessments that existed at the date of the financial statements being reported on and during the period from the date of the financial statements to the date the information is furnished, including an identification of those matters referred to legal counsel;³

³ For purposes of this section, the term *legal counsel* refers to the entity's in-house legal counsel and external legal counsel.

- c. reviewing minutes of meetings of those charged with governance; documents obtained from management concerning litigation, claims, and assessments; and correspondence between the entity and its external legal counsel; and
- d. reviewing legal expense accounts and invoices from external legal counsel.

.17 For actual or potential litigation, claims, and assessments identified based on the audit procedures required in paragraph .16, the auditor should obtain audit evidence relevant to the following factors:

- a. The period in which the underlying cause for legal action occurred
- b. The degree of probability of an unfavorable outcome
- c. The amount or range of potential loss

Communication With the Entity's Legal Counsel

.18 Unless the audit procedures required by paragraph .16 indicate that no actual or potential litigation, claims, or assessments that may give rise to a risk of material misstatement exist, the auditor should, in addition to the procedures required by other AU-C sections, seek direct communication with the entity's external legal counsel. The auditor should do so through a letter of inquiry prepared by management and sent by the auditor requesting the entity's external legal counsel to communicate directly with the auditor. (Ref: par. .A40 and .A46–.A63)

.19 In addition to the direct communications with the entity's external legal counsel referred to in paragraph .18, the auditor should, in cases when the entity's in-house legal counsel has the responsibility for the entity's litigation, claims, and assessments, seek direct communication with the entity's in-house legal counsel through a letter of inquiry similar to the letter referred to in paragraph .18. Audit evidence obtained from in-house legal counsel in this manner is not, however, a substitute for the auditor seeking direct communication with the entity's external legal counsel, as described in paragraph .18. (Ref: par. .A64)

.20 The auditor should document the basis for any determination not to seek direct communication with the entity's legal counsel, as required by paragraphs .18–.19.

.21 The auditor should request management to authorize the entity's legal counsel to discuss applicable matters with the auditor.

.22 As described in paragraphs .18–.19, the auditor should request, through letter(s) of inquiry, the entity's legal counsel to inform the auditor of any litigation, claims, assessments, and unasserted claims that the counsel is aware of, together with an assessment of the outcome of the litigation, claims, and assessments, and an estimate of the financial implications, including costs involved. Each letter of inquiry should include, but not be limited to, the following matters: (Ref: par. .A69)

- a. Identification of the entity, including subsidiaries, and the date of the audit
- b. A list prepared by management (or a request by management that the legal counsel prepare a list) that describes and evaluates pending or threatened litigation, claims, and assessments with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the company in the form of legal consultation or representation

- c. A list prepared by management that describes and evaluates unasserted claims and assessments that management considers to be probable of assertion and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome with respect to which the legal counsel has been engaged and to which the legal counsel has devoted substantive attention on behalf of the entity in the form of legal consultation or representation
- d. Regarding each matter listed in item *b*, a request that the legal counsel either provide the following information or comment on those matters on which the legal counsel's views may differ from those stated by management, as appropriate:
 - i. A description of the nature of the matter, the progress of the case to date, and the action that the entity intends to take (for example, to contest the matter vigorously or to seek an out-of-court settlement)
 - ii. An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss (Ref: par. .A65)
 - iii. With respect to a list prepared by management (or by the legal counsel at management's request), an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete
- e. Regarding each matter listed in item *c*, a request that the legal counsel comment on those matters on which the legal counsel's views concerning the description or evaluation of the matter may differ from those stated by management
- f. A statement that management understands that whenever, in the course of performing legal services for the entity with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, the legal counsel has formed a professional conclusion that the entity should disclose or consider disclosure concerning such possible claim or assessment, the legal counsel, as a matter of professional responsibility to the entity, will so advise the entity and will consult with the entity concerning the question of such disclosure and the requirements of the applicable financial reporting framework (for example, the requirements of Financial Accounting Standards Board [FASB] *Accounting Standards Codification* [ASC] 450, *Contingencies*)
- g. A request that the legal counsel confirm whether the understanding described in item *f* is correct
- h. A request that the legal counsel specifically identify the nature of, and reasons for, any limitation on the response
- i. A request that the legal counsel specify the effective date of the response

.23 When the auditor is aware that an entity has changed legal counsel or that the legal counsel previously engaged by the entity has resigned, the auditor should consider making inquiries of management or others about the reasons such legal counsel is no longer associated with the entity. (Ref: par. .A55)

.24 The auditor should modify the opinion in the auditor's report, in accordance with section 705, if (Ref: par. .A56–.A65)

- a. the entity's legal counsel refuses to respond appropriately to the letter of inquiry and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures or
- b. management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel.

Segment Information

.25 The auditor should obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information, in accordance with the applicable financial reporting framework, by (Ref: par. .A66–.A67)

- a. obtaining an understanding of the methods used by management in determining segment information and (Ref: par. .A68)
 - i. evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework and
 - ii. when appropriate, testing the application of such methods and
- b. performing analytical procedures or other audit procedures appropriate in the circumstances.

Application and Other Explanatory Material

Investments in Securities and Derivative Instruments (Ref: par. .04–.10)

.A1 Evaluating audit evidence for assertions about investments in securities and derivative instruments may involve professional judgment because the assertions, especially those about valuation, are based on highly subjective assumptions or are particularly sensitive to changes in the underlying circumstances. Valuation assertions may be based on assumptions about the occurrence of future events for which expectations are difficult to develop or on assumptions about conditions expected to exist over a long period (for example, default rates or prepayment rates). Accordingly, competent persons could reach different conclusions about estimates of fair values or estimates of ranges of fair values. Professional judgment also may be necessary when evaluating audit evidence for assertions based on features of the security or derivative and the requirements of the applicable financial reporting framework, including underlying criteria for hedge accounting, which are extremely complex. For example, determining the fair value of a structured note may require consideration of a variety of features of the note that react differently to changes in economic conditions. In addition, one or more other derivatives may be designated to hedge changes in cash flows under the note. Evaluating audit evidence about the fair value of the note, the determination of whether the hedge is highly effective, and the allocation of changes in fair value to earnings and other comprehensive income requires professional judgment.

.A2 This section addresses only certain specific aspects relating to auditing valuation of investments in securities and derivative instruments. Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures in an audit of financial statements. The Audit Guide *Auditing*

Derivative Instruments, Hedging Activities, and Investments in Securities provides additional and more detailed guidance to auditors related to planning and performing auditing procedures for assertions about derivative instruments, hedging activities, and investments in securities.

Investments in Securities When Valuations Are Based on Cost

.A3 Procedures to obtain evidence about the valuation of securities that are recorded at cost may include inspection of documentation of the purchase price, confirmation with the issuer or holder of those securities, and testing discount or premium amortization either by recomputation or through the use of analytical procedures. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .04–.05)

.A4 Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, addresses auditing investments accounted for using the equity method of accounting.

.A5 For valuations based on an investee's financial results (excluding investments accounted for using the equity method of accounting), obtaining and reading the financial statements of the investee that have been audited by an auditor whose report is satisfactory may be sufficient for the purpose of obtaining sufficient appropriate audit evidence. In determining whether the report of another auditor is satisfactory, the auditor may perform procedures such as making inquiries regarding the professional reputation and standing of the other auditor, visiting the other auditor, discussing the audit procedures followed and the results thereof, and reviewing the audit plan and audit documentation of the other auditor.

.A6 After obtaining and reading the audited financial statements of an investee, the auditor may conclude that additional audit procedures are necessary to obtain sufficient appropriate audit evidence. For example, the auditor may conclude that additional audit evidence is needed because of significant differences in fiscal year-ends, significant differences in accounting principles, changes in ownership, or the significance of the investment to the investor's financial position or results of operations. Examples of procedures that the auditor may perform are reviewing information in the investor's files that relates to the investee, such as investee minutes and budgets, and investee cash flow information and making inquiries of investor management about the investee's financial results.

.A7 The auditor may need to obtain evidence relating to transactions between the entity and investee to evaluate

- a. the propriety of the elimination of unrealized profits and losses on transactions between the entity and investee, if applicable, and
- b. the adequacy of disclosures about material related party transactions or relationships.

.A8 Section 540A and paragraphs .06–.08 of this section address auditing fair value accounting estimates. The Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* also provides guidance on audit evidence that may be relevant to the fair value of derivative instruments and securities and on procedures that may be performed by the auditor

to evaluate management's consideration of the need to recognize impairment losses.

.A9 The date of the investor's financial statements and those of the investee may be different. If the difference between the date of the entity's financial statements and those of the investee has or could have a material effect on the entity's financial statements, the auditor is required, in accordance with paragraph .04d, to determine whether the entity's management has properly considered the lack of comparability. The effect may be material, for example, because the difference between the financial statement period ends of the entity and investee is not consistent with the prior period in comparative statements or because a significant transaction occurred during the time period between the financial statement period end of the entity and investee. If a change in the difference between the financial statement period end of the entity and investee has a material effect on the investor's financial statements, the auditor may be required, in accordance with section 708, *Consistency of Financial Statements*, to add an emphasis-of-matter paragraph to the auditor's report because the comparability of financial statements between periods has been materially affected by a change in reporting period.

.A10 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements.

Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value (Ref: par. .06–.08)

.A11 The method for determining fair value may be specified by the applicable financial reporting framework and may vary depending on the industry in which the entity operates or the nature of the entity. Such differences may relate to the consideration of price quotations from inactive markets and significant liquidity discounts, control premiums, and commissions and other costs that would be incurred to dispose of the derivative instrument or security.

.A12 If the determination of fair value requires the use of accounting estimates, see section 540A, which addresses auditing fair value accounting estimates, including requirements and guidance relating to the auditor's understanding of the applicable financial reporting framework relevant to accounting estimates and the method used in making the estimate⁴ and the auditor's determination of whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate.⁵ The Audit Guide *Special Considerations in Auditing Financial Instruments* also provides guidance on audit evidence that may be relevant to the fair value of derivative instruments and investments in securities.

.A13 Quoted market prices for derivative instruments and securities listed on national exchanges or over-the-counter markets are available from sources such as financial publications, the exchanges, NASDAQ, or pricing services based on sources such as those. Quoted market prices obtained from those sources generally provide sufficient evidence of the fair value of the derivative instruments and securities.

.A14 For certain other derivative instruments and securities, quoted market prices may be obtained from broker-dealers who are market makers in them or through the National Quotation Bureau. However, using such a price quote

⁴ Paragraphs .08a, .08c, .A12–.A14, and .A23–.A25 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

⁵ Paragraphs .12a and .A53–.A57 of section 540A.

to test valuation assertions may require special knowledge to understand the circumstances in which the quote was developed. For example, quotations published by the National Quotation Bureau may not be based on recent trades and may be only an indication of interest and not an actual price for which a counterparty will purchase or sell the underlying derivative instrument or security.

.A15 If quoted market prices are not available for the derivative instrument or security, estimates of fair value frequently may be obtained from broker-dealers or other third-party sources, based on proprietary valuation models, or from the entity, based on internally or externally developed valuation models (for example, the Black-Scholes option pricing model). Understanding the method used by the broker-dealer or other third-party source in developing the estimate may include, for example, understanding whether a pricing model or cash flow projection was used. The auditor also may determine that it is necessary to obtain estimates from more than one pricing source. For example, this may be appropriate if either of the following occurs:

- The pricing source has a relationship with an entity that might impair its objectivity, such as an affiliate or a counterparty involved in selling or structuring the product.
- The valuation is based on assumptions that are highly subjective or particularly sensitive to changes in the underlying circumstances.

See also section 540A.⁶

.A16 Examples of valuation models include the present value of expected future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Refer to section 540A for the auditor's procedures to obtain evidence supporting management's assertions about fair value that are determined using a valuation model.

Impairment Losses (Ref: par. .09)

.A17 Regardless of the valuation method used, the applicable financial reporting framework might require recognizing, in earnings or other comprehensive income, an impairment loss for a decline in fair value that is other than temporary. Determinations of whether losses are other than temporary may involve estimating the outcome of future events and making judgments in determining whether factors exist that indicate that an impairment loss has been incurred at the end of the reporting period. These judgments are based on subjective as well as objective factors, including knowledge and experience about past and current events and assumptions about future events. The following are examples of such factors:

- Fair value is significantly below cost or carrying value and
 - the decline is attributable to adverse conditions specifically related to the security or specific conditions in an industry or a geographic area.
 - the decline has existed for an extended period of time.
 - for an equity security, management has the intent to sell the security or it is more likely than not that it will be required to sell the security before recovery.

⁶ Paragraphs .A68–.A89 of section 540A.

— for a debt security, management has the intent to sell the security or it is more likely than not it will be required to sell the security before the security's anticipated recovery of its amortized cost basis (for example, if the entity's cash or working capital requirements or contractual or regulatory obligations indicate that the debt security will be required to be sold before the forecasted recovery occurs).

- The security has been downgraded by a rating agency.
- The financial condition of the issuer of those securities has deteriorated.
- Dividends have been reduced or eliminated or scheduled interest payments have not been made.
- The entity recorded losses from the security subsequent to the end of the reporting period.

[Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

.A18 Evaluating the relevance of the information considered may include obtaining evidence about factors such as those referred to in paragraph .A17 that tend to corroborate or conflict with management's conclusions.

Unrealized Appreciation or Depreciation (Ref: par. .10)

.A19 Obtaining audit evidence about the amount of unrealized appreciation or depreciation in the fair value of a derivative that is recognized or that is disclosed because of the ineffectiveness of a hedge may include understanding the methods used to determine whether the hedge is highly effective and to determine the ineffective portion of the hedge.

Inventory

Attendance at Physical Inventory Counting (Ref: par. .11a)

.A20 Management ordinarily establishes procedures under which inventory is physically counted at least once per year to serve as a basis for the preparation of the financial statements and, if applicable, to ascertain the reliability of the entity's perpetual inventory system.

.A21 Attendance at physical inventory counting involves

- inspecting the inventory to ascertain its existence and evaluate its condition and performing test counts,
- observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count, and
- obtaining audit evidence about the reliability of management's count procedures.

These procedures may serve as tests of controls or substantive procedures, or both, depending on the auditor's risk assessment, planned approach, and the specific procedures carried out.

.A22 Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs .11–.15) include, for example, the following:

- The risks of material misstatement related to inventory.

- The control risk related to inventory.
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- The timing of physical inventory counting.
- Whether the entity maintains a perpetual inventory system.
- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. Section 600 addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.
- Whether the assistance of an auditor's specialist is needed. Section 620, *Using the Work of an Auditor's Specialist*, addresses the use of an auditor's specialist to assist the auditor in obtaining sufficient appropriate audit evidence.

Evaluate Management's Instructions and Procedures (Ref: par. .11a(i))

.A23 Matters relevant in evaluating management's instructions and procedures for recording and controlling the physical inventory counting include whether they address, for example, the following:

- The application of appropriate control activities (for example, the collection of used physical inventory count records, accounting for unused physical inventory count records, and count and recount procedures)
- The accurate identification of the stage of completion of work in progress; slow moving, obsolete, or damaged items; and inventory owned by a third party (for example, on consignment)
- The procedures used to estimate physical quantities, when applicable, such as may be needed in estimating the physical quantity of a coal pile
- Control over the movement of inventory between areas and the shipping and receipt of inventory before and after the cutoff date

Observe the Performance of Management's Count Procedures (Ref: par. .11a(ii))

.A24 Observing the performance of management's count procedures (for example, those relating to control over the movement of inventory before, during, and after the count) assists the auditor in obtaining audit evidence that management's instructions and count procedures are designed and implemented adequately. In addition, the auditor may obtain copies of cutoff information, such as details of the movement of inventory, to assist the auditor in performing audit procedures over the accounting for such movements at a later date.

Inspect the Inventory (Ref: par. .11a(iii))

.A25 Inspecting inventory when attending physical inventory counting assists the auditor in ascertaining the existence of the inventory (though not necessarily its ownership) and in identifying obsolete, damaged, or aging inventory.

Perform Test Counts (Ref: par. .11a(iv))

.A26 Performing test counts (for example, by tracing items selected from management's count records to the physical inventory and tracing items

selected from the physical inventory to management's count records) provides audit evidence about the completeness and accuracy of those records.

.A27 In addition to recording the auditor's test counts, obtaining copies of management's completed physical inventory count records assists the auditor in performing subsequent audit procedures to determine whether the entity's final inventory records accurately reflect actual inventory count results.

Use of Management's Specialists

.A28 Management may engage specialists who have expertise in the taking of physical inventories to count, list, price, and subsequently compute the total dollar amount of inventory on hand at the date of the physical count. For example, entities such as retail stores, hospitals, and automobile dealers may use specialists in this manner.

.A29 An inventory count performed by an external inventory firm engaged as a management specialist does not, by itself, provide the auditor with sufficient appropriate audit evidence. The auditor is required by section 500A to perform certain procedures if information to be used as audit evidence has been prepared using the work of a management's specialist.⁷ The auditor may, for example, examine the specialist's program, observe its procedures and controls, make or observe some physical counts of the inventory, recompute calculations of the submitted inventory on a test basis, and apply appropriate tests to the intervening transactions.

.A30 Although the auditor may adjust the extent of the work on the physical count of inventory because of the work of management's specialist, any restriction imposed on the auditor such that the auditor is unable to perform the procedures that the auditor considers necessary is a scope limitation. In such cases, section 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

Physical Inventory Counting Conducted Other Than at the Date of the Financial Statements (Ref: par. .12)

.A31 For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation, and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date (or dates) other than the date of the financial statements is appropriate for audit purposes. Section 330 addresses substantive procedures performed at an interim date.⁸

.A32 When a perpetual inventory system is maintained, management may perform physical counts or other tests to ascertain the reliability of inventory quantity information included in the entity's perpetual inventory records. In some cases, management or the auditor may identify differences between the perpetual inventory records and actual physical inventory quantities on hand; this may indicate that the controls over changes in inventory are not operating effectively.

.A33 Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between

⁷ Paragraph .08 of section 500A addresses management's specialists.

⁸ Paragraphs .23–.24 of section 330.

the count date, or dates, and the final inventory records are recorded properly include the following:

- Whether the perpetual inventory records are properly adjusted
- Reliability of the entity's perpetual inventory records
- Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records

Attendance at Physical Inventory Counting Is Impracticable (Ref: par. .14)

.A34 In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory (for example, when inventory is held in a location that may pose threats to the safety of the auditor). The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the matter of difficulty, time, or cost involved is not, in itself, a valid basis for the auditor to omit an audit procedure for which no alternative exists or to be satisfied with audit evidence that is less than persuasive.

.A35 In some cases, when attendance is impracticable, alternative audit procedures (for example, observing a current physical inventory count and reconciling it to the opening inventory quantities or inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting) may provide sufficient appropriate audit evidence about the existence and condition of inventory. If the audit covers the current period and one or more periods for which the auditor had not observed or made some physical counts of prior inventories, alternative audit procedures, such as tests of prior transactions or reviews of the records of prior counts, may provide sufficient appropriate audit evidence about the prior inventories. The effectiveness of the alternative procedures that an auditor may perform is affected by the length of the period that the alternative procedures cover.

.A36 In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, section 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation. In addition, section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, addresses the auditor's procedures regarding inventory opening balances in initial audit engagements.⁹

Inventory Under the Custody and Control of a Third Party

Confirmation (Ref: par. .15a)

.A37 Section 505, *External Confirmations*, addresses external confirmation procedures.

Other Audit Procedures (Ref: par. .15b)

.A38 Depending on the circumstances (for example, when information is obtained that raises doubt about the integrity and objectivity of the third party),

⁹ Paragraph .A13 of section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*.

the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include the following:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable
- Obtaining another auditor's report on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded
- Inspecting documentation regarding inventory held by third parties (for example, warehouse receipts)
- Requesting confirmation from other parties when inventory has been pledged as collateral

Litigation, Claims, and Assessments

Completeness of Litigation, Claims, and Assessments (Ref: par. .16)

.A39 Litigation, claims, and assessments involving the entity may have a material effect on the financial statements and, thus, may be required to be recognized, measured, or disclosed in the financial statements.

.A40 Other legal matters involving the entity may not have a material effect on the entity's financial statements and, accordingly, would not give rise to risks of material misstatement. Examples of such other legal matters may be

- matters unrelated to actual or potential litigation, claims, or assessments, such as consulting services related to real estate or potential merger and acquisition transactions;
- matters in which the entity records indicate that management or the legal counsel has not devoted substantive attention to the matter;
- matters in which the entity's insurance coverage exceeds the amount of the actual or potential litigation, claim, or assessment sought against the entity; or
- matters that are clearly trivial to the financial statements.

.A41 Management is responsible for adopting policies and procedures to identify, evaluate, and account for litigation, claims, and assessments as a basis for the preparation of financial statements, in accordance with the requirements of the applicable financial reporting framework.

.A42 Management is the primary source of information about events or conditions considered in the financial accounting for, and reporting of, litigation, claims, and assessments because these matters are within the direct knowledge and, often, control of management. Accordingly, the auditor's procedures with respect to litigation, claims, and assessments include the following:

- Making inquiries of management as required by paragraph .16a, which may include a discussion about the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments involving the entity that may give rise to a risk of material misstatement
- Obtaining written representations from management, in accordance with section 580, *Written Representations*, that all known actual or possible litigation, claims, and assessments whose effects

should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework¹⁰

.A43 In addition to the procedures identified in paragraph .16, other relevant procedures include, for example, using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation, claims, and assessments involving the entity. Examples of such procedures are as follows:

- Reading minutes of meetings of stockholders; directors; governing bodies of governmental entities; and appropriate committees held during, and subsequent to, the period being audited
- Reading contracts, loan agreements, leases, correspondence from taxing or other governmental agencies, and similar documents
- Obtaining information concerning guarantees from bank confirmation forms
- Inspecting other documents for possible guarantees by the entity

Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity and its environment.¹¹ In addition, section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, requires the auditor to obtain an understanding of the entity's legal and regulatory framework applicable to the entity and industry or sector in which the entity operates and how the entity is complying with that framework.

.A44 Audit evidence obtained for purposes of identifying litigation, claims, and assessments that may give rise to a risk of material misstatement also may provide audit evidence regarding other relevant considerations, such as valuation or measurement, regarding litigation, claims, and assessments. Section 540A establishes requirements and provides guidance relevant to the auditor's consideration of litigation, claims, and assessments requiring accounting estimates or related disclosures in the financial statements.

.A45 This section addresses inquiries of the entity's legal counsel with whom management has consulted. If management has not consulted legal counsel, the auditor would rely on the procedures required by paragraph .16 to identify litigation, claims, and assessments involving the entity, which may give rise to a risk of material misstatement, and the written representation of management regarding litigation, claims, and assessments, as required by section 580.

Communication With the Entity's Legal Counsel (Ref: par. .18--.24)

.A46 An auditor ordinarily does not possess legal skills and, therefore, cannot make legal judgments concerning information coming to the auditor's attention.

.A47 Direct communication with the entity's legal counsel assists the auditor in obtaining sufficient appropriate audit evidence about whether potentially material litigation, claims, and assessments are known and management's estimates of the financial implications, including costs, are reasonable.

¹⁰ Paragraph .15 of section 580, *Written Representations*.

¹¹ Paragraph .12 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

.A48 The American Bar Association (ABA) has approved *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* (the ABA statement), which explains the concerns of the legal counsel and the nature of the limitations that an auditor is likely to encounter in connection with seeking direct communication with the entity's legal counsel about litigation, claims, assessments, and unasserted claims.¹²

.A49 A letter of inquiry to the entity's legal counsel is the auditor's primary means of obtaining corroboration of the information provided by management concerning material litigation, claims, and assessments. Audit evidence obtained from the entity's in-house general counsel or legal department may provide the auditor with the necessary corroboration.

.A50 In certain circumstances, the auditor also may judge it necessary to meet with the entity's legal counsel to discuss the likely outcome of the litigation or claims. This may be the case, for example, when

- the auditor determines that the matter is a significant risk.
- the matter is complex.
- a disagreement exists between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

.A51 An external legal counsel's response to a letter of inquiry and the procedures set forth in paragraphs .16–.17 provide the auditor with sufficient appropriate audit evidence concerning the accounting for, and reporting of, pending and threatened litigation, claims, and assessments.

.A52 Audit evidence about the status of litigation, claims, and assessments up to the date of the auditor's report may be obtained by inquiry of management, including in-house legal counsel responsible for dealing with the relevant matters. The auditor may need to obtain updated information from the entity's legal counsel.

.A53 In accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.¹³ Accordingly, it is preferable that the entity's legal counsel's response be as close to the date of the auditor's report as is practicable in the circumstances. Specifying the effective date of the entity's legal counsel's response to reasonably approximate the expected date of the auditor's report may obviate the need to obtain updated information

¹² The *Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information* is reprinted as exhibit A, "American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," for the convenience of readers but is not an integral part of this section.

¹³ Paragraph .43 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .82 and .126 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

from the entity's legal counsel. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A54 Clearly specifying the earliest acceptable effective date of the response and the latest date by which it is to be sent to the auditor and informing the entity's legal counsel of these dates timely facilitates the entity's legal counsel's ability to respond timely and adequately. A two-week period between the specified effective date of the entity's legal counsel's response and the latest date by which the response is to be sent to the auditor is generally sufficient.

.A55 In some circumstances, the legal counsel may be required by relevant ethical requirements to resign the engagement if the legal counsel's advice concerning financial accounting and reporting for litigation, claims, and assessments is disregarded by the entity.

.A56 The legal counsel appropriately may limit the response to matters to which the legal counsel has given substantive attention in the form of legal consultation or representation. Also, the legal counsel's response may be limited to matters that are considered individually or collectively material to the financial statements, such as when the entity and auditor have reached an understanding on the limits of materiality for this purpose and management has communicated such understanding to the legal counsel. Such limitations are not limitations on the scope of the audit.

.A57 The legal counsel may be unable to respond concerning the likelihood of an unfavorable outcome of litigation, claims, and assessments or the amount or range of potential loss because of inherent uncertainties. Factors influencing the likelihood of an unfavorable outcome sometimes may not be within the legal counsel's competence to judge; historical experience of the entity in similar litigation or the experience of other entities may not be relevant or available, and the amount of the possible loss frequently may vary widely at different stages of litigation. Consequently, the legal counsel may not be able to form a conclusion with respect to such matters. In such circumstances, the auditor may conclude that the financial statements are affected by an uncertainty concerning the outcome of a future event that cannot be reasonably estimated. If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, section 705 requires the auditor to modify the opinion in addressing the effect, if any, of the legal counsel's response on the auditor's report as a result of the scope limitation.¹⁴

.A58 An external legal counsel's refusal to furnish the information requested in an inquiry letter either in writing or orally may cause a scope limitation of the audit sufficient to preclude an unmodified opinion.

.A59 Although the auditor would consider the inability to review information that could have a significant bearing on the audit as a scope limitation, in recognition of the public interest in protecting the confidentiality of lawyer-client communications, such inability is not intended to require an auditor to examine documents that the client identifies as subject to the lawyer-client privilege. In the event of questions concerning the applicability of this privilege, the auditor may request confirmation from the entity's legal counsel that the information is subject to that privilege and that the information was considered by the legal counsel in responding to the letter of inquiry or, if the matters are

¹⁴ Paragraph .07 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

being handled by another legal counsel, an identification of such legal counsel for the purpose of sending a letter of inquiry.

.A60 If management imposes a limitation on the scope of the audit and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, the auditor is required by section 705 to either disclaim an opinion on the financial statements or, when practicable, withdraw from the audit.¹⁵

.A61 In some cases, in order to emphasize the preservation of the attorney-client privilege or the attorney work-product privilege, some entities may include the following or substantially similar language in the audit inquiry letter to legal counsel:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

For the same reason, some legal counsel may include the following or substantially similar language in their response letters to auditors:

The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

Explanatory language similar to the foregoing in the letters of the entity or legal counsel is not a limitation on the scope of the legal counsel's response. See exhibit B, "Report of the Subcommittee on Audit Inquiry Responses."

.A62 In order to emphasize the preservation of the attorney-client privilege with respect to unasserted possible claims or assessments, some legal counsel may include the following or substantially similar language in their responses to audit inquiry letters:

Please be advised that pursuant to clauses (b) and (c) of Paragraph 5 of the ABA Statement of Policy [*American Bar Association's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*] and related Commentary referred to in the last paragraph of this letter, it would be inappropriate for this firm to respond to a general inquiry relating to the existence of unasserted possible claims or assessments involving the Company. We can only furnish information concerning those unasserted possible claims or assessments upon which the Company has specifically requested in writing that we comment. We also cannot comment upon the adequacy of the Company's listing, if any, of unasserted possible claims or assessments or its assertions concerning the advice, if any, about the need to disclose same.

Additional language similar to the foregoing in a letter from legal counsel is not a limitation on the scope of the audit. However, the ABA statement and the understanding between the legal and accounting professions assumes that the legal counsel, under certain circumstances, will advise and consult with the entity concerning the entity's obligation to make financial statement disclosure with respect to unasserted possible claims or assessments. Confirmation of this understanding is included in the legal counsel's response.

¹⁵ Paragraph .13 of section 705.

.A63 If the auditor believes that there may be actual or potential material litigation, claims, or assessments and the entity has not engaged external legal counsel relating to such matters, the auditor may discuss with the client the possible need to consult legal counsel to assist the client in determining the appropriate measurement, recognition, or disclosure of related liabilities or loss contingencies in the financial statements, in accordance with the applicable financial reporting framework. Depending on the significance of the matter(s), refusal by management to consult legal counsel in these circumstances may result in a scope limitation of the audit sufficient to preclude an unmodified opinion.

Direct Communication With the Entity's In-House Legal Counsel

.A64 In-house legal counsel can range from one lawyer to a large staff, with responsibilities ranging from specific internal matters to a comprehensive coverage of all of the entity's legal needs, including litigation with outside parties. Because both in-house and external legal counsel are bound by an applicable code of ethics, there should be no significant difference in their professional obligations and responsibilities. In some circumstances, external legal counsel, if used at all, may be used only for limited purposes, such as data accumulation or account collection activity. In such circumstances, in-house legal counsel may have the primary responsibility for corporate legal matters and may be in the best position to know and precisely describe the status of all litigation, claims, and assessments or to corroborate information provided by management.

Evaluation of the Outcome of Litigation, Claims, or Assessment (Ref: par. .22d(ii))

.A65 Although paragraph 5 of the ABA statement states that the legal counsel "may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is 'probable' or 'remote,'" the legal counsel is not required to use those terms in communicating the evaluation to the auditor. The auditor may find other wording sufficiently clear, as long as the terms can be used to classify the outcome of the uncertainty under one of the three probability classifications established in FASB ASC 450. Some examples of evaluations concerning litigation that may be considered to provide sufficient clarity that the likelihood of an unfavorable outcome is remote, even though they do not use that term, are the following:

- "We are of the opinion that this action will not result in any liability to the company."
- "It is our opinion that the possible liability to the company in this proceeding is nominal in amount."
- "We believe the company will be able to defend this action successfully."
- "We believe that the plaintiff's case against the company is without merit."
- "Based on the facts known to us, after a full investigation, it is our opinion that no liability will be established against the company in these suits."

Absent any contradictory information obtained by the auditor either in other parts of the legal counsel's letter or otherwise, the auditor need not obtain further clarification of evaluations such as the foregoing. Because of inherent uncertainties described in paragraph .A57 and the ABA statement, an evaluation furnished by the legal counsel may indicate significant uncertainties or stipulations about whether the client will prevail. The following are examples of the

legal counsel's evaluations that are unclear about the likelihood of an unfavorable outcome:

- "This action involves unique characteristics wherein authoritative legal precedents do not seem to exist. We believe that the plaintiff will have serious problems establishing the company's liability under the act; nevertheless, if the plaintiff is successful, the award may be substantial."
- "It is our opinion that the company will be able to assert meritorious defenses to this action." (The term *meritorious defenses* indicates that the entity's defenses will not be summarily dismissed by the court; it does not necessarily indicate the legal counsel's opinion that the entity will prevail.)
- "We believe the action can be settled for less than the damages claimed."
- "We are unable to express an opinion as to the merits of the litigation at this time. The company believes there is absolutely no merit to the litigation." (If the entity's legal counsel, with the benefit of all relevant information, is unable to conclude that the likelihood of an unfavorable outcome is remote, it is unlikely that management would be able to form a judgment to that effect.)
- "In our opinion, the company has a substantial chance of prevailing in this action." (A *substantial chance*, a *reasonable opportunity*, and similar terms indicate more uncertainty than an opinion that the company will prevail.)

If the auditor is uncertain about the meaning of the legal counsel's evaluation, clarification either in a follow-up letter or conference with the legal counsel and entity, appropriately documented, may be appropriate. If the legal counsel is still unable to give an unequivocal evaluation of the likelihood of an unfavorable outcome in writing or orally, the auditor is required by section 700, or section 703, to determine the effect, if any, of the legal counsel's response on the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Segment Information (Ref: par. .25)

.A66 Depending on the applicable financial reporting framework, the entity may be required or permitted to disclose segment information in the financial statements. The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a stand-alone basis.

Considerations Specific to Governmental Entities

.A67 For governmental entities required by the applicable financial reporting framework to disclose segment information, the auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements of the opinion unit(s) on which the segment information is based.¹⁶

¹⁶ Paragraph .A14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Understanding of the Methods Used by Management (Ref: par. .25a)

.A68 Depending on the circumstances, examples of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include the following:

- Sales, transfers, and charges between segments and elimination of intersegment amounts
- Comparisons with budgets and other expected results (for example, operating profits as a percentage of sales)
- The allocation of assets and costs among segments
- Consistency with prior periods and the adequacy of the disclosures with respect to inconsistencies
- Management's process for identifying those segments that require disclosure in accordance with the entity's financial reporting framework

.A69

Appendix—Illustrative Audit Inquiry Letter to Legal Counsel (Ref: par. .22)

In connection with an audit of our financial statements at (balance sheet date) and for the (period) then ended, management of the Company has prepared, and furnished to our auditors (name and address of auditors), a description and evaluation of certain contingencies, including those set forth below involving matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. These contingencies are regarded by management of the Company as material for this purpose (management may indicate a materiality limit if an understanding has been reached with the auditor). Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

In connection with an audit of our financial statements as of (balance-sheet date) and for the (period) then ended, please furnish our auditors, (name and address of auditors), with the information requested below concerning certain contingencies involving matters with respect to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. *[When a materiality limit has been established based on an understanding between management and the auditor, the following sentence should be added: This request is limited to contingencies amounting to (amount) individually or items involving lesser amounts that exceed (amount) in the aggregate.]*

Pending or Threatened Litigation (Excluding Unasserted Claims)

[Ordinarily the information would include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3) how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.] This letter will serve as our consent for you to furnish to our auditor all the information requested herein. Accordingly, please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated and an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

Regarding pending or threatened litigation, claims, and assessments, please include in your response: (1) the nature of each matter, (2) the progress of each matter to date, (3) how the Company is responding or intends to respond (for example, to contest the case vigorously or seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

Unasserted Claims and Assessments (Considered by Management to be Probable of Assertion and That, if Asserted, Would Have at Least a Reasonable Possibility of an Unfavorable Outcome)

[Ordinarily management's information would include the following: (1) the nature of the matter, (2) how management intends to respond if the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.] Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters for which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 450, Contingencies*. Please specifically confirm to our auditors that our understanding is correct.

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

We have represented to our auditors that there are no unasserted possible claims or assessments that you have advised us are probable of assertion and must be disclosed in accordance with FASB ASC 450. We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of FASB ASC 450. Please specifically confirm to our auditors that our understanding is correct.

Please specifically identify the nature of and reasons for any limitation on your response.

[The auditor may request the client to inquire about additional matters, for example, unpaid or unbilled charges or specified information on certain contractually assumed obligations of the Company, such as guarantees of indebtedness of others.]

[Alternative wording when management requests the lawyer to prepare the list that describes and evaluates pending or threatened litigation, claims, and assessments is as follows:]

Your response should include matters that existed as of (balance-sheet date) and during the period from that date to the effective date of your response. Please specifically identify the nature of and reasons for any limitations on your response. Our auditors expect to have the audit completed about (expected completion date). They would appreciate receiving your reply by that date with a specified effective date no earlier than (ordinarily two weeks before expected completion date).

[Wording that could be used in an audit inquiry letter, instead of the heading and first paragraph, when the client believes that there are no unasserted claims]

or assessments (to be specified to the lawyer for comment) that are probable of assertion and that, if asserted, would have a reasonable possibility of an unfavorable outcome as specified by Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies, is as follows:]

Unasserted claims and assessments—We have represented to our auditors that there are no unasserted possible claims that you have advised us are probable of assertion and must be disclosed, in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*. (The second paragraph in the section relating to unasserted claims and assessments would not be altered.)

.A70

Exhibit A—American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (Ref: par. .A48)

Note: This document, in the form herein set forth, was approved by the Board of Governors of the American Bar Association (ABA) in December 1975, which official action permitted its release to lawyers and accountants as the standard recommended by the ABA for the lawyer's response to letters of audit inquiry.

Source: Statement on Auditing Standards No. 12 section 337C, *Exhibit II—American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information**

Preamble

The public interest in protecting the confidentiality of lawyer-client communications is fundamental. The American legal, political and economic systems depend heavily upon voluntary compliance with the law and upon ready access to a respected body of professionals able to interpret and advise on the law. The expanding complexity of our laws and governmental regulations increases the need for prompt, specific and unhampered lawyer-client communication. The benefits of such communication and early consultation underlie the strict statutory and ethical obligations of the lawyer to preserve the confidences and secrets of the client, as well as the long-recognized testimonial privilege for lawyer-client communication.

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate

* Statement on Auditing Standards No. 12 section 337C, *Exhibit II—American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, has been superseded by this section.

a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and encouraging its readiness to seek advice of counsel and to act in accordance with counsel's advice.

Consistent with the foregoing public policy considerations, it is believed appropriate to distinguish between, on the one hand, litigation which is pending or which a third party has manifested to the client a present intention to commence and, on the other hand, other contingencies of a legal nature or having legal aspects. As regards the former category, unquestionably the lawyer representing the client in a litigation matter may be the best source for a description of the claim or claims asserted, the client's position (e.g., denial, contest, etc.), and the client's possible exposure in the litigation (to the extent the lawyer is in a position to do so). As to the latter category, it is submitted that, for the reasons set forth above, it is not in the public interest for the lawyer to be required to respond to general inquiries from auditors concerning possible claims.

It is recognized that the disclosure requirements for enterprises subject to the reporting requirements of the Federal securities laws are a major concern of managements and counsel, as well as auditors. It is submitted that compliance therewith is best assured when clients are afforded maximum encouragement, by protecting lawyer-client confidentiality, freely to consult counsel. Likewise, lawyers must be keenly conscious of the importance of their clients being competently advised in these matters.

Statement of Policy

NOW, THEREFORE, BE IT RESOLVED that it is desirable and in the public interest that this Association adopt the following Statement of Policy regarding the appropriate scope of the lawyer's response to the auditor's request, made by the client at the request of the auditor, for information concerning matters referred to the lawyer during the course of his representation of the client:

1. *Client Consent to Response.* The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5,[†] promulgated by the Financial Accounting Standards Board in March 1975 and discussed in Paragraph 5.1 of the accompanying Commentary), to the extent hereinafter set forth, subject to the following:
 - a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

- b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.
- c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.
- d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

- [‡] As contemplated by Paragraph 8 of this Statement of Policy, this sentence is intended to be the subject of incorporation by reference as therein provided.

of the inquiry when responding to the auditor, he should consider advising the auditor that his response is limited, in order to avoid any inference that the lawyer has responded to all aspects; otherwise, he may be assuming a responsibility which he does not intend.

5. *Loss Contingencies.* When properly requested by the client, it is appropriate for the lawyer to furnish to the auditor information concerning the following matters if the lawyer has been engaged by the client to represent or advise the client professionally with respect thereto and he has devoted substantive attention to them in the form of legal representation or consultation:
- a. *overtly threatened or pending litigation*, whether or not specified by the client;
 - b. *a contractually assumed obligation* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor;
 - c. *an unasserted possible claim or assessment* which the client has specifically identified and upon which the client has specifically requested, in the inquiry letter or a supplement thereto, comment to the auditor.

With respect to clause (a), overtly threatened litigation means that a potential claimant has manifested to the client an awareness of and present intention to assert a possible claim or assessment unless the likelihood of litigation (or of settlement when litigation would normally be avoided) is considered remote. With respect to clause (c), where there has been no manifestation by a potential claimant of an awareness of and present intention to assert a possible claim or assessment, consistent with the considerations and concerns outlined in the Preamble and Paragraph 1 hereof, the client should request the lawyer to furnish information to the auditor only if the client has determined that it is probable that a possible claim will be asserted, that there is a reasonable possibility that the outcome (assuming such assertion) will be unfavorable, and that the resulting liability would be material to the financial condition of the client. Examples of such situations might (depending in each case upon the particular circumstances) include the following: (i) a catastrophe, accident or other similar physical occurrence in which the client's involvement is open and notorious, or (ii) an investigation by a government agency where enforcement proceedings have been instituted or where the likelihood that they will not be instituted is remote, under circumstances where assertion of one or more private claims for redress would normally be expected, or (iii) a public disclosure by the client acknowledging (and thus focusing attention upon) the existence of one or more probable claims arising out of an event or circumstance. In assessing whether or not the assertion of a possible claim is probable, it is expected that the client would normally employ, by reason of the inherent uncertainties involved and insufficiency of available data, concepts parallel to those used by the lawyer (discussed below) in assessing whether or not an unfavorable outcome is probable; thus, assertion of a possible claim would be considered probable only when the prospects of its being asserted seem reasonably certain (i.e., supported by extrinsic

evidence strong enough to establish a presumption that it will happen) and the prospects of nonassertion seem slight.

It would not be appropriate, however, for the lawyer to be requested to furnish information in response to an inquiry letter or supplement thereto if it appears that (a) the client has been required to specify unasserted possible claims without regard to the standard suggested in the preceding paragraph, or (b) the client has been required to specify all or substantially all unasserted possible claims as to which legal advice may have been obtained, since, in either case, such a request would be in substance a general inquiry and would be inconsistent with the intent of this Statement of Policy.

The information that lawyers may properly give to the auditor concerning the foregoing matters would include (to the extent appropriate) an identification of the proceedings or matter, the stage of proceedings, the claim(s) asserted, and the position taken by the client.

In view of the inherent uncertainties, the lawyer should normally refrain from expressing judgments as to outcome except in those relatively few clear cases where it appears to the lawyer that an unfavorable outcome is either "probable" or "remote"; for purposes of any such judgment it is appropriate to use the following meanings:

- i. *probable*—an unfavorable outcome for the client is probable if the prospects of the claimant not succeeding are judged to be extremely doubtful and the prospects for success by the client in its defense are judged to be slight.
- ii. *remote*—an unfavorable outcome is remote if the prospects for the client not succeeding in its defense are judged to be extremely doubtful and the prospects of success by the claimant are judged to be slight.

If, in the opinion of the lawyer, considerations within the province of his professional judgment bear on a particular loss contingency to the degree necessary to make an informed judgment, he may in appropriate circumstances communicate to the auditor his view that an unfavorable outcome is "probable" or "remote," applying the above meanings. No inference should be drawn, from the absence of such a judgment, that the client will not prevail.

The lawyer also may be asked to estimate, in dollar terms, the potential amount of loss or range of loss in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the amount or range of potential loss will normally be as inherently impossible to ascertain, with any degree of certainty, as the outcome of the litigation. Therefore, it is appropriate for the lawyer to provide an estimate of the amount or range of potential loss (if the outcome should be unfavorable) only if he believes that the probability of inaccuracy of the estimate of the amount or range of potential loss is slight.

The considerations bearing upon the difficulty in estimating loss (or range of loss) where pending litigation is concerned are obviously even more compelling in the case of unasserted possible claims. In most cases, the lawyer will not be able to provide any such estimate to the auditor.

As indicated in Paragraph 4 hereof, the auditor may assume that all loss contingencies specified by the client in the manner specified in clauses (b) and (c) above have received comment in the response, unless otherwise therein indicated. The lawyer should not be asked, nor need the lawyer undertake, to furnish information to the auditor concerning loss contingencies except as contemplated by this Paragraph 5.

6. *Lawyer's Professional Responsibility.* Independent of the scope of his response to the auditor's request for information, the lawyer, depending upon the nature of the matters as to which he is engaged, may have as part of his professional responsibility to his client an obligation to advise the client concerning the need for or advisability of public disclosure of a wide range of events and circumstances. The lawyer has an obligation not knowingly to participate in any violation by the client of the disclosure requirements of the securities laws. In appropriate circumstances, the lawyer also may be required under the Code of Professional Responsibility to resign his engagement if his advice concerning disclosures is disregarded by the client. The auditor may properly assume that whenever, in the course of performing legal services for the client with respect to a matter recognized to involve an unasserted possible claim or assessment which may call for financial statement disclosure, the lawyer has formed a professional conclusion that the client must disclose or consider disclosure concerning such possible claim or assessment, the lawyer, as a matter of professional responsibility to the client, will so advise the client and will consult with the client concerning the question of such disclosure and the applicable requirements¹¹ of FAS 5.
7. *Limitation on Use of Response.* Unless otherwise stated in the lawyer's response, it shall be solely for the auditor's information in connection with his audit of the financial condition of the client and is not to be quoted in whole or in part or otherwise referred to in any financial statements of the client or related documents, nor is it to be filed with any governmental agency or other person, without the lawyer's prior written consent.[‡] Notwithstanding such limitation, the response can properly be furnished to others in compliance with court process or when necessary in order to defend the auditor against a challenge of the audit by the client or a regulatory agency, provided that the lawyer is given written notice of the circumstances at least twenty days before the response is so to be furnished to others, or as long in advance as possible if the situation does not permit such period of notice.[‡]
8. *General.* This Statement of Policy, together with the accompanying Commentary (which is an integral part hereof), has been developed for the general guidance of the legal profession. In a particular case, the lawyer may elect to supplement or modify the approach hereby set forth. If desired, this Statement of Policy may

¹¹ Under FAS 5, when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment, disclosure of an unasserted possible claim is required only if the enterprise concludes that (i) it is probable that a claim will be asserted, (ii) there is a reasonable possibility, if the claim is in fact asserted, that the outcome will be unfavorable, and (iii) the liability resulting from such unfavorable outcome would be material to its financial condition.

[‡] As contemplated by Paragraph 8 of this Statement of Policy, this sentence is intended to be the subject of incorporation by reference as therein provided.

be incorporated by reference in the lawyer's response by the following statement: "This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any 'loss contingencies' is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement)."

The accompanying Commentary is an integral part of this Statement of Policy.

Commentary

Paragraph 1 (Client Consent to Response)

In responding to any aspect of an auditor's inquiry letter, the lawyer must be guided by his ethical obligations as set forth in the Code of Professional Responsibility. Under Canon 4 of the Code of Professional Responsibility a lawyer is enjoined to preserve the client's confidences (defined as information protected by the attorney-client privilege under applicable law) and the client's secrets (defined as other information gained in the professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client). The observance of this ethical obligation, in the context of public policy, ". . . not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance." (Ethical Consideration 4-1).

The lawyer's ethical obligation therefore includes a much broader range of information than that protected by the attorney-client privilege. As stated in Ethical Consideration 4-4: "The attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidences and secrets of his client. This ethical precept, unlike the evidentiary privilege, exists without regard to the nature or source of information or the fact that others share the knowledge."

In recognition of this ethical obligation, the lawyer should be careful to disclose fully to his client any confidence, secret or evaluation that is to be revealed to another, including the client's auditor, and to satisfy himself that the officer or agent of a corporate client consenting to the disclosure understands the legal consequences thereof and has authority to provide the required consent.

The law in the area of attorney-client privilege and the impact of statements made in letters to auditors upon that privilege has not yet been developed. Based upon cases treating the attorney-client privilege in other contexts, however, certain generalizations can be made with respect to the possible impact of statements in letters to auditors.

It is now generally accepted that a corporation may claim the attorney-client privilege. Whether the privilege extends beyond the control group of the corporation (a concept found in the existing decisional authority), and if so, how far, is yet unresolved.

If a client discloses to a third party a part of any privileged communication he has made to his attorney, there may have been a waiver as to the whole communication; further, it has been suggested that giving accountants access to privileged statements made to attorneys may waive any privilege as to those

statements. Any disclosure of privileged communications relating to a particular subject matter may have the effect of waiving the privilege on other communications with respect to the same subject matter.

To the extent that the lawyer's knowledge of unasserted possible claims is obtained by means of confidential communications from the client, any disclosure thereof might constitute a waiver as fully as if the communication related to pending claims.

A further difficulty arises with respect to requests for evaluation of either pending or unasserted possible claims. It might be argued that any evaluation of a claim, to the extent based upon a confidential communication with the client, waives any privilege with respect to that claim.

Another danger inherent in a lawyer's placing a value on a claim, or estimating the likely result, is that such a statement might be treated as an admission or might be otherwise prejudicial to the client.

The Statement of Policy has been prepared in the expectation that judicial development of the law in the foregoing areas will be such that useful communication between lawyers and auditors in the manner envisaged in the Statement will not prove prejudicial to clients engaged in or threatened with adversary proceedings. If developments occur contrary to this expectation, appropriate review and revision of the Statement of Policy may be necessary.

Paragraph 2 (Limitation on Scope of Response)

In furnishing information to an auditor, the lawyer can properly limit himself to loss contingencies which he is handling on a substantive basis for the client in the form of legal consultation (advice and other attention to matters not in litigation by the lawyer in his professional capacity) or legal representation (counsel of record or other direct professional responsibility for a matter in litigation). Some auditors' inquiries go further and ask for information on matters of which the lawyer "has knowledge." Lawyers are concerned that such a broad request may be deemed to include information coming from a variety of sources including social contact and third party contacts as well as professional engagement and that the lawyer might be criticized or subjected to liability if some of this information is forgotten at the time of the auditor's request.

It is also believed appropriate to recognize that the lawyer will not necessarily have been authorized to investigate, or have investigated, all legal problems of the client, even when on notice of some facts which might conceivably constitute a legal problem upon exploration and development. Thus, consideration in the form of preliminary or passing advice, or regarding an incomplete or hypothetical state of facts, or where the lawyer has not been requested to give studied attention to the matter in question, would not come within the concept of "substantive attention" and would therefore be excluded. Similarly excluded are matters which may have been mentioned by the client but which are not actually being handled by the lawyer. Paragraph 2 undertakes to deal with these concerns.

Paragraph 2 is also intended to recognize the principle that the appropriate lawyer to respond as to a particular loss contingency is the lawyer having charge of the matter for the client (e.g., the lawyer representing the client in a litigation matter and/or the lawyer having overall charge and supervision of the matter), and that the lawyer not having that kind of role with respect to the matter should not be expected to respond merely because of having become aware of its existence in a general or incidental way.

The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the

complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.

As the lawyer's response is limited to matters involving his professional engagement as counsel, such response should not include information concerning the client which the lawyer receives in another role. In particular, a lawyer who is also a director or officer of the client would not include information which he received as a director or officer unless the information was also received (or, absent the dual role, would in the normal course be received) in his capacity as legal counsel in the context of his professional engagement. Where the auditor's request for information is addressed to a law firm as a firm, the law firm may properly assume that its response is not expected to include any information which may have been communicated to the particular individual by reason of his serving in the capacity of director or officer of the client. The question of the individual's duty, in his role as a director or officer, is not here addressed.

Paragraph 3 (Response May Cover only Material Items in Certain Cases)

Paragraph 3 makes it clear that the lawyer may optionally limit his responses to those items which are individually or collectively material to the auditor's inquiry. If the lawyer takes responsibility for making a determination that a matter is not material for the purposes of his response to the audit inquiry, he should make it clear that his response is so limited. The auditor, in such circumstance, should properly be entitled to rely upon the lawyer's response as providing him with the necessary corroboration. It should be emphasized that the employment of inside general counsel by the client should not detract from the acceptability of his response since inside general counsel is as fully bound by the professional obligations and responsibilities contained in the Code of Professional Responsibility as outside counsel. If the audit inquiry sets forth a definition of materiality but the lawyer utilizes a different test of materiality, he should specifically so state. The lawyer may wish to reach an understanding with the auditor concerning the test of materiality to be used in his response, but he need not do so if he assumes responsibility for the criteria used in making materiality determinations. Any such understanding with the auditor should be referred to or set forth in the lawyer's response. In this connection, it is assumed that the test of materiality so agreed upon would not be so low in amount as to result in a disservice to the client and an unreasonable burden on counsel.

Paragraph 4 (Limited Responses)

The Statement of Policy is designed to recognize the obligation of the auditor to complete the procedures considered necessary to satisfy himself as to the fair presentation of the company's financial condition and results, in order to render a report which includes an opinion not qualified because of a limitation on the scope of the audit. In this connection, reference is made to SEC Accounting Series Release No. 90 [*Financial Reporting Release No. 1, section 607.01(b)*], in which it is stated:

"A 'subject to' or 'except for' opinion paragraph in which these phrases refer to the scope of the audit, indicating that the accountant has not been able to satisfy himself on some significant element in the financial statements, is

not acceptable in certificates filed with the Commission in connection with the public offering of securities. The 'subject to' qualification is appropriate when the reference is to a middle paragraph or to footnotes explaining the status of matters which cannot be resolved at statement date."

Paragraph 5 (Loss Contingencies)

Paragraph 5 of the Statement of Policy summarizes the categories of "loss contingencies" about which the lawyer may furnish information to the auditor. The term loss contingencies and the categories relate to concepts of accounting accrual and disclosure specified for the accounting profession in Statement of Financial Accounting Standards No. 5[†] ("FAS 5") issued by the Financial Accounting Standards Board in March, 1975.

5.1 Accounting Requirements

To understand the significance of the auditor's inquiry and the implications of any response the lawyer may give, the lawyer should be aware of the following accounting concepts and requirements set out in FAS 5:[#]

- a. A "loss contingency" is an existing condition, situation or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more events occur or fail to occur. Resolutions of the uncertainty may confirm the loss or impairment of an asset or the incurrence of a liability. (Para. 1)
- b. When a "loss contingency" exists, the likelihood that a future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. There are three areas within that range, defined as follows:
 - i. Probable—"The future event or events are likely to occur."
 - ii. Reasonably possible—"The chance of the future event or events occurring is more than remote but less than likely."
 - iii. Remote—"The chance of the future event or events occurring is slight." (Para. 3)
- c. *Accrual* in a client's financial statements by a charge to income of the period will be required if both the following conditions are met:
 - i. "Information available prior to issuance of the financial statements indicates that it is *probable* that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be *probable* that one or more future events will occur confirming the fact of the loss." (emphasis added; footnote omitted)
 - ii. "The amount of loss can be reasonably estimated." (Para. 8)
- d. If there is no *accrual* of the loss contingency in the client's financial statements because one of the two conditions outlined in (c)

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

[#] Citations are to paragraph numbers of FAS 5.

above are not met, disclosure may be required as provided in the following:

"If no accrual is made for a loss contingency because one or both of the conditions in paragraph 8 are not met, or if an exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 8, *disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.*" (emphasis added; footnote omitted) (Para. 10)

- e. The accounting requirements recognize or specify that (i) the opinions or views of counsel are not the sole source of audit evidence in making determinations about the accounting recognition or treatment to be given to litigation, and (ii) the fact that the lawyer is not able to express an opinion that the outcome will be favorable does not necessarily require an accrual of a loss. Paragraphs 36 and 37 of FAS 5 state as follows:

"If the underlying cause of the litigation, claim, or assessment is an event occurring before the date of an enterprise's financial statements, the probability of an outcome unfavorable to the enterprise must be assessed to determine whether the condition in paragraph 8(a) is met. Among the factors that should be considered are the nature of the litigation, claim, or assessment, the progress of the case (including progress after the date of the financial statements but before those statements are issued), the opinions or views of legal counsel and other advisers, the experience of the enterprise in similar cases, the experience of other enterprises, and any decision of the enterprise's management as to how the enterprise intends to respond to the lawsuit, claim, or assessment (for example, a decision to contest the case vigorously or a decision to seek an out-of-court settlement). The fact that legal counsel is unable to express an opinion that the outcome will be favorable to the enterprise should not necessarily be interpreted to mean that the condition for accrual of a loss in paragraph 8(a) is met.

"The filing of a suit or formal assertion of a claim or assessment does not automatically indicate that accrual of a loss may be appropriate. The degree of probability of an unfavorable outcome must be assessed. The condition for accrual in paragraph 8(a) would be met if an unfavorable outcome is determined to be probable. If an unfavorable outcome is determined to be reasonably possible but not probable, or if the amount of loss cannot be reasonably estimated, accrual would be inappropriate, but disclosure would be required by paragraph 10 of this Statement."

- f. Paragraph 38 of FAS 5 focuses on certain examples concerning the determination by the enterprise whether an assertion of an *unasserted possible claim* may be considered probable:

"With respect to unasserted claims and assessments, an enterprise must determine the degree of probability that a suit may be filed or a claim or assessment may be asserted and the possibility of an unfavorable outcome. For example, a catastrophe, accident, or other similar physical occurrence predictably engenders claims for redress, and in such circumstances their assertion may be probable; similarly, an investigation of an enterprise by a governmental agency, if enforcement proceedings have been or are likely to be instituted, is often followed by private claims for redress, and the probability of their assertion and the possibility of loss should be considered in each case. By way of further example, an enterprise may believe there is a possibility that it has infringed on another enterprise's patent rights, but the enterprise owning the patent rights has not indicated an intention to take any action and has not even indicated an awareness of the possible infringement. In that case, a judgment must first be made as to whether the assertion of a claim is probable. If the judgment is that assertion is not probable, no accrual or disclosure would be required. On the other hand, if the judgment is that assertion is probable, then a second judgment must be made as to the degree of probability of an unfavorable outcome. If an unfavorable outcome is probable and the amount of loss can be reasonably estimated, accrual of a loss is required by paragraph 8. If an unfavorable outcome is probable but the amount of loss cannot be reasonably estimated, accrual would not be appropriate, but disclosure would be required by paragraph 10. If an unfavorable outcome is reasonably possible but not probable, disclosure would be required by paragraph 10."

For a more complete presentation of FAS 5, reference is made to AU section 337B, *Exhibit I—Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies* [SAS No. 12 section 337B],** in which are set forth excerpts selected by the AICPA as relevant to a Statement on Auditing Standards, issued by its Auditing Standards Executive Committee, captioned "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments."

5.2 Lawyer's Response

Concepts of probability inherent in the usage of terms like "probable" or "reasonably possible" or "remote" mean different things in different contexts. Generally, the outcome of, or the loss which may result from, litigation cannot be assessed in any way that is comparable to a statistically or empirically determined concept of "probability" that may be applicable when determining such matters as reserves for warranty obligations or accounts receivable or loan losses when there is a large number of transactions and a substantial body of known historical experience for the enterprise or comparable enterprises. While lawyers are accustomed to counseling clients during the progress of litigation as to the possible amount required for settlement purposes, the estimated risks of the

** Statement on Auditing Standards No. 12 section 337B, *Exhibit I—Excerpts From Financial Accounting Standards Board Accounting Standards Codification 450, Contingencies*, has been withdrawn by this section.

proceedings at particular times and the possible application or establishment of points of law that may be relevant, such advice to the client is not possible at many stages of the litigation and may change dramatically depending upon the development of the proceedings. Lawyers do not generally quantify for clients the "odds" in numerical terms; if they do, the quantification is generally only undertaken in an effort to make meaningful, for limited purposes, a whole host of judgmental factors applicable at a particular time, without any intention to depict "probability" in any statistical, scientific or empirically-grounded sense. Thus, for example, statements that litigation is being defended vigorously and that the client has meritorious defenses do not, and do not purport to, make a statement about the probability of outcome in any measurable sense.

Likewise, the "amount" of loss—that is, the total of costs and damages that ultimately might be assessed against a client—will, in most litigation, be a subject of wide possible variance at most stages; it is the rare case where the amount is precise and where the question is whether the client against which claim is made is liable either for all of it or none of it.

In light of the foregoing considerations, it must be concluded that, as a general rule, it should not be anticipated that meaningful quantifications of "probability" of outcome or amount of damages can be given by lawyers in assessing litigation. To provide content to the definitions set forth in Paragraph 5 of the Statement of Policy, this Commentary amplifies the meanings of the terms under discussion, as follows:

"probable"—An unfavorable outcome is normally "probable" if, but only if, investigation, preparation (including development of the factual data and legal research) and progress of the matter have reached a stage where a judgment can be made, taking all relevant factors into account which may affect the outcome, that it is extremely doubtful that the client will prevail.

"remote"—The prospect for an unfavorable outcome appears, at the time, to be slight; i.e., it is extremely doubtful that the client will not prevail. Normally, this would entail the ability to make an unqualified judgment, taking into account all relevant factors which may affect the outcome, that the client may confidently expect to prevail on a motion for summary judgment on all issues due to the clarity of the facts and the law.

In other words, for purposes of the lawyer's response to the request to advise auditors about litigation, an unfavorable outcome will be "probable" only if the chances of the client prevailing appear slight and of the claimant losing appear extremely doubtful; it will be "remote" when the client's chances of losing appear slight and of not winning appear extremely doubtful. It is, therefore, to be anticipated that, in most situations, an unfavorable outcome will be neither "probable" nor "remote" as defined in the Statement of Policy.

The discussion above about the very limited basis for furnishing judgments about the outcome of litigation applies with even more force to a judgment concerning whether or not the assertion of a claim not yet asserted is "probable." That judgment will infrequently be one within the professional competence of lawyers and therefore the lawyer should not undertake such assessment except where such judgment may become meaningful because of the presence of special circumstances, such as catastrophes, investigations and previous public disclosure as cited in Paragraph 5 of the Statement of Policy, or similar extrinsic evidence relevant to such assessment. Moreover, it is unlikely, absent relevant extrinsic evidence, that the client or anyone else will be in a position to make an informed judgment that assertion of a possible claim is "probable" as opposed to "reasonably possible" (in which event disclosure is not required). In light of the legitimate concern that the public interest would not be well served by

resolving uncertainties in a way that invites the assertion of claims or otherwise causes unnecessary harm to the client and its stockholders, a decision to treat an unasserted claim as "probable" of assertion should be based only upon compelling judgment.

Consistent with these limitations believed appropriate for the lawyer, he should not represent to the auditor, nor should any inference from his response be drawn, that the unasserted possible claims identified by the client (as contemplated by Paragraph 5(c) of the Statement of Policy) represent all such claims of which the lawyer may be aware or that he necessarily concurs in his client's determination of which unasserted possible claims warrant specification by the client; within proper limits, this determination is one which the client is entitled to make—and should make—and it would be inconsistent with his professional obligations for the lawyer to volunteer information arising from his confidential relationship with his client.

As indicated in Paragraph 5, the lawyer also may be asked to estimate the potential loss (or range) in the event that an unfavorable outcome is not viewed to be "remote." In such a case, the lawyer would provide an estimate only if he believes that the probability of inaccuracy of the estimate of the range or amount is slight. What is meant here is that the estimate of amount of loss presents the same difficulty as assessment of outcome and that the same formulation of "probability" should be used with respect to the determination of estimated loss amounts as should be used with respect to estimating the outcome of the matter.

In special circumstances, with the proper consent of the client, the lawyer may be better able to provide the auditor with information concerning loss contingencies through conferences where there is opportunity for more detailed discussion and interchange. However, the principles set forth in the Statement of Policy and this Commentary are fully applicable to such conferences.

Subsumed throughout this discussion is the ongoing responsibility of the lawyer to assist his client, at the client's request, in complying with the requirements of FAS 5 to the extent such assistance falls within his professional competence. This will continue to involve, to the extent appropriate, privileged discussions with the client to provide a better basis on which the client can make accrual and disclosure determinations in respect of its financial statements.

In addition to the considerations discussed above with respect to the making of any judgment or estimate by the lawyer in his response to the auditor, including with respect to a matter specifically identified by the client, the lawyer should also bear in mind the risk that the furnishing of such a judgment or estimate to any one other than the client might constitute an admission or be otherwise prejudicial to the client's position in its defense against such litigation or claim (see Paragraph 1 of the Statement of Policy and of this Commentary).

Paragraph 6 (Lawyer's Professional Responsibility)

The client must satisfy whatever duties it has relative to timely disclosure, including appropriate disclosure concerning material loss contingencies, and, to the extent such matters are given substantive attention in the form of legal consultation, the lawyer, when his engagement is to advise his client concerning a disclosure obligation, has a responsibility to advise his client concerning its obligations in this regard. Although lawyers who normally confine themselves to a legal specialty such as tax, antitrust, patent or admiralty law, unlike lawyers consulted about SEC or general corporate matters, would not be expected to advise generally concerning the client's disclosure obligations in respect of a

matter on which the lawyer is working, the legal specialist should counsel his client with respect to the client's obligations under FAS 5 to the extent contemplated herein. Without regard to legal specialty, the lawyer should be mindful of his professional responsibility to the client described in Paragraph 6 of the Statement of Policy concerning disclosure.

The lawyer's responsibilities with respect to his client's disclosure obligations have been a subject of considerable discussion and there may be, in due course, clarification and further guidance in this regard. In any event, where in the lawyer's view it is clear that (i) the matter is of material importance and seriousness, and (ii) there can be no reasonable doubt that its non-disclosure in the client's financial statements would be a violation of law giving rise to material claims, rejection by the client of his advice to call the matter to the attention of the auditor would almost certainly require the lawyer's withdrawal from employment in accordance with the Code of Professional Responsibility. (See, e.g., Disciplinary Rule 7-102 (A)(3) and (7), and Disciplinary Rule 2-110 (B)(2).) Withdrawal under such circumstances is obviously undesirable and might present serious problems for the client. Accordingly, in the context of financial accounting and reporting for loss contingencies arising from unasserted claims, the standards for which are contained in FAS 5, clients should be urged to disclose to the auditor information concerning an unasserted possible claim or assessment (not otherwise specifically identified by the client) where in the course of the services performed for the client it has become clear to the lawyer that (i) the client has no reasonable basis to conclude that assertion of the claim is not probable (employing the concepts hereby enunciated) and (ii) given the probability of assertion, disclosure of the loss contingency in the client's financial statements is beyond reasonable dispute required.

Paragraph 7 (Limitation on Use of Response)

Some inquiry letters make specific reference to, and one might infer from others, an intention to quote verbatim or include the substance of the lawyer's reply in footnotes to the client's financial statements. Because the client's prospects in pending litigation may shift as a result of interim developments, and because the lawyer should have an opportunity, if quotation is to be made, to review the footnote in full, it would seem prudent to limit the use of the lawyer's reply letter. Paragraph 7 sets out such a limitation.

Paragraph 7 also recognizes that it may be in the client's interest to protect information contained in the lawyer's response to the auditor, if and to the extent possible, against unnecessary further disclosure or use beyond its intended purpose of informing the auditor. For example, the response may contain information which could prejudice efforts to negotiate a favorable settlement of a pending litigation described in the response. The requirement of consent to further disclosure, or of reasonable advance notice where disclosure may be required by court process or necessary in defense of the audit, is designed to give the lawyer an opportunity to consult with the client as to whether consent should be refused or limited or, in the case of legal process or the auditor's defense of the audit, as to whether steps can and should be taken to challenge the necessity of further disclosure or to seek protective measures in connection therewith. It is believed that the suggested standard of twenty days advance notice would normally be a minimum reasonable time for this purpose.

Paragraph 8 (General)

It is reasonable to assume that the Statement of Policy will receive wide distribution and will be readily available to the accounting profession. Specifically,

the Statement of Policy has been reprinted as Exhibit II to the Statement on Auditing Standards, "Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments," issued by the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants. Accordingly, the mechanic for its incorporation by reference will facilitate lawyer-auditor communication. The incorporation is intended to include not only limitations, such as those provided by Paragraphs 2 and 7 of the Statement of Policy, but also the explanatory material set forth in this Commentary.

Annex A

[Illustrative forms of letters for full response by outside practitioner or law firm and inside general counsel to the auditor's inquiry letter. These illustrative forms, which are not part of the Statement of Policy, have been prepared by the Committee on Audit Inquiry Responses solely in order to assist those who may wish to have, for reference purposes, a form of response which incorporates the principles of the Statement of Policy and accompanying Commentary. Other forms of response letters will be appropriate depending on the circumstances.]

Illustrative Form of Letter for Use by Outside Practitioner or Law Firm:

[Name and Address of Accounting Firm]

Re: [Name of Client] [and Subsidiaries]

Dear Sirs:

By letter date [insert date of request] Mr. [insert name and title of officer signing request] of [insert name of client] [(the "Company") or (together with its subsidiaries, the "Company")]

 has requested us to furnish you with certain information in connection with your examination of the accounts of the Company as at [insert fiscal year-end].

[Insert description of the scope of the lawyer's engagement; the following are sample descriptions:]

While this firm represents the Company on a regular basis, our engagement has been limited to specific matters as to which we were consulted by the Company.

[or]

We call your attention to the fact that this firm has during the past year represented the Company only in connection with certain *[Federal income tax matters] [litigation] [real estate transactions] [describe other specific matters, as appropriate]* and has not been engaged for any other purpose.

Subject to the foregoing and to the last paragraph of this letter, we advise you that since [insert date of beginning of fiscal period under audit] we have not been engaged to give substantive attention to, or represent the Company in connection with, [material]^{††} loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[Describe litigation and claims which fit the foregoing criteria.]

[If the inquiry letter requests information concerning specified unasserted possible claims or assessments and /or contractually assumed obligations:]

^{††} **Note:** See Paragraph 3 of the Statement of Policy and the accompanying Commentary for guidance where the response is limited to material items.

With respect to the matters specifically identified in the Company's letter and upon which comment has been specifically requested, as contemplated by clauses (b) or (c) of Paragraph 5 of the ABA Statement of Policy, we advise you, subject to the last paragraph of this letter, as follows:

[Insert information as appropriate]

The information set forth herein is *[as of the date of this letter]* *[as of (insert date), the date on which we commenced our internal review procedures for purposes of preparing this response]*, except as otherwise noted, and we disclaim any undertaking to advise you of changes which thereafter may be brought to our attention.

[Insert information with respect to outstanding bills for services and disbursements.]

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy and pursuant to the Company's request, this will confirm as correct the Company's understanding as set forth in its audit inquiry letter to us that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, we have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, we, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5.[†] *[Describe any other or additional limitation as indicated by Paragraph 4 of the Statement]*

Very truly yours,

Illustrative Form of Letter for Use by Inside General Counsel:

[Name and Address of Accounting Firm]

Re: *[Name of Company]* *[and Subsidiaries]*

Dear Sirs:

As General Counsel^{**} of *[insert name of client]* *[(the "Company")]* *[(together with its subsidiaries, the "Company")]*, I advise you as follows in connection with your examination of the accounts of the Company as at *[insert fiscal year-end]*.

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

^{**} It may be appropriate in some cases for the response to be given by inside counsel other than inside general counsel, in which event this letter should be appropriately modified.

I call your attention to the fact that as General Counsel^{**} for the Company I have general supervision of the Company's legal affairs. *[If the general legal supervisory responsibilities of the person signing the letter are limited, set forth here a clear description of those legal matters over which such person exercises general supervision, indicating exceptions to such supervision and situations where primary reliance should be placed on other sources.]* In such capacity, I have reviewed litigation and claims threatened or asserted involving the Company and have consulted with outside legal counsel with respect thereto where I have deemed appropriate.

Subject to the foregoing and to the last paragraph of this letter, I advise you that since *[insert date of beginning of fiscal period under audit]* neither I, nor any of the lawyers over whom I exercise general legal supervision, have given substantive attention to, or represented the Company in connection with, *[material]*^{††} loss contingencies coming within the scope of clause (a) of Paragraph 5 of the Statement of Policy referred to in the last paragraph of this letter, except as follows:

[Describe litigation and claims which fit the foregoing criteria.]

[If information concerning specified unasserted possible claims or assessments and/or contractually assumed obligations is to be supplied:]

With respect to matters which have been specifically identified as contemplated by clauses (b) or (c) of Paragraph 5 of the ABA Statement of Policy, I advise you, subject to the last paragraph of this letter, as follows:

[Insert information as appropriate]

The information set forth herein is *[as of the date of this letter]* as of *[insert date]*, the date on which we commenced our internal review procedures for purposes of preparing this response, except as otherwise noted, and I disclaim any undertaking to advise you of changes which thereafter may be brought to my attention or to the attention of the lawyers over whom I exercise general legal supervision.

This response is limited by, and in accordance with, the ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information (December 1975); without limiting the generality of the foregoing, the limitations set forth in such Statement on the scope and use of this response (Paragraphs 2 and 7) are specifically incorporated herein by reference, and any description herein of any "loss contingencies" is qualified in its entirety by Paragraph 5 of the Statement and the accompanying Commentary (which is an integral part of the Statement). Consistent with the last sentence of Paragraph 6 of the ABA Statement of Policy, this will confirm as correct the Company's understanding that whenever, in the course of performing legal services for the Company with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, I have formed a professional conclusion that the Company must disclose or consider disclosure concerning such possible claim or assessment, I, as a matter of professional responsibility to the Company, will so advise the Company and will consult with the Company concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards

^{**} It may be appropriate in some cases for the response to be given by inside counsel other than inside general counsel, in which event this letter should be appropriately modified.

^{††} **Note:** See Paragraph 3 of the Statement of Policy and the accompanying Commentary for guidance where the response is limited to material items.

No. 5.[†] [*Describe any other or additional limitation as indicated by Paragraph 4 of the Statement.*]

Very truly yours,

[†] In July 2009, the Financial Accounting Standards Board (FASB) issued FASB *Accounting Standards Codification* (ASC) as authoritative. FASB ASC is now the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance promulgated by the Securities and Exchange Commission (SEC). As of July 1, 2009, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. FASB Statement No. 5, *Accounting for Contingencies*, has been codified as FASB ASC 450, *Contingencies*.

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Exhibit B—Report of the Subcommittee on Audit Inquiry Responses¹

Because of a recent court case and other judicial decisions involving lawyers' responses to auditors' requests for information, an area of uncertainty or concern has been brought to the Subcommittee's attention and is the subject of the following comment:

This Committee's report does not modify the ABA Statement of Policy, nor does it constitute an interpretation thereof. The Preamble to the ABA Statement of Policy states as follows:

Both the Code of Professional Responsibility and the cases applying the evidentiary privilege recognize that the privilege against disclosure can be knowingly and voluntarily waived by the client. It is equally clear that disclosure to a third party may result in loss of the "confidentiality" essential to maintain the privilege. Disclosure to a third party of the lawyer-client communication on a particular subject may also destroy the privilege as to other communications on that subject. Thus, the mere disclosure by the lawyer to the outside auditor, with due client consent, of the substance of communications between the lawyer and client may significantly impair the client's ability in other contexts to maintain the confidentiality of such communications.

Under the circumstances a policy of audit procedure which requires clients to give consent and authorize lawyers to respond to general inquiries and disclose information to auditors concerning matters which have been communicated in confidence is essentially destructive of free and open communication and early consultation between lawyer and client. The institution of such a policy would inevitably discourage management from discussing potential legal problems with counsel for fear that such discussion might become public and precipitate a loss to or possible liability of the business enterprise and its stockholders that might otherwise never materialize.

It is also recognized that our legal, political, and economic systems depend to an important extent on public confidence in published financial statements. To meet this need the accounting profession must adopt and adhere to standards and procedures that will command confidence in the auditing process. It is not, however, believed necessary, or sound public policy, to intrude upon the confidentiality of the lawyer-client relationship in order to command such confidence. On the contrary, the objective of fair disclosure in financial statements is more likely to be better served by maintaining the integrity of the confidential relationship between lawyer and client, thereby strengthening corporate management's confidence in counsel and to act in accordance with counsel's advice.

Paragraph 1 of the ABA Statement of Policy provides as follows:

1. *Client Consent to Response.* The lawyer may properly respond to the auditor's requests for information concerning loss contingencies (the term and concept established by Statement of Financial Accounting Standards No. 5, promulgated by the Financial Accounting Standards Board in March 1975 and discussed in

¹ Excerpted from "Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information," *The Business Lawyer* 31, no. 3 (1976). Reprinted by permission of the American Bar Association.

Paragraph 5.1 of the accompanying commentary), to the extent hereinafter set forth, subject to the following:

- a. Assuming that the client's initial letter requesting the lawyer to provide information to the auditor is signed by an agent of the client having apparent authority to make such a request, the lawyer may provide to the auditor information requested, without further consent, unless such information discloses a confidence or a secret or requires an evaluation of a claim.
- b. In the normal case, the initial request letter does not provide the necessary consent to the disclosure of a confidence or secret or to the evaluation of a claim since that consent may only be given after full disclosure to the client of the legal consequences of such action.
- c. Lawyers should bear in mind, in evaluating claims, that an adverse party may assert that any evaluation of potential liability is an admission.
- d. In securing the client's consent to the disclosure of confidences or secrets, or the evaluation of claims, the lawyer may wish to have a draft of his letter reviewed and approved by the client before releasing it to the auditor; in such cases, additional explanation would in all probability be necessary so that the legal consequences of the consent are fully disclosed to the client.

In order to preserve explicitly the evidentiary privileges, some lawyers have suggested that clients include language in the following or substantially similar form:

We do not intend that either our request to you to provide information to our auditor or your response to our auditor should be construed in any way to constitute a waiver of the attorney-client privilege or the attorney work-product privilege.

If client's request letter does not contain language similar to that in the preceding paragraph, the lawyer's statement that the client has so advised him or her may be based upon the fact that the client has in fact so advised the lawyer, in writing or orally, in other communications or in discussions.

For the same reason, the response letter from some lawyers also includes language in the following or substantially similar form:

The Company [*or other defined term*] has advised us that, by making the request set forth in its letter to us, the Company [*or other defined term*] does not intend to waive the attorney-client privilege with respect to any information which the Company [*or other defined term*] has furnished to us. Moreover, please be advised that our response to you should not be construed in any way to constitute a waiver of the protection of the attorney work-product privilege with respect to any of our files involving the Company [*or other defined term*].

We believe that language similar to the foregoing in letters of the client or the lawyer simply makes explicit what has always been implicit, namely, it expressly states clearly that neither the client nor the lawyer intended a waiver. It follows that non-inclusion of either or both of the foregoing statements by the client or the lawyer in their respective letters at any time in the past or the future would not constitute an expression of intent to waive the privileges.

On the other hand, the inclusion of such language does not necessarily assure the client that, depending on the facts and circumstances, a waiver may not be found by a court of law to have occurred.

We do not believe that the foregoing types of inclusions cause a negative impact upon the public policy considerations described in the Preamble to the ABA Statement of Policy nor do they intrude upon the arrangements between the legal profession and the accounting profession contemplated by the ABA Statement of Policy. Moreover, we do not believe that such language interferes in any way with the standards and procedures of the accounting profession in the auditing process nor should it be construed as a limitation upon the lawyer's reply to the auditors. We have been informed that the Auditing Standards Board of the AICPA has adopted an interpretation of SAS 12 recognizing the propriety of these statements.

Lawyers, in any case, should be encouraged to have their draft letters to auditors reviewed and approved by the client before releasing them to the auditors and may wish to explain to the client the legal consequences of the client's consent to lawyer's response as contemplated by subparagraph 1(d) of the Statement of Policy.

.A72

Exhibit C—Statement on Updates to Audit Response Letters*

By Audit Responses Committee, ABA Business Law Section

Requests for updates to lawyers' audit response letters have become more frequent in recent years. Typically, the client's audit inquiry letter to its lawyers calls for a response before the anticipated issuance date of the audited financial statements. An "update" or "bringdown" is an audit response letter provided to the auditor in which a lawyer provides information about loss contingencies as of a date after the date of the lawyer's initial response to the audit inquiry letter and any previous update.

The *ABA Statement of Policy Regarding Lawyers' Responses to Auditors' Requests*¹ does not specifically discuss updates to audit response letters. In view of the increased frequency of update requests and the lack of guidance regarding these requests, the ABA Business Law Section Audit Responses Committee has prepared this statement to outline the reasons auditors seek updates of audit response letters and to present the Committee's views on appropriate practices for responding to update requests under the *ABA Statement of Policy*. The Committee hopes that the guidance provided in this Statement will enhance the ability of lawyers to respond efficiently to update requests, thereby facilitating the audit process and contributing to audit quality.

The Reasons for Update Requests

The *ABA Statement of Policy*, including its reference to accounting and auditing standards, provides the framework for lawyers' audit response letters. The *ABA Statement of Policy* recognizes the fundamental importance to the American legal system of maintaining client confidences. It makes clear that lawyers may provide information to auditors only at the request, and with the express consent, of their clients.² In accordance with the *ABA Statement of Policy*, lawyers typically indicate in their audit response letters that the information they are furnishing is as of a specified date and disclaim any undertaking to advise the auditor of changes that may later be brought to the lawyer's attention.³ The *ABA Statement of Policy* also contemplates that "the auditor may assume that the firm or department has endeavored, to the extent believed necessary by the firm or department, to determine from lawyers currently in the firm or department who have performed services for the client since the beginning of the fiscal period under audit whether such services involved substantive attention in the form of legal consultation concerning" loss contingencies.⁴

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¹ *American Bar Association Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information*, 31 BUS. LAW. 1709 (1976) [hereinafter *ABA Statement of Policy*], reprinted in ABA BUS. LAW SECTION AUDIT RESPONSES COMM., AUDITOR'S LETTER HANDBOOK 1 (2d ed. 2013).

² *Id.* at 2–3 (¶ 1).

³ *Id.* at 3 (¶ 2) ("It is also appropriate for the lawyer to indicate the date as of which information is furnished and to disclaim any undertaking to advise the auditor of changes which may thereafter be brought to the lawyer's attention.").

⁴ *Id.* Although a law firm's or law department's internal review procedure may include canvassing lawyers who performed services for a client from the beginning of the fiscal period under audit,

(continued)

In recent years, requests for updates have become standard procedure for many auditors. This reflects changes in applicable accounting standards and auditing practices, as well as increased emphasis on loss contingencies by the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB"), which in turn has increased auditors' focus on loss contingencies. Requests for updates to audit response letters typically are made in three contexts:

- *Audit of annual financial statements.* Changes to financial reporting standards require the entity's management to evaluate "subsequent events," which can include changes in loss contingencies, through the date the financial statements are issued or are available to be issued.⁵

As a result of changes in auditing practices,⁶ most auditors' reports are now dated as of the date the financial statements are issued or are available to be issued, as opposed to the date on which fieldwork is completed. Accordingly, the auditor may seek to obtain audit evidence, in the form of audit letter updates, to corroborate management's identification of and accounting for loss contingencies as of the issuance date.

- *Review of quarterly financial statements.* As with annual financial statements, an entity is required to consider subsequent events,

(footnote continued)

many firms or departments limit their response to matters existing at the end of that period or arising after the end of the period. This approach is based upon the statement in the typical request letter to the effect that the response should include matters that existed at the end of the fiscal period under audit and during the period from that date to the date as of which the response is given. See INTERIM AUDITING STANDARDS, AU § 337A (Pub. Co. Accounting Oversight Bd. 2003) (illustrative audit inquiry letter); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 501A.A69 (Am. Inst. of Certified Pub. Accountants 2011) (illustrative audit inquiry letter). Thus, under this approach, matters resolved during the fiscal period, which no longer comprise "loss contingencies" at or after the fiscal period end date, are not reported.

⁵ See SUBSEQUENT EVENTS, Accounting Standards Codification, Topic 855 (Fin. Accounting Standards Bd. 2010) [hereinafter ASC 855]. ASC 855 codifies a prior accounting standard on subsequent events. See SUBSEQUENT EVENTS, Statement of Fin. Accounting Standards, No. 165 (Fin. Accounting Standards Bd. 2009) [hereinafter SFAS 165]. Notably, SFAS 165 amended the accounting standard governing contingencies. See ACCOUNTING FOR CONTINGENCIES, Statement of Fin. Accounting Standards No. 5 (Fin. Accounting Standards Bd. 1975), amended by SFAS 165, ¶ B3 (codified as CONTINGENCIES, Accounting Standards Codification, Topic 450 (Fin. Accounting Standards Bd. 2009)) [hereinafter ASC 450]. As amended, ASC 450 provides that, in assessing the accounting for a loss contingency, the reporting entity must consider information available through the date the financial statements were issued or available to be issued. See *id.* 450-20-25. Under ASC 855, for SEC filers, financial statements are "issued" on the date they are filed with the SEC; for non-SEC filers, they are "available to be issued" when they are complete and all internal approvals for issuance have occurred. ASC 855-10-25. ASC 855 also requires that entities disclose in the financial statements the date through which they evaluated subsequent events. See *id.* 855-10-50.

⁶ In connection with its adoption of Auditing Standard No. 5 in 2007, the Public Company Accounting Oversight Board amended Interim Auditing Standard AU 530 to provide that "the auditor should date the audit report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion." INTERIM AUDITING STANDARDS, AU § 530.01 (Pub. Co. Accounting Oversight Bd. 2007). Previously, AU 530 had provided that generally the date of completion of the field work should be used as the date of the report. See Proposed Auditing Standard—An Audit of Internal Control over Financial Reporting that Is Integrated with an Audit of Financial Statements and Related Other Proposals, PCAOB Release No. 2006-007, at 34 (Dec. 19, 2006), available at http://pcaobus.org/Rules/Documents/2006-12-19_Release_No._2006-007.pdf. The PCAOB also amended its Interim Auditing Standards to provide that "the latest date of the period covered by the lawyer's response (the 'effective date') should be as close to the date of the auditor's report as is practicable in the circumstances." INTERIM AUDITING STANDARDS, AU § 9337.05 (Pub. Co. Accounting Oversight Bd. 2007). Previously, the standard had said that the effective date should be "as close to the completion of field work" as practicable in the circumstances. INTERIM AUDITING STANDARDS, AU § 9337.05 (Pub. Co. Accounting Oversight Bd. 2003).

including loss contingencies, through the date of issuance of its quarterly financial statements. SEC rules require that quarterly financial statements be reviewed by the entity's external auditors in accordance with relevant auditing standards.⁷ Although they are not ordinarily required to do so,⁸ auditors may request confirmation from counsel about loss contingencies as part of their internal procedures before they will sign off on the filing of quarterly financial statements with the SEC.

- *Consents in connection with registered securities offerings.* Auditors must consent to the use of their audit reports in registration statements for public offerings of securities. Auditing standards require the auditors to perform certain procedures before consenting to the inclusion of a previously issued audit report in a registration statement or amendment to a registration statement.⁹ Although these standards do not require an auditor to make inquiries of lawyers, before issuing a consent, many auditors ask lawyers to update their audit response letters. In offerings involving shelf takedowns, the auditors may request one or more updates in connection with their delivery of "comfort letters" to underwriters.

The foregoing explains the increased frequency of auditors' requests for updates. However, the experience of many lawyers suggests that auditors (and sometimes clients) do not always appreciate the need for lawyers to perform internal procedures to be able to deliver an update.

Lawyers' Responses to Update Requests—A Framework

A lawyer's update to an audit response letter is subject to the *ABA Statement of Policy* and should be prepared and delivered in accordance with its terms. This has several implications.

Client Requests for Updates to Audit Response Letters. As with the initial response letter, a lawyer may only provide information to the auditor at the client's request, even if, as is often the case, the auditor requests the update directly. The lawyer should be satisfied that the client has provided the necessary authorization for the update. The Committee does not believe that any specific form of authorization is necessary, so long as it expresses the client's intent that the lawyer deliver an update to the lawyer's response letter to the auditor. A lawyer may rely on any form of written request, including electronic mail. The Committee believes that lawyers may also rely on oral requests for an update, though it may be advisable for them to document such requests.

Standing Requests. In some cases, a client's initial request letter may contain a standing request that the lawyer deliver updates to response letters upon request by the auditor. The inclusion of such a request can facilitate the audit response process. Many lawyers view a client request to provide information to

⁷ Regulation S-X, Rule 10-01(d), 17 C.F.R. § 210.10-01(d) (2014).

⁸ See INTERIM AUDITING STANDARDS, AU § 722.20 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF AUDITING STANDARDS AND PROCEDURES, Statement on Auditing Standards No. 100, AU §722.20 (Am. Inst. of Certified Pub. Accountants 2002), *superseded by* CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 930.15 (Am. Inst. of Certified Pub. Accountants 2011).

⁹ See INTERIM AUDITING STANDARDS, AU § 711 (Pub. Co. Accounting Oversight Bd. 2003); CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, Statement on Auditing Standards No. 122, AU-C § 925 (Am. Inst. of Certified Pub. Accountants 2011).

the auditors in connection with the audit of the annual financial statements to include an implicit standing request to respond to update requests related to issuance of those financial statements. Other lawyers require a separate authorization for every update, absent a standing request.

The Committee believes that lawyers may provide an update on the basis of a standing request, but recognizes that in some circumstances they may want a specific request or consent from the client. Among those circumstances are (1) when significant time has elapsed since the initial request, and (2) when developments have occurred that would be required to be reported in the update, such as pending or threatened litigation that has arisen since the previous response or significant developments in previously described pending or threatened litigation, and the lawyer believes the client should be consulted before issuing the update response.

Preparation of Updates to Audit Response Letters. The Committee recognizes that circumstances may allow lawyers significantly less time to prepare an update than they had for the initial response letter. Still, clients and auditors should recognize that because, from the lawyers' standpoint, each update is tantamount to reissuance of the initial response letter, lawyers may have to perform internal review procedures similar to those performed for the initial response letter. Those may include inquiring again of lawyers in the law firm or law department who may have relevant information. Clients should be encouraged to communicate with their lawyers and the auditor when the client becomes aware of a filing or transaction that will require an update to an audit response letter, so that the lawyers have adequate time to perform sufficient internal review procedures to provide the update.¹⁰

The internal procedures lawyers perform to issue an update will depend on the particular circumstances and the professional judgment of the lawyers involved as to what is necessary. For example, some law firms or law departments may canvass the lawyers who provided information reflected in the earlier response to the audit inquiry letter, even if those lawyers have not subsequently recorded time for the client. Other firms or law departments may only canvass lawyers who have performed legal services for the client since the cutoff date for the last internal inquiry and any other lawyers they believe are likely to have relevant information. The Committee believes that either approach is acceptable. The Committee recognizes that the professional judgment of lawyers may lead to different procedures in particular cases, which might involve varying types and amount of inquiry and documentation.

Form of Updates to Audit Response Letters. Updates ordinarily should be delivered in writing, not communicated orally. Any update to an audit response letter should be made in accordance with the *ABA Statement of Policy*, including its conditions and limitations. Unlike lawyers' initial responses to audit inquiry letters, no illustrative form of update response has been established, and many different forms are in common use.

Some lawyers regularly use a "long form" response letter that employs the same form as the initial response letter but provides information about loss

¹⁰ See *ABA Statement of Policy*, *supra* note 1, at 9–10 (commentary ¶ 2) ("The internal procedures to be followed by a law firm or law department may vary based on factors such as the scope of the lawyer's engagement and the complexity and magnitude of the client's affairs. Such procedures could, but need not, include use of a docket system to record litigation, consultation with lawyers in the firm or department having principal responsibility for the client's affairs or other procedures which, in light of the cost to the client, are not disproportionate to the anticipated benefit to be derived. Although these procedures may not necessarily identify all matters relevant to the response, the evolution and application of the lawyer's customary procedures should constitute a reasonable basis for the lawyer's response.").

contingencies as of an effective date after the effective date of the previous letter. Others use a "short form" letter that does not contain all the language of a long-form letter, but rather references the information in the previous letter and identifies any reportable developments with respect to previously reported loss contingencies or reportable loss contingencies that have arisen since the prior effective date. Finally, some lawyers have adopted a hybrid approach under which they use a short form in some circumstances and a long form in others; these lawyers may use a short form when they have no developments to report since the previous response letter and a long form when additional information about loss contingencies (whether previously reported or new) needs to be reported.

If a short form is used, the Committee suggests that it should (1) refer to the relevant client request(s), the entity or entities covered by the response, and the most recent long form response letter and previous update letters, if any, identifying them by date, and (2) state expressly that the response is subject to the same limitations and qualifications contained in the earlier letter. Nothing in this statement is intended to limit the professional judgment of a lawyer regarding the form the lawyer uses to update an audit response letter.

[Paragraph added, June 2015, to reflect *Statement on Updates to Audit Response Letter* by the Audit Responses Committee of the American Bar Association. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

AU-C Section 505

External Confirmations

Source: SAS No. 122.

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

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's use of external confirmation procedures to obtain audit evidence, in accordance with the requirements of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, and section 500A, *Audit Evidence*. It does not address inquiries regarding litigation, claims, and assessments, which are addressed in section 501A, *Audit Evidence—Specific Considerations for Selected Items*.

External Confirmation Procedures to Obtain Audit Evidence

.02 Section 500A indicates that the reliability of audit evidence is influenced by its source and nature and is dependent on the individual circumstances under which it is obtained.¹ Section 500A also includes the following generalizations applicable to audit evidence:²

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic, or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity.

¹ Paragraph .A5 of section 500A, *Audit Evidence*.

² Paragraph .A32 of section 500A.

This section is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

.03 Other AU-C sections recognize the importance of external confirmations as audit evidence; for example

- section 330 discusses the auditor's responsibility (a) to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level and (b) to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.³ In addition, section 330 requires that, irrespective of the assessed risks of material misstatement, the auditor design and perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.⁴ The auditor is required to consider whether external confirmation procedures are to be performed as substantive audit procedures and is required to use external confirmation procedures for accounts receivable unless
 - the overall account balance is immaterial,
 - external confirmation procedures would be ineffective, or
 - the auditor's assessed level of risk of material misstatement at the relevant assertion level is low, and the other planned substantive procedures address the assessed risk.⁵
- section 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁶ To do this, the auditor may increase the quantity of the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. Section 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.⁷
- section 240, *Consideration of Fraud in a Financial Statement Audit*, indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.⁸
- section 500A indicates that corroborating information obtained from a source independent of the entity (such as external confirmations) may increase the assurance the auditor obtains from

³ Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

⁴ Paragraph .18 of section 330.

⁵ Paragraphs .19–.20 of section 330.

⁶ Paragraph .07b of section 330.

⁷ Paragraph .A58 of section 330.

⁸ Paragraph .A43 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

evidence existing within the accounting records or representations made by management.⁹

Effective Date

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

Objective

.05 The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

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

External confirmation. Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), either in paper form or by electronic or other medium (for example, through the auditor's direct access to information held by a third party). (Ref: par. .A1)

Negative confirmation request. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

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

Positive confirmation request. A request that the confirming party respond directly to the auditor by providing the requested information or indicating whether the confirming party agrees or disagrees with the information in the request.

Requirements

External Confirmation Procedures

.07 When using external confirmation procedures, the auditor should maintain control over external confirmation requests, including

- a. determining the information to be confirmed or requested; (Ref: par. .A2)
- b. selecting the appropriate confirming party; (Ref: par. .A3)
- c. designing the confirmation requests, including determining that requests are properly directed to the appropriate confirming party and provide for being responded to directly to the auditor; and (Ref: par. .A4–.A7)

⁹ Paragraph .A8 of section 500A.

- d. sending the requests, including follow-up requests, when applicable, to the confirming party. (Ref: par. .A8)

Management's Refusal to Allow the Auditor to Perform External Confirmation Procedures

.08 If management refuses to allow the auditor to perform external confirmation procedures, the auditor should

- a. inquire about management's reasons for the refusal and seek audit evidence about their validity and reasonableness; (Ref: par. .A9)
- b. evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing, and extent of other audit procedures; and (Ref: par. .A10)
- c. perform alternative audit procedures designed to obtain relevant and reliable audit evidence. (Ref: par. .A11)

.09 If the auditor concludes that management's refusal to allow the auditor to perform external confirmation procedures is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor should communicate with those charged with governance, in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*.¹⁰ The auditor also should determine the implications for the audit and the auditor's opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests

.10 If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor should obtain further audit evidence to resolve those doubts. (Ref: par. .A12–.A22)

.11 If the auditor determines that a response to a confirmation request is not reliable, the auditor should evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing, and extent of other audit procedures. (Ref: par. .A23)

Nonresponses and Oral Responses

.12 In the case of each nonresponse, the auditor should perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: par. .A24–.A27)

When a Written Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

.13 If the auditor has determined that a written response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor should

¹⁰ Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

determine the implications for the audit and the auditor's opinion, in accordance with section 705. (Ref: par. .A28–.A29)

Exceptions

.14 The auditor should investigate exceptions to determine whether they are indicative of misstatements. (Ref: par. .A30–.A31)

Negative Confirmations

.15 Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor should not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level, unless all of the following are present:

- a. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion.
- b. The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions, or conditions.
- c. A very low exception rate is expected.
- d. The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests. (Ref: par. .A32)

Evaluating the Evidence Obtained

.16 The auditor should evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence or whether further audit evidence is necessary. (Ref: par. .A33–.A34)

Application and Other Explanatory Material

Definitions

External Confirmation (Ref: par. .06)

.A1 The auditor's direct access to information held by a third party (the confirming party) may meet the definition of an *external confirmation* when, for example, the auditor is provided by the confirming party with the electronic access codes or information necessary to access a secure website where data that addresses the subject matter of the confirmation is held. The auditor's access to information held by the confirming party may also be facilitated by a third-party service provider. When access codes or information necessary to access the confirming party's data is provided to the auditor by management, evidence obtained by the auditor from access to such information does not meet the definition of an *external confirmation*.

External Confirmation Procedures

Determining the Information to Be Confirmed or Requested (Ref: par. .07a)

.A2 External confirmation procedures frequently are performed to confirm or request information regarding account balances, elements thereof, and disclosures. They also may be used to confirm the terms of agreements, contracts,

or transactions between an entity and other parties or to confirm the absence of certain conditions, such as a "side agreement."

Selecting the Appropriate Confirming Party (Ref: par. .07b)

.A3 Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party who the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.

Designing Confirmation Requests (Ref: par. .07c)

.A4 The design of a confirmation request may directly affect the confirmation response rate and the reliability and nature of the audit evidence obtained from responses.

.A5 Factors to consider when designing confirmation requests include the following:

- The assertions being addressed.
- Specific identified risks of material misstatement, including fraud risks.
- The layout and presentation of the confirmation request.
- Prior experience on the audit or similar engagements.
- The method of communication (for example, in paper form or by electronic or other medium).
- Management's authorization or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorization.
- The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

.A6 A positive external confirmation request asks the confirming party to reply to the auditor in all cases, either by indicating the confirming party's agreement with the given information or asking the confirming party to provide information. A response to a properly designed positive confirmation request ordinarily is expected to provide reliable audit evidence. A risk exists, however, that a confirming party may reply to the confirmation request without verifying that the information is correct. The auditor may reduce this risk by using positive confirmation requests that do not state the amount (or other information) on the confirmation request and that ask the confirming party to fill in the amount or furnish other information. On the other hand, use of this type of "blank" confirmation request may result in lower response rates because additional effort is required from the confirming parties to provide the requested information.

.A7 Determining that requests are properly addressed includes verifying the accuracy of the addresses, including testing the validity of some or all of the addresses on the confirmation requests before they are sent out, regardless of the confirmation method used. When a confirmation request is sent by e-mail, the auditor's determination that the request is being properly directed

to the appropriate confirming party may include performing procedures to test the validity of some or all of the e-mail addresses supplied by management. The nature and extent of the necessary procedures is dependent on the risks associated with the particular type of confirmation or address. For example, a confirmation addressing a higher risk assertion or a confirmation address that appears to be potentially less reliable (for example, an electronic confirmation addressed in a manner that appears easier to falsify) may necessitate different or more extensive procedures to determine that the request is directed to the intended recipient. See further guidance in paragraphs .A14–.A15.

Follow-Up on Confirmation Requests (Ref: par. .07d)

.A8 The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having reverified the accuracy of the original address, send an additional or follow-up request.

Management's Refusal to Allow the Auditor to Perform External Confirmation Procedures

Reasonableness of Management's Refusal (Ref: par. .08a)

.A9 A refusal by management to allow the auditor to perform external confirmation procedures is a limitation on the audit evidence the auditor seeks to obtain; therefore, the auditor is required to inquire about the reasons for the limitation. A common reason offered by management is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence about the validity and reasonableness of the reasons for management's refusal because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: par. .08b)

.A10 The auditor may conclude from the evaluation in paragraph .08b that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.¹¹ For example, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation, in accordance with section 240.¹²

Alternative Audit Procedures (Ref: par. .08c)

.A11 The alternative audit procedures performed may be similar to those appropriate for a nonresponse, as set out in paragraphs .A24–.A27. Such procedures also would take into account the results of the auditor's evaluation in paragraph .08b.

¹¹ Paragraph .32 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

¹² Paragraph .24 of section 240.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests (Ref: par. .10)

.A12 Section 500A indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.¹³ All responses carry some risk of interception, alteration, or fraud. Such risk exists regardless of whether a response is obtained in paper form or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include whether it

- was received by the auditor indirectly or
- appeared not to come from the originally intended confirming party.

.A13 The auditor's consideration of the reliability of the information obtained through the confirmation process to be used as audit evidence includes consideration of the risks that

- a. the information obtained may not be from an authentic source,
- b. a respondent may not be knowledgeable about the information to be confirmed, and
- c. the integrity of the information may have been compromised.

When an electronic confirmation process or system is used, the auditor's consideration of the risks described in a–c includes the consideration of risks that the electronic confirmation process is not secure or is improperly controlled.

.A14 Responses received electronically (for example, by fax or e-mail) involve risks relating to reliability because proof of origin or identity of the confirming party may be difficult to establish, and alterations may be difficult to detect. The auditor may determine that it is appropriate to address such risks by utilizing a system or process that validates the respondent or by directly contacting the purported sender (for example, by telephone) to validate the identity of the sender of the response and to validate that the information received by the auditor corresponds to what was transmitted by the sender.

.A15 An electronic confirmation system or process that creates a secure confirmation environment may mitigate the risks of interception or alteration. Creating a secure confirmation environment depends on the process or mechanism used by the auditor and the respondent to minimize the possibility that the results will be compromised because of interception or alteration of the confirmation. If the auditor is satisfied that such a system or process is secure and properly controlled, evidence provided by responses received using the system or process may be considered reliable. Various means might be used to validate the source of the electronic information. For example, the use of encryption, electronic digital signatures, and procedures to verify website authenticity may improve the security of the electronic confirmation system or process. If a system or process that facilitates electronic confirmation between the auditor and the respondent is in place and the auditor plans to rely on the controls over such a system or process, an assurance trust services report (for example, Systrust) or another assurance report on that system or process may assist the auditor in assessing the design and operating effectiveness of the electronic and manual controls with respect to that system or process. Such an assurance report may address the risks described in paragraph .A13. If these

¹³ Paragraph .A32 of section 500A.

risks are not adequately addressed in such a report, the auditor may perform additional procedures to address those risks.

.A16 The auditor is required by section 500A to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence.¹⁴ The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the confirming party (for example, as described in paragraph .A14). When a response has been returned to the auditor indirectly (for example, because the confirming party incorrectly addressed it to the entity rather than the auditor), the auditor may request the confirming party to respond in writing directly to the auditor.

Disclaimers and Other Restrictions in Confirmation Responses

.A17 A response to a confirmation request may contain restrictive language regarding its use. Such restrictions do not necessarily invalidate the reliability of the response as audit evidence. Whether the auditor may rely on the information confirmed and the degree of such reliance will depend on the nature and substance of the restrictive language.

.A18 Restrictions that appear to be boilerplate disclaimers of liability may not affect the reliability of the information being confirmed. Examples of such disclaimers may include the following:

- Information is furnished as a matter of courtesy without a duty to do so and without responsibility, liability, or warranty, express or implied.
- The reply is given solely for the purpose of the audit without any responsibility on the part of the respondent, its employees, or its agents, and it does not relieve the auditor from any other inquiry or the performance of any other duty.

.A19 Other restrictive language also may not affect the reliability of a response if it does not relate to the assertion being tested. For example, in a confirmation of investments, a disclaimer regarding the valuation of the investments may not affect the reliability of the response if the auditor's objective in using the confirmation request is to obtain audit evidence regarding whether the investments exist.

.A20 Certain restrictive language may, however, cast doubt about the completeness or accuracy of the information contained in the response or on the auditor's ability to rely on such information. Examples of such restrictions may include the following:

- Information is obtained from electronic data sources, which may not contain all information in the respondent's possession.
- Information is not guaranteed to be accurate nor current and may be a matter of opinion.
- The recipient may not rely upon the information in the confirmation.

.A21 When the auditor has doubts about the reliability of the response as a result of restrictive language, then, in accordance with paragraph .10, the auditor is required to obtain further audit evidence to resolve those doubts. When the practical effect of the restrictive language is difficult to ascertain in the particular circumstances, the auditor may consider it appropriate to seek clarification from the respondent or seek legal advice.

¹⁴ Paragraph .10 of section 500A.

.A22 If the auditor is unable to resolve the doubts about the reliability of a response as a result of restrictive language, then, in accordance with paragraph .11, the auditor is required to evaluate the implications on the assessment of the relevant risks of misstatement, including the risk of fraud, and on the related nature, timing, and extent of other audit procedures. The nature, timing, and extent of such procedures will depend on factors such as the nature of the financial statement item, the assertion being tested, the nature and substance of the restrictive language, and relevant information obtained through other audit procedures.

Unreliable Responses (Ref: par. .11)

.A23 When the auditor concludes that a response is unreliable, the auditor may need to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures accordingly, in accordance with section 315A.¹⁵ For example, an unreliable response may indicate a fraud risk factor that requires evaluation, in accordance with section 240.¹⁶

Nonresponses and Oral Responses (Ref: par. .12)

.A24 The nature and extent of alternative procedures are affected by the account and assertion in question. Examples of alternative audit procedures the auditor may perform include the following:

- For accounts receivable balances, examining specific subsequent cash receipts (including matching such receipts with the actual items being paid), shipping documentation, or other client documentation providing evidence for the existence assertion
- For accounts payable balances, examining subsequent cash disbursements or correspondence from third parties and other records, such as receiving reports and statements that the client receives from vendors providing evidence for the completeness assertion

.A25 A nonresponse to a confirmation request may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement at the assertion level and modify planned audit procedures, in accordance with section 315A.¹⁷ For example, a fewer or greater number of responses to confirmation requests than anticipated may indicate a previously unidentified fraud risk factor that requires evaluation, in accordance with section 240.¹⁸

.A26 The auditor may determine that it is not necessary to perform additional alternative audit procedures beyond the evaluation of the confirmation results if such evaluation indicates that relevant and reliable audit evidence has already been obtained. This may be the case when testing for overstatement of amounts and (a) the nonresponses in the aggregate, projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated and (b) the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions.

¹⁵ Paragraph .32 of section 315A.

¹⁶ Paragraph .24 of section 240.

¹⁷ Paragraph .32 of section 315A.

¹⁸ Paragraph .24 of section 240.

.A27 An oral response to a confirmation request does not meet the definition of an *external confirmation* because it is not a direct written response to the auditor. Provided that the auditor has not concluded that a direct written response to a positive confirmation is necessary to obtain sufficient appropriate audit evidence, the auditor may take the receipt of an oral response to a confirmation request into consideration when determining the nature and extent of alternative audit procedures required to be performed for nonresponses, in accordance with paragraph .12. The auditor may perform additional procedures to address the reliability of the evidence provided by the oral response, such as initiating a call to the respondent using a telephone number that the auditor has independently verified as being associated with the entity. For example, the auditor might call the main telephone number obtained from a reliable source and ask to be directed to the named respondent instead of calling a direct extension provided by the client or included in the statement or other correspondence received by the entity. The auditor may determine that the additional evidence provided by contacting the respondent directly, together with the evidence upon which the original confirmation request is based (for example, a statement or other correspondence received by the entity), is sufficient appropriate audit evidence. In appropriately documenting the oral response, the auditor may include specific details, such as the identity of the person from whom the response was received, his or her position, and the date and time of the conversation.

When a Written Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .13)

.A28 In certain circumstances, the auditor may identify an assessed risk of material misstatement at the assertion level for which a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence. Such circumstances may include the following:

- The information available to corroborate management's assertion(s) is only available outside the entity.
- Specific fraud risk factors, such as the risk of management override of controls or the risk of collusion, which can involve employee(s) or management, or both, prevent the auditor from relying on evidence from the entity.

.A29 When the auditor has determined that a written response is necessary to obtain sufficient appropriate audit evidence and the auditor has obtained only an oral response to a confirmation request, the auditor may request the confirming party to respond in writing directly to the auditor. If no such response is received, in accordance with paragraph .13, alternative audit procedures will not provide the audit evidence the auditor requires, and the auditor is required to determine the implications for the audit and the auditor's opinion, in accordance with section 705.

Exceptions (Ref: par. .14)

.A30 Exceptions noted in responses to confirmation requests may indicate misstatements or potential misstatements in the financial statements. When a misstatement is identified, the auditor is required by section 240 to evaluate whether such misstatement is indicative of fraud.¹⁹ Exceptions may provide a guide to the quality of responses from similar confirming parties or for similar accounts. Exceptions also may indicate a deficiency, or deficiencies, in the entity's internal control over financial reporting.

¹⁹ Paragraph .35 of section 240.

.A31 Some exceptions do not represent misstatements. For example, the auditor may conclude that differences in responses to confirmation requests are due to timing, measurement, or clerical errors in the external confirmation procedures.

Negative Confirmations (Ref: par. .15)

.A32 The failure to receive a response to a negative confirmation request does not indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Confirming parties also may be more likely to respond indicating their disagreement with a confirmation request when the information in the request is not in their favor but less likely to respond otherwise. For example, holders of bank deposit accounts may be more likely to respond if they believe that the balance in their account is understated in the confirmation request but less likely to respond when they believe the balance is overstated. Therefore, sending negative confirmation requests to holders of bank deposit accounts may be a useful procedure in considering whether such balances may be understated but is unlikely to be effective if the auditor is seeking evidence regarding overstatement.

Evaluating the Evidence Obtained (Ref: par. .16)

.A33 When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows:

- a. A response by the appropriate confirming party indicating agreement with the information provided in the confirmation request or providing requested information without exception
- b. A response deemed unreliable
- c. A nonresponse
- d. A response indicating an exception

.A34 The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether further audit evidence is necessary, as required by section 330.²⁰

²⁰ Paragraphs .28–.29 of section 330.

AU-C Section 510

Opening Balances — Initial Audit Engagements, Including Reaudit Engagements

Source: SAS No. 122; SAS No. 134; SAS No. 135; SAS No. 136; SAS No. 138.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to opening balances in an initial audit engagement, including a reaudit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. When comparative financial statements are presented, the relevant requirements and guidance for comparative financial statements in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, also apply. Section 300, *Planning an Audit*, includes additional requirements and guidance regarding activities prior to starting an initial audit. Section 708, *Consistency of Financial Statements*, also applies with respect to the auditor's evaluation of the consistency of accounting principles between the periods presented and covered by the auditor's opinion. Section A, *Terms of Engagement*, includes requirements and guidance with respect to communications with a predecessor auditor before accepting an initial audit engagement, including a reaudit engagement. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.02 This section, with respect to predecessor auditors, does not apply if the most recent audited financial statements are more than one year prior to the beginning of the earliest period to be audited.

Effective Date

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

Objective

.04 The objective of the auditor, in conducting an initial audit engagement, including a reaudit engagement, is to obtain sufficient appropriate audit evidence regarding opening balances about whether (Ref: par. .A1)

- a. opening balances contain misstatements that materially affect the current period's financial statements and

- b. appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Definitions

.05 For the purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Initial audit engagement. An engagement in which either (a) the financial statements for the prior period were not audited, or (b) the financial statements for the prior period were audited by a predecessor auditor.

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

Predecessor auditor. The auditor from a different audit firm who has reported on the most recent audited financial statements or was engaged to perform but did not complete an audit of the financial statements. (Ref: par. .A2)

Reaudit. An initial audit engagement to audit financial statements that have been previously audited by a predecessor auditor.

Requirements

Audit Procedures

.06 The auditor should read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures, and consistency in the application of accounting policies.

.07 In instances in which the prior period financial statements were audited by a predecessor auditor, the auditor should request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, thereby providing the auditor with information to assist in planning and performing the engagement. (Ref: par. .A3–.A11)

Opening Balances

.08 The auditor should obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by

- a. determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;
- b. determining whether the opening balances reflect the application of appropriate accounting policies; and

- c. evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances and performing one or both of the following: (Ref: par. .A7–.A9 and .A12–.A14)
 - i. When the prior year financial statements were audited, reviewing the predecessor auditor's audit documentation to obtain evidence regarding the opening balances
 - ii. Performing specific audit procedures to obtain evidence regarding the opening balances

.09 If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor should perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor should communicate the misstatements to the appropriate level of management and those charged with governance, in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*. If the prior period financial statements were audited by a predecessor auditor, the auditor should also refer to paragraphs .12–.13.

Consistency of Accounting Policies

.10 The auditor should obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements and whether changes in the accounting policies have been appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Relevant Information in the Predecessor Auditor's Report

.11 If the prior period's financial statements were audited by a predecessor auditor, and a modification was made to the opinion, the auditor should evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements, in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

Discovery of Possible Material Misstatements in Financial Statements Reported on by a Predecessor Auditor

.12 If the auditor becomes aware of information during the audit that leads the auditor to believe that financial statements reported on by the predecessor auditor may require revision, the auditor should request management to inform the predecessor auditor of the situation and arrange for the three parties to discuss this information and attempt to resolve the matter. The auditor should communicate to the predecessor auditor information that the auditor believes the predecessor auditor may need to consider, in accordance with section 560, *Subsequent Events and Subsequently Discovered Facts*, which addresses the auditor's responsibilities when facts become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report. (Ref: par. .A15)

.13 If management refuses to inform the predecessor auditor that the prior period financial statements may need revision or if the auditor is not satisfied with the resolution of the matter, the auditor should evaluate (a) the implications on the current engagement and (b) whether to withdraw from the

engagement or, when withdrawal is not possible under applicable law or regulation, disclaim an opinion on the financial statements. (Ref: par. .A16)

Audit Conclusions and Reporting

.14 The auditor should not make reference to the report or work of the predecessor auditor as the basis, in part, for the auditor's own opinion.

Opening Balances

.15 If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor should express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A17)

.16 If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not appropriately accounted for or adequately presented or disclosed, the auditor should express a qualified opinion or an adverse opinion, as appropriate, in accordance with section 705.

Consistency of Accounting Policies

.17 If the auditor concludes that

- a. the current period's accounting policies are not consistently applied regarding opening balances, in accordance with the applicable financial reporting framework, or
- b. a change in accounting policies is not appropriately accounted for or adequately presented or disclosed, in accordance with the applicable financial reporting framework,

the auditor should express a qualified opinion or an adverse opinion, as appropriate, in accordance with section 705.

Modification to the Opinion in the Predecessor Auditor's Report

.18 If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor should modify the auditor's opinion on the current period's financial statements, in accordance with section 705. (Ref: par. .A18)

Application and Other Explanatory Material

Objective (Ref: par. .04)

.A1 Audit evidence regarding opening balances and the consistency of accounting principles may include the most recent audited financial statements, the predecessor auditor's report thereon, the results of inquiry of the predecessor auditor, the results of the auditor's review of the predecessor auditor's audit documentation relating to the most recently completed audit, and audit procedures performed on the current period's transactions that may provide evidence about the opening balances or consistency.

Definitions

Predecessor Auditor (Ref: par. .05)

.A2 Two predecessor auditors may exist: the auditor who reported on the most recent audited financial statements and the auditor who was engaged to perform, but did not complete, an audit of any subsequent financial statements.

Audit Procedures (Ref: par. .07)

.A3 The auditor may initiate communications with management to authorize review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, either before or after accepting the engagement. Relevant ethical and professional requirements guide the auditor's communications with the predecessor auditor.

.A4 The predecessor auditor may request a consent and acknowledgment letter from the entity to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized. Exhibit B, "Illustrative Entity Consent and Acknowledgment Letter," contains an illustrative entity consent and acknowledgment letter.

.A5 It is customary for the predecessor auditor to make himself or herself available to the auditor and to make available for review certain audit documentation. The predecessor auditor determines which audit documentation is to be made available for review and which may be copied. The predecessor auditor ordinarily permits the auditor to review audit documentation, including documentation of planning; risk assessment procedures; further audit procedures; audit results; and other matters of continuing accounting and auditing significance, such as the schedule of uncorrected misstatements, working paper analysis of balance sheet accounts, and those relating to contingencies, related parties, and significant unusual transactions. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A6 Before permitting access to the audit documentation, the predecessor auditor may request written confirmation of the auditor's agreement regarding the use of the audit documentation. Exhibit C, "Illustrative Successor Auditor Acknowledgment Letter," contains an illustrative successor auditor acknowledgment letter.

.A7 The extent, if any, to which a predecessor auditor permits access to the audit documentation or responds to inquiries from the auditor is a matter of the predecessor auditor's professional judgment. The predecessor auditor's denial or limitation of access may affect the auditor's assessment of risk regarding the opening balances or the nature, timing, and extent of the auditor's procedures with respect to the opening balances and consistency of accounting principles. (Ref: par. .07 and .08c)

.A8 If the predecessor auditor permits access to the audit documentation, the auditor may review the predecessor auditor's audit documentation for information relevant to planning and performing the audit. The auditor's determination whether to use information resulting from such review as part of the auditor's risk assessment procedures or as evidence regarding the opening balances is influenced by the auditor's assessment of the professional competence and independence of the predecessor auditor. Although the predecessor auditor is not a component auditor, as defined in section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, the auditor may make inquiries similar to those listed in section 600

concerning the professional competence and independence of the predecessor auditor.¹ (Ref: par. .07 and .08c)

.A9 The auditor's review of the predecessor auditor's audit documentation may provide audit evidence about the opening balances and consistency of accounting principles. However, the nature, timing, and extent of audit work performed and the conclusions reached are solely the responsibility of the auditor, as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. (Ref: par. .07 and .08c)

Considerations Specific to Governmental Entities (Ref: par. .07)

.A10 In audits of governmental entities, law or regulation may limit the information that the auditor can obtain from a predecessor auditor. Certain information may be identified as classified or otherwise prohibited from disclosure by federal, state, or local laws or public safety or security concerns. For example, if a governmental entity that has previously been audited by a government audit organization (for example, the U.S. Government Accountability Office, a federal inspector general, an elected or statutorily appointed state auditor general, or other suitably qualified audit organization) engages a public accounting firm, the amount of access to audit documentation or other information that the government audit organization can provide an incoming auditor may be constrained by privacy or confidentiality laws or regulations. In situations when communications with a predecessor auditor are restricted, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration given to the effect on the auditor's opinion, in accordance with the requirement in paragraph .15.

.A11 If a government audit organization engages a public accounting firm in an agency capacity to perform an audit of a governmental entity and such firm did not audit the financial statements of the governmental entity in the prior period, this is usually regarded as a change in auditors; therefore, this section applies.

Opening Balances (Ref: par. .08c)

.A12 The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as the following:

- The accounting policies followed by the entity
- The nature of the account balances, classes of transactions and disclosures, and the risks of material misstatement in the current period's financial statements
- The significance of the opening balances relative to the current period's financial statements
- Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified

.A13 For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness, and valuation at the beginning

¹ Paragraph .22 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

of the period. In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures, such as one or more of the following, may be necessary to obtain sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities
- Performing audit procedures on the valuation of the opening inventory items
- Performing audit procedures on gross profit and cutoff

.A14 For noncurrent assets and liabilities, such as property, plant, and equipment; investments; and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties (for example, for long-term debt and investments). In other cases, the auditor may need to carry out additional audit procedures.

Discovery of Possible Material Misstatements in Financial Statements Reported on by a Predecessor Auditor

.A15 Section 560 provides reporting guidance to the predecessor auditor who is requested to reissue a previously issued report on financial statements of a prior period when those financial statements are to be presented on a comparative basis with audited financial statements of a subsequent period.² Section 700 and section 703, as applicable, provides reporting guidance to the auditor reporting on comparative financial statements when the predecessor auditor is unable or unwilling to reissue the auditor's report on prior period financial statements that have been restated.³ (Ref: par. .12) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A16 If management refuses to inform the predecessor auditor that the prior period financial statements may need revision, or if the auditor is not satisfied with the resolution of the matter, the auditor may seek legal advice in determining an appropriate course of action, including evaluating whether to withdraw from the engagement when withdrawal is possible under applicable law or regulation. (Ref: par. .13)

Audit Conclusions and Reporting

Opening Balances (Ref: par. .15)

.A17 Section 705 addresses circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

² Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

³ Paragraph .A75 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .A129 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

- a. A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances.
- b. An opinion that is qualified or disclaimed, as appropriate, regarding the results of operations and cash flows, when relevant, and unmodified regarding financial position. Exhibit A, "Illustration of Report With Disclaimer of Opinion on Results of Operations and Cash Flows and Unmodified Opinion on Financial Position," includes such an illustrative report.

.A18 If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements, the auditor may determine this to be a key audit matter in accordance with section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Modification to the Opinion in the Predecessor Auditor's Report
(Ref: par. .18)

.A19 In some situations, a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements. This may be the case when, for example, there was a scope limitation in the prior period but the matter giving rise to the scope limitation has been resolved in the current period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A20

Exhibit A—Illustration of Report With Disclaimer of Opinion on Results of Operations and Cash Flows and Unmodified Opinion on Financial Position

Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section A, *Terms of Engagement*.
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material and pervasive to the entity's results of operations and cash flows.¹
- The financial position at year-end is fairly presented.
- A disclaimer of opinion regarding the results of operations and cash flows and an unmodified opinion regarding financial position is considered appropriate in the circumstances.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinions

We have audited the balance sheet of ABC Company as of December 31, 20X1, and were engaged to audit the related statements of income, changes in

¹ If the possible effects, in the auditor's professional judgment, are considered to be material but not pervasive to the entity's results of operations and cash flows, the auditor would express a qualified opinion on the results of operations and cash flows.

² The subtitle "Report on the Audit of Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Disclaimer of Opinion on the Results of Operations and Cash Flows

We do not express an opinion on the results of operations and cash flows of ABC Company for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows for the year ended December 31, 20X1.

Opinion on the Financial Position

In our opinion, the balance sheet presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We were not engaged as auditors of the Company until after December 31, 20X0, and, therefore, did not observe the counting of physical inventories at the beginning of the year. We were unable to satisfy ourselves by performing other auditing procedures concerning the inventory held at December 31, 20X0. Since opening inventories enter into the determination of net income and cash flows, we were unable to determine whether any adjustments might have been necessary in respect of the profit for the year reported in the income statement and the net cash flows from operating activities reported in the cash flow statement.

We conducted our audit of the balance sheet in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the financial position.

Responsibility of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of the Company's financial statements in accordance with auditing standards generally accepted in the United States of America. However, because of the matters described in the Basis for Opinions section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to

fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards (GAAS) will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control.³ Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

³ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A21

Exhibit B—Illustrative Entity Consent and Acknowledgment Letter (Ref: par. .07 and .A4)

Paragraph .07 requires that the auditor request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and for the predecessor auditor to respond fully to inquiries by the auditor, thereby providing the auditor with information to assist in planning and performing the engagement. Paragraph .A4 states that the predecessor auditor may request a consent and acknowledgment letter from the entity to document this authorization in an effort to reduce misunderstandings about the scope of the communications being authorized. The following letter is presented for illustrative purposes only and is not required by professional standards.

[Date]

ABC Enterprises

[Address]

You have given your consent to allow [*name of successor CPA firm*], as independent auditors for ABC Enterprises (ABC), access to our audit documentation for our audit of the December 31, 20X1, financial statements of ABC. You also have given your consent to us to respond fully to [*name of successor CPA firm*] inquiries. You understand and agree that the review of our audit documentation is undertaken solely for the purpose of obtaining an understanding about ABC and certain information about our audit to assist [*name of successor CPA firm*] in planning and performing the audit of the December 31, 20X2, financial statements of ABC.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Attached is the form of the letter we will furnish [*name of successor CPA firm*] regarding the use of the audit documentation.

Very truly yours,

[*Predecessor Auditor*]

By: _____

Accepted:

ABC Enterprises

By: _____

Date: _____

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

.A22

Exhibit C—Illustrative Successor Auditor Acknowledgment Letter (Ref: par. .A6)

Paragraph .A6 states that the predecessor auditor may request that the auditor confirm in writing his or her agreement regarding the use of the predecessor auditor's audit documentation before permitting access to it. The following letter is presented for illustrative purposes only and is not required by professional standards.

[Date]

[Successor Auditor]

[Address]

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the December 31, 20X1, financial statements of ABC Enterprises (ABC). We rendered a report on those financial statements and have not performed any audit procedures subsequent to the audit report date. In connection with your audit of ABC's 20X2 financial statements, you have requested access to our audit documentation prepared in connection with that audit. ABC has authorized our firm to allow you to review that audit documentation.

Our audit, and the audit documentation prepared in connection therewith, of ABC's financial statements were not planned or conducted in contemplation of your review. Therefore, items of possible interest to you may not have been specifically addressed. Our use of professional judgment and the assessment of audit risk and materiality for the purpose of our audit mean that matters may have existed that would have been assessed differently by you. We make no representation about the sufficiency or appropriateness of the information in our audit documentation for your purposes.

We understand that the purpose of your review is to obtain information about ABC and our 20X1 audit results to assist you in planning and performing your 20X2 audit of ABC. For that purpose only, we will provide you access to our audit documentation that relates to that objective.

Upon request, we will provide copies of audit documentation that provides factual information about ABC. You agree to subject any such copies or information otherwise derived from our audit documentation to your normal policy for retention of audit documentation and protection of confidential entity information. Furthermore, in the event of a third-party request for access to your audit documentation prepared in connection with your audits of ABC, you agree to obtain our permission before voluntarily allowing any such access to our audit documentation or information otherwise derived from our audit documentation, and to obtain on our behalf any releases that you obtain from such third party. You agree to advise us promptly and provide us a copy of any subpoena, summons, or other court order for access to your audit documentation that include copies of our audit documentation or information otherwise derived therefrom.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Very truly yours,

[Predecessor Auditor]

By: _____

Accepted:

[*Successor Auditor*]

By: _____

Date: _____

Even with management's consent, access to the predecessor auditor's audit documentation may still be limited. Experience has shown that the predecessor auditor may be willing to grant broader access if given additional assurance concerning the use of the audit documentation. Accordingly, the auditor might consider agreeing to the following additional limitations on the review of the predecessor auditor's audit documentation in order to obtain broader access:

- The auditor will not comment, orally or in writing, to anyone as a result of the review about whether the predecessor auditor's engagement was performed in accordance with generally accepted auditing standards.
- The auditor will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of the predecessor auditor's audit.
- The auditor accepts sole responsibility for the nature, timing, and extent of audit work performed and the conclusions reached in expressing an opinion on the 20X2 financial statements of ABC.

The following paragraph illustrates the previous text:

Because your review of our audit documentation is undertaken solely for the purpose described previously and may not entail a review of all our audit documentation, you agree that (1) the information obtained from the review will not be used by you for any other purpose, (2) you will not comment, orally or in writing, to anyone as a result of that review about whether our audit was performed in accordance with generally accepted auditing standards, (3) you will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of our audit, and (4) you accept sole responsibility for the nature, timing and extent of audit work performed and the conclusions reached in expressing your opinion on the 20X2 financial statements of ABC.

[Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

AU-C Section 520

Analytical Procedures

Source: SAS No. 122.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's use of analytical procedures as substantive procedures (substantive analytical procedures). It also addresses the auditor's responsibility to perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements. Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, addresses the use of analytical procedures as risk assessment procedures (which may be referred to as analytical procedures used to plan the audit).¹ Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, addresses the nature, timing, and extent of audit procedures in response to assessed risks; these audit procedures may include substantive analytical procedures.²

Effective Date

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

Objectives

.03 The objectives of the auditor are to

- a. obtain relevant and reliable audit evidence when using substantive analytical procedures and
- b. design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion about whether the financial statements are consistent with the auditor's understanding of the entity. (Ref: par. .A1)

Definition

.04 For the purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass

¹ Paragraph .06b of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

² Paragraphs .06 and .18 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. (Ref: par. .A2–.A6)

Requirements

Substantive Analytical Procedures

.05 When designing and performing analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with section 330, the auditor should³ (Ref: par. .A7–.A9)

- a. determine the suitability of particular substantive analytical procedures for given assertions, taking into account the assessed risks of material misstatement and tests of details, if any, for these assertions; (Ref: par. .A10–.A16)
- b. evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available and controls over preparation; (Ref: par. .A17–.A20)
- c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise (taking into account whether substantive analytical procedures are to be performed alone or in combination with tests of details) to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and (Ref: par. .A21–.A23)
- d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph .07 and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations. (Ref: par. .A24)

Analytical Procedures That Assist When Forming an Overall Conclusion

.06 The auditor should design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion about whether the financial statements are consistent with the auditor's understanding of the entity. (Ref: par. .A25–.A27)

Investigating Results of Analytical Procedures

.07 If analytical procedures performed in accordance with this section identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor should investigate such differences by

- a. inquiring of management and obtaining appropriate audit evidence relevant to management's responses and

³ Paragraph .18 of section 330.

- b. performing other audit procedures as necessary in the circumstances. (Ref: par. .A28–.A29)

Documentation (Ref: par. .A30)

.08 When substantive analytical procedures have been performed, the auditor should include in the audit documentation the following:⁴

- a. The expectation referred to in paragraph .05c and the factors considered in its development when that expectation or those factors are not otherwise readily determinable from the audit documentation
- b. Results of the comparison referred to in paragraph .05d of the recorded amounts, or ratios developed from recorded amounts, with the expectations
- c. Any additional auditing procedures performed in accordance with paragraph .07 relating to the investigation of fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount and the results of such additional procedures

Application and Other Explanatory Material

Objectives (Ref: par. .03b)

.A1 Analytical procedures performed near the end of the audit are intended to corroborate audit evidence obtained during the audit of the financial statements to assist the auditor in drawing reasonable conclusions on which to base the auditor's opinion.

Definition (Ref: par. .04)

.A2 Analytical procedures include the consideration of comparisons of the entity's financial information with, for example

- comparable information for prior periods.
- anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable and gross margin percentages with industry averages or other entities of comparable size in the same industry.

.A3 Analytical procedures also include consideration of relationships, for example

- among elements of financial information, such as gross margin percentages, that would be expected to conform to a predictable pattern based on recent history of the entity and industry.
- between financial information and relevant nonfinancial information, such as payroll costs to number of employees.

⁴ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

.A4 Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, components, and individual elements of information.

.A5 *Scanning* is a type of analytical procedure involving the auditor's exercise of professional judgment to review accounting data to identify significant or unusual items to test. This type of analytical procedure is described further in section 500A, *Audit Evidence*.⁵

.A6 A basic premise underlying the application of analytical procedures is that plausible relationships among data may reasonably be expected to exist and continue in the absence of known conditions to the contrary. The reasons that make relationships plausible are an important consideration because data sometimes appears to be related when it is not, which may lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship may provide important evidence when appropriately scrutinized.

Substantive Analytical Procedures (Ref: par. .05)

.A7 The auditor's substantive procedures to address the assessed risk of material misstatement for relevant assertions may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's professional judgment about the expected effectiveness and efficiency of the available audit procedures to reduce the assessed risk of material misstatement to an acceptably low level.

.A8 The expected effectiveness and efficiency of a substantive analytical procedure in addressing risks of material misstatement depends on, among other things, (a) the nature of the assertion, (b) the plausibility and predictability of the relationship, (c) the availability and reliability of the data used to develop the expectation, and (d) the precision of the expectation.

.A9 The auditor may inquire of management about the availability and reliability of information needed to apply substantive analytical procedures and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided that the auditor is satisfied that such data is properly prepared.

Suitability of Particular Substantive Analytical Procedures for Given Assertions (Ref: par. .05a)

.A10 When more persuasive audit evidence is desired from substantive analytical procedures, more predictable relationships are necessary to develop the expectation. Relationships in a stable environment are usually more predictable than relationships in a dynamic or unstable environment. Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts because income statement accounts represent transactions over a period of time, whereas balance sheet accounts represent amounts as of a point in time. Relationships involving transactions subject to management discretion may be less predictable. For example, management may elect to incur maintenance expense rather than replace plant and equipment, or they may delay advertising expenditures.

⁵ Paragraph .A22 of section 500A, *Audit Evidence*.

.A11 Substantive analytical procedures are generally more effective for large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. Particular conditions that can cause variations in these relationships include, for example, specific unusual transactions or events, accounting changes, business changes, random fluctuations, or misstatements. The suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

.A12 In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, when an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognized trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

.A13 Different types of analytical procedures provide different levels of assurance. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments, and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided that the elements are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence but may provide useful corroboration if used in combination with other audit procedures.

.A14 The determination of the suitability of particular substantive analytical procedures is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. For example, if controls over payroll processing are deficient, the auditor may need to perform more extensive tests of details for assertions related to compensation.

.A15 Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion. For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts, in addition to performing tests of details on subsequent cash receipts, to determine the collectability of the receivables.

Considerations Specific to Governmental Entities

.A16 The relationships between individual financial statement items traditionally considered in the audit of for-profit businesses may not always be relevant in the audit of governmental entities. For example, relationships describing profitability or return on investment may have limited or no applicability. In addition, the nature of balances reported by a governmental entity may result in different expected relationships than those traditionally assumed for businesses. For example, relationships between revenue, receivables, and inventory may be different when revenue and receivables arise from nonexchange transactions and inventory does not represent products held for sale. Also, governmental entities' budgets are a source of data that may be used as a benchmark for evaluating individual financial statements.

The Reliability of the Data (Ref: par. .05b)

.A17 The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- a. The source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.⁶
- b. The comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.
- c. The nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- d. Controls over the preparation of the information that are designed to ensure its completeness, accuracy, and validity. For example, controls over the preparation, review, and maintenance of budgets.

.A18 Data may be readily available to develop expectations for some assertions. For example, the auditor may consider whether financial information, such as budgets or forecasts, and nonfinancial information, such as the number of units produced or sold, is available to design substantive analytical procedures.

.A19 The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor may have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over nonfinancial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor may test the operating effectiveness of controls over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices. Alternatively, the auditor may consider whether the information was subjected to audit testing. Section 330 addresses determining the audit procedures to be performed on the information to be used for substantive analytical procedures.⁷

.A20 The matters discussed in paragraph .A17a–d are relevant irrespective of whether the auditor performs substantive analytical procedures on the entity's period-end financial statements or at an interim date and plans to perform substantive analytical procedures for the remaining period. Section 330 addresses performing substantive procedures at an interim date.⁸

Evaluation of Whether the Expectation Is Sufficiently Precise (Ref: par. .05c)

.A21 In evaluating whether the expectation is sufficiently precise when performing a substantive analytical procedure, it is appropriate for the auditor

⁶ Paragraph .A32 of section 500A.

⁷ Paragraph .25 of section 330.

⁸ Paragraphs .23–.24 of section 330.

to take into account whether substantive analytical procedures are the only substantive procedures planned to address a particular risk of misstatement at the relevant assertion level or whether the risk will be addressed through a combination of substantive analytical procedures and tests of details. A less precise expectation may be appropriate when evidence obtained from performing the substantive analytical procedure will be combined with audit evidence from performing tests of details. A more precise expectation, however, is necessary when the substantive analytical procedure is the only procedure planned to address a particular risk of misstatement for a relevant assertion.

.A22 As expectations become more precise, the range of expected differences becomes narrower, and accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. Matters relevant to the auditor's evaluation of whether the expectation can be developed with sufficient precision to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include the following:

- The accuracy with which the expected results of substantive analytical procedures can be predicted. For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.
- The degree to which information can be disaggregated. For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity than when applied to the financial statements of the entity as a whole.

.A23 When expectations are developed at a more detailed level, it is more likely that the analytical procedure will more effectively address the assessed risk of misstatement to which it is directed. Monthly amounts may be more effective than annual amounts, and comparisons by location or line of business usually are more effective than companywide comparisons. The appropriate level of detail may be influenced by the nature of the entity, its size, and its complexity. The risk that material misstatements may be obscured by offsetting factors increases as an entity's operations become more complex and diversified. Disaggregation of the information helps reduce this risk.

Amount of Acceptable Difference of Recorded Amounts From Expected Values (Ref: par. .05d)

.A24 The auditor's determination of the amount of difference from the expectation that can be accepted without further investigation is influenced by materiality⁹ and the desired level of assurance, while taking into account the possibility that a misstatement, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated. Section 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of risk.¹⁰ Accordingly, as the assessed risk increases, the amount of difference considered acceptable without further investigation decreases in order to achieve the desired level of persuasive evidence.¹¹

⁹ Paragraph .A16 of section 320, *Materiality in Planning and Performing an Audit*.

¹⁰ Paragraph .07b of section 330.

¹¹ Paragraph .A20 of section 330.

Analytical Procedures That Assist When Forming an Overall Conclusion (Ref: par. .06)

.A25 A wide variety of analytical procedures may be used when forming an overall conclusion. These procedures may include reading the financial statements and considering (a) the adequacy of the evidence gathered in response to unusual or unexpected balances identified during the course of the audit and (b) unusual or unexpected balances or relationships that were not previously identified. Results of these analytical procedures may indicate that additional evidence is needed.

.A26 The results of analytical procedures designed and performed in accordance with paragraph .06 may identify a previously unrecognized risk of material misstatement. In such circumstances, section 315A requires the auditor to revise the auditor's assessment of the risks of material misstatement and modify the further planned audit procedures accordingly.¹²

.A27 The analytical procedures performed in accordance with paragraph .06 may be similar to those that would be used as risk assessment procedures.

Investigating Results of Analytical Procedures (Ref: par. .07)

.A28 Audit evidence relevant to management's responses may be obtained by evaluating those responses, taking into account the auditor's understanding of the entity and its environment and other audit evidence obtained during the course of the audit.

.A29 The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

Documentation (Ref: par. .08)

.A30 Section 230, *Audit Documentation*, addresses the auditor's responsibilities for preparing audit documentation and applies to substantive analytical procedures and analytical procedures performed near the end of the audit. Paragraph .08 of this section addresses specific requirements that apply to substantive analytical procedures but is not intended to provide a complete list of items that are required to be documented by section 230.

¹² Paragraph .32 of section 315A.

AU-C Section 530

Audit Sampling

Source: SAS No. 122.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 142, *Audit Evidence*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.

In October 2021, the Auditing Standards board issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section applies when the auditor has decided to use audit sampling in performing audit procedures. It addresses the auditor's use of statistical and nonstatistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample. (Ref: par. .A1–.A2)

.02 This section complements section 500A, *Audit Evidence*, which addresses the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions as a basis for forming the auditor's opinion. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides guidance on the means available to the auditor for selecting items for testing, one of which is audit sampling.¹

Effective Date

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

¹ Paragraphs .A65–.A71 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

Objective

.04 The objective of the auditor, when using audit sampling, is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Definitions

.05 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Audit sampling (sampling). The selection and evaluation of less than 100 percent of the population of audit relevance such that the auditor expects the items selected (the sample) to be representative of the population and, thus, likely to provide a reasonable basis for conclusions about the population. In this context, *representative* means that evaluation of the sample will result in conclusions that, subject to the limitations of sampling risk, are similar to those that would be drawn if the same procedures were applied to the entire population. (Ref: par. .A3)

Nonsampling risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. (Ref: par. .A4)

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

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

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

Sampling unit. The individual items constituting a population. (Ref: par. .A5)

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

- a. Random selection of the sample items (Ref: par. .A16)
- b. The use of an appropriate statistical technique to evaluate sample results, including measurement of sampling risk

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

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

Tolerable misstatement. A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population. (Ref: par. .A6)

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

Requirements

Sample Design, Size, and Selection of Items for Testing

.06 When designing an audit sample, the auditor should consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. (Ref: par. .A7–.A11)

.07 The auditor should determine a sample size sufficient to reduce sampling risk to an acceptably low level. (Ref: par. .A12–.A14)

.08 The auditor should select items for the sample in such a way that the auditor can reasonably expect the sample to be representative of the relevant population and likely to provide the auditor with a reasonable basis for conclusions about the population. (Ref: par. .A15–.A17)

Performing Audit Procedures

.09 The auditor should perform audit procedures, appropriate to the purpose, on each item selected.

.10 If the audit procedure is not applicable to the selected item, the auditor should perform the procedure on a replacement item. (Ref: par. .A18)

.11 If the auditor is unable to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor should treat that item as a deviation from the prescribed control (in the case of tests of controls) or a misstatement (in the case of tests of details). (Ref: par. .A19–.A20)

Nature and Cause of Deviations and Misstatements

.12 The auditor should investigate the nature and cause of any deviations or misstatements identified and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit. (Ref: par. .A21–.A23)

Projecting the Results of Audit Sampling

.13 The auditor should project the results of audit sampling to the population. (Ref: par. .A24–.A25)

Evaluating the Results of Audit Sampling

.14 The auditor should evaluate

- a. the results of the sample, including sampling risk, and (Ref: par. .A26–.A27)
- b. whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (Ref: par. .A28)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The AICPA Audit Guide *Audit Sampling* provides interpretative guidance to apply the concepts in this section, including its definitions.

Considerations Specific to Governmental Entities

.A2 Chapter 11 of the AICPA Audit Guide Government Auditing Standards and Circular A-133 Audits provides interpretative guidance in designing an audit approach that includes audit sampling to achieve audit objectives related to both compliance and internal control over compliance in a Circular A-133 compliance audit or program-specific audit performed in accordance with Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

Definitions

Audit Sampling (Ref: par. .05)

.A3 There may be audit procedures that are not considered audit sampling but that involve examination of fewer than 100 percent of the items comprising an account balance or class of transactions. For example, an auditor may examine only a few transactions from an account balance or class of transactions to (a) gain an understanding of the nature of an entity's operations or (b) clarify the auditor's understanding of the entity's internal control. In such cases, the guidance in this section is not applicable.

Nonsampling Risk (Ref: par. .05)

.A4 Examples of nonsampling risk include the use of inappropriate audit procedures or misinterpretation of audit evidence and failure to recognize a misstatement or deviation. Nonsampling risk may be reduced to an acceptable level through such factors as adequate planning (see section 300, *Planning an Audit*) and proper conduct of a firm's audit practice (see section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*).

Sampling Unit (Ref: par. .05)

.A5 The sampling units might be physical items (for example, checks listed on deposit slips, credit entries on bank statements, sales invoices, or accounts receivable) or monetary units.

Tolerable Misstatement (Ref: par. .05)

.A6 The auditor is required by section 320, *Materiality in Planning and Performing an Audit*, to determine performance materiality.² Performance materiality is determined to reduce to an appropriately low level the probability

² Paragraph .11 of section 320, *Materiality in Planning and Performing an Audit*.

that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. *Tolerable misstatement* is the application of performance materiality to a particular sampling procedure. Tolerable misstatement may be the same amount or an amount smaller than performance materiality (for example, when the population from which the sample is selected is smaller than the account balance).

Sample Design, Size, and Selection of Items for Testing

Sample Design (Ref: par. .06)

.A7 Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either statistical or nonstatistical sampling approaches.

.A8 When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to achieve that purpose. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling. In fulfilling the requirement in section 500A when performing audit sampling, the auditor is required to perform audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.³

.A9 The auditor's consideration of the purpose of the audit procedure, as required by paragraph .06, includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the assertions are included in the evaluation of deviations or projection of misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after that date by the client are not considered a misstatement. Also, an incorrect posting between customer accounts does not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this a misstatement in relation to the relevant assertion even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.

.A10 In considering the test objective and characteristics of a population for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls. This assessment is made in order to design an audit sample and determine sample size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100 percent examination or increasing the sample size may be appropriate when performing tests of details.

.A11 In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

³ Paragraph .09 of section 500A, *Audit Evidence*.

Sample Size (Ref: par. .07)

.A12 The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size necessary.

.A13 The sample size can be determined by the application of a statistically based formula or through the exercise of professional judgment. Various factors typically influence determination of sample size, as follows:

- For tests of controls:
 - The tolerable rate of deviation of the population to be tested
 - The expected rate of deviation of the population to be tested
 - The desired level of assurance (complement of risk of overreliance) that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population; the auditor may decide the desired level of assurance based on the extent to which the auditor's risk assessment takes into account relevant controls
 - The number of sampling units in the population if the population is very small
- For substantive tests of details:
 - The auditor's desired level of assurance (complement of risk of incorrect acceptance) that tolerable misstatement is not exceeded by actual misstatement in the population; the auditor may decide the desired level of assurance based on the following:
 - The auditor's assessment of the risk of material misstatement
 - The assurance obtained from other substantive procedures directed at the same assertion
 - Tolerable misstatement
 - Expected misstatement for the population
 - Stratification of the population when performed
 - For some sampling methods, the number of sampling units in each stratum

.A14 The decision whether to use a statistical or nonstatistical sampling approach is a matter for the auditor's professional judgment; however, sample size is not a valid criterion to use in deciding between statistical and nonstatistical approaches. An auditor who applies statistical sampling may use tables or formulas to compute sample size based on the factors in paragraph .A13. An auditor who applies nonstatistical sampling exercises professional judgment to relate the same factors used in statistical sampling in determining the appropriate sample size. Ordinarily, this would result in a sample size comparable with the sample size resulting from an efficient and effectively designed statistical sample, considering the same sampling parameters. This guidance does not suggest that the auditor using nonstatistical sampling also compute a corresponding sample size using an appropriate statistical technique.

Selection of Items for Testing (Ref: par. .08)

.A15 Audit sampling involves selection techniques that are probabilistic in nature. For example, through the assessment of the risk of material misstatement, an auditor might identify areas in which misstatement is relatively likely. The auditor might first separately examine those items deemed to be of relatively high risk and then use audit sampling (which will involve some form of probabilistic selection) to form an estimate of some characteristic of the remaining population.

.A16 Random selection techniques include the following:

- a. Simple random
- b. Systematic random
- c. Probability weighted, including monetary unit

A detailed discussion of selection techniques is included in the AICPA Audit Guide *Audit Sampling*.

.A17 With statistical sampling, sample items are selected using random selection techniques. The principal techniques of selecting a nonstatistical sample are the use of random selection and haphazard selection to select sample items.

Performing Audit Procedures (Ref: par. .10–.11)

.A18 An example of when it is necessary to perform the procedure on a replacement item is when a voided check is selected while testing for evidence of payment authorization. If the auditor is satisfied that the check has been properly voided such that it does not constitute a deviation, an appropriately chosen replacement is examined.

.A19 In some circumstances, the auditor may not be able to apply the planned audit procedures to selected sample items because, for example, the entity might not be able to locate supporting documentation. The auditor's treatment of unexamined items will depend on their effect on the auditor's evaluation of the sample. If the auditor's evaluation of the sample results would not be altered by considering those unexamined items to be misstated, it may not be necessary to examine the items, for example, if the aggregate amount of the unexamined items, if treated as misstatements or deviations, would not cause the auditor's assessment of the amount of the misstatement or deviation in the population to exceed tolerable misstatement or tolerable deviation, respectively. However, when this is not the case, the auditor is required by paragraph .11 to perform alternative procedures that provide sufficient appropriate audit evidence to form a conclusion about the sample item and use the results of these procedures in assessing the sample results. If alternative procedures cannot be satisfactorily performed in these cases, the auditor is required to treat the items as misstatements or deviations, as appropriate, in evaluating the results of the sample. Section 240, *Consideration of Fraud in a Financial Statement Audit*, also requires the auditor to consider whether the reasons for the auditor's inability to examine the items have implications with regard to assessing risks of material misstatement due to fraud, the assessed level of control risk that the auditor expects to be supported, or the degree of reliance on management representations.

.A20 An example of a suitable alternative procedure for an accounts receivable positive confirmation request for which no reply has been received might be the examination of subsequent cash receipts, together with evidence of their source and the items they are intended to settle.

Nature and Cause of Deviations and Misstatements (Ref: par. .12)

.A21 Section 450, *Evaluation of Misstatements Identified During the Audit*, explains that the auditor may request management to examine a class of transactions, account balance, or disclosure in order for management to understand the cause of a misstatement identified by the auditor; perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance, or disclosure; and make appropriate adjustments to the financial statements.⁴

.A22 In analyzing the deviations and misstatements identified, the auditor may observe that many have a common feature (for example, type of transaction, location, product line, or period of time). In such circumstances, the auditor may decide to identify all items in the population that possess the common feature and extend audit procedures to those items. In addition, such deviations or misstatements may be intentional and may indicate the possibility of fraud.

.A23 In addition to the evaluation of the frequency and amounts of monetary misstatements, section 450 requires the auditor to consider the qualitative aspects of the misstatements.⁵ These include (a) the nature and cause of misstatements, such as whether they are differences in principle or application, are errors, or are caused by fraud or are due to misunderstanding of instructions or carelessness, and (b) the possible relationship of the misstatements to other phases of the audit. The discovery of fraud requires a broader consideration of possible implications than does the discovery of an error.

Projecting the Results of Audit Sampling (Ref: par. .13)

.A24 For tests of details, the auditor is required by paragraph .13 to project misstatements observed in an audit sample to the population in order to obtain a likely misstatement. Due to sampling risk, this projection may not be sufficient to determine an amount to be recorded.

.A25 For tests of controls, the sample deviation rate is also the projected deviation rate for the population as a whole. Section 330 addresses the auditor's response when deviations from controls upon which the auditor intends to rely are detected.⁶

Evaluating the Results of Audit Sampling (Ref: par. .14)

.A26 For tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risks of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists.

.A27 Considering the results of other audit procedures helps the auditor assess the risk that actual misstatement in the population exceeds tolerable misstatement; such risk may be reduced if additional audit evidence is obtained. In the case of tests of details, the *projected misstatement* is the

⁴ Paragraph .A9 of section 450, *Evaluation of Misstatements Identified During the Audit*.

⁵ Paragraph .11 of section 450.

⁶ Paragraph .17 of section 330.

auditor's best estimate of misstatement in the population. As the projected misstatement approaches or exceeds tolerable misstatement, the more likely that actual misstatement in the population exceeds tolerable misstatement. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement. The AICPA Audit Guide *Audit Sampling* contains further guidance regarding the concept of sampling risk.

.A28 If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may

- request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments or
- tailor the nature, timing, and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control, or modify related substantive procedures.

Section 450 addresses misstatements identified by the auditor during the audit.

AU-C Section 540

Auditing Accounting Estimates and Related Disclosures

(Supersedes SAS No. 122 section 540)

Source: SAS No. 143; SAS No. 144; SAS No. 145.

Effective for audits of financial statements for periods ending on or after December 15, 2023.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. Specifically, it includes requirements and guidance that refer to or expand on how section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 450, *Evaluation of Misstatements Identified During the Audit*; and section 500, *Audit Evidence*, and other relevant AU-C sections are to be applied with regard to accounting estimates and related disclosures. It also includes requirements and guidance related to the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

Nature of Accounting Estimates

.02 Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be directly observed. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method using assumptions and data, which requires judgment by management and can give rise to complexity in measurement. The effects of complexity, subjectivity, or other inherent risk factors on the measurement of these monetary amounts affects their susceptibility to misstatement. (Ref: par. .A1–.A6 and app. A)

.03 Although this section applies to all accounting estimates, including fair value accounting estimates,¹ the degree to which an accounting estimate is subject to estimation uncertainty will vary substantially. The nature, timing, and extent of the risk assessment and further audit procedures required by this section will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. For certain accounting estimates,

¹ For purposes of generally accepted auditing standards, a fair value measurement is a form of accounting estimate.

estimation uncertainty may be very low, based on their nature, and the complexity and subjectivity involved in making them may also be very low. For such accounting estimates, the risk assessment procedures and further audit procedures required by this section would not be expected to be extensive. When estimation uncertainty, complexity, or subjectivity are very high, such procedures would be expected to be much more extensive. This section contains guidance on how the requirements of this section can be scaled. (Ref: par. .A7)

Key Concepts of This Section

.04 Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires inherent risk and control risk to be assessed separately for identified risks of material misstatement at the relevant assertion level. In the context of this section and depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, and the interrelationship among them. As explained in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,² inherent risk is influenced by inherent risk factors. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the susceptibility of an assertion to misstatement, and the level of inherent risk varies on a scale that is referred to as *the spectrum of inherent risk*. In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not intend to test and rely on the operating effectiveness of controls, the auditor's assessment of control risk is such that the assessment of the risk of material misstatement is the same as the assessment of inherent risk. (Ref: par. .A8–.A10, .A65–.A66, and app. A) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.05 This section refers to relevant requirements in SAS No. 145 and section 330 and provides related guidance to emphasize the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether

- there are controls required to be identified in accordance with SAS No. 145³ for which the auditor is required to evaluate their design and determine whether they have been implemented.
- to test the operating effectiveness of relevant controls.

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

.06 This section emphasizes that the auditor's further audit procedures (including, when appropriate, tests of controls) need to be responsive to the reasons for the assessed risks of material misstatement at the relevant assertion level, taking into account the effect of one or more inherent risk factors and the auditor's assessment of control risk.

² Paragraph .A42 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

³ See paragraphs 27 and 29b of Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.07 The exercise of professional skepticism in relation to accounting estimates is affected by the auditor's consideration of inherent risk factors, and its importance increases when accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity, or other inherent risk factors. Similarly, the exercise of professional skepticism is important when there is greater susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. (Ref: par. .A11) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.08 This section requires the auditor to evaluate, based on the audit procedures performed and the audit evidence obtained, whether the accounting estimates and related disclosures are reasonable⁴ in the context of the applicable financial reporting framework or are misstated. For purposes of this section, *reasonable*, in the context of the applicable financial reporting framework, means that the relevant requirements of the applicable financial reporting framework have been applied appropriately, including those that address the following: (Ref: par. .A12–.A13 and .A139–.A144)

- The development of the accounting estimate, including the selection of the method, assumptions, and data in view of the nature of the accounting estimate and the facts and circumstances of the entity
- The selection of management's point estimate
- The disclosures about the accounting estimate, including disclosures about how the accounting estimate was developed and that explain the nature, extent, and sources of estimation uncertainty

Effective Date

.09 This section is effective for audits of financial statements for periods ending on or after December 15, 2023.

Objective

.10 The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable, in the context of the applicable financial reporting framework.

Definitions

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

Accounting estimate. A monetary amount for which the measurement, in accordance with the requirements of the applicable financial reporting framework, is subject to estimation uncertainty. (Ref: par. .A14)

Auditor's point estimate or auditor's range. An amount, or range of amounts, respectively, developed by the auditor in evaluating management's point estimate. (Ref: par. .A15)

⁴ See also paragraph .15c of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraph .40c of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Estimation uncertainty. Susceptibility to an inherent lack of precision in measurement. (Ref: par. .A16 and app. A)

Management bias. A lack of neutrality by management in the preparation of information. (Ref: par. .A17)

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

Outcome of an accounting estimate. The actual monetary amount that results from the resolution of the transactions, events, or conditions addressed by an accounting estimate. (Ref: par. .A18)

Requirements

Risk Assessment Procedures and Related Activities

.12 When obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control, as required by SAS No. 145, the auditor should obtain an understanding of the following matters related to the entity's accounting estimates. The auditor's procedures to obtain the understanding should be performed to the extent necessary to obtain audit evidence that provides an appropriate basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels.⁵ (Ref: par. .A19–.A23)

Obtaining an Understanding of the Entity and Its Environment and the Applicable Financial Reporting Framework

- a. The entity's transactions or other events and conditions that may give rise to the need for or changes in accounting estimates to be recognized or disclosed in the financial statements (Ref: par. .A24)
- b. The requirements of the applicable financial reporting framework related to accounting estimates (including the recognition criteria, measurement bases, and the related presentation and disclosure requirements) and how they apply in the context of the nature and circumstances of the entity and its environment, including how the inherent risk factors affect susceptibility of assertions to misstatement. (Ref: par. .A25–.A26)
- c. Regulatory factors relevant to the entity's accounting estimates, including, when applicable, regulatory frameworks (Ref: par. .A27)
- d. The nature of the accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements, based on the auditor's understanding of the matters in paragraph .12a–c of this section (Ref: par. .A28)

Obtaining an Understanding of the Entity's System of Internal Control

- e. The nature and extent of oversight and governance that the entity has in place over management's financial reporting process relevant to accounting estimates (Ref: par. .A29–.A31)

⁵ Paragraphs .05–.06 and .12–.13 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- f.* How management identifies the need for and applies specialized skills or knowledge related to accounting estimates, including with respect to the use of a management's specialist (Ref: par. .A32)
- g.* How the entity's risk assessment process identifies and addresses risks relating to accounting estimates (Ref: par. .A33–.A34)
- h.* The entity's information system as it relates to accounting estimates, including the following:
 - i.* How information relating to accounting estimates and related disclosures for significant classes of transactions, account balances, or disclosures flows through the entity's information system (Ref: par. .A20 and .A35)
 - ii.* For such accounting estimates and related disclosures, how management
 - (1) identifies the relevant methods, assumptions, or sources of data, and the need for changes in them, that are appropriate in the context of the applicable financial reporting framework, including how management (Ref: par. .A36–.A37)
 - (a) selects or designs, and applies, the methods used, including the use of models (Ref: par. .A38–.A39)
 - (b) selects the assumptions to be used, including consideration of alternatives, and identifies significant assumptions (Ref: par. .A40–.A43)
 - (c) selects the data to be used (Ref: par. .A44)
 - (2) understands the degree of estimation uncertainty, including by considering the range of possible measurement outcomes (Ref: par. .A45)
 - (3) addresses the estimation uncertainty, including selecting a point estimate and related disclosures for inclusion in the financial statements (Ref: par. .A46–.A49)
 - i.* Identified controls in the control activities component⁶ over management's process for making accounting estimates as described in paragraph .12*h*(ii) of this section (Ref: par. .A50–.A54)
 - j.* How management reviews the outcomes of previous accounting estimates and responds to the results of that review

.13 The auditor should review the outcome of previous accounting estimates or, when applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period. The auditor should take into account the characteristics of the accounting estimates in determining the nature and extent of that review. The review is not intended to call into question judgments about previous-period accounting estimates that were appropriate based on the information available at the time they were made. (Ref: par. .A55–.A60)

⁶ Paragraphs 27 and 29*b* of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.14 With respect to accounting estimates, the auditor should determine whether the engagement team requires specialized skills or knowledge to perform the risk assessment procedures, to identify and assess the risks of material misstatement, to design and perform audit procedures to respond to those risks, or to evaluate the audit evidence obtained. (Ref: par. .A61–.A63)

Identifying and Assessing the Risks of Material Misstatement

.15 In identifying and assessing the risks of material misstatement relating to an accounting estimate and related disclosures at the assertion level, including separately assessing inherent risk and control risk, as required by SAS No. 145,⁷ the auditor should take the following into account in identifying the risks of material misstatement and assessing inherent risk: (Ref: par. .A64–.A71)

- a. The degree to which the accounting estimate is subject to estimation uncertainty (Ref: par. .A72–.A75)
- b. The degree to which one or both of the following are affected by complexity, subjectivity, or other inherent risk factors: (Ref: par. .A76–.A79)
 - i. The selection and application of the method, assumptions, and data in making the accounting estimate
 - ii. The selection of management's point estimate and related disclosures for inclusion in the financial statements

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

.16 The auditor should determine whether any of the risks of material misstatement identified and assessed in accordance with paragraph .15 are, in the auditor's professional judgment, a significant risk.⁸ If the auditor has determined that a significant risk exists, the auditor should identify controls that address that risk⁹ and evaluate whether such controls have been suitably designed and implemented to mitigate such risks.¹⁰ (Ref: par. .A80) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Responses to the Assessed Risks of Material Misstatement

.17 As required by section 330,¹¹ the auditor's further audit procedures should be responsive to the assessed risks of material misstatement at the relevant assertion level,¹² considering the reasons for the assessment given to those risks. The auditor's further audit procedures should include one or more of the following approaches:

⁷ Paragraphs 31–34 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

⁸ Paragraph 32 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

⁹ Paragraph 26a(i) of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

¹⁰ Paragraph 26a of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

¹¹ Paragraphs .06–.15 and .18 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

¹² Paragraphs .06–.07 and .22 of section 330. [Footnote renumbered, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

- a. Obtaining audit evidence from events occurring up to the date of the auditor's report (see paragraph .20 of this section)
- b. Testing how management made the accounting estimate (see paragraphs .21–.26 of this section)
- c. Developing an auditor's point estimate or range (see paragraphs .27–.28 of this section)

The auditor's further audit procedures should take into account that the higher the assessed risk of material misstatement, the more persuasive the audit evidence needs to be.¹³ The auditor should design and perform further audit procedures in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory. (Ref: par. .A81–.A84)

.18 As required by section 330,¹⁴ the auditor should design and perform tests to obtain sufficient appropriate audit evidence about the operating effectiveness of controls, if

- a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that the controls are operating effectively, or
- b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level.

In relation to accounting estimates, the auditor's tests of such controls should be responsive to the reasons for the assessment given to the risks of material misstatement. In designing and performing tests of controls, the auditor should obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control.¹⁵ (Ref: par. .A85–.A89) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.19 For a significant risk relating to an accounting estimate, the auditor's further audit procedures should include tests of controls in the current period if the auditor plans to rely on those controls. When the approach to a significant risk consists only of substantive procedures, those procedures should include tests of details.¹⁶ (Ref: par. .A90)

Obtaining Audit Evidence From Events Occurring Up to the Date of the Auditor's Report

.20 When the auditor's further audit procedures include obtaining audit evidence from events occurring up to the date of the auditor's report, the auditor should evaluate whether such audit evidence is sufficient and appropriate to address the risks of material misstatement relating to the accounting estimate, taking into account that changes in circumstances and other relevant conditions between the event and the measurement date may affect the relevance of such audit evidence in the context of the applicable financial reporting framework. (Ref: par. .A91–.A93)

¹³ Paragraph .07b of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

¹⁴ Paragraph .08 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

¹⁵ Paragraph .09 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

¹⁶ Paragraphs .15 and .22 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Testing How Management Made the Accounting Estimate

.21 When testing how management made the accounting estimate, the auditor's further audit procedures should include procedures, designed and performed in accordance with paragraphs .22–.25, to obtain sufficient appropriate audit evidence regarding the risks of material misstatement¹⁷ relating to the following: (Ref: par. .A94)

- a. The selection and application of the methods, significant assumptions, and data used by management in making the accounting estimate
- b. How management selected the point estimate and developed related disclosures about estimation uncertainty

Methods

.22 In applying the requirements of paragraph .21, with respect to methods, the auditor's further audit procedures should address the following:

- a. Whether the method selected is appropriate in the context of the applicable financial reporting framework and, if applicable, changes from the method used in prior periods are appropriate (Ref: par. .A95 and .A97)
- b. Whether judgments made in selecting the method give rise to indicators of possible management bias (Ref: par. .A96)
- c. Whether the calculations are applied in accordance with the method and are mathematically accurate
- d. When management's application of the method involves complex modeling, whether judgments have been applied consistently, and whether, when applicable (Ref: par. .A98–.A100)
 - i. the design of the model meets the measurement objective of the applicable financial reporting framework, is appropriate in the circumstances, and, if applicable, changes from the prior period's model are appropriate in the circumstances.
 - ii. adjustments to the output of the model are consistent with the measurement objective of the applicable financial reporting framework and are appropriate in the circumstances.
- e. Whether the integrity of the significant assumptions and the data has been maintained in applying the method (Ref: par. .A101)

Significant Assumptions

.23 In applying the requirements of paragraph .21, with respect to significant assumptions, the auditor's further audit procedures should address the following:

- a. Whether the significant assumptions are appropriate in the context of the applicable financial reporting framework and, if applicable, changes from prior periods are appropriate (Ref: par. .A95 and .A102–.A103)
- b. Whether judgments made in selecting the significant assumptions give rise to indicators of possible management bias (Ref: par. .A96)

¹⁷ See paragraph .17 of this section for discussion regarding the responses to the assessed risk of material misstatement. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- c. Whether the significant assumptions are consistent with each other and with those used in other accounting estimates, or with related assumptions used in other areas of the entity's business activities, based on the auditor's knowledge obtained in the audit (Ref: par. .A104)
- d. When applicable, whether management has the intent to carry out specific courses of action and has the ability to do so (Ref: par. .A105)

Data

.24 In applying the requirements of paragraph .21, with respect to data, the auditor's further audit procedures should address the following:

- a. Whether the data is appropriate in the context of the applicable financial reporting framework and, if applicable, changes from prior periods are appropriate (Ref: par. .A95 and .A106)
- b. Whether judgments made in selecting the data give rise to indicators of possible management bias (Ref: par. .A96)
- c. Whether the data is relevant and reliable in the circumstances (Ref: par. .A107)
- d. Whether the data has been appropriately understood or interpreted by management, including with respect to contractual terms (Ref: par. .A108)

Management's Selection of a Point Estimate and Related Disclosures About Estimation Uncertainty

.25 In applying the requirements of paragraph .21, the auditor's further audit procedures should address whether, in the context of the applicable financial reporting framework, management has taken appropriate steps to do the following:

- a. Understand estimation uncertainty (Ref: par. .A109)
- b. Address estimation uncertainty by selecting an appropriate point estimate and by developing related disclosures about estimation uncertainty (Ref: par. .A110–.A114)

.26 When, in the auditor's judgment based on the audit evidence obtained, management has not taken appropriate steps to understand or address estimation uncertainty, the auditor should (Ref: par. .A115–.A117)

- a. request management to perform additional procedures to understand estimation uncertainty or address it by reconsidering the selection of management's point estimate or considering providing additional disclosures relating to the estimation uncertainty, and evaluate management's responses in accordance with paragraph .25 of this section.
- b. to the extent practicable, develop an auditor's point estimate or range in accordance with paragraphs .27–.28 of this section, if the auditor determines that management's response to the auditor's request does not sufficiently address estimation uncertainty.
- c. evaluate whether a deficiency in internal control exists and, if so, communicate in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

Developing an Auditor's Point Estimate or Range

.27 When the auditor develops a point estimate or range to evaluate management's point estimate and related disclosures about estimation uncertainty,

including when required by paragraph .26*b*, the auditor's further audit procedures should include procedures to evaluate whether the methods, assumptions, or data used are appropriate in the context of the applicable financial reporting framework. Regardless of whether the auditor uses management's or the auditor's own methods, assumptions, or data, these further audit procedures should be designed and performed to address the matters in paragraphs .22–.24. (Ref: par. .A118–.A123)

.28 If the auditor develops an auditor's range, the auditor should

- a. determine that the range includes only amounts that are supported by sufficient appropriate audit evidence and have been evaluated by the auditor to be reasonable in the context of the measurement objectives and other requirements of the applicable financial reporting framework. (Ref: par. .A124–.A125)
- b. design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement relating to the disclosures in the financial statements that describe the estimation uncertainty.

Other Considerations Relating to Audit Evidence

.29 In obtaining audit evidence regarding the risks of material misstatement relating to accounting estimates, irrespective of the sources of information to be used as audit evidence, the auditor should comply with the relevant requirements in section 500 and section 501, *Audit Evidence — Specific Considerations for Selected Items*.

.30 When using the work of a management's specialist, the requirements in paragraphs .20–.28 of this section may assist the auditor in evaluating the appropriateness of the specialist's work as audit evidence for a relevant assertion in accordance with section 501.¹⁸ In evaluating the work of the management's specialist, the nature, timing, and extent of the further audit procedures are affected by the auditor's evaluation of the specialist's competence, capabilities, and objectivity; the auditor's understanding of the nature of the work performed by the specialist; and the auditor's familiarity with the specialist's field of expertise. (Ref: par. .A126–.A132)

Disclosures Related to Accounting Estimates

.31 The auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level for disclosures related to an accounting estimate, including those procedures related to estimation uncertainty addressed in paragraphs .25*b* and .28*b*.

Indicators of Possible Management Bias

.32 The auditor should evaluate whether judgments and decisions made by management in making the accounting estimates included in the financial

¹⁸ Paragraph .26*c* of section 501, *Audit Evidence — Specific Considerations for Selected Items*, as amended by Statement on Auditing Standards (SAS) No. 142, *Audit Evidence* (sec. 500). (Refer to paragraph .A68 of section 500 for the amended text.) [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

statements, even if they are individually reasonable, are indicators of possible management bias. When indicators of possible management bias are identified, the auditor should evaluate the implications for the audit. When there is intention to mislead, management bias is fraudulent in nature. (Ref: par. .A133–.A136)

Overall Evaluation Based on Audit Procedures Performed

.33 In applying section 330 to accounting estimates,¹⁹ the auditor should evaluate, based on the audit procedures performed and audit evidence obtained, whether (Ref: par. .A137–.A138)

- a. the assessments of the risks of material misstatement at the relevant assertion level remain appropriate, including when indicators of possible management bias have been identified;
- b. management's decisions relating to the recognition, measurement, presentation, and disclosure of these accounting estimates in the financial statements are in accordance with the applicable financial reporting framework; and
- c. sufficient appropriate audit evidence has been obtained.

.34 In making the evaluation required by paragraph .33c of this section, the auditor should take into account all relevant audit evidence obtained, whether corroborative or contradictory.²⁰ If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should evaluate the implications for the audit or the auditor's opinion on the financial statements in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Determining Whether the Accounting Estimates Are Reasonable or Misstated

.35 The auditor should determine whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated. Section 450²¹ provides guidance on how the auditor may distinguish misstatements (whether factual, judgmental, or projected) for the auditor's evaluation of the effect of uncorrected misstatements on the financial statements. (Ref: par. .A12–.A13 and .A139–.A145)

.36 In relation to accounting estimates, the auditor should evaluate whether management has included disclosures, beyond those specifically required by the framework, that are necessary to achieve the fair presentation of the financial statements as a whole.²²

¹⁹ Paragraphs .27–.28 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

²⁰ Paragraph .28 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

²¹ Paragraph .A3 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

²² See also paragraphs .16 and .A16 of section 700 or paragraphs .41 and .A71 of section 703. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Communication With Those Charged With Governance, Management, or Other Relevant Parties

.37 In applying section 260, *The Auditor's Communication With Those Charged With Governance*,²³ and section 265,²⁴ the auditor is required to communicate with those charged with governance or management about certain matters, including significant qualitative aspects of the entity's significant accounting practices and significant deficiencies and material weaknesses in internal control identified during the audit, respectively. In doing so, the auditor should consider the matters, if any, to communicate regarding accounting estimates and take into account whether the reasons given to the risks of material misstatement relate to estimation uncertainty or the effects of complexity, subjectivity, or other inherent risk factors in making accounting estimates and related disclosures. In addition, in certain circumstances, the auditor is required by law or regulation to communicate about certain matters with other relevant parties, such as regulators. (Ref: par. .A146–.A147)

Documentation

.38 The auditor should include the following in the audit documentation:²⁵ (Ref: par. .A148–.A151)

- a. Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates
- b. The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level,²⁶ taking into account the reasons given to the assessment of those risks
- c. The auditor's responses when management has not taken appropriate steps to understand and address estimation uncertainty
- d. Indicators of possible management bias related to accounting estimates, if any, and the auditor's evaluation of the implications for the audit, as required by paragraph .32
- e. Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated

Application and Other Explanatory Material

Nature of Accounting Estimates

Examples of Accounting Estimates

.A1 Examples of accounting estimates related to classes of transactions, account balances, and disclosures include the following:

²³ Paragraph .12a of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

²⁴ Paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

²⁵ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

²⁶ Paragraph .30b of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- Inventory obsolescence
- Depreciation of property and equipment
- Valuation of infrastructure assets, such as buildings and roadways
- Valuation of financial instruments
- Outcome of pending litigation
- Provision for expected credit losses
- Valuation of insurance contract liabilities
- Warranty obligations
- Employee retirement benefits liabilities
- Share-based payments
- Fair value of assets or liabilities acquired in a business combination, including the determination of goodwill and intangible assets
- Impairment of long-lived assets or property or equipment held for disposal
- Nonmonetary exchanges of assets or liabilities between independent parties
- Revenue recognized for long-term contracts

Methods

.A2 A *method* is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. For example, one recognized method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black-Scholes option-pricing formula. A method is applied using a computational tool or process, sometimes referred to as a *model*, and involves applying assumptions and data and taking into account a set of relationships between them.

Assumptions and Data

.A3 Assumptions involve judgments based on available information about matters such as the choice of an interest rate, a discount rate, or judgments about future conditions or events. An assumption may be selected by management from a range of appropriate alternatives. Assumptions that may be made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate.

.A4 For purposes of this section, *data* is information that can be obtained through direct observation or from a party external to the entity. Information obtained by applying analytical or interpretive techniques to data is referred to as *derived data* when such techniques have a well-established theoretical basis and, therefore, less need for management judgment. Otherwise, such information is an assumption.

.A5 Examples of data include one or more of the following:

- Prices generated by market transactions
- Operating times or quantities of output from a production machine
- Historical prices or other terms included in contracts, such as a contracted interest rate, a payment schedule, and term included in a loan agreement

- Forward-looking information, such as economic or earnings forecasts obtained from an external information source
- A future interest rate determined using interpolation techniques from forward interest rates (derived data)

.A6 Data can come from a wide range of sources. For example, data can be

- generated within the organization or externally,
- obtained from a system that is either within or outside the general or subsidiary ledgers,
- observable in contracts, or
- observable in legislative or regulatory pronouncements.

Scalability (Ref: par. .03)

.A7 Examples of paragraphs that include guidance on how the requirements of this section can be scaled include paragraphs .A21–.A23, .A64, .A68, and .A85.

Key Concepts of This Section

Inherent Risk Factors (Ref: par. .04)

.A8 *Inherent risk factors* are characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls.²⁷ Appendix A, "Inherent Risk Factors," further explains the nature of these inherent risk factors, and their interrelationships, in the context of making accounting estimates and their presentation in the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A9 When assessing the risks of material misstatement at the assertion level²⁸ in addition to estimation uncertainty, complexity, and subjectivity, the auditor also takes into account the degree to which other inherent risk factors included in SAS No. 145 affect susceptibility of assertions to misstatement about the accounting estimate. Such additional inherent risk factors include the following:

- A change in the nature or circumstances of the relevant financial statement items, or requirements of the applicable financial reporting framework, which may give rise to the need for changes in the method, assumptions, or data used to make the accounting estimate
- Susceptibility to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk, in making the accounting estimate
- Uncertainty, other than estimation uncertainty

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

²⁷ Paragraph 12 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

²⁸ Paragraph 31 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Control Risk

.A10 In assessing control risk at the relevant assertion level in accordance with SAS No. 145, the auditor takes into account whether the auditor plans to test the operating effectiveness of controls. When the auditor is considering whether to test the operating effectiveness of controls, the auditor's evaluation that controls are effectively designed and have been implemented supports an expectation, by the auditor, about the operating effectiveness of the controls in establishing the plan to test them. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Professional Skepticism (Ref: par. .07)

.A11 Paragraphs .A60, .A95–.A96, .A137, and .A139 are examples of paragraphs that describe ways in which the auditor can exercise professional skepticism. Paragraph .A151 provides guidance on ways in which the auditor's exercise of professional skepticism may be documented and includes examples of specific paragraphs in this section for which documentation may provide evidence of the exercise of professional skepticism.

Concept of "Reasonable" (Ref: par. .08 and .35)

.A12 Other considerations that may be relevant to the auditor's consideration of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework include whether

- the data and assumptions used in making the accounting estimate are consistent with each other and with those used in other accounting estimates or areas of the entity's business activities, and
- the accounting estimate takes into account appropriate information as required by the applicable financial reporting framework.

.A13 The term *applied appropriately* as used in paragraph .08 means in a manner that not only complies with the requirements of the applicable financial reporting framework but, in doing so, reflects judgments that are consistent with the objective of the measurement basis in that framework.

Definitions**Accounting Estimate (Ref: par. .11)**

.A14 *Accounting estimates* are monetary amounts that may be related to classes of transactions or account balances recognized or disclosed in the financial statements. Accounting estimates also include monetary amounts included in disclosures or used to make judgments about recognition or disclosure relating to a class of transactions or account balances. For purposes of GAAS, a fair value measurement is a form of accounting estimate.

Auditor's Point Estimate or Auditor's Range (Ref: par. .11)

.A15 An auditor's point estimate or range may be used to evaluate an accounting estimate directly (for example, an impairment provision or the fair value of different types of financial instruments) or indirectly (for example, an amount to be used as a significant assumption for an accounting estimate). A similar approach may be taken by the auditor in developing an amount or range of amounts in evaluating a nonmonetary item of data or an assumption (for example, an estimated useful life of an asset).

Estimation Uncertainty (Ref: par. .11)

.A16 Not all accounting estimates are subject to a high degree of estimation uncertainty. For example, some financial statement items may have an active and open market that provides readily available and reliable information on the prices at which actual exchanges occur. Estimation uncertainty may exist even when the valuation method and data are well-defined. In addition, general economic circumstances prevailing at the time, for example, illiquidity in a particular market, may affect estimation uncertainty.

Management Bias (Ref: par. .11)

.A17 Financial reporting frameworks often call for neutrality, that is, freedom from bias. Estimation uncertainty gives rise to subjectivity in making an accounting estimate. The presence of subjectivity gives rise to the need for judgment by management and the susceptibility to unintentional or intentional management bias. The susceptibility of an accounting estimate to management bias increases with the extent to which there is subjectivity in making the accounting estimate

Outcome of an Accounting Estimate (Ref: par. .11)

.A18 Some accounting estimates, by their nature, do not have an outcome that is relevant for the auditor's work performed in accordance with this section. For example, an accounting estimate may be based on perceptions of market participants at a point in time. Accordingly, the price realized when an asset is sold or a liability is transferred may differ from the related accounting estimate made at the reporting date because, with the passage of time, the market participants' perceptions of value have changed.

Risk Assessment Procedures and Related Activities***Obtaining an Understanding of the Entity and Its Environment (Ref: par. .12)***

.A19 SAS No. 145²⁹ requires the auditor to obtain an understanding of certain matters about the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. The requirements in paragraph .12 of this section relate more specifically to accounting estimates and build on the broader requirements in SAS No. 145. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A20 The classes of transactions, events, and conditions within the scope of paragraph .12h of this section are the same as the classes of transactions, events, and conditions relating to accounting estimates and related disclosures that are subject to SAS No. 145.³⁰ In obtaining the understanding of the entity's information system as it relates to accounting estimates, the auditor may consider

- whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions.

²⁹ Paragraphs .12–.25 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

³⁰ Paragraph .19a and d of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- how the information system addresses the completeness of accounting estimates and related disclosures, in particular, for accounting estimates related to liabilities.

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

Scalability

.A21 The nature, timing, and extent of the auditor's procedures to obtain the understanding of the entity and its environment, including the applicable financial reporting framework, and the entity's system of internal control, related to the entity's accounting estimates, may depend, to a greater or lesser degree, on the extent to which the individual matters apply in the circumstances. For example, the entity may have few transactions or other events or conditions that give rise to the need for accounting estimates; the applicable financial reporting requirements may be simple to apply; and there may be no relevant regulatory factors. Further, the accounting estimates may not require significant judgments, and the process for making the accounting estimates may be less complex. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors to a lesser degree, and there may be fewer identified controls in the control activities component. If so, the auditor's risk assessment procedures are likely to be less extensive and may be performed primarily through inquiries of management with appropriate responsibilities for the financial statements, such as observation of management's process for making the accounting estimate (including when evaluating whether identified controls in that process are designed effectively and when determining whether the control has been implemented). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A22 By contrast, the accounting estimates may require significant judgments by management, and the process for making the accounting estimates may be complex and involve the use of complex models. In addition, the entity may have a more sophisticated information system and more extensive controls over accounting estimates. In these circumstances, the accounting estimates may be subject to or affected by estimation uncertainty, subjectivity, complexity, or other inherent risk factors to a greater degree. If so, the nature or timing of the auditor's risk assessment procedures are likely to be different, or more extensive, than in the circumstances in paragraph .A21.

.A23 The following considerations may be relevant for entities with only simple businesses, which may include many smaller entities: (Ref: par. .A72 and .A149)

- Processes relevant to accounting estimates may be uncomplicated because the business activities are simple or the required estimates may have a lesser degree of estimation uncertainty.
- Accounting estimates may be generated outside of the general and subsidiary ledgers, controls over their development may be limited, and an owner-manager may have significant influence over their determination. The owner-manager's role in making the accounting estimates may need to be taken into account by the auditor both when identifying the risks of material misstatement and when considering the risk of management bias.

The Entity and Its Environment

.A24 *The entity's transactions and other events or conditions (Ref: par. .12a).* Changes in circumstances that may give rise to the need for or changes in accounting estimates may include, for example, whether

- the entity has engaged in new types of transactions,
- terms of transactions have changed, or
- new events or conditions have occurred.

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

.A25 *The requirements of the applicable financial reporting framework (Ref: par. .12b).* Obtaining an understanding of the requirements of the applicable financial reporting framework provides the auditor with a basis for discussion with management and, when applicable, those charged with governance about how management has applied the requirements of the applicable financial reporting framework relevant to the accounting estimates, and about the auditor's determination of whether they have been applied appropriately. This understanding also may assist the auditor in communicating with those charged with governance when the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework to not be the most appropriate in the circumstances of the entity.³¹ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A26 In obtaining this understanding, the auditor may seek to understand whether

- the applicable financial reporting framework
 - prescribes certain criteria for the recognition, or methods for the measurement of, accounting estimates,
 - specifies certain criteria that permit or require measurement at a fair value, for example, by referring to management's intentions to carry out certain courses of action with respect to an asset or liability, or
 - specifies required or suggested disclosures, including disclosures concerning judgments, assumptions, or other sources of estimation uncertainty relating to accounting estimates, and
- changes in the applicable financial reporting framework require changes to the entity's accounting policies relating to accounting estimates.

.A27 *Regulatory factors (Ref: par. .12c).* Obtaining an understanding of regulatory factors, if any, that are relevant to accounting estimates may assist the auditor in identifying applicable regulatory frameworks and in determining whether such regulatory frameworks

- address conditions for the recognition, or methods for the measurement, of accounting estimates or provides related guidance thereon,
- specify or provide guidance about disclosures in addition to the requirements of the applicable financial reporting framework,

³¹ Paragraph .12a of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- provide an indication of areas for which there may be a potential for management bias to meet regulatory requirements, or
- contain requirements for regulatory purposes that are not consistent with requirements of the applicable financial reporting framework, which may indicate potential risks of material misstatement. For example, some regulators may seek to influence minimum levels for expected credit loss provisions that exceed those required by the applicable financial reporting framework.

.A28 *The nature of the accounting estimates and related disclosures that the auditor expects to be included in the financial statements (Ref: par. .12d).* Obtaining an understanding of the nature of accounting estimates and related disclosures that the auditor expects to be included in the entity's financial statements assists the auditor in understanding the measurement basis of such accounting estimates and the nature and extent of disclosures that may be relevant. Such an understanding provides the auditor with a basis for discussion with management about how management makes the accounting estimates.

The Entity's System of Internal Control

.A29 *The nature and extent of oversight and governance (Ref: par. .12e).* In applying SAS No. 145,³² the auditor's understanding of the nature and extent of oversight and governance that the entity has in place over management's process for making accounting estimates may be important to the auditor's required evaluation about whether

- management, with the oversight of those charged with governance, has created and maintained a culture of honesty and ethical behavior, and
- the control environment provides an appropriate foundation for the other components of the system of internal control considering the nature and size of the entity, and
- control deficiencies identified in the control environment undermine the other components of the system of internal control.

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

.A30 The auditor may obtain an understanding of whether those charged with governance

- have the skills or knowledge to understand the characteristics of a particular method or model to make accounting estimates, or the risks related to the accounting estimate, for example, risks related to the method or IT used in making the accounting estimates, or the susceptibility of the accounting estimate to misstatement due to management bias or fraud,
- have the skills and knowledge to understand whether management made the accounting estimates in accordance with the applicable financial reporting framework,
- have the information required to evaluate on a timely basis how management made the accounting estimates and the authority to call into question management's actions when those actions appear to be inadequate or inappropriate,

³² Paragraph 21a of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

- oversee management's process for making the accounting estimates, including the use of models, or
- oversee the monitoring activities undertaken by management. This may include supervision and review procedures designed to detect and correct any deficiencies in the design or operating effectiveness of controls over the accounting estimates.

.A31 Obtaining an understanding of the oversight by those charged with governance may be important when there are accounting estimates that

- require significant judgment by management to address subjectivity,
- have high estimation uncertainty,
- are complex to make, for example, because of the extensive use of IT, large volumes of data, or the use of multiple data sources or assumptions with complex interrelationships,
- had or ought to have had a change in the method, assumptions, or data compared to previous periods, or
- involve significant assumptions.

.A32 *Management's application of specialized skills or knowledge, including the use of management's specialists (Ref: par. .12f).* The auditor may consider whether the following circumstances increase the likelihood that management needs to engage a specialist:³³

- The specialized nature of the matter requiring estimation, for example, the accounting estimate may involve measurement of mineral or hydrocarbon reserves in extractive industries or the evaluation of the likely outcome of applying complex contractual terms
- The complex nature of the models required to apply the relevant requirements of the applicable financial reporting framework, as may be the case in certain measurements, such as level 3 fair values³⁴
- The unusual or infrequent nature of the condition, transaction, or event requiring an accounting estimate

.A33 *The entity's risk assessment process (Ref: par. .12g).* Understanding how the entity's risk assessment process identifies and addresses risks relating to accounting estimates may assist the auditor in considering changes in the following:

- The requirements of the applicable financial reporting framework related to the accounting estimates
- The availability or nature of data sources that are relevant to making the accounting estimates or that may affect the reliability of the data used
- The entity's information system or IT environment
- Key personnel

³³ See paragraph .26 of section 501 as amended by SAS No. 142. (Refer to paragraph .A68 of section 500 for the amended text). [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

³⁴ See, for example, FASB *Accounting Standards Codification (ASC) 820, Fair Value Measurement*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A34 Matters that the auditor may consider in obtaining an understanding of how management identifies and addresses the susceptibility to misstatement due to management bias or fraud in making accounting estimates, include whether, and if so, how, management does the following:

- Pays particular attention to selecting or applying the methods, assumptions, and data used in making accounting estimates
- Monitors key performance indicators that may indicate unexpected or inconsistent performance compared with historical or budgeted performance or with other known factors
- Identifies financial or other incentives that may be a motivation for bias
- Monitors the need for changes in the methods, significant assumptions, or the data used in making accounting estimates
- Establishes appropriate oversight and review of models used in making accounting estimates
- Requires documentation of the rationale for or an independent review of significant judgments made in making accounting estimates

.A35 *The entity's information system relating to accounting estimates (Ref: par. .12h(i)).* During the audit, the auditor may identify classes of transactions, events, or conditions that give rise to the need for accounting estimates and related disclosures that management failed to identify. SAS No. 145 addresses circumstances in which the auditor identifies risks of material misstatement that management failed to identify, including considering the implications for the auditor's evaluation of the entity's risk assessment process.³⁵ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A36 *Management's identification of the relevant methods, assumptions, and sources of data (Ref: par. .12h(ii)(1)).* If management has changed the method for making an accounting estimate, considerations may include whether the new method is, for example, more appropriate; is itself a response to changes in the environment or circumstances affecting the entity or to changes in the requirements of the applicable financial reporting framework or regulatory environment; or whether management has another valid reason.

.A37 If management has not changed the method for making an accounting estimate, considerations may include whether the continued use of the previous methods, assumptions, and data is appropriate in view of the current environment or circumstances.

.A38 *Methods (Ref: par. .12h(ii)(1)(a)).* The applicable financial reporting framework may prescribe the method to be used in making an accounting estimate. In many cases, however, the applicable financial reporting framework does not prescribe a single method, or the required measurement basis prescribes, or allows, the use of alternative methods.

.A39 *Models.* Management may design and implement specific controls around models used for making accounting estimates, whether it's management's own model or an external model. When the model itself has an increased level of complexity or subjectivity, such as an expected credit loss model or a fair value model using level 3 inputs, controls that address the risks of material

³⁵ Paragraph .18 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

misstatement related to such complexity or subjectivity may be more likely to be identified in accordance with SAS No. 145.³⁶ When complexity in relation to models is present, controls over data integrity are also more likely to be identified controls in accordance with SAS No. 145. Factors that may be appropriate for the auditor to consider in obtaining an understanding of the model and related identified controls include the following:

- How management determines the relevance and accuracy of the model.
 - The validation or back-testing of the model, including whether the model is validated prior to use and revalidated at regular intervals to determine whether it remains suitable for its intended use. The entity's validation of the model may include evaluation of
 - the model's theoretical soundness,
 - the model's mathematical integrity, and
 - the accuracy and completeness of the data and the appropriateness of data and assumptions used in the model.
- How the model is appropriately changed or adjusted on a timely basis for changes in market or other conditions and whether there are appropriate change control policies over the model.
- Whether adjustments, also referred to as *overlays* in certain industries, are made to the output of the model and whether such adjustments are appropriate in the circumstances in accordance with the requirements of the applicable financial reporting framework. When the adjustments are not appropriate, such adjustments may be indicators of possible management bias.
- Whether the model is adequately documented, including its intended applications, limitations, key parameters, required data and assumptions, and the results of any validation performed on it and the nature of and basis for any adjustments made to its output.

Examples of valuation models may include the present value of expected future cash flows, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A40 Assumptions (*Ref: par. .12h(ii)(1)(b)*). Matters that the auditor may consider in obtaining an understanding of how management selected the assumptions used in making the accounting estimates include, for example, the following:

- The basis for management's selection and the documentation supporting the selection of the assumption. The applicable financial reporting framework may provide criteria or guidance to be used in the selection of an assumption.
- How management assesses whether the assumptions are relevant and complete.

³⁶ Paragraph 27 and 29b of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

- When applicable, how management determines that the assumptions are consistent with each other, with those used in other accounting estimates or areas of the entity's business activities, or with other matters that are
 - within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life) and whether they are consistent with the entity's business plans and the external environment, and
 - outside the control of management (for example, assumptions about interest rates, mortality rates, or potential judicial or regulatory actions).
- The requirements of the applicable financial reporting framework related to the disclosure of assumptions.

.A41 With respect to fair value accounting estimates, assumptions vary in terms of the sources of the data and the basis for the judgments to support them, as follows:

- a. Those that reflect what market participants would use in pricing an asset or liability, developed based on market data obtained from sources independent of the reporting entity
- b. Those that reflect the entity's own judgments about what assumptions market participants would use in pricing the asset or liability, developed based on the best data available in the circumstances

In practice, however, the distinction between (a) and (b) may not always be apparent, and distinguishing between them depends on understanding the sources of data and the basis for the judgments that support the assumption. Further, it may be necessary for management to select from a number of different assumptions used by different market participants.

.A42 Assumptions used in making an accounting estimate are referred to as *significant assumptions* in this section if a reasonable variation in the assumption would materially affect the measurement of the accounting estimate. A sensitivity analysis may be useful in demonstrating the degree to which the measurement varies based on one or more assumptions used in making the accounting estimate.

.A43 *Inactive or illiquid markets.* When markets are inactive or illiquid, the auditor's understanding of how management selects assumptions may include understanding the following:

- Whether management has implemented appropriate policies for adapting the application of the method in such circumstances. Such adaptation may include making model adjustments or developing new models that are appropriate in the circumstances.
- Whether management has resources with the necessary skills or knowledge to adapt or develop a model, if necessary, on an urgent basis, including selecting the valuation technique that is appropriate in such circumstances.
- Whether management has the resources to determine the range of outcomes, given the uncertainties involved, for example, by performing a sensitivity analysis.
- Whether management has the means to assess how, when applicable, the deterioration in market conditions has affected the

entity's operations, environment, and relevant business risks and the implications for the entity's accounting estimates, in such circumstances.

- Whether management has an appropriate understanding of how the price data, and the relevance thereof, from particular external information sources may vary in such circumstances.

.A44 *Data (Ref: par. .12h(ii)(1)(c)).* Matters that the auditor may consider in obtaining an understanding of how management selects the data on which the accounting estimates are based include the following:

- The nature and source of the data, including information obtained from an external information source
- How management evaluates whether the data is appropriate
- The accuracy and completeness of the data
- The consistency of the data used with data used in previous periods
- The complexity of the IT applications or other aspects of the entity's IT environment used to obtain and process the data, including when this involves handling large volumes of data
- How the data is obtained, transmitted, and processed and how its integrity is maintained

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

.A45 *How management understands and addresses estimation uncertainty (Ref: par. .12h(2)–(3)).* Matters that may be appropriate for the auditor to consider relating to whether and how management understands the degree of estimation uncertainty include, for example, the following:

- Whether, and if so, how, management identified alternative methods, significant assumptions, or sources of data that are appropriate in the context of the applicable financial reporting framework
- Whether, and if so, how, management considered alternative outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the significant assumptions or the data used in making the accounting estimate

.A46 The requirements of the applicable financial reporting framework may specify the approach to selecting management's point estimate from the reasonably possible measurement outcomes. Financial reporting frameworks may recognize that the appropriate amount is one that is appropriately selected from the reasonably possible measurement outcomes and, in some cases, may indicate that the most relevant amount may be in the central part of that range.

.A47 For example, with respect to fair value estimates, FASB *Accounting Standards Codification* (ASC) 820, *Fair Value Measurement*,³⁷ indicates that if multiple valuation techniques are used to measure fair value, the results (that is, respective indications of fair value) should be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances. In other cases, such as estimates for loss contingencies,

³⁷ Paragraph 24B of FASB ASC 820-10-35. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

FASB ASC 450, *Contingencies*,³⁸ indicates that when recognition criteria are met and the reasonably estimable loss is a range, if no amount in the range is a better estimate than any other amount, the minimum amount in the range is required to be accrued.

.A48 The applicable financial reporting framework may prescribe disclosures or disclosure objectives related to accounting estimates, and some entities may choose to disclose additional information. These disclosures or disclosure objectives may address, for example, the following:

- The method of estimation used, including any applicable model and the basis for its selection
- Information that has been obtained from models, or from other calculations used to determine estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as
 - assumptions developed internally, or
 - data, such as interest rates, that are affected by factors outside the control of the entity
- The effect of any changes to the method of estimation from the prior period
- The sources of estimation uncertainty
- Fair value information
- Information about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions

.A49 In some cases, the applicable financial reporting framework may require specific disclosures regarding estimation uncertainty. Examples follow:

- The disclosure of information about the assumptions made about the future and other major sources of estimation uncertainty that give rise to a higher likelihood or magnitude of material adjustment to the carrying amounts of assets and liabilities after the period end. Such requirements may be described using terms such as *key sources of estimation uncertainty* or *critical accounting estimates*. They may relate to accounting estimates that require management's most difficult, subjective, or complex judgments. Such judgments may be more subjective and complex, and accordingly, the potential for a consequential material adjustment to the carrying amounts of assets and liabilities may increase, with the number of items of data and assumptions affecting the possible future resolution of the estimation uncertainty. Information that may be disclosed includes the following:
 - The nature of the assumption or other source of estimation uncertainty
 - The sensitivity of carrying amounts to the methods and assumptions used, including the reasons for the sensitivity
 - The expected resolution of an uncertainty and the range of reasonably possible outcomes in respect of the carrying amounts of the assets and liabilities affected

³⁸ Paragraph 1 of FASB ASC 450-20-30. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved
- The disclosure of the range of possible outcomes and the assumptions used in determining the range.
- The disclosure of specific information, such as
 - information regarding the significance of fair value accounting estimates to the entity's financial position and performance, and
 - disclosures regarding market inactivity or illiquidity.
- Qualitative disclosures, such as the exposures to risk, and how they arise; the entity's objectives, policies, and procedures for managing the risk and the methods used to measure the risk; and any changes from the previous period of these qualitative concepts.
- Quantitative disclosures, such as the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel, including credit risk, liquidity risk, and market risk.

.A50 *Identified controls over management's process for making accounting estimates (Ref: par. .12i).* The auditor's judgment in identifying controls in the control activities component and, therefore, the need to evaluate the design of those controls and determine whether they have been implemented, relates to management's process described in paragraph .12h(ii). The auditor may not identify controls in relation to all aspects of paragraph .12h(ii). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A51 As part of identifying controls, and evaluating their design and determining whether they have been implemented,³⁹ the auditor may consider the following:

- How management determines the appropriateness of the data used to develop the accounting estimates, including when management uses an external information source or data from outside the general and subsidiary ledgers.
- The review and approval of accounting estimates, including the assumptions or data used in their development, by appropriate levels of management and, where appropriate, those charged with governance.
- The segregation of duties between those responsible for making the accounting estimates and those committing the entity to the related transactions, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services. For example, in the case of a large financial institution, relevant segregation of duties may consist of an independent function responsible for estimation and validation of fair value pricing of the entity's financial products staffed by individuals whose remuneration is not tied to such products.
- The effectiveness of the design of the controls. Generally, it may be more difficult for management to design controls that address

³⁹ Paragraph 30 of SAS No. 145. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

subjectivity and estimation uncertainty in a manner that effectively prevents, or detects and corrects, material misstatements than it is to design controls that address complexity. Controls that address subjectivity and estimation uncertainty may need to include more manual elements, which may be less reliable than automated controls as they can be more easily bypassed, ignored, or overridden by management. The design effectiveness of controls addressing complexity may vary depending on the reason for and the nature of the complexity. For example, it may be easier to design more effective controls related to a method that is routinely used or over the integrity of data.

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

.A52 When management makes extensive use of IT in making an accounting estimate, identified controls in the control activities component are likely to include general IT controls and information-processing controls. Such controls may address risks related to the following:

- Whether the IT application or other aspects of the IT environment system has the capability and are appropriately configured to process large volumes of data.
- Complex calculations in applying a method. When diverse IT applications are required to process complex transactions, regular reconciliations between the IT applications are made, in particular, when the IT applications do not have automated interfaces or may be subject to manual intervention.
- Whether the design and calibration of models is periodically evaluated.
- The complete and accurate extraction of data regarding accounting estimates from the entity's records or from external information sources.
- Data, including the complete and accurate flow of data through the entity's information system, the appropriateness of any modification to the data used in making accounting estimates, and the maintenance of the integrity and security of the data; when using external information sources, risks related to processing or recording the data.
- Whether management has controls around access, change, and maintenance of individual models to maintain a strong audit trail of the accredited versions of models and to prevent unauthorized access or amendments to those models.
- Whether there are appropriate controls over the transfer of information relating to accounting estimates into the general ledger, including appropriate controls over journal entries.

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

.A53 In some entities, the term *governance* may be used to describe activities within the control environment, the entity's process to monitor the system of internal control, and other components of the system of internal control, as

described in SAS No. 145.⁴⁰ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A54 For entities with an internal audit function, its work may be particularly helpful to the auditor in obtaining an understanding of the following:

- The nature and extent of management's use of accounting estimates
- The design and implementation of controls that address the risks related to the data, assumptions, and models used to make the accounting estimates
- The aspects of the entity's information system that generate the data on which the accounting estimates are based
- How new risks relating to accounting estimates are identified, assessed, and managed

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

Reviewing the Outcome or Re-Estimation of Previous Accounting Estimates (Ref: par. .13)

.A55 A review of the outcome or re-estimation of previous accounting estimates (retrospective review) assists in identifying and assessing the risks of material misstatement when previous accounting estimates have an outcome through transfer or realization of the asset or liability in the current period or are re-estimated for the purpose of the current period. Through performing a retrospective review, the auditor may obtain the following:

- Information regarding the effectiveness of management's previous estimation process, from which the auditor can obtain audit evidence about the likely effectiveness of management's current process.
- Audit evidence of matters, such as the reasons for changes that may be required to be disclosed in the financial statements.
- Information regarding the complexity, subjectivity, or estimation uncertainty pertaining to the accounting estimates.
- Information regarding the susceptibility of accounting estimates to, or that may be an indicator of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing, and extent of further audit procedures.

.A56 A retrospective review may provide audit evidence that supports the identification and assessment of the risks of material misstatement in the current period. Such a retrospective review may be performed for accounting estimates made for the prior period's financial statements or may be performed over several periods or a shorter period (such as half-yearly or quarterly). In some cases, a retrospective review over several periods may be appropriate when the outcome of an accounting estimate is resolved over a longer period, or when a history of outcomes provides meaningful information or evidence of a trend.

⁴⁰ Paragraph .A78 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A57 A retrospective review of management judgments and assumptions related to significant accounting estimates is required by section 240, *Consideration of Fraud in a Financial Statement Audit*.⁴¹ As a practical matter, the auditor's review of previous accounting estimates as a risk assessment procedure in accordance with this section may be carried out in conjunction with the review required by section 240.

.A58 Based on the auditor's previous assessment of the risks of material misstatement, for example, if inherent risk is assessed as higher for one or more risks of material misstatement, the auditor may judge that a more detailed retrospective review is required. As part of the detailed retrospective review, the auditor may pay particular attention, when practicable, to the effect of data and significant assumptions used in making the previous accounting estimates. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

.A59 The measurement objective for fair value accounting estimates and other accounting estimates, based on current conditions at the measurement date, deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. The auditor may, therefore, focus the review on obtaining information that may be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in market participant assumptions that affected the outcome of a previous period's fair value accounting estimates may be unlikely to provide relevant audit evidence. In this case, audit evidence may be obtained by understanding the outcomes of assumptions (such as a cash flow projection) and understanding the effectiveness of management's prior estimation process that supports the identification and assessment of the risk of material misstatement in the current period.

.A60 A difference between the outcome of an accounting estimate and the amount recognized in the previous period's financial statements does not necessarily represent a misstatement of the previous period's financial statements. For example, an entity assumed a forecasted unemployment rate in the development of a loan loss estimate, and the actual losses and unemployment rate differed from that assumed. A difference may represent a misstatement if, for example, the difference arises from information that was available to management when the previous period's financial statements were finalized or that could reasonably be expected to have been obtained and taken into account in the context of the applicable financial reporting framework.⁴² Such a difference may call into question management's process for taking information into account in making the accounting estimate. As a result, the auditor may need to reconsider his or her risk assessment or may determine that more persuasive audit evidence needs to be obtained about the matter. Many financial reporting frameworks contain guidance on distinguishing between changes in accounting estimates that constitute misstatements and changes that do not, and the accounting treatment required to be followed in each case.

⁴¹ Paragraph .32b(ii) of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁴² Paragraph .15 of section 560, *Subsequent Events*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

Specialized Skills or Knowledge (Ref: par. .14)

.A61 Matters that may affect the auditor's determination of whether the engagement team requires specialized skills or knowledge, include, for example, the following:⁴³

- The nature of the accounting estimates for a particular business or industry (for example, mineral deposits, agricultural assets, complex financial instruments, and insurance contract liabilities)
- The degree of estimation uncertainty
- The complexity of the method or model used
- The complexity of the requirements of the applicable financial reporting framework relevant to accounting estimates, including whether there are areas known to be subject to differing interpretation or practice or areas where there are inconsistencies in how accounting estimates are made
- The procedures that the auditor intends to undertake in responding to assessed risks of material misstatement
- The need for judgment about matters not specified by the applicable financial reporting framework
- The degree of judgment needed to select data and assumptions
- The complexity and extent of the entity's use of IT in making accounting estimates

The nature, timing, and extent of the involvement of individuals with specialized skills and knowledge may vary throughout the audit.

.A62 The auditor may not possess the specialized skills or knowledge necessary when the matter involved is in a field other than accounting or auditing (for example, valuation skills) and may need to use an auditor's specialist.⁴⁴

.A63 Many accounting estimates do not require the application of specialized skills or knowledge. For example, specialized skills or knowledge may not be needed for a simple inventory obsolescence calculation. However, for example, for expected credit losses of a banking institution or an insurance contract liability for an insurance entity, the auditor is likely to conclude that it is necessary to apply specialized skills or knowledge.

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .04 and .15)

.A64 Identifying and assessing risks of material misstatement at the assertion level relating to accounting estimates includes not only accounting estimates that are recognized in the financial statements but also those that are included in the notes to the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A65 SAS No. 145 requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit

⁴³ Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, and paragraph .08e of section 300, *Planning an Audit*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁴⁴ See section 620, *Using the Work of an Auditor's Specialist*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

procedures to respond to the risks of material misstatement at the assertion level,^{[45], 46} including significant risks, in accordance with section 330. See paragraphs .A148–.A149 of this section for discussion about documentation of inherent risk factors. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A66 As discussed in paragraph .04 of this section, section 200⁴⁷ explains that inherent risk is influenced by inherent risk factors. In identifying the risks of material misstatement and in assessing inherent risk for accounting estimates in accordance with SAS No. 145, the auditor is required to take into account the inherent risk factors that affect the susceptibility of assertions to misstatement and how they do so. The auditor's consideration of the inherent risk factors may also provide information to be used in the following:

- Assessing the likelihood and magnitude of misstatement (such as, where inherent risk is assessed on the spectrum of inherent risk)
- Determining the reasons for the assessment given to the risks of material misstatement at the relevant assertion level, and that the auditor's further audit procedures in accordance with paragraph .18 of this section are responsive to those reasons

The interrelationships between the inherent risk factors are further explained in appendix A. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A67 The reasons for the auditor's assessment of inherent risk at the relevant assertion level may result from one or more of the inherent risk factors of estimation uncertainty, complexity, subjectivity, or other inherent risk factors. Examples follow:

- Accounting estimates of expected credit losses are likely to be complex because the expected credit losses cannot be directly observed and may require the use of a complex model. The model may use a complex set of historical data and assumptions about future developments in a variety of entity-specific scenarios that may be difficult to predict. Accounting estimates for expected credit losses are also likely to be subject to high estimation uncertainty and significant subjectivity in making judgments about future events or conditions. Similar considerations apply to insurance contract liabilities.
- An accounting estimate for an obsolescence provision for an entity with a wide range of different inventory types may require complex systems and processes but may involve little subjectivity, and the degree of estimation uncertainty may be low, depending on the nature of the inventory.
- Other accounting estimates may not be complex to make but may have high estimation uncertainty and require significant judgment, for example, an accounting estimate that requires a single critical judgment about a liability, the amount of which is contingent on the outcome of the litigation.

^[45] [Footnote renumbered and deleted by the issuance of SAS No. 145, October 2021.]

⁴⁶ Paragraphs 31 and 34 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

⁴⁷ Paragraph .A42 of section 200. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A68 The relevance and significance of inherent risk factors may vary from one estimate to another. Accordingly, the inherent risk factors may, either individually or in combination, affect simple accounting estimates to a lesser degree, and the auditor may identify fewer risks or assess inherent risk close to the lower end of the spectrum of inherent risk. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A69 Conversely, the inherent risk factors may, either individually or in combination, affect complex accounting estimates to a greater degree and may lead the auditor to assess inherent risk at the higher end of the spectrum of inherent risk. For these accounting estimates, the auditor's consideration of the effects of the inherent risk factors is likely to directly affect the number and nature of identified risks of material misstatement, the assessment of such risks, and ultimately, the persuasiveness of the audit evidence needed in responding to the assessed risks. Also, for these accounting estimates, the auditor's application of professional skepticism may be particularly important.

.A70 Events occurring after the date of the financial statements may provide additional information relevant to the auditor's assessment of the risks of material misstatement at the relevant assertion level. For example, the outcome of an accounting estimate may become known during the audit. In such cases, the auditor may assess or revise the assessment of the risks of material misstatement at the relevant assertion level,⁴⁸ regardless of how inherent risk factors affect susceptibility of assertions to misstatement relating to the accounting estimate. Events occurring after the date of the financial statements also may influence the auditor's selection of the approach to testing the accounting estimate in accordance with paragraph .18. For example, for a simple bonus accrual that is based on a straightforward percentage of compensation for selected employees, the auditor may conclude that there is relatively little complexity or subjectivity in making the accounting estimate and, therefore, may assess inherent risk at the relevant assertion level close to the lower end of the spectrum of inherent risk. The payment of the bonuses subsequent to period-end may provide sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the relevant assertion level. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A71 The auditor's assessment of control risk may be done in different ways depending on preferred audit techniques or methodologies. The control risk assessment may be expressed using qualitative categories (for example, control risk assessed as maximum, moderate, or minimum) or in terms of the auditor's expectation of how effective the controls are in addressing the identified risk, that is, the planned reliance on the effective operation of controls. For example, if control risk is assessed as maximum, the auditor contemplates no reliance on the effective operation of controls. If control risk is assessed at less than maximum, the auditor contemplates reliance on the effective operation of controls.

Estimation Uncertainty (Ref: par. .15a)

.A72 In taking into account the degree to which the accounting estimate is subject to estimation uncertainty, the auditor may consider the following:

- Whether the applicable financial reporting framework requires

⁴⁸ Paragraph 37 of SAS No. 145. [Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

- the use of a method to make the accounting estimate that inherently has a high level of estimation uncertainty. For example, the financial reporting framework may require the use of unobservable inputs.
 - the use of assumptions that inherently have a high level of estimation uncertainty, such as assumptions with a long forecast period, assumptions that are based on data that are unobservable and, therefore, difficult for management to develop, or the use of various assumptions that are interrelated.
 - disclosures about estimation uncertainty.
- The business environment. An entity may be active in a market that experiences turmoil or possible disruption (for example, from major currency movements or inactive markets) and the accounting estimate may, therefore, be dependent on data that is not readily observable.
 - Whether it is possible (or practicable, insofar as permitted by the applicable financial reporting framework) for management
 - to make a precise and reliable prediction about the future realization of a past transaction (for example, the amount that will be paid under a contingent contractual term) or about the incidence and impact of future events or conditions (for example, the amount of a future credit loss or the amount at which an insurance claim will be settled and the timing of its settlement), or
 - to obtain precise and complete information about a present condition (for example, information about valuation attributes that would reflect the perspective of market participants at the date of the financial statements, to develop a fair value estimate).

.A73 The size of the amount recognized or disclosed in the financial statements for an accounting estimate is not, in itself, an indicator of its susceptibility to misstatement because, for example, the accounting estimate may be understated.

.A74 In some circumstances, the estimation uncertainty may be so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may preclude recognition of an item in the financial statements or its measurement at fair value. In such cases, there may be risks of material misstatement that relate not only to whether an accounting estimate should be recognized, or whether it should be measured at fair value, but also to the reasonableness of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the estimation uncertainty associated with them (see paragraphs .A112–.A113 and .A143–.A144).

.A75 In some cases, the estimation uncertainty relating to an accounting estimate may cast significant doubt about the entity's ability to continue as a going concern. Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, establishes requirements and provides guidance in such circumstances.

Complexity or Subjectivity (Ref: par. .15b)*The Degree to Which Complexity Affects the Selection and Application of the Method*

.A76 In taking into account the degree to which the selection and application of the method used in making the accounting estimate are affected by complexity, the auditor may consider the following:

- The need for specialized skills or knowledge by management, which may indicate that the method used to make an accounting estimate is inherently complex and, therefore, the accounting estimate may have a greater susceptibility to material misstatement. There may be a greater susceptibility to material misstatement when management has developed a model internally and has relatively little experience in doing so or uses a model that applies a method that is not established or commonly used in a particular industry or environment.
- The nature of the measurement basis required by the applicable financial reporting framework, which may result in the need for a complex method that requires multiple sources of historical and forward-looking data or assumptions, with multiple interrelationships between them. For example, an expected credit loss provision may require judgments about future credit repayments and other cash flows, based on consideration of historical experience data and the application of forward-looking assumptions. Similarly, the valuation of an insurance contract liability may require judgments about future insurance contract payments to be projected based on historical experience and current and assumed future trends.

The Degree to Which Complexity Affects the Selection and Application of the Data

.A77 In taking into account the degree to which the selection and application of the data used in making the accounting estimate are affected by complexity, the auditor may consider the following:

- The complexity of the process to derive the data, taking into account the relevance and reliability of the data source. Data from certain sources may be more reliable than from others. Also, for confidentiality or proprietary reasons, some external information sources will not (or not fully) disclose information that may be relevant in considering the reliability of the data they provide, such as the sources of the underlying data they used or how it was accumulated and processed.
- The inherent complexity in maintaining the integrity of the data. When there is a high volume of data and multiple sources of data, there may be inherent complexity in maintaining the integrity of data that is used to make an accounting estimate.
- The need to interpret complex contractual terms. For example, the determination of cash inflows or outflows arising from a commercial supplier or customer rebates may depend on very complex contractual terms that require specific experience or competence to understand or interpret.

The Degree to Which Subjectivity Affects the Selection and Application of the Method, Assumptions, or Data

.A78 In taking into account the degree to which the selection and application of method, assumptions, or data are affected by subjectivity, the auditor may consider the following:

- The degree to which the applicable financial reporting framework does not specify the valuation approaches, concepts, techniques, and factors to use in the estimation method.
- The uncertainty regarding the amount or timing, including the length of the forecast period. The amount and timing is a source of inherent estimation uncertainty and gives rise to the need for management judgment in selecting a point estimate, which, in turn, creates an opportunity for management bias. For example, an accounting estimate that incorporates forward-looking assumptions may have a high degree of subjectivity, which may be susceptible to management bias.

Other Inherent Risk Factors (Ref: par. .15b)

.A79 The degree of subjectivity associated with an accounting estimate influences the susceptibility of the accounting estimate to misstatement due to management bias or other fraud risk factors insofar as they affect inherent risk. For example, when an accounting estimate is subject to a high degree of subjectivity, the accounting estimate is likely to be more susceptible to misstatement due to management bias or fraud, and this may result in a wide range of possible measurement outcomes. Management may select a point estimate from that range that is inappropriate in the circumstances, or that is inappropriately influenced by unintentional or intentional management bias, and that is, therefore, misstated. For continuing audits, indicators of possible management bias identified during the audit of preceding periods may influence the planning and risk assessment procedures in the current period. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

Significant Risks (Ref: par. .16)

.A80 The auditor's assessment of inherent risk, which takes into account the degree to which an accounting estimate is subject to or affected by estimation uncertainty, complexity, subjectivity, or other inherent risk factors, assists the auditor in determining whether any of the risks of material misstatement identified and assessed are a significant risk.

Responses to the Assessed Risks of Material Misstatement

The Auditor's Further Audit Procedures (Ref: par. .17)

.A81 In designing and performing further audit procedures, the auditor may use any of the three testing approaches (individually or in combination) listed in paragraph .17. For example, when several assumptions are used to make an accounting estimate, the auditor may decide to use a different testing approach or combination of testing approaches for each assumption tested.

Obtaining Relevant Audit Evidence, Whether Corroborative or Contradictory

.A82 Audit evidence comprises both information that supports and corroborates management's assertions and any information that contradicts such

assertions.⁴⁹ Obtaining audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

.A83 Section 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of the risk.⁵⁰ Therefore, the consideration of the nature or quantity of the audit evidence may be more important when inherent risks relating to an accounting estimate is assessed at the higher end of the spectrum of inherent risk.

.A84 Scalability. The nature, timing, and extent of the auditor's further audit procedures are affected by, for example, the following:

- The assessed risks of material misstatement, which affect the persuasiveness of the audit evidence needed and influence the approach the auditor selects to audit an accounting estimate. For example, the assessed risks of material misstatement relating to the existence or valuation assertions may be lower for a straight-forward accrual for bonuses that are paid to employees shortly after period-end. In this situation, it may be more practical for the auditor to obtain sufficient appropriate audit evidence by evaluating events occurring up to the date of the auditor's report, rather than through other testing approaches.
- The reasons for the assessed risks of material misstatement.

When the Auditor Intends to Rely on the Operating Effectiveness of Relevant Controls (Ref: par. .18)

.A85 Testing the operating effectiveness of controls may be appropriate when inherent risk is assessed as higher on the spectrum of inherent risk, including for significant risks. This may be the case when the accounting estimate is subject to or affected by a high degree of complexity. When the accounting estimate is affected by a high degree of subjectivity and, therefore, requires significant judgment by management, inherent limitations in the effectiveness of the design of controls may lead the auditor to focus more on substantive procedures than on testing the operating effectiveness of controls. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 145.]

.A86 In determining the nature, timing, and extent of testing of the operating effectiveness of controls relating to accounting estimates, the auditor may consider factors such as the following:

- The nature, frequency, and volume of transactions
- The effectiveness of the design of the controls, including whether controls are appropriately designed to respond to the assessed inherent risk, and the strength of governance
- The importance of particular controls to the overall control objectives and processes in place at the entity, including the sophistication of the information system to support transactions
- The monitoring of controls and identified deficiencies in internal control

⁴⁹ Paragraphs .A35–.A38 of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁵⁰ Paragraph .07b and .A20 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- The nature of the risks the controls are intended to address, for example, controls related to the exercise of judgment compared with controls over supporting data
- The competency of those involved in the control activities
- The frequency of performance of the control activities
- The evidence of performance of control activities

Section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements. However, section 940 includes guidance and examples of factors that affect the risk associated with a control that may be useful information when determining the nature, timing, and extent of testing of the operating effectiveness of controls relating to accounting estimates.⁵¹

Substantive Procedures Alone Cannot Provide Sufficient Appropriate Audit Evidence

.A87 When management makes extensive use of IT to conduct business, it may be more likely that there are risks related to certain accounting estimates for which substantive procedures alone cannot provide sufficient appropriate audit evidence.

.A88 Circumstances when risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence at the relevant assertion level may exist include

- when controls are necessary to mitigate risks relating to the initiation, recording, processing, or reporting of information obtained from outside of the general and subsidiary ledgers.
- information supporting one or more assertions is electronically initiated, recorded, processed, or reported. This is likely to be the case when there is a high volume of transactions or data, or a complex model is used, requiring the extensive use of IT to ensure the accuracy and completeness of the information. A complex expected credit loss provision may be required for a financial institution or utility entity. For example, in the case of a utility entity, the data used in developing the expected credit loss provision may comprise many small balances resulting from a high volume of transactions. In these circumstances, the auditor may conclude that sufficient appropriate audit evidence cannot be obtained without testing controls around the model used to develop the expected credit loss provision.

In such cases, the sufficiency and appropriateness of the audit evidence may depend on the effectiveness of controls over the accuracy and completeness of the information.

.A89 As part of the audit of the financial statements for certain entities, the auditor also may be required by law or regulation to undertake additional procedures in relation to, or to provide an assurance conclusion on, internal control. In these and other similar circumstances, the auditor may be able to use

⁵¹ Paragraph .A66 of section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

information obtained in performing such procedures as audit evidence, subject to determining whether subsequent changes have occurred that may affect its relevance to the audit.

Significant Risks (Ref: par. .19)

.A90 When the auditor's further audit procedures in response to a significant risk consist only of substantive procedures, section 330⁵² requires that those procedures include tests of details. Such tests of details may be designed and performed under each of the approaches described in paragraph .17 of this section based on the auditor's professional judgment in the circumstances. Examples of tests of details for significant risks related to accounting estimates include the following:

- Examination, for example, examining contracts to corroborate terms or assumptions
- Recalculation, for example, verifying the mathematical accuracy of a model
- Agreeing assumptions used to supporting documentation, such as third-party published information

Obtaining Audit Evidence From Events Occurring Up to the Date of the Auditor's Report (Ref: par. .20)

.A91 In some circumstances, obtaining audit evidence from events occurring up to the date of the auditor's report may provide sufficient appropriate audit evidence to address the risks of material misstatement. For example, sale of the complete inventory of a discontinued product shortly after the period-end may provide sufficient appropriate audit evidence relating to the estimate of its net realizable value at the period-end. In other cases, it may be necessary to use this testing approach in connection with another approach in paragraph .17.

.A92 For some accounting estimates, events occurring up to the date of the auditor's report are unlikely to provide sufficient appropriate audit evidence regarding the accounting estimate. For example, the conditions or events relating to some accounting estimates develop only over an extended period. Also, because of the measurement objective of fair value accounting estimates, information after the period-end may not reflect the events or conditions existing at the balance sheet date and, therefore, may not be relevant to the measurement of the fair value accounting estimate.

.A93 Even if the auditor decides not to undertake this testing approach in respect of specific accounting estimates, the auditor is required to comply with section 560, *Subsequent Events and Subsequently Discovered Facts*. Section 560 requires the auditor to perform audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that require adjustment of or disclosure in the financial statements have been identified⁵³ and appropriately reflected in the financial statements in accordance with the applicable financial reporting framework.⁵⁴ Because the measurement of many accounting estimates, other than fair value accounting estimates, usually

⁵² Paragraph .22 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁵³ Paragraph .09 of section 560. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁵⁴ Paragraph .11 of section 560. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

depends on the outcome of future conditions, transactions, or events, the auditor's work under section 560 is particularly relevant.

Testing How Management Made the Accounting Estimate (Ref: par. .21)

.A94 Testing how management made the accounting estimate may be an appropriate approach when, for example

- the auditor's review of similar accounting estimates made in the prior-period financial statements suggests that management's current period process is appropriate.
- the accounting estimate is based on a large population of items of a similar nature that individually are not significant.
- the applicable financial reporting framework specifies how management is expected to make the accounting estimate. For example, this may be the case for an expected credit loss provision.
- the accounting estimate is derived from the routine processing of data.

Testing how management made the accounting estimate may also be an appropriate approach when neither of the other testing approaches is practical to perform or may be an appropriate approach in combination with one of the other testing approaches.

Changes in Methods, Significant Assumptions, and the Data From Prior Periods (Ref: par. .22a, .23a, and .24a)

.A95 The auditor may need to have further discussions with management about the following circumstances and, in doing so, challenge management regarding the appropriateness of the assumptions used:

- When there is a change from prior periods in a method, or significant assumption
- When the data is not based on new circumstances or new information
- When significant assumptions are inconsistent with each other and with those used in other accounting estimates or with related assumptions used in other areas of the entity's business activities

Indicators of Management Bias (Ref: par. .22b, .23b, and .24b)

.A96 When the auditor identifies indicators of possible management bias, the auditor may need a further discussion with management and may need to reconsider whether sufficient appropriate audit evidence has been obtained, indicating that the method, assumptions, and data used were appropriate and supportable in the circumstances. An example of an indicator of management bias for a particular accounting estimate may be when management has developed an appropriate range for several different assumptions, and in each case, the assumption used was from the end of the range that resulted in the most favorable measurement outcome.

Methods

.A97 *The selection of the method (Ref: par. .22a).* Relevant considerations for the auditor regarding the appropriateness of the method selected in the context of the applicable financial reporting framework and, if applicable, the appropriateness of changes from the prior period may include the following:

- Whether management's rationale for the method selected is appropriate.

- Whether the method is appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, other available valuation concepts or techniques, regulatory requirements, and the business, industry, and environment in which the entity operates.
- When management has determined that different methods result in a range of significantly different estimates, how management has investigated the reasons for these differences.
- Whether the change is based on new circumstances or new information. When this is not the case, the change may not be reasonable or in compliance with the applicable financial reporting framework. Arbitrary changes result in inconsistent financial statements over time and may give rise to financial statement misstatements or may be an indicator of possible management bias. (See also paragraphs .A133–.A136).

These matters are important when the applicable financial reporting framework does not prescribe the method of measurement or allows multiple methods.

.A98 *Complex modeling (Ref: par. .22d).* A model, and the related method, is more likely to be complex when

- understanding and applying the method, including designing the model and selecting and using appropriate data and assumptions, requires specialized skills or knowledge;
- it is difficult to obtain data needed for use in the model because there are restrictions on the availability or observability of, or access to, data; or
- it is difficult to maintain the integrity (for example, accuracy, consistency, or completeness) of the data and assumptions in using the model due to multiple valuation attributes, multiple relationships between them, or multiple iterations of the calculation.

.A99 Matters that the auditor may consider when management uses a complex model include, for example, the following:

- Whether the model is validated prior to usage or when there has been a change to the model, with periodic reviews to ensure it is still suitable for its intended use. The entity's validation process may include evaluation of
 - the model's theoretical soundness,
 - the model's mathematical integrity,
 - the accuracy and completeness of the model's data and assumptions, and
 - the model's output as compared to actual transactions.
- Whether appropriate change control policies and procedures exist.
- Whether management uses appropriate skills and knowledge in using the model.

.A100 Management may make adjustments to the output of the model to meet the requirements of the applicable financial reporting framework. In some industries these adjustments are referred to as *overlays*. In the case of fair value accounting estimates, it may be relevant to consider whether adjustments to

the output of the model, if any, reflect the assumptions market participants would use in similar circumstances.

.A101 *Maintenance of integrity of significant assumptions and the data used in applying the method (Ref: par. .22e).* Maintaining the integrity of significant assumptions and the data in applying the method refers to the maintenance of the accuracy and completeness of the data and assumptions through all stages of information processing. A failure to maintain such integrity may result in corruption of the data, and assumptions and may give rise to misstatements. In this regard, relevant considerations for the auditor may include whether the data and assumptions are subject to all changes intended by management, and not subject to any unintended changes, during activities such as input, storage, retrieval, transmission, or processing.

Significant Assumptions (Ref: par. .23)

.A102 Relevant considerations for the auditor regarding the appropriateness of the significant assumptions in the context of the applicable financial reporting framework and, if applicable, the appropriateness of changes from the prior period may include the following:

- Management's rationale for the selection of the assumption.
- Whether the assumption is appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, and the business, industry, and environment in which the entity operates.
- Whether a change from prior periods in selecting an assumption is based on new circumstances or new information. When it is not, the change may not be reasonable nor in compliance with the applicable financial reporting framework. Arbitrary changes in an accounting estimate may give rise to material misstatements of the financial statements or may be an indicator of possible management bias. (See paragraphs .A133–.A136.)

.A103 Management may evaluate alternative assumptions or outcomes of accounting estimates, which may be accomplished through a number of approaches depending on the circumstances. One possible approach is a sensitivity analysis. This might involve determining how the monetary amount of an accounting estimate varies with different assumptions. Even for accounting estimates measured at fair value, there may be variation because different market participants will use different assumptions. A sensitivity analysis may lead to the development of a number of outcome scenarios, sometimes characterized as a range of outcomes by management, including "pessimistic" and "optimistic" scenarios.

.A104 Through the knowledge obtained in performing the audit, the auditor may become aware of or may have obtained an understanding of assumptions used in other areas of the entity's business. Such matters may include, for example, business prospects, assumptions in strategy documents, and future cash flows. Also, if the engagement partner has performed other engagements for the entity, section 315⁵⁵ requires the engagement partner to consider whether information obtained from those other engagements is relevant to identifying risks of material misstatement. This information may also be useful to consider in addressing whether significant assumptions are consistent with each other and with those used in other accounting estimates.

⁵⁵ Paragraph .08 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A105 The appropriateness of the significant assumptions in the context of the requirements of the applicable financial reporting framework may depend on management's intent and ability to carry out certain courses of action. Management often documents plans and intentions relevant to specific assets or liabilities, and the applicable financial reporting framework may require management to do so. The nature and extent of audit evidence to be obtained about management's intent and ability is a matter of professional judgment. When applicable, the auditor's procedures may include the following:

- Review of management's history of carrying out its stated intentions
- Inspection of written plans and other documentation, including, when applicable, formally approved budgets, authorizations, or minutes
- Inquiry of management about its reasons for a particular course of action
- Review of events occurring subsequent to the date of the financial statements and up to the date of the auditor's report
- Evaluation of the entity's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its existing commitments and legal, regulatory, or contractual restrictions that could affect the feasibility of management's actions
- Consideration of whether management has met the applicable documentation requirements, if any, of the applicable financial reporting framework

Certain financial reporting frameworks, however, may not permit management's intentions or plans to be taken into account when making an accounting estimate. This is often the case for fair value accounting estimates because their measurement objective requires that significant assumptions reflect those used by market participants.

.A106 *Data (Ref: par. .24a)*. Relevant considerations for the auditor regarding the appropriateness of the data selected for use in the context of the applicable financial reporting framework and, if applicable, the appropriateness of the changes from the prior period may include the following:

- Management's rationale for the selection of the data.
- Whether the data is appropriate in the circumstances given the nature of the accounting estimate, the requirements of the applicable financial reporting framework, and the business, industry, and environment in which the entity operates.
- Whether the change from prior periods in the sources or items of data selected or data selected is based on new circumstances or new information. When it is not, it is unlikely to be reasonable nor in compliance with the applicable financial reporting framework. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time and may give rise to financial statement misstatements or may be an indicator of possible management bias. (See paragraphs .A133–.A136.)

.A107 *Relevance and reliability of the data (Ref: par. .24c)*. Section 500 requires the auditor to evaluate information to be used as audit evidence by taking into account, among other things, the relevance and reliability of the information, including its source. The auditor's evaluation of such information to

be used as audit evidence is required to include evaluating whether the information is sufficiently precise and detailed for the auditor's purposes and obtaining audit evidence about the accuracy and completeness of the information, as necessary.⁵⁶ Paragraphs .A126–.A129 provide further guidance related to evaluating information from external information sources. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A108 *Complex legal or contractual terms* (Ref: par. .24d). Procedures that the auditor may consider when the accounting estimate is based on complex legal or contractual terms include the following:

- Considering whether specialized skills or knowledge are needed to understand or interpret the contract
- Inquiring of the entity's legal counsel regarding the legal or contractual terms
- Inspecting the underlying contracts to
 - evaluate the underlying business purpose for the transaction or agreement, and
 - consider whether the terms of the contracts are consistent with management's explanations.

Management's Selection of a Point Estimate and Related Disclosures About Estimation Uncertainty

.A109 *Management's steps to understand and address estimation uncertainty* (Ref: par. .25a). *Estimation uncertainty* is the susceptibility to an inherent lack of precision in measurement. This arises when the required monetary amount for a financial statement item cannot be measured with precision through direct observation of the cost or price. The susceptibility to a lack of precision in measurement is often referred to in accounting frameworks as *measurement uncertainty*. Relevant considerations regarding whether management has taken appropriate steps to understand and address estimation uncertainty may include whether management has

- a. understood the estimation uncertainty, by identifying the sources, and assessing the degree of inherent variability in the measurement outcomes and the resulting range of reasonably possible measurement outcomes;
- b. identified the degree to which, in the measurement process, complexity or subjectivity affect the risk of material misstatement, and addressed the resulting potential for misstatement by applying
 - i. appropriate skills and knowledge in making accounting estimates, and
 - ii. professional judgment, including identifying and addressing susceptibility to management bias; and
- c. addressed estimation uncertainty through appropriately selecting management's point estimate and related disclosures that describe the estimation uncertainty.

.A110 *The selection of management's point estimate and related disclosures of estimation uncertainty* (Ref: par. .25b). Matters that may be relevant

⁵⁶ Paragraphs .07–.08 of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

regarding the selection of management's point estimate and the development of related disclosures about estimation uncertainty include whether

- the methods and data used were selected appropriately, including when alternative methods for making the accounting estimate and alternative sources of data were available.
- valuation attributes used were appropriate and complete.
- the assumptions used were selected from a range of reasonably possible amounts and were supported by appropriate data that is relevant and reliable.
- the data used was appropriate, relevant, and reliable, and the integrity of that data was maintained.
- the calculations were applied in accordance with the method and were mathematically accurate.
- management's point estimate is appropriately chosen from the reasonably possible measurement outcomes.
- the related disclosures appropriately describe the amount as an estimate and explain the nature and limitations of the estimation process, including the variability of the reasonably possible measurement outcomes.

.A111 Relevant considerations for the auditor regarding the appropriateness of management's point estimate may include the following:

- When the requirements of the applicable financial reporting framework prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions, or prescribes a specific measurement method, whether management has followed the requirements of the applicable financial reporting framework
- When the applicable financial reporting framework has not specified how to select an amount from reasonably possible measurement outcomes, whether management has exercised judgment, taking into account the requirements of the applicable financial reporting framework

.A112 Relevant considerations for the auditor regarding management's disclosures about estimation uncertainty include the requirements of the applicable financial reporting framework, which may require disclosures

- that describe the amount as an estimate and explain the nature and limitations of the process for making it, including the variability in reasonably possible measurement outcomes. The framework also may require additional disclosures to meet a disclosure objective.⁵⁷
- about significant accounting policies related to accounting estimates. Depending on the circumstances, relevant accounting policies may include matters such as the specific principles, bases, conventions, rules, and practices applied in preparing and presenting accounting estimates in the financial statements.
- about significant or critical judgments (for example, those that had the most significant effect on the amounts recognized in the

⁵⁷ Paragraph 1A of FASB ASC 820-10-50. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

financial statements) as well as significant forward-looking assumptions or other sources of estimation uncertainty.

In certain circumstances, additional disclosures beyond those explicitly required by the financial reporting framework may be needed in order to achieve fair presentation, or in the case of a compliance framework, for the financial statements not to be misleading.

.A113 The greater the degree to which an accounting estimate is subject to estimation uncertainty, the more likely the risks of material misstatement will be assessed as higher and, therefore, the more persuasive the audit evidence needs to be to determine, in accordance with paragraph .35, whether management's point estimate and related disclosures about estimation uncertainty are reasonable in the context of the applicable financial reporting framework, or are misstated.

.A114 If the auditor's consideration of estimation uncertainty associated with an accounting estimate, and its related disclosure, is a matter that required significant auditor attention, then this may constitute a key audit matter.⁵⁸

When Management Has Not Taken Appropriate Steps to Understand and Address Estimation Uncertainty (Ref: par. .26)

.A115 When the auditor determines that management has not taken appropriate steps to understand and address estimation uncertainty, additional procedures that the auditor may request management to perform to understand estimation uncertainty may include, for example, consideration of alternative assumptions or the performance of a sensitivity analysis.

.A116 In considering whether it is practicable to develop a point estimate or range, matters that the auditor may need to take into account include whether the auditor could do so without impairing independence.⁵⁹ This may include relevant ethical requirements that address prohibitions on assuming management responsibilities.

.A117 If, after considering management's response, the auditor determines that it is not practicable to develop an auditor's point estimate or range, the auditor is required to evaluate the implications for the audit or the auditor's opinion on the financial statements in accordance with paragraph .34.

Developing an Auditor's Point Estimate or Using an Auditor's Range (Ref: par. .27–.28)

.A118 Developing an auditor's point estimate or range to evaluate management's point estimate and related disclosures about estimation uncertainty may be an appropriate approach when, for example

- the auditor's review of similar accounting estimates made in the prior-period financial statements suggests that management's current period process is not expected to be effective.
- the entity's controls within and over management's process for making accounting estimates are not well-designed or properly implemented.

⁵⁸ See section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁵⁹ See management responsibilities in the "Nonattest Services" interpretation (ET sec. 1.295) under the "Independence Rule" (ET sec. 1.200) of the AICPA Code of Professional Conduct. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

- events or transactions between the period-end and the date of the auditor's report have not been properly taken into account, when it is appropriate for management to do so, and such events or transactions appear to contradict management's point estimate.
- there are appropriate alternative assumptions or sources of relevant data that can be used in developing an auditor's point estimate or a range.
- management has not taken appropriate steps to understand or address the estimation uncertainty (see paragraph .26).

.A119 The decision to develop a point estimate or range also may be influenced by the applicable financial reporting framework, which may prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions, or prescribe a specific measurement method (for example, the use of a discounted probability-weighted expected value or the most likely outcome).

.A120 The auditor's decision about whether to develop a point estimate, rather than a range, may depend on the nature of the estimate and the auditor's judgment in the circumstances. For example, the nature of the estimate may be such that there is expected to be less variability in the reasonably possible outcomes. In these circumstances, developing a point estimate may be an effective approach, particularly when it can be developed with a higher degree of precision.

.A121 The auditor may develop a point estimate or a range in a number of ways, for example, by

- using a different model than the one used by management, for example, one that is commercially available for use in a particular sector or industry, or a proprietary or auditor-developed model.
- using management's model but developing alternative assumptions or data sources to those used by management.
- using the auditor's own method but developing alternative assumptions to those used by management.
- employing or engaging a person with specialized expertise to develop or execute a model, or to provide relevant assumptions.
- considering other comparable conditions, transactions, or events, or, where relevant, markets for comparable assets or liabilities.

.A122 The auditor also may develop a point estimate or range for only part of the accounting estimate (for example, for a particular assumption or when only a certain part of the accounting estimate is giving rise to the risk of material misstatement).

.A123 When using the auditor's own methods, assumptions, or data to develop a point estimate or range, the auditor may obtain evidence about the appropriateness of management's methods, assumptions, or data. For example, if the auditor uses the auditor's own assumptions in developing a range to evaluate the reasonableness of management's point estimate, the auditor may also develop a view about whether management's judgments in selecting the significant assumptions used in making the accounting estimate give rise to indicators of possible management bias.

.A124 The requirement in paragraph .28a for the auditor to determine that the range includes only amounts that are supported by sufficient appropriate audit evidence does not mean that the auditor is expected to obtain audit

evidence to support each possible outcome in the range individually. Rather, the auditor is likely to obtain evidence to determine that the points at both ends of the range are reasonable in the circumstances, thereby supporting that amounts falling between those two points also are reasonable.

.A125 The size of the auditor's range may be multiples of materiality for the financial statements as a whole, particularly when materiality is based on operating results (for example, pre-tax income), and this measure is relatively small in relation to assets or other balance sheet measures. This situation is more likely to arise in circumstances in which the estimation uncertainty associated with the accounting estimate is itself multiples of materiality, which is more common for certain types of accounting estimates in which a high degree of estimation uncertainty is more typical, and there may be specific requirements in the applicable financial reporting framework in that regard. Based on the procedures performed and audit evidence obtained in accordance with the requirements of this section, the auditor may conclude that a range that is multiples of materiality is, in the auditor's judgment, appropriate in the circumstances. When this is the case, the auditor's evaluation of the reasonableness of the disclosures about estimation uncertainty becomes increasingly important, particularly whether such disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes. Paragraphs .A139–.A144 include additional considerations that may be relevant in these circumstances.

Other Considerations Relating to Audit Evidence (Ref: par. .30)

.A126 Information to be used as audit evidence, regarding risks of material misstatement relating to accounting estimates, may have been produced by the entity, prepared using the work of a management's specialist, or provided by an external information source.

External Information Sources

.A127 As explained in section 500, the reliability of evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias.⁶⁰ Consequently, the nature and extent of the auditor's further audit procedures to consider the reliability of the information used in making an accounting estimate may vary depending on the nature of these factors. Examples follow:

- When market or industry data is obtained from a single external information source specializing in such information, the auditor may seek data from an alternative independent source with which to compare.
- When market or industry data, prices, or pricing-related data are obtained from multiple independent external information sources and points to consensus across those sources, the auditor may need to obtain less evidence about the reliability of the data from an individual source.
- When information obtained from multiple information sources points to divergent market views, the auditor may seek to understand the reasons for the diversity in views. The diversity may result from the use of different methods, assumptions, or data.

⁶⁰ Paragraph .A22 and appendix A, "Considerations Regarding the Use of External Information Sources," of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

For example, one source may be using current prices, and another may be using future prices. When the diversity relates to estimation uncertainty, the auditor is required by paragraph .26*b* of this section to obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework, the disclosures in the financial statements that describe the estimation uncertainty are reasonable. In such cases, professional judgment is also important in considering information about the methods, assumptions, or data applied.

- When information obtained from an external information source has been developed by that source using its own models (for example, for a derivative instrument or security, a pricing model or cash flow projection model), Statement on Auditing Standards (SAS) No. 142, *Audit Evidence* (sec. 500),⁶¹ provides relevant guidance for the auditor.
- When, for derivative instruments or securities, a pricing source has a relationship with an entity that might impair its objectivity, such as an affiliate or a counterparty involved in selling or structuring the product, the auditor may determine that it is necessary to obtain estimates from more than one pricing source.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A128 For fair value accounting estimates, additional considerations of the relevance and reliability of information obtained from external information sources may include the following:

- a. Whether fair values are based on trades of the same instrument or active market quotations
- b. When the fair values are based on transactions of comparable assets or liabilities, how those transactions are identified and considered comparable
- c. When there are no transactions either for the asset or liability or comparable assets or liabilities, how the information was developed, including whether the inputs developed and used represent the assumptions that market participants would use when pricing the asset or liability, if applicable

Examples of sources relating to (a) and (b) for derivative instruments and securities listed on national exchanges or over-the-counter (OTC) markets include financial publications, the exchanges, NASDAQ, or pricing services based on sources such as those. For derivative instruments and securities, if quoted market prices are not available, estimates of fair value frequently may be obtained from, for example, broker-dealers or other third-party sources, based on proprietary valuation models, or from the entity, based on internally or externally developed valuation models (for example, the Black-Scholes option-pricing model). Examples of broker quotes for certain derivative instruments and securities include quoted market prices obtained from broker-dealers who are market makers in such derivative instruments and securities or through electronic quotation and trading systems for OTC securities. However, using such a price quote to test valuation assertions may require special knowledge to understand the circumstances in which the quote was developed. For example, quotations published by electronic quotation and trading systems for OTC

⁶¹ Appendix A of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

securities may not be based on recent trades and may be only an indication of interest and not an actual price for which a counterparty will purchase or sell the underlying derivative instrument or security. Appendix C, "Use of Pricing Information From Third Parties as Audit Evidence," provides further guidance on the use of pricing information from third parties, including brokers or dealers, as audit evidence. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A129 When information from an external information source is used as audit evidence, a relevant consideration for the auditor may be whether information can be obtained, or whether the information is sufficiently detailed, to understand the methods, assumptions, and other data used by the external information source. This may be limited in some respects and consequently influence the auditor's consideration of the nature, timing, and extent of procedures to perform. For example, pricing services often provide information about their methods and assumptions by asset class, rather than individual securities. Brokers often provide only limited information about their inputs and assumptions when providing broker-indicative quotes for individual securities. Section 500⁶² provides guidance with respect to restrictions placed by the external information source on the provision of supporting information.

Management's Specialist

.A130 Assumptions relating to accounting estimates that are made or identified by a management's specialist become management's assumptions when used by management in making an accounting estimate. Accordingly, the auditor applies the relevant requirements in this section to those assumptions.

.A131 If the work of a management's specialist involves the use of methods or sources of data relating to accounting estimates, or developing or providing findings or conclusions relating to a point estimate or related disclosures for inclusion in the financial statements, the requirements in paragraphs .21–.29 of this section may assist the auditor in applying the requirements in section 501 relating to the use of management's specialists.⁶³

Service Organizations

.A132 Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, deals with the auditor's understanding of the services provided by a service organization, including internal control, as well as the auditor's responses to assessed risks of material misstatement. When the entity uses the services of a service organization in making accounting estimates, the requirements and guidance in section 402 may assist the auditor in applying the requirements of this section.

Indicators of Possible Management Bias (Ref: par. .32)

.A133 Management bias may be difficult to detect at an account level and may only be identified by the auditor when considering groups of accounting estimates, all accounting estimates in aggregate, or when observed over a number of accounting periods. For example, if accounting estimates included in the financial statements are considered to be individually reasonable but management's point estimates consistently trend toward one end of the auditor's range

⁶² Appendix A of section 500. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁶³ Paragraph .26c of section 501, as amended by SAS No. 142. (Refer to paragraph .A68 of section 500 for the amended text.) [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

of reasonable outcomes that provide a more favorable financial reporting outcome for management, such circumstances may indicate possible bias by management.

.A134 Examples of indicators of possible management bias with respect to accounting estimates include the following:

- Changes in an accounting estimate, or the method for making it, when management has made a subjective assessment that there has been a change in circumstances
- Selection or development of significant assumptions or the data that yield a point estimate favorable for management objectives
- Selection of a point estimate that may indicate a pattern of optimism or pessimism

When such indicators are identified, there may be a risk of material misstatement either at the assertion or financial statement level. Indicators of possible management bias themselves do not constitute misstatements for purposes of drawing conclusions about the reasonableness of individual accounting estimates. However, in some cases, the audit evidence may point to a misstatement, rather than simply an indicator of management bias.

.A135 Indicators of possible management bias may affect the auditor's conclusion about whether the auditor's risk assessment and related responses remain appropriate. The auditor may also need to consider the implications for other aspects of the audit, including the need to further question the appropriateness of management's judgments in making accounting estimates. Further, indicators of possible management bias may affect the auditor's conclusion about whether the financial statements as a whole are free from material misstatement, as discussed in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.⁶⁴

.A136 In addition, in applying section 240, the auditor is required to evaluate whether management's judgments and decisions in making the accounting estimates included in the financial statements indicate a possible bias that may represent a material misstatement due to fraud.⁶⁵ Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates, which may include intentionally understating or overstating accounting estimates. Indicators of possible management bias that may also be a fraud risk factor may cause the auditor to reassess whether the auditor's risk assessments, in particular, the assessment of fraud risks, and related responses remain appropriate.

Overall Evaluation Based on Audit Procedures Performed (Ref: par. .33)

.A137 As the auditor performs planned audit procedures, the audit evidence obtained may cause the auditor to modify the nature, timing, or extent of other planned audit procedures.⁶⁶ In relation to accounting estimates, information may come to the auditor's attention through performing procedures to

⁶⁴ Paragraph .14 of section 700 or paragraph .39 of section 703. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁶⁵ Paragraph .32b of section 240. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁶⁶ Paragraph .A73 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

obtain audit evidence that differs significantly from the information on which the risk assessment was based. For example, the auditor may have identified that the only reason for an assessed risk of material misstatement is the subjectivity involved in making the accounting estimate. However, while performing procedures to respond to the assessed risks of material misstatement, the auditor may discover that the accounting estimate is more complex than originally contemplated, which may call into question the assessment of the risk of material misstatement (for example, the inherent risk may need to be re-assessed on the higher end of the spectrum of inherent risk due to the effect of complexity) and, therefore, the auditor may need to perform additional further audit procedures to obtain sufficient appropriate audit evidence.⁶⁷

.A138 With respect to accounting estimates that have not been recognized, a particular focus of the auditor's evaluation may be on whether the recognition criteria of the applicable financial reporting framework have, in fact, been met. When an accounting estimate has not been recognized, and the auditor concludes that this treatment is appropriate, some financial reporting frameworks may require disclosure of the circumstances in the notes to the financial statements.

Determining Whether the Accounting Estimates Are Reasonable or Misstated (Ref: par. .35)

.A139 In determining whether, based on the audit procedures performed and evidence obtained, management's point estimate and related disclosures are reasonable or are misstated

- when the audit evidence supports a range, the size of the range may be wide and, in some circumstances, may be multiples of materiality for the financial statements as a whole (see also paragraph .A125). Although a wide range may be appropriate in the circumstances, it may indicate that it is important for the auditor to reconsider whether sufficient appropriate audit evidence has been obtained regarding the reasonableness of the amounts within the range.
- the audit evidence may support a point estimate that differs from management's point estimate. In such circumstances, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement.
- the audit evidence may support a range that does not include management's point estimate. In such circumstances, the misstatement is the difference between management's point estimate and the nearest point of the auditor's range.

.A140 Paragraphs .A110–.A114 provide guidance to assist the auditor in evaluating management's selection of a point estimate and related disclosures to be included in the financial statements.

.A141 When the auditor's further audit procedures include testing how management made the accounting estimate or developing an auditor's point estimate or range, the auditor is required to obtain sufficient appropriate audit evidence about disclosures that describe estimation uncertainty in accordance with paragraphs .25b and .28b and other disclosures in accordance with paragraph .31. The auditor then considers the audit evidence obtained about

⁶⁷ See also paragraph .32 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

disclosures as part of the overall evaluation, in accordance with paragraph .35, of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated.

.A142 Section 450 also provides guidance regarding qualitative disclosures⁶⁸ and when misstatements in disclosures could be indicative of fraud.⁶⁹

.A143 The auditor's evaluation about whether the financial statements achieve fair presentation⁷⁰ includes the consideration of the overall presentation, structure, and content of the financial statements and whether the financial statements, including the related notes, represent the transactions and events in a manner that achieves fair presentation. The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. For example, when an accounting estimate is subject to a higher degree of estimation uncertainty, the auditor may determine that additional disclosures are necessary to achieve fair presentation. If management does not include such additional disclosures, the auditor may conclude that the financial statements are materially misstated.

.A144 Section 705⁷¹ provides guidance on the implications for the auditor's opinion when the auditor believes that management's disclosures in the financial statements are inadequate or misleading, including, for example, with respect to estimation uncertainty.

Written Representations

.A145 Part of the auditor's audit evidence related to accounting estimates, as required by section 580, *Written Representations*, includes representations obtained from management about whether management believes the methods, significant assumptions, and the data used in making the accounting estimates and the related disclosures are appropriate to achieve recognition, measurement, or disclosure that is in accordance with the applicable financial reporting framework.⁷²

Communication With Those Charged With Governance, Management, or Other Relevant Parties (Ref: par. .37)

.A146 In applying section 260, the auditor communicates with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices relating to accounting estimates and related disclosures.⁷³ Appendix B, "Communications With Those Charged With Governance," includes matters specific to accounting estimates that the auditor may consider communicating to those charged with governance.

⁶⁸ Paragraph .A23 of section 450. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁶⁹ Paragraph .A24 of section 450. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷⁰ Paragraph .16 of section 700 or paragraph .41 of section 703. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷¹ Paragraphs .23–.24 of section 705. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷² Paragraph .16 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷³ Paragraph .12a of section 260. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

.A147 Section 265 requires the auditor to communicate in writing to those charged with governance significant deficiencies and material weaknesses in internal control identified during the audit.⁷⁴ Deficiencies in controls, which may also be significant deficiencies or material weaknesses, may include those related to controls over

- a. the selection and application of significant accounting policies and the selection and application of methods, assumptions, and data,
- b. risk management and related systems,
- c. data integrity, including when data is obtained from an external information source, and
- d. the use, development, and validation of models, including models obtained from an external provider, and any adjustments that may be required.

Documentation (Ref: par. .38)

.A148 Section 315⁷⁵ and section 330⁷⁶ provide requirements and guidance on documenting the auditor's understanding of the entity, risk assessments, and responses to assessed risks. This guidance is based on the requirements and guidance in section 230, *Audit Documentation*.⁷⁷ In the context of auditing accounting estimates, the auditor is required to prepare audit documentation about key elements of the auditor's understanding of the entity and its environment related to accounting estimates. In addition, the auditor's judgments about the assessed risks of material misstatement related to accounting estimates, and the auditor's responses, may likely be further supported by documentation of communications with those charged with governance and management.

.A149 In documenting the linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the relevant assertion level, in accordance with section 330, this section requires that the auditor take into account the reasons given to the risks of material misstatement at the relevant assertion level. Those reasons may relate to one or more inherent risk factors or the auditor's assessment of control risk. However, the auditor is not required to document how every inherent risk factor was taken into account in identifying and assessing the risks of material misstatement in relation to each accounting estimate.

.A150 The auditor also may consider documenting the following:

- When management's application of the method involves complex modeling, whether management's judgments have been applied consistently and, when applicable, that the design of the model meets the measurement objective of the applicable financial reporting framework.
- When the selection and application of methods, significant assumptions, or the data is affected by complexity to a higher degree,

⁷⁴ Paragraph .11 of section 265. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷⁵ Paragraphs .33 and .A161–.A164 of section 315. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷⁶ Paragraphs .30 and .A77 of section 330. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

⁷⁷ Paragraph .09c of section 230. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

the auditor's judgments in determining whether specialized skills or knowledge are required to perform the risk assessment procedures, to design and perform procedures responsive to those risks, or to evaluate the audit evidence obtained. In these circumstances, the documentation also may include how the required skills or knowledge were applied.

.A151 Section 230⁷⁸ notes that although there may be no single way in which the auditor's exercise of professional skepticism is documented, the audit documentation may, nevertheless, provide evidence of the auditor's exercise of professional skepticism. For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, the documentation may include how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion about the sufficiency and appropriateness of the audit evidence obtained. Examples of other requirements in this section for which documentation may provide evidence of the exercise of professional skepticism by the auditor include the following:

- Paragraph .12*d* of this section, regarding how the auditor has applied an understanding in developing the auditor's own expectation of the accounting estimates and related disclosures to be included in the entity's financial statements and how that expectation compares with the entity's financial statements prepared by management
- Paragraph .17 of this section, which requires further audit procedures to be designed and performed to obtain sufficient appropriate evidence in a manner that is not biased toward obtaining audit evidence that may be corroborative or toward excluding audit evidence that may be contradictory
- Paragraphs .22*b*, .23*b*, .24*b*, and .32 of this section, which address indicators of possible management bias
- Paragraph .34 of this section, which addresses the auditor's consideration of all relevant audit evidence, whether corroborative or contradictory

⁷⁸ Paragraph .A9 of section 230. [Footnote renumbered by the issuance of SAS No. 145, October 2021.]

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Appendix A — Inherent Risk Factors

Introduction

1. In identifying, assessing, and responding to the risks of material misstatement at the relevant assertion level for an accounting estimate and related disclosures, this section requires the auditor to take into account the degree to which the accounting estimate is subject to estimation uncertainty; the degree to which the selection and application of the methods, assumptions, and data used in making the accounting estimate; and the degree to which the selection of management's point estimate and related disclosures for inclusion in the financial statements are affected by complexity, subjectivity, or other inherent risk factors.
2. Inherent risk related to an accounting estimate is the susceptibility of an assertion about the accounting estimate to material misstatement, before consideration of controls. Inherent risk results from inherent risk factors, which give rise to challenges in appropriately making the accounting estimate. This appendix provides further explanation about the nature of the inherent risk factors of estimation uncertainty, subjectivity, and complexity and their interrelationships in the context of making accounting estimates and selecting management's point estimate and related disclosures for inclusion in the financial statements.

Measurement Basis

3. The measurement basis and the nature, condition, and circumstances of the financial statement item give rise to relevant valuation attributes. When the cost or price of the item cannot be directly observed, an accounting estimate is required to be made by applying an appropriate method and using appropriate data and assumptions. The method may be specified by the applicable financial reporting framework, or is selected by management, to reflect the available knowledge about how the relevant valuation attributes would be expected to influence the cost or price of the item on the measurement basis.

Estimation Uncertainty

4. Susceptibility to a lack of precision in measurement may be referred to in accounting frameworks as *measurement uncertainty*. *Estimation uncertainty* is defined in this section as susceptibility to an inherent lack of precision in measurement. It arises when the required monetary amount for a financial statement item that is recognized or disclosed in the financial statements cannot be measured with precision through direct observation of the cost or price. When direct observation is not possible, the next most precise alternative measurement strategy is to apply a method that reflects the available knowledge about cost or price for the item on the relevant measurement basis, using observable data about relevant valuation attributes.
5. However, constraints on the availability of such knowledge or data may limit the verifiability of such inputs to the measurement process and, therefore, limit the precision of measurement

outcomes. Furthermore, most accounting frameworks acknowledge that there are practical constraints on the information that should be taken into account, such as when the cost of obtaining it would exceed the benefits. The lack of precision in measurement arising from these constraints is inherent because it cannot be eliminated from the measurement process. Accordingly, such constraints are sources of estimation uncertainty. Other sources of measurement uncertainty that may occur in the measurement process are, at least in principle, capable of elimination if the method is applied appropriately and, therefore, are sources of potential misstatement, rather than estimation uncertainty.

6. When estimation uncertainty relates to uncertain future inflows or outflows of economic benefits that will ultimately result from the underlying asset or liability, the outcome of these flows will only be observable after the date of the financial statements. Depending on the nature of the applicable measurement basis and on the nature, condition, and circumstances of the financial statement item, this outcome may be directly observable before the financial statements are finalized or may only be directly observable at a later date. For some accounting estimates, there may be no directly observable outcome at all.
7. Some uncertain outcomes may be relatively easy to predict with a high level of precision for an individual item. For example, the useful life of a production machine may be easily predicted if sufficient technical information is available about its average useful life. When it is not possible to predict a future outcome, such as an individual's life expectancy based on actuarial assumptions, with reasonable precision, it may still be possible to predict that outcome for a group of individuals with greater precision. Measurement bases may, in some cases, indicate a portfolio level as the relevant unit of account for measurement purposes, which may reduce inherent estimation uncertainty.

Complexity

8. Complexity (that is, the complexity inherent in the process of making an accounting estimate, before consideration of controls) gives rise to inherent risk. Inherent complexity may arise when
 - there are many valuation attributes with many or nonlinear relationships between them.
 - determining appropriate values for one or more valuation attributes requires multiple data sets.
 - more assumptions are required in making the accounting estimate, or when there are correlations between the required assumptions.
 - the data used is inherently difficult to identify, capture, access, or understand.
9. Complexity may be related to the complexity of the method and the computational process or model used to apply it. For example, complexity in the model may reflect the need to apply probability-based valuation concepts or techniques, option pricing formulae, or simulation techniques to predict uncertain future outcomes or hypothetical behaviors. Similarly, the computational process may require data from multiple sources or multiple data sets to

support the making of an assumption or the application of sophisticated mathematical or statistical concepts.

10. The greater the complexity, the more likely it is that management will need to apply specialized skills or knowledge in making an accounting estimate or engage a management's expert, for example, in relation to
 - valuation concepts and techniques that could be used in the context of the measurement basis and objectives or other requirements of the applicable financial reporting framework and how to apply those concepts or techniques;
 - the underlying valuation attributes that may be relevant given the nature of the measurement basis and the nature, condition, and circumstances of the financial statement items for which accounting estimates are being made; or
 - identifying appropriate sources of data from internal sources (including from sources outside the general or subsidiary ledgers) or from external information sources, determining how to address potential difficulties in obtaining data from such sources or in maintaining its integrity in applying the method, or understanding the relevance and reliability of that data.
11. Complexity relating to data may arise, for example, in the following circumstances:
 - a. When data is difficult to obtain or when it relates to transactions that are not generally accessible. Even when such data is accessible, for example, through an external information source, it may be difficult to consider the relevance and reliability of the data, unless the external information source discloses adequate information about the underlying data sources it has used and about any data processing that has been performed
 - b. When data reflecting an external information source's views about future conditions or events, which may be relevant in developing support for an assumption, is difficult to understand without transparency about the rationale and information taken into account in developing those views
 - c. When certain types of data are inherently difficult to understand because they require an understanding of technically complex business or legal concepts, such as may be required to properly understand data that comprises the terms of legal agreements about transactions involving complex financial instruments or insurance products

Subjectivity

12. Subjectivity (that is, the subjectivity inherent in the process of making an accounting estimate, before consideration of controls) reflects inherent limitations in the knowledge or data reasonably available about valuation attributes. When such limitations exist, the applicable financial reporting framework may reduce the degree of subjectivity by providing a required basis for making certain judgments. Such requirements may, for example, set explicit or implied objectives relating to measurement, disclosure,

the unit of account, or the application of a cost constraint. The applicable financial reporting framework may also highlight the importance of such judgments through requirements for disclosures about those judgments.

13. Management judgment is generally needed in determining some or all of the following matters, which often involve subjectivity:
 - To the extent not specified under the requirements of the applicable financial reporting framework, the appropriate valuation approaches, concepts, techniques, and factors to use in the estimation method, having regard to available knowledge
 - To the extent valuation attributes are observable when there are various potential sources of data, the appropriate sources of data to use
 - To the extent valuation attributes are not observable, the appropriate assumptions or range of assumptions to make, considering the best available data, including, for example, market views
 - The range of reasonably possible outcomes from which to select management's point estimate, and the relative likelihood that certain points within that range would be consistent with the objectives of the measurement basis required by the applicable financial reporting framework
 - The selection of management's point estimate, and the related disclosures to be made, in the financial statements
14. Making assumptions about future events or conditions involves the use of judgment, the difficulty of which varies with the degree to which those events or conditions are uncertain. The precision with which it is possible to predict uncertain future events or conditions depends on the degree to which those events or conditions are determinable based on knowledge, including knowledge of past conditions, events, and related outcomes. The lack of precision also contributes to estimation uncertainty, as described previously.
15. With respect to future outcomes, assumptions will only need to be made for those features of the outcome that are uncertain. For example, in considering the measurement of a possible impairment of a receivable for a sale of goods at the balance sheet date, the amount of the receivable may be unequivocally established and directly observable in the related transaction documents. What may be uncertain is the amount, if any, for loss due to impairment. In this case, assumptions may only be required about the likelihood of loss and the amount and timing of any such loss.
16. However, in other cases, the amounts of cash flows embodied in the rights relating to an asset may be uncertain. In those cases, assumptions may have to be made about both the amounts of the underlying rights to cash flows and about potential losses due to impairment.
17. It may be necessary for management to consider information about past conditions and events, together with current trends and expectations about future developments. Past conditions and events provide historical information that may highlight repeat-

ing historical patterns that can be extrapolated in evaluating future outcomes. Such historical information may also indicate changing patterns of such behavior over time (cycles or trends). These may suggest that the underlying historical patterns of behavior have been changing in somewhat predictable ways that may also be extrapolated in evaluating future outcomes. Other types of information may also be available that indicate possible changes in historical patterns of such behavior or in related cycles or trends. Difficult judgments may be needed about the predictive value of such information.

18. The extent and nature (including the degree of subjectivity involved) of the judgments taken in making the accounting estimates may create opportunity for management bias in making decisions about the course of action that, according to management, is appropriate in making the accounting estimate. When there is also a high level of complexity or a high level of estimation uncertainty, or both, the risk of and opportunity for management bias or fraud may also be increased.

Relationship of Estimation Uncertainty to Subjectivity and Complexity

19. Estimation uncertainty gives rise to inherent variation in the possible methods, data sources, and assumptions that could be used to make an accounting estimate. This gives rise to subjectivity and, hence, the need for the use of judgment in making the accounting estimate. Such judgments are required in selecting the appropriate methods and data sources, in making the assumptions, and in selecting management's point estimate and related disclosures for inclusion in the financial statements. These judgments are made in the context of the recognition, measurement, presentation, and disclosure requirements of the applicable financial reporting framework. However, because there are constraints on the availability and accessibility of knowledge or information to support these judgments, they are subjective in nature.
20. Subjectivity in such judgments creates the opportunity for unintentional or intentional management bias in making them. Many accounting frameworks require that information prepared for inclusion in the financial statements should be neutral (that is, it should not be biased). Given that bias can, at least in principle, be eliminated from the estimation process, sources of potential bias in the judgments made to address subjectivity are sources of potential misstatement, rather than sources of estimation uncertainty.
21. The inherent variation in the possible methods, data sources, and assumptions that could be used to make an accounting estimate (see paragraph 19) also gives rise to variation in the possible measurement outcomes. The size of the range of reasonably possible measurement outcomes results from the degree of estimation uncertainty and is often referred to as the *sensitivity of the accounting estimate*. In addition to determining measurement outcomes, an estimation process also involves analyzing the effect of inherent variations in the possible methods, data sources, and assumptions on the range of reasonably possible measurement outcomes (referred to as *sensitivity analysis*).
22. Developing a financial statement presentation for an accounting estimate, which, when required by the applicable financial

reporting framework, achieves faithful representation (that is, complete, neutral, and free from error) includes making appropriate judgments in selecting a management point estimate that is appropriately chosen from within the range of reasonably possible measurement outcomes and related disclosures that appropriately describe the estimation uncertainty. These judgments may themselves involve subjectivity, depending on the nature of the requirements in the applicable financial reporting framework that address these matters. For example, the applicable financial reporting framework may require a specific basis (such as a probability-weighted average or a best estimate) for the selection of the management point estimate. Similarly, it may require specific disclosures or disclosures that meet specified disclosure objectives or additional disclosures that are required to achieve fair presentation in the circumstances.

23. Although an accounting estimate that is subject to a higher degree of estimation uncertainty may be less precisely measurable than one subject to a lower degree of estimation uncertainty, the accounting estimate may still have sufficient relevance for users of the financial statements to be recognized in the financial statements if, when required by the applicable financial reporting framework, a faithful representation of the item can be achieved. In some cases, estimation uncertainty may be so great that the recognition criteria in the applicable financial reporting framework are not met, and the accounting estimate cannot be recognized in the financial statements. Even in these circumstances, there may still be relevant disclosure requirements, for example, to disclose the point estimate or range of reasonably possible measurement outcomes and information describing the estimation uncertainty and constraints in recognizing the item. The requirements of the applicable financial reporting framework that apply in these circumstances may be specified to a greater or lesser degree. Accordingly, in these circumstances, there may be additional judgments that involve subjectivity to be made.

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Appendix B — Communications With Those Charged With Governance (Ref: par. .A146)

1. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate with those charged with governance the auditor's views about the qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.¹ Section 260² also identifies matters that may be communicated as part of this communication. The following is a list of additional matters that the auditor may consider communicating with those charged with governance with respect to the auditor's views about significant qualitative aspects of the entity's accounting practices related to accounting estimates and related disclosures:
 - How management identifies transactions, other events, and conditions that may give rise to the need for or changes in accounting estimates and related disclosures
 - Risks of material misstatement
 - The relative materiality of the accounting estimates to the financial statements as a whole
 - Management's understanding (or lack thereof) regarding the nature and extent of and the risks associated with accounting estimates
 - Whether management has applied appropriate specialized skills or knowledge or engaged appropriate experts
 - The auditor's views about differences between the auditor's point estimate or range and management's point estimate
 - The auditor's views about the appropriateness of the selection of accounting policies related to accounting estimates and presentation of accounting estimates in the financial statements
 - Indicators of possible management bias
 - Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates
 - When there has been a change from the prior period in the methods for making the accounting estimate, why, as well as the outcome of accounting estimates in prior periods
 - Whether management's methods for making the accounting estimates, including when management has used a model, are appropriate in the context of the measurement objectives; the nature, conditions, and circumstances; and

¹ Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

² The appendix, "Qualitative Aspects of Accounting Practices," of section 260.

other requirements of the applicable financial reporting framework

- The nature and consequences of significant assumptions used in accounting estimates and the degree of subjectivity involved in the development of the assumptions
- Whether significant assumptions are consistent with each other and with those used in other accounting estimates or with assumptions used in other areas of the entity's business activities
- When relevant to the appropriateness of the significant assumptions or the appropriate application of the applicable financial reporting framework, whether management has the intent to carry out specific courses of action and has the ability to do so
- How management has considered alternative assumptions or outcomes and why it has rejected them or how management has otherwise addressed estimation uncertainty in making the accounting estimate
- Whether the data and significant assumptions used by management in making the accounting estimates are appropriate in the context of the applicable financial reporting framework
- The relevance and reliability of information obtained from an external information source
- Significant difficulties encountered when obtaining sufficient appropriate audit evidence relating to data obtained from an external information source or valuations performed by management or management's expert
- Significant differences in judgments between the auditor and management or management's expert regarding valuations
- The potential effects on the entity's financial statements of material risks and exposures required to be disclosed in the financial statements, including the estimation uncertainty associated with accounting estimates
- The reasonableness of disclosures about estimation uncertainty in the financial statements
- Whether management's decisions relating to the recognition, measurement, presentation, and disclosure of the accounting estimates and related disclosures in the financial statements are in accordance with the applicable financial reporting framework

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Appendix C — Use of Pricing Information From Third Parties as Audit Evidence

1. Section 500, *Audit Evidence*, contains requirements and provides guidance about evaluating information to be used as audit evidence, including information from external information sources. This section provides guidance on complying with section 500 with respect to information to be used as audit evidence relating to accounting estimates, without regard to the sources of information. As explained in section 500, the reliability of evidence depends on the nature and source of the audit evidence and the circumstances under which it is obtained. Generally, the reliability of audit evidence increases when it is obtained from external parties because the information is less susceptible to management bias. This appendix provides additional guidance about information used as audit evidence for estimates, when that information is pricing information obtained from external information sources.
2. When the auditor uses pricing information from an external information source to develop an independent expectation or evaluates pricing information provided by a third party used by the entity, the requirement in section 500¹ to evaluate information to be used as audit evidence applies. Quoted market prices for derivative instruments and securities listed on national exchanges or over-the-counter markets that are obtained from sources such as financial publications, the exchanges, NASDAQ, or pricing services based on sources such as these generally provide sufficient evidence of the fair value of the derivative instruments and securities. The following paragraphs provide guidance for evaluating pricing information from the following sources:
 - a. Organizations that routinely provide uniform pricing information to users, generally on a subscription basis (pricing services). Note that when a pricing service is engaged to individually develop a price for a specific financial instrument not routinely priced for its subscribers, the requirements in sections 501, *Audit Evidence — Specific Considerations for Selected Items*, and 620, *Using the Work of an Auditor's Specialist*, relating to management's or the auditor's specialist, respectively, apply.
 - b. Brokers or dealers.

Using Pricing Information From Pricing Services

3. Appendix A, "Considerations Regarding the Use of External Information Sources," of section 500 provides guidance relevant to evaluating the reliability of information from external information sources. The reliability of information to be used as audit evidence depends on the nature and source of the information and the circumstances under which it is obtained. The following factors affect the reliability of pricing information provided by a pricing service:
 - a. The experience and expertise of the pricing service relative to the types of financial instruments being valued, including whether the types of financial instruments being valued are routinely priced by the pricing service

¹ Paragraph .07 of section 500, *Audit Evidence*.

- b. Whether the methodology used by the pricing service in determining fair value of the types of financial instruments being valued is in accordance with the applicable financial reporting framework
 - c. Whether the pricing service has a relationship with the entity by which management has the ability to influence the pricing service
4. The procedures performed under section 550, *Related Parties*, can assist the auditor in evaluating the reliability of the audit evidence obtained from the pricing service by taking into account the ability of management to influence the information obtained from the pricing service through relationships between the entity and the pricing service. The existence of a process by which subscribers can challenge a pricing service's pricing information does not, by itself, mean that management has the ability to influence that pricing service.
5. If the auditor performs procedures to assess the reliability of pricing information provided by a pricing service at an interim date, the auditor may determine it necessary to evaluate whether the pricing service has changed its valuation process relative to the types of financial instruments being valued and, if so, the effect of such changes on the pricing information provided at period end.
6. The relevance of audit evidence refers to its relationship to the assertion or to the objective of the control being tested. The following factors affect the relevance of pricing information provided by a pricing service:
 - a. Whether the fair values are based on quoted prices in active markets for identical financial instruments
 - b. When the fair values are based on transactions of similar financial instruments, how those transactions are identified and considered comparable to the financial instruments being valued
 - c. When no recent transactions have occurred for either the financial instrument being valued or similar financial instruments or the price was developed using a nonbinding quote from a broker or dealer, how the fair value was developed, including whether the inputs used represent the assumptions that market participants would use when pricing the financial instruments
7. Fair values of financial instruments based on trades of identical financial instruments in an active market have a lower risk of material misstatement than fair values derived from observable trades of similar financial instruments or unobservable inputs. When the fair values are based on transactions of similar financial instruments, audit procedures to evaluate the process used by the pricing service may include evaluating how transactions are identified, considered comparable, and used to value the types of financial instruments selected for testing.
8. When financial instruments are similar, and are priced by the pricing service using the same process, procedures related to the information from the pricing service may be performed for financial instruments as a group, rather than for each instrument individually. Considerations for determining the similarity of the financial instruments include the following matters:
 - The terms and characteristics of the financial instruments
 - The extent to which the fair value of the type of financial instrument is based on inputs that are observable directly or indirectly

- Other factors affecting the valuation of the financial instruments, such as credit or counterparty risk, market risk, and liquidity risk
9. When no recent transactions have occurred for either the financial instrument being valued or similar financial instruments, audit procedures may include evaluating the appropriateness of the valuation method and the reasonableness of observable and unobservable inputs used by the pricing service.

Using Pricing Information From Multiple Pricing Services

10. When pricing information is obtained from multiple pricing services (that is, more than one), less information may be needed about the particular methods and inputs used by the individual pricing services based on the presence of factors such as the following:
- a. There are recent trades of the financial instrument or of financial instruments substantially similar to the financial instruments being valued.
 - b. The type of financial instrument being valued is routinely priced by several (that is, more than two) pricing services.
 - c. Prices obtained are reasonably consistent across pricing services, taking into account the nature and characteristics of the financial instruments being valued, and market conditions.
 - d. The pricing information for the type of financial instrument is generally based on inputs that are observable.
11. When one or more of the preceding factors are not present, further audit procedures may be necessary to evaluate the appropriateness of the valuation method and the reasonableness of observable and unobservable inputs for a representative price for the type of financial instrument being valued.

Using Pricing Information From a Broker or Dealer

12. When a fair value measurement is based on a quote from a broker or dealer (broker quote), the relevance and reliability of the evidence provided by the broker quote depend on whether
- a. the broker or dealer has a relationship with the entity by which management has the ability to influence the broker or dealer;
 - b. the broker or dealer making the quote is a market maker that transacts in the same type of financial instrument;
 - c. the broker quote reflects market conditions as of the date of the financial statements;
 - d. the broker quote is binding on the broker or dealer; and
 - e. there are any restrictions, limitations, or disclaimers in the broker quote and, if so, their nature.
13. Broker quotes generally provide more relevant and reliable evidence when they are timely, binding quotes, without any restrictions, limitations, or disclaimers, from unaffiliated market makers transacting in the same type of financial instrument. If the broker quote does not provide sufficient appropriate audit evidence, additional procedures the auditor may perform include obtaining relevant and reliable pricing information from another pricing source.
14. The procedures performed under section 550 can assist the auditor in evaluating the reliability of the audit evidence obtained from the broker or dealer by taking into account the ability of management to

influence the information obtained from the broker or dealer through relationships between the entity and the broker or dealer.

Unobservable Inputs

15. When the valuation of a financial instrument includes unobservable inputs that are significant to the valuation, obtaining an understanding of how unobservable inputs were determined and evaluating the reasonableness of the unobservable inputs may include taking into account the following:
 - a. Whether modifications made to observable information generally reflect the assumptions that market participants would use when pricing the financial instrument, including assumptions about risk
 - b. How management determined its fair value measurement, including whether it appropriately considered the information available

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A155

Appendix D — Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended; SAS No. 134, *Auditor Reporting and Amendments*, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as Amended; and SAS No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as Amended

This appendix addresses the amendments to certain AU-C sections. This table is a reference tool for these amendments.

SAS No. 122 Section	Title	Paragraphs Amended
200	<i>Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards</i>	.A44
230	<i>Audit Documentation</i>	.A9, .A12, and .A30
240	<i>Consideration of Fraud in a Financial Statement Audit</i>	.A53
260, as amended by SAS No. 134	<i>The Auditor's Communication With Those Charged With Governance</i>	.A27–.A28 and .A56–.A57
501	<i>Audit Evidence — Specific Considerations for Selected Items</i>	.01, .04, .06–.10, .A1–.A2, .A5–.A6, .A8, and .A11–.A19
580	<i>Written Representations</i>	.16, .A13–.A14, and .A35
SAS No. 134 Section	Title	Paragraphs Amended
700	<i>Forming an Opinion and Reporting on Financial Statements</i>	.15c
701	<i>Communicating Key Audit Matters in the Independent Auditor's Report</i>	.08b, title before .A21
SAS No. 136 Section	Title	Paragraphs Amended
703	<i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>	.40

Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification, as Amended*

(*Boldface italics* denotes new language. Deleted text is in ~~strikethrough~~.)

1. The amendment to each section is effective for audits of financial statements for periods ending on or after December 15, 2023.

Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*

[No amendment to paragraphs .01–.A43.]

....

.A44 The assessment of the risks of material misstatement may be expressed in quantitative terms, such as percentages or nonquantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. GAAS do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the risks of material misstatement. However, ***section 540, Auditing Accounting Estimates and Related Disclosures***,¹⁵ ***requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement, including significant risks, for accounting estimates at the relevant assertion level in accordance with section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.***¹⁶ ***In identifying and assessing risks of material misstatement for significant classes of transactions, account balances, or disclosures other than accounting estimates, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages or in nonquantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.***

¹⁵ ***Paragraph .15 of section 540, Auditing Accounting Estimates and Related Disclosures.***

¹⁶ ***Paragraph .07b of section 330.***

[Subsequent footnotes renumbered.]

[No further amendment to section 200.]

Section 230, *Audit Documentation*

[No amendment to paragraphs .01–.A7. Paragraph .A8 included for contextual purposes only.]

Documentation of Compliance With GAAS (Ref: par. .08a)

.A8 In principle, compliance with the requirements of this section will result in the audit documentation being sufficient and appropriate in the circumstances. Other AU-C sections contain specific documentation requirements that are intended to clarify the application of this section in the particular circumstances of those other AU-C sections. The specific documentation requirements of other AU-C sections do not limit the application of this section. Furthermore, the absence of a documentation requirement in any particular AU-C section is not intended to suggest that there is no documentation that will be prepared as a result of complying with that AU-C section.

.A9 Audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed to the terms of the audit engagement with management or, when appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances in accordance with GAAS.
- Regarding requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with GAAS, ***for example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, documenting how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion about the sufficiency and appropriateness of the audit evidence obtained.*** ~~Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.~~
 - Similarly, that the engagement partner has taken responsibility for the direction, supervision, and performance of the audit in compliance with GAAS may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussions required by section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.⁶

^{fn 6} [Footnote omitted for purposes of this SAS.]

Documentation of Significant Findings or Issues and Related Significant Professional Judgments (Ref: par. .08c)

[No amendment to paragraphs .A10–.A11.]

.A12 Some examples of circumstances in which, in accordance with paragraph .08, it is appropriate to prepare audit documentation relating to the exercise of professional judgment include, when the findings, issues, and judgments are significant

- the rationale for the auditor's conclusion when a requirement provides that the auditor *should consider* certain information or factors, and that consideration is significant in the context of the particular engagement.
- the basis for the auditor's conclusion on the reasonableness of areas of subjective judgments ***made by management*** (for example, the reasonableness of significant accounting estimates).
- ***The basis for the auditor's evaluation of whether an accounting estimate and related disclosures are reasonable in the context of the applicable financial reporting framework or are misstated.***
- the basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of a specialist or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
- when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies, the auditor's determination of the key audit matters or the determination that there are no key audit matters to be communicated, including in the extremely rare circumstances in which the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

[No amendment to paragraphs .A13–.A29.]

Exhibit — Audit Documentation Requirements in Other AU-C Sections

.A30 The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

- a. Paragraphs .10, .13, and .16 of section 210, *Terms of Engagement*
- b. Paragraphs .25–.26 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
- c. Paragraphs .43–.46 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- d. Paragraph .28 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- e. Paragraph .20 of section 260, *The Auditor's Communication With Those Charged With Governance*
- f. Paragraph .12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- g. Paragraph .14 of section 300, *Planning an Audit*
- h. Paragraph .33 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- i. Paragraph .14 of section 320, *Materiality in Planning and Performing an Audit*
- j. Paragraphs .30–.33 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

- k. Paragraph .12 of section 450, *Evaluation of Misstatements Identified During the Audit*
- l. Paragraph .20 of section 501, *Audit Evidence — Specific Considerations for Selected Items*
- m. Paragraph .08 of section 520, *Analytical Procedures*
- n. Paragraph ~~.22~~**.38** of section 540, *Auditing Accounting Estimates ~~, Including Fair Value Accounting Estimates,~~ and Related Disclosures*
- o. Paragraph .28 of section 550, *Related Parties*
- p. Paragraph .22 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- q. Paragraphs .49 and .64 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*
- r. Paragraphs .33–.35 of section 610, *Using the Work of Internal Auditors*
- s. Paragraph .17 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- tr. Paragraph .13 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*
- us. Paragraphs .42–.43 of section 930, *Interim Financial Information*
- v†. Paragraphs .39–.42 of section 935, *Compliance Audits*

[No further amendment to section 230.]

Section 240, Consideration of Fraud in a Financial Statement Audit

[No amendment to paragraphs .01–.A50. Paragraphs .A51–.A52 included for contextual purposes only.]

Accounting Estimates (Ref: par. .32b)

.A51 The preparation and fair presentation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, for example, understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions about the entity's performance and profitability.

.A52 The purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether an indication exists of a possible bias on the part of management. This review is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.

.A53 A retrospective review is also required by section 540, *Auditing Accounting Estimates ~~, Including Fair Value Accounting Estimates,~~ and Related Disclosures*.²⁰ That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's **previous accounting estimates** prior period estimation process, audit evidence about the outcome, or when applicable, the subsequent reestimation **to assist** of prior period accounting estimates that is pertinent to making **in identifying and assessing the risks of material misstatement in the** current period

accounting estimates, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could represent a risk of material misstatement due to fraud in accordance with this section may be carried out in conjunction with the review required by section 540.

²⁰ Paragraph .1309 of section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

[No further amendment to section 240.]

Section 260, *The Auditor's Communication With Those Charged With Governance*

[No amendment to paragraphs .01–.09. Paragraphs .10–.12 included for contextual purposes only.]

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit

.10 The auditor should communicate with those charged with governance the auditor's responsibilities with regard to the financial statement audit, including that (Ref: par. .A13–.A18)

- a. the auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management, with the oversight of those charged with governance, are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- b. the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Planned Scope and Timing of the Audit

.11 The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. (Ref: par. .A19–.A24)

Significant Findings or Issues From the Audit

.12 The auditor should communicate with those charged with governance (Ref: par. .A25–.A26)

- a. the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor should (Ref: par. .A27–.A29)
 - i. explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity and
 - ii. determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.
- b. significant unusual transactions, if any (Ref: par. .A30)

- c. significant difficulties, if any, encountered during the audit. (Ref: par. .A31)
- d. disagreements with management, if any. (Ref: par. .A32)
- e. circumstances that affect the form and content of the auditor's report, if any. (Ref: par. .A33–.A34)
- f. matters that are difficult or contentious for which the auditor consulted outside the engagement team and that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.
- g. other findings or issues, if any, arising during the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. .A35–.A37)

[No amendment to paragraphs .13–.A26. Paragraph .A29 included for contextual purposes only.]

Qualitative Aspects of the Entity's Significant Accounting Practices (Ref: par. .12a)

.A27 Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures, for example, the use of key assumptions in the development of accounting estimates ~~for which there is significant measurement uncertainty~~. In addition, law, regulation, or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective, or complex judgments made by management in preparing the financial statements.

.A28 As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph .A27, those charged with governance may be interested in the auditor's ~~evaluation of the adequacy of disclosures of the estimation uncertainty relating to accounting estimates that give rise to significant risks and the quality of the disclosures~~ ***views on the degree to which complexity, subjectivity, or other inherent risk factors affect the selection or application of the methods, assumptions, and data used in making a significant accounting estimate, as well as the auditor's evaluation of whether management's point estimate and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework***. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may also include comment on the acceptability of significant accounting practices and the quality of the disclosures. ***When applicable, this may include whether a significant accounting practice of the entity relating to accounting estimates is considered by the auditor to not be the most appropriate to the particular circumstances of the entity, for example, when an alternative acceptable method for making an accounting estimate would, in the auditor's judgment, be more appropriate***. The appendix, "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication.

.A29 Certain accounting estimates have higher estimation uncertainty because of their significance to the financial statements and because of the possibility

that future events affecting them may differ markedly from management's current judgments. In communicating with those charged with governance about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates, the auditor may consider communicating

- the nature of significant assumptions,
- the degree of subjectivity involved in the development of the assumptions, and
- the relative materiality of the items being measured to the financial statements as a whole.

[No amendment to paragraphs .A30–.A55.]

Appendix — Qualitative Aspects of Accounting Practices

.A56 The communication required by paragraph .12a and discussed in paragraphs .A24–.A25 may include such matters as the following:

Accounting Policies

- The appropriateness of the accounting policies to the particular circumstances of the entity, considering the need to balance the cost of providing information with the likely benefit to users of the entity's financial statements (when acceptable alternative accounting policies exist, the communication may include identification of the financial statement items that are affected by the choice of significant policies as well as information on accounting policies used by similar entities)
- The initial selection of, and changes in, significant accounting policies, including the application of new accounting pronouncements (the communication may include the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity, and the timing of a change in accounting policies with regard to expected new accounting pronouncements)
- The effect of significant accounting policies in controversial or emerging areas (or those unique to an industry, particularly when there is a lack of authoritative material or consensus)
- The effect of the timing of transactions in relation to the period in which they are recorded

Accounting Estimates and Related Disclosures

- ~~For items for which estimates are significant, issues discussed in section **Appendix B of section 540** 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, includes matters that the auditor may consider communicating with respect to significant qualitative aspects of the entity's accounting practices related to accounting estimates and related disclosures. including the following examples:~~
 - Management's identification of accounting estimates
 - Management's process for making accounting estimates
 - Risks of material misstatement
 - Indicators of possible management bias

~~— Disclosure of estimation uncertainty in the financial statements~~

Financial Statement Disclosures

- The issues involved, and related judgments made, in formulating particularly sensitive financial statement disclosures (for example, disclosures related to revenue recognition, going concern, subsequent events, and contingency issues)
- The overall neutrality, consistency, and clarity of the disclosures in the financial statements

Related Matters

- The potential effect on the financial statements of significant risks and exposures and uncertainties, such as pending litigation, that are disclosed in the financial statements
- The extent to which the financial statements are affected by unusual transactions, including nonrecurring amounts recognized during the period, and the extent to which such transactions are separately disclosed in the financial statements
- The factors affecting asset and liability carrying values, including the entity's bases for determining useful lives assigned to tangible and intangible assets (the communication may explain how factors affecting carrying values were selected and how alternative selections would have affected the financial statements)
- The selective correction of misstatements (for example, correcting misstatements with the effect of increasing reported earnings, but not those that have the effect of decreasing reported earnings)

Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

.A57 Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

- a. paragraph .17 of section 210, *Terms of Engagement*
- b. paragraphs .21, .38ci, and .39–.41 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- c. paragraphs .14, .18, and .21–.23 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- d. paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- e. paragraph .27 of section 550, *Related Parties*
- f. paragraphs .10b–c, .12a, .15a, .17a, and .18 of section 560, *Subsequent Events and Subsequently Discovered Facts*
- g. paragraph .37 of section 540, Auditing Accounting Estimates and Related Disclosures**
- gh. paragraph .28 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- hi. paragraphs .45–.48 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*
- ji. paragraph .28 of section 610, *Using the Work of Internal Auditors*

- kj.** paragraph .16 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- lk.** paragraphs .12, .14, .24, and .31 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*
- ml.** paragraph .12 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*
- nm.** paragraphs .15, .20b, and .21a of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- on.** paragraph .06 of section 730, *Required Supplementary Information*
- po.** paragraphs .23–.28 of section 930, *Interim Financial Information*
- qp.** paragraphs .36–.37 of section 935, *Compliance Audits*

[No further amendment to section 260.]

Section 501, Audit Evidence — Specific Considerations for Selected Items

Scope of This Section

.01 This section addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; section 500, *Audit Evidence*; **section 540, Auditing Accounting Estimates and Related Disclosures**; and other relevant AU-C sections, regarding certain aspects of (a) investments in securities and derivative instruments; (b) inventory; (c) litigation, claims, and assessments involving the entity; and (d) segment information in an audit of financial statements.

[No amendment to paragraphs .02–.03.]

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting)

.04 When investments in securities are valued based on an investee's financial results, excluding investments accounted for using the equity method of accounting, the auditor should obtain sufficient appropriate audit evidence **regarding** ~~in support of~~ the investee's financial results, **including as applicable in the circumstances, performing the** ~~as follows~~ **following procedures**: (Ref: par. .A4–.A8)

- a. Obtain and read available financial statements of the investee and the accompanying audit report, if any, including determining whether the report of the other auditor is satisfactory for this purpose.
- b. If the investee's financial statements are not audited, or if the audit report on such financial statements is not satisfactory to the auditor, apply, or request that the investor entity arrange with the investee to have another auditor apply, appropriate auditing procedures to such financial statements, considering the materiality of the investment in relation to the financial statements of the investor entity.
- c. If the carrying amount of the investment reflects factors that are not recognized in the investee's financial statements or fair values of assets that are materially different from the investee's

carrying amounts, obtain sufficient appropriate audit evidence **regarding** ~~in support of~~ such amounts.

- d. If the difference between the financial statement period of the entity and the investee has or could have a material effect on the entity's financial statements, determine whether the entity's management has properly considered the lack of comparability and determine the effect, if any, on the auditor's report. (Ref: par. .A9)

If the auditor is not able to obtain sufficient appropriate audit evidence **in support of the investee's financial results** because of an inability to perform **appropriate procedures**, ~~one or more of these procedures~~, the auditor should determine the effect on the auditor's opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

[No amendment to paragraph .05.]

~~Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value~~

~~.06 With respect to investments in derivative instruments and securities measured or disclosed at fair value, the auditor should~~

- a. ~~determine whether the applicable financial reporting framework specifies the method to be used to determine the fair value of the entity's derivative instruments and investments in securities and~~
- b. ~~evaluate whether the determination of fair value is consistent with the specified valuation method. (Ref: par. .A11–.A13)~~

~~.07 If estimates of fair value of derivative instruments or securities are obtained from broker-dealers or other third-party sources based on valuation models, the auditor should understand the method used by the broker-dealer or other third-party source in developing the estimate and consider the applicability of section 500.¹ (Ref: par. .A14–.A15)~~

¹ Paragraph .08 of section 500, *Audit Evidence*, addresses management's specialists.

~~.08 If derivative instruments or securities are valued by the entity using a valuation model, the auditor should obtain sufficient appropriate audit evidence supporting management's assertions about fair value determined using the model. (Ref: par. .A16)~~

~~Impairment Losses~~

~~.09 The auditor should~~

- a. ~~evaluate management's conclusion (including the relevance of the information considered) about the need to recognize an impairment loss for a decline in a security's fair value below its cost or carrying amount and~~
- b. ~~obtain sufficient appropriate audit evidence supporting the amount of any impairment adjustment recorded, including evaluating whether the requirements of the applicable financial reporting framework have been complied with. (Ref: par. .A17–.A18)~~

~~Unrealized Appreciation or Depreciation~~

~~.10 The auditor should obtain sufficient appropriate audit evidence about the amount of unrealized appreciation or depreciation in the fair value of a derivative that is recognized or that is disclosed because of the ineffectiveness of a hedge, including evaluating whether the requirements of the applicable financial reporting framework have been complied with. (Ref: par. .A19)~~

[No amendment to paragraphs .11–.25, which are renumbered as paragraphs .06–.20. Subsequent footnotes also renumbered.]

Application and Other Explanatory Material

Investments in Securities and Derivative Instruments (Ref: par. .04–.10)

.A1 Section 540, Auditing Accounting Estimates and Related Disclosures, addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. This section addresses aspects relating to auditing valuation of investments in securities and derivative instruments that are incremental to section 540.

~~**.A1.A2**~~ Evaluating audit evidence for assertions about investments in securities and derivative instruments **often involves** ~~may involve~~ professional judgment because the assertions, especially those about valuation, are based on highly subjective assumptions or are particularly sensitive to changes in the underlying circumstances. Valuation assertions **relating to investments in securities and derivative instruments** may be based on assumptions about the occurrence of future events for which expectations are difficult to develop or on assumptions about conditions expected to exist over a long period (for example, default rates or prepayment rates). Accordingly, competent persons could reach different conclusions about estimates of fair values or estimates of ranges of fair values. Professional judgment also may be necessary when evaluating audit evidence for assertions based on features of the security or derivative and the requirements of the applicable financial reporting framework, including underlying criteria for hedge accounting, which **may be** ~~are~~ extremely complex. For example, determining the fair value of a structured note may require consideration of a variety of features of the note that react differently to changes in economic conditions. In addition, one or more other derivatives may be designated to hedge changes in cash flows under the note. Evaluating audit evidence about the fair value of the note, the determination of whether the hedge is highly effective, and the allocation of changes in fair value to earnings and other comprehensive income requires professional judgment.

~~**.A2** This section addresses only certain specific aspects relating to auditing valuation of investments in securities and derivative instruments. Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures, addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures in an audit of financial statements. The Audit Guide Auditing Derivative Instruments, Hedging Activities, and Investments in Securities provides additional and more detailed guidance to auditors related to planning and performing auditing procedures for assertions about derivative instruments, hedging activities, and investments in securities.~~

[No amendment to paragraph .A3. Paragraphs .A4 and .A7 included for contextual purposes only.]

Investments in Securities When Valuations Are Based on the Investee's Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .04–.05)

.A4 Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, addresses auditing investments accounted for using the equity method of accounting.

.A5 For valuations based on an investee's financial results (excluding investments accounted for using the equity method of accounting), obtaining and reading the financial statements of the investee that have been audited by an

auditor whose report is satisfactory may be sufficient for the purpose of obtaining sufficient appropriate audit evidence ***of the amount used in the estimate***. In determining whether the report of another auditor is satisfactory, the auditor may perform procedures such as making inquiries regarding the professional reputation and standing of the other auditor, visiting the other auditor, discussing the audit procedures followed and the results thereof, and reviewing the audit plan and audit documentation of the other auditor.

.A6 After obtaining and reading the audited financial statements of an investee, the auditor may conclude that additional audit procedures are necessary to obtain sufficient appropriate audit evidence, ***for example, when the date of the audited financial statements is different from the investor's measurement date***. Further examples for when ~~For example,~~ the auditor may conclude that additional audit evidence is needed ***include*** ~~because of significant differences in fiscal year-ends,~~ significant differences in accounting principles, changes in ownership, or the significance of the investment to the investor's financial position or results of operations. Examples of procedures that the auditor may perform are reviewing information in the investor's files that relates to the investee, such as investee minutes and budgets, and investee cash flow information and making inquiries of investor management about the investee's financial results.

.A7 The auditor may need to obtain evidence relating to transactions between the entity and investee to evaluate

- a. the propriety of the elimination of unrealized profits and losses on transactions between the entity and investee, if applicable, and
- b. the adequacy of disclosures about material related party transactions or relationships.

.A8 Section 540, Auditing Accounting Estimates and Related Disclosures, addresses Section 540 and paragraphs .06–.08 of this section address auditing fair value accounting estimates. The Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* also provides guidance on audit evidence that may be relevant to the fair value of derivative instruments and securities and on procedures that may be performed by the auditor to evaluate management's consideration of the need to recognize impairment losses.

[No amendment to paragraphs .A9–.A10.]

Investments in Derivative Instruments and Securities Measured or Disclosed at Fair Value (Ref: par. .06–.08)

.A11 The method for determining fair value may be specified by the applicable financial reporting framework and may vary depending on the industry in which the entity operates or the nature of the entity. Such differences may relate to the consideration of price quotations from inactive markets and significant liquidity discounts, control premiums, and commissions and other costs that would be incurred to dispose of the derivative instrument or security.

.A12 If the determination of fair value requires the use of accounting estimates, see section 540, which addresses auditing fair value accounting estimates, including requirements and guidance relating to the auditor's understanding of the applicable financial reporting framework relevant to accounting estimates and the method used in making the estimate⁴ and the auditor's determination of whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate.⁵ The Audit Guide *Special Considerations in Auditing Financial Instruments* also provides guidance on audit evidence that may be relevant to the fair value of derivative instruments and investments in securities.

⁴ Paragraphs .08a, .08c, .A12–.A14, and .A23–.A25 of section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

⁵ Paragraphs .12a and .A53–.A57 of section 540.

~~**A13** Quoted market prices for derivative instruments and securities listed on national exchanges or over the counter markets are available from sources such as financial publications, the exchanges, NASDAQ, or pricing services based on sources such as those. Quoted market prices obtained from those sources generally provide sufficient evidence of the fair value of the derivative instruments and securities.~~

~~**A14** For certain other derivative instruments and securities, quoted market prices may be obtained from broker-dealers who are market makers in them or through the National Quotation Bureau. However, using such a price quote to test valuation assertions may require special knowledge to understand the circumstances in which the quote was developed. For example, quotations published by the National Quotation Bureau may not be based on recent trades and may be only an indication of interest and not an actual price for which a counterparty will purchase or sell the underlying derivative instrument or security.~~

~~**A15** If quoted market prices are not available for the derivative instrument or security, estimates of fair value frequently may be obtained from broker-dealers or other third-party sources, based on proprietary valuation models, or from the entity, based on internally or externally developed valuation models (for example, the Black-Scholes option pricing model). Understanding the method used by the broker-dealer or other third-party source in developing the estimate may include, for example, understanding whether a pricing model or cash flow projection was used. The auditor also may determine that it is necessary to obtain estimates from more than one pricing source. For example, this may be appropriate if either of the following occurs:~~

- ~~• The pricing source has a relationship with an entity that might impair its objectivity, such as an affiliate or a counterparty involved in selling or structuring the product.~~
- ~~• The valuation is based on assumptions that are highly subjective or particularly sensitive to changes in the underlying circumstances.~~

See also section 540.⁶

⁶ Paragraphs .A68–.A89 of section 540.

~~**A16** Examples of valuation models include the present value of expected future cash flows, option pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Refer to section 540 for the auditor's procedures to obtain evidence supporting management's assertions about fair value that are determined using a valuation model.~~

Impairment Losses (Ref: par. .09)

~~**A17** Regardless of the valuation method used, the applicable financial reporting framework might require recognizing, in earnings or other comprehensive income, an impairment loss for a decline in fair value that is other than temporary. Determinations of whether losses are other than temporary may involve estimating the outcome of future events and making judgments in determining whether factors exist that indicate that an impairment loss has been incurred at the end of the reporting period. These judgments are based on subjective as well as objective factors, including~~

knowledge and experience about past and current events and assumptions about future events. The following are examples of such factors:

- Fair value is significantly below cost or carrying value and
 - the decline is attributable to adverse conditions specifically related to the security or specific conditions in an industry or a geographic area.
 - the decline has existed for an extended period of time.
 - for an equity security, management has the intent to sell the security or it is more likely than not that it will be required to sell the security before recovery.
 - for a debt security, management has the intent to sell the security or it is more likely than not it will be required to sell the security before the security's anticipated recovery of its amortized cost basis (for example, if the entity's cash or working capital requirements or contractual or regulatory obligations indicate that the debt security will be required to be sold before the forecasted recovery occurs).
- The security has been downgraded by a rating agency.
- The financial condition of the issuer of those securities has deteriorated.
- Dividends have been reduced or eliminated or scheduled interest payments have not been made.
- The entity recorded losses from the security subsequent to the end of the reporting period.

.A18 Evaluating the relevance of the information considered may include obtaining evidence about factors such as those referred to in paragraph .A17 that tend to corroborate or conflict with management's conclusions.

Unrealized Appreciation or Depreciation (Ref. par. .10)

.A19 Obtaining audit evidence about the amount of unrealized appreciation or depreciation in the fair value of a derivative that is recognized or that is disclosed because of the ineffectiveness of a hedge may include understanding the methods used to determine whether the hedge is highly effective and to determine the ineffective portion of the hedge.

[No amendment to paragraphs .A20–.A72, which are renumbered as paragraphs .A11–.A64. Subsequent footnotes also renumbered.]

[No further amendment to section 501.]

Section 580, *Written Representations*

[No amendment to paragraphs .01–.15.]

Estimates

.16 The auditor should request *written representations from management and, when appropriate, those charged with governance* to provide written representations about whether *the methods, significant assumptions, and the data used in making the accounting estimates and the related disclosures are appropriate to achieve recognition, measurement, or disclosure that is in accordance with the applicable financial reporting framework. The auditor should also consider the need to obtain representations about specific accounting estimates, including in*

relation to the methods, assumptions, or data used.—it believes significant assumptions used by it in making accounting estimates are reasonable.

[No amendment to paragraphs .17–.A12.]

Estimates (Ref: par. .16)

~~.A13~~ Depending on the nature, materiality, and extent of estimation uncertainty, ~~Written~~ written representations about ***specific*** accounting estimates recognized or disclosed in the financial statements may include representations

- ~~about the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework and the consistency in the application of the processes.~~
- ***that the significant judgments made in making the accounting estimates have taken into account all relevant information of which management is aware.***
- ***about the consistency and appropriateness in the selection or application of the methods, assumptions, and data used by management in making the accounting estimates.***
- that the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity when relevant to the accounting estimates and disclosures.
- that disclosures related to accounting estimates, ***including disclosures describing estimation uncertainty***, are complete and ***reasonable in the context of the*** appropriate under the applicable financial reporting framework.
- ***that appropriate specialized skills or expertise has been applied in making the accounting estimates.***
- that no subsequent event has occurred that would requires adjustment to the accounting estimates and ***related*** disclosures included in the financial statements.
- ***when accounting estimates are not recognized or disclosed in the financial statements, about the appropriateness of management's decision that the recognition or disclosure criteria of the applicable financial reporting framework have not been met.***

~~.A14~~ For those accounting estimates not recognized or disclosed in the financial statements, written representations also may include representations about the following:

- ~~The appropriateness of the basis used by management for determining that the criteria of the applicable financial reporting framework for recognition or disclosure have not been met^{fn 4}~~
- ~~The appropriateness of the basis used by management to overcome a presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework for those accounting estimates not measured or disclosed at fair value~~

[No amendment to paragraphs .A15–.A34, which are renumbered as paragraphs .A14–.A33. Subsequent footnotes also renumbered.]

Exhibit A — Illustrative Representation Letter

~~A35.A34~~ The following illustrative letter includes written representations that are required by this and other AU-C sections in effect for audits of financial statements for periods ending on or after December 15, 2012. It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States, that the requirement in section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to obtain a written representation is not relevant, and that no exceptions exist to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, for the purpose of expressing an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

Except where otherwise stated below, immaterial matters less than \$[insert amount] collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to or disclosure in the financial statements.

We confirm that [, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves] [as of (date of auditor's report),]:

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP. (par. .10a)
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. (par. .10b)
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud. (par. .12a)
- ***The methods, data, and significant*** Significant assumptions used by us in making accounting estimates, ~~including those measured at fair value, and their related disclosures~~

are ***appropriate to achieve recognition, measurement, or disclosure that is reasonable in the context of the applicable financial reporting framework.*** (par. .16)

- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP. (par. .17b)
- All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed. (par. .18)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (par. .14)
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with U.S. GAAP. (par. .15)

[Any other matters that the auditor may consider appropriate (see paragraph .A21).]

Information Provided

- We have provided you with
 - access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters; (par. .11a)
 - additional information that you have requested from us for the purpose of the audit; (par. .11a) and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence. (par. .11a)
- All transactions have been recorded in the accounting records and are reflected in the financial statements. (par. .11b)
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (par. .12b)
- We have [no knowledge of any] [disclosed to you all information that we are aware of regarding] fraud or suspected fraud that affects the entity and involves
 - management;
 - employees who have significant roles in internal control; or
 - others when the fraud could have a material effect on the financial statements (par. .12c)
- We have [no knowledge of any] [disclosed to you all information that we are aware of regarding] allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators, or others. (par. .12d)

- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (par. .13)
- We *[have disclosed to you all known actual or possible] [are not aware of any pending or threatened]* litigation, claims, and assessments whose effects should be considered when preparing the financial statements *[and we have not consulted legal counsel concerning litigation, claims, or assessments]*. (par. .15)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (par. .17a)

[Any other matters that the auditor may consider necessary (see paragraph .A21).]

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

[No amendment to paragraphs .A36–.A38, which are renumbered as paragraphs .A35–.A37. Subsequent footnotes also renumbered.]

[No further amendment to section 580.]

Amendments to Various Sections in SAS No. 134, Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements, as Amended

(Boldface italics) denotes new language. Deleted text is in ~~strikethrough~~.

2. The amendment to each section is effective for audits of financial statements for periods ending on or after December 15, 2023.

Section 700, Forming an Opinion and Reporting on Financial Statements

[No amendment to paragraphs .01–.14.]

Requirements

Forming an Opinion on the Financial Statements

....

.15 In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

- a. the financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the entity and whether they have been presented in an understandable manner. (Ref: par. .A10)
- b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
- c. the accounting estimates ***and related disclosures*** made by management are reasonable.
- d. the information presented in the financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented. (Ref: par. .A11)

- e. the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. (Ref: par. .A12)
- f. the terminology used in the financial statements, including the title of each financial statement, is appropriate.

[No further amendment to section 700.]

Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

[No amendment to paragraphs .01–.07.]

Requirements

Determining Key Audit Matters

.08 The auditor should determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor should take into account the following: (Ref: par. .A7–.A16)

- a. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Ref: par. .A17–.A20)
- b. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that **are subject to a high degree of** ~~have been identified as having high estimation uncertainty~~ (Ref: par. .A21–.A22)
- c. The effect on the audit of significant events or transactions that occurred during the period (Ref: par. .A23–.A24)

[No amendment to paragraphs .09–.A20. Paragraph .A21–.A22 included for contextual purposes only.]

*Significant Auditor Judgments Relating to Areas in the Financial Statements That Involved Significant Management Judgment, Including Accounting Estimates That ~~Have Been Identified as~~ **Are Subject to a High Degree of** ~~Having High Estimation Uncertainty~~* (Ref: par. 08b)

.A21 Section 260 requires the auditor to communicate with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.¹⁶ In particular, this may include accounting policies that have a significant effect on the financial statements (and significant changes to those policies), especially in circumstances in which an entity's accounting policies are not consistent with others in its industry.

.A22 In many cases, the auditor's communication with those charged with governance relates to accounting estimates and related disclosures. Among other things, estimates may be highly dependent on management judgment and are often the most complex areas of the financial statements, and the estimates may require the involvement of both a management's expert and an auditor's expert. Such estimates are often areas of significant auditor attention, and they may be identified as significant risks.

^{fn 16} [Footnote omitted for purposes of this SAS.]

[No further amendment to section 701.]

Amendment to SAS No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

(**Boldface italics** denotes new language. Deleted text is in ~~striketrough~~.)

3. The amendment to section 703 is effective for audits of financial statements for periods ending on or after December 15, 2023.

Section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

[No amendment to paragraphs .01–.39.]

Forming an Opinion on the ERISA Plan Financial Statements

....

.40 In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

- a. the ERISA plan financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the plan and whether they have been presented in an understandable manner. (Ref: par. .A65)
- b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
- c. the accounting estimates **and related disclosures** made by management are reasonable.
- d. the information presented in the ERISA plan financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented. (Ref: par. .A66)
- e. the ERISA plan financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the ERISA plan financial statements. (Ref: par. .A67)
- f. the terminology used in the ERISA plan financial statements, including the title of each financial statement, is appropriate.

[No further amendment to section 703.]

[Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

AU-C Section 540A

Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

Source: SAS No. 122; SAS No. 134; SAS No. 136.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 142, *Audit Evidence*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2022, and can be viewed in appendix B of section 500 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements. Specifically, it expands on how section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; and other relevant AU-C sections are to be applied with regard to accounting estimates. It also includes requirements and guidance related to misstatements of individual accounting estimates and indicators of possible management bias.

Nature of Accounting Estimates

.02 Some financial statement items cannot be measured precisely but can only be estimated. For purposes of this section, such financial statement items are referred to as *accounting estimates*. The nature and reliability of information available to management to support the making of an accounting estimate varies widely, which thereby affects the degree of estimation uncertainty associated with accounting estimates. The degree of estimation uncertainty affects, in turn, the risks of material misstatement of accounting estimates, including their susceptibility to unintentional or intentional management bias. (Ref: par. .A1–.A10 and .A136)

.03 The measurement objective of accounting estimates can vary, depending on the applicable financial reporting framework and the financial item

being reported.¹ The measurement objective for some accounting estimates is to forecast the outcome of one or more transactions, events, or conditions giving rise to the need for the accounting estimate. For other accounting estimates, including many fair value accounting estimates, the measurement objective is different and is expressed in terms of the value of a current transaction or financial statement item based on conditions prevalent at the measurement date, such as estimated market price for a particular type of asset or liability. For example, the applicable financial reporting framework may require fair value measurement based on an assumed hypothetical current transaction between knowledgeable, willing parties (sometimes referred to as *market participants* or equivalent) in an arm's length transaction, rather than the settlement of a transaction at some past or future date.²

.04 A difference between the outcome of an accounting estimate and the amount originally recognized or disclosed in the financial statements does not necessarily represent a misstatement of the financial statements; rather, it could be an outcome of estimation uncertainty (see paragraph .02). This is particularly the case for fair value accounting estimates because any observed outcome may be affected by events or conditions subsequent to the date at which the measurement is estimated for purposes of the financial statements.

Effective Date

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

Objective

.06 The objective of the auditor is to obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework

- a. accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable and
- b. related disclosures in the financial statements are adequate.

Definitions

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Accounting estimate. An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value when there is estimation uncertainty, as well as for other amounts that require estimation. When this section addresses only accounting estimates involving measurement at fair value, the term *fair value accounting estimates* is used.

Auditor's point estimate or auditor's range. The amount or range of amounts, respectively, derived from audit evidence for use in evaluating the recorded or disclosed amount(s).

¹ Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, defines *financial report framework* and the term *fair presentation framework*.

² Different definitions of *fair value* may exist among financial reporting frameworks.

Estimation uncertainty. The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

Management bias. A lack of neutrality by management in the preparation and fair presentation of information.

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

Outcome of an accounting estimate. The actual monetary amount that results from the resolution of the underlying transaction(s), event(s), or condition(s) addressed by the accounting estimate.

Requirements

Risk Assessment Procedures and Related Activities

.08 When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, as required by section 315A, the auditor should obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates:³ (Ref: par. .A11)

- a. The requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosures. (Ref: par. .A12–.A14)
- b. How management identifies those transactions, events, and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements. In obtaining this understanding, the auditor should make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates. (Ref: par. .A15–.A20)
- c. How management makes the accounting estimates and the data on which they are based, including (Ref: par. .A21–.A22)
 - i. the method(s), including, when applicable, the model, used in making the accounting estimate; (Ref: par. .A23–.A25)
 - ii. relevant controls; (Ref: par. .A26–.A27)
 - iii. whether management has used a specialist; (Ref: par. .A28–.A29)
 - iv. the assumptions underlying the accounting estimates; (Ref: par. .A30–.A35)
 - v. whether there has been or ought to have been a change from the prior period in the method(s) or assumption(s) for making the accounting estimates and, if so, why; and (Ref: par. .A36)
 - vi. whether and, if so, how management has assessed the effect of estimation uncertainty. (Ref: par. .A37)

³ Paragraphs .05–.06 and .12–.13 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

.09 The auditor should review the outcome of accounting estimates included in the prior period financial statements or, when applicable, their subsequent reestimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements. However, the review is not intended to call into question the auditor's professional judgments made in the prior periods that were based on information available at the time. (Ref: par. .A38–.A44)

Identifying and Assessing the Risks of Material Misstatement

.10 In identifying and assessing the risks of material misstatement, as required by section 315A, the auditor should evaluate the degree of estimation uncertainty associated with an accounting estimate.⁴ (Ref: par. .A45–.A46)

.11 The auditor should determine whether, in the auditor's professional judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks. (Ref: par. .A47–.A51)

Responding to the Assessed Risks of Material Misstatement

.12 Based on the assessed risks of material misstatement, the auditor should determine (Ref: par. .A52)

- a. whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate and (Ref: par. .A53–.A57)
- b. whether the methods for making the accounting estimates are appropriate and have been applied consistently and whether changes from the prior period, if any, in accounting estimates or the method for making them are appropriate in the circumstances. (Ref: par. .A58–.A59)

.13 In responding to the assessed risks of material misstatement, as required by section 330, the auditor should undertake one or more of the following, taking into account the nature of the accounting estimate:⁵ (Ref: par. .A60–.A62)

- a. Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate. (Ref: par. .A63–.A67)
- b. Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor should evaluate whether (Ref: par. .A68–.A71)
 - i. the method of measurement used is appropriate in the circumstances, (Ref: par. .A72–.A77)
 - ii. the assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework, and (Ref: par. .A78–.A89)
 - iii. the data on which the estimate is based is sufficiently reliable for the auditor's purposes. (Ref: par. .A70)

⁴ Paragraph .26 of section 315A.

⁵ Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

- c. Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures. (Ref: par. .A90–.A92)
- d. Develop a point estimate or range to evaluate management's point estimate. For this purpose (Ref: par. .A93–.A97)
 - i. if the auditor uses assumptions or methods that differ from management's, the auditor should obtain an understanding of management's assumptions or methods sufficient to establish that the auditor's point estimate or range takes into account relevant variables and to evaluate any significant differences from management's point estimate. (Ref: par. .A98)
 - ii. if the auditor concludes that it is appropriate to use a range, the auditor should narrow the range, based on audit evidence available, until all outcomes within the range are considered reasonable. (Ref: par. .A99–.A101)

.14 In determining the matters identified in paragraph .12 or in responding to the assessed risks of material misstatement in accordance with paragraph .13, the auditor should consider whether specialized skills or knowledge with regard to one or more aspects of the accounting estimates is required in order to obtain sufficient appropriate audit evidence. (Ref: par. .A102–.A107)

Further Substantive Procedures to Respond to Significant Risks (Ref: par. .A108)

Estimation Uncertainty

.15 For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of section 330, the auditor should evaluate the following:⁶

- a. How management has considered alternative assumptions or outcomes and why it has rejected them or how management has otherwise addressed estimation uncertainty in making the accounting estimate (Ref: par. .A109–.A112)
- b. Whether the significant assumptions used by management are reasonable (Ref: par. .A113–.A115)
- c. When relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so (Ref: par. .A116)

.16 If, in the auditor's professional judgment, management has not addressed adequately the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor should, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate. (Ref: par. .A117–.A118)

Recognition and Measurement Criteria

.17 For accounting estimates that give rise to significant risks, the auditor should obtain sufficient appropriate audit evidence about whether

⁶ Paragraph .18 of section 330.

- a. management's decision to recognize or not recognize the accounting estimates in the financial statements and (Ref: par. .A119–.A120)
- b. the selected measurement basis for the accounting estimates (Ref: par. .A121)

are in accordance with the requirements of the applicable financial reporting framework.

Evaluating the Reasonableness of the Accounting Estimates and Determining Misstatements

.18 The auditor should evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework or are misstated. (Ref: par. .A122–.A127)

Disclosures Related to Accounting Estimates

.19 The auditor should obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework. (Ref: par. .A128–.A129)

.20 For accounting estimates that give rise to significant risks, the auditor also should evaluate the adequacy of the disclosure of estimation uncertainty in the financial statements in the context of the applicable financial reporting framework. (Ref: par. .A108 and .A130–.A132)

Indicators of Possible Management Bias

.21 The auditor should review the judgments and decisions made by management in the making of accounting estimates to identify whether indicators of possible management bias exist. Indicators of possible management bias do not, themselves, constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates. (Ref: par. .A133–.A134)

Documentation

- .22** The auditor should include in the audit documentation⁷
- a. for those accounting estimates that give rise to significant risks, the basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure and
 - b. indicators of possible management bias, if any. (Ref: par. .A135)

Application and Other Explanatory Material

Nature of Accounting Estimates (Ref: par. .02)

.A1 Because of the uncertainties inherent in business activities, some financial statement items can only be estimated. Further, the specific characteristics of an asset, a liability, or a component of equity or the basis or method

⁷ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

of measurement prescribed by the financial reporting framework may give rise to the need to estimate a financial statement item. Some financial reporting frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements whereas other financial reporting frameworks are less specific.

.A2 Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements. For example

- accounting estimates arising in entities that engage in business activities that are not complex.
- accounting estimates that are frequently made and updated because they relate to routine transactions.
- accounting estimates derived from data that is readily available, such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as *observable* in the context of a fair value accounting estimate.
- fair value accounting estimates in which the method of measurement prescribed by the applicable financial reporting framework is simple and applied easily to the asset or liability requiring measurement at fair value.
- fair value accounting estimates in which the model used to measure the accounting estimate is well-known or generally accepted, provided that the assumptions or inputs to the model are observable.

.A3 However, for some accounting estimates, relatively high estimation uncertainty may exist, particularly when they are based on significant assumptions. For example

- accounting estimates relating to the outcome of litigation.
- fair value accounting estimates for derivative financial instruments not publicly traded.
- fair value accounting estimates for which a highly specialized entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the marketplace.

.A4 The degree of estimation uncertainty varies based on the nature of the accounting estimate, the extent to which there is a generally accepted method or model used to make the accounting estimate, and the subjectivity of the assumptions used to make the accounting estimate. In some cases, estimation uncertainty associated with an accounting estimate may be so great that the recognition criteria in the applicable financial reporting framework are not met, and the accounting estimate cannot be made.

.A5 Not all financial statement items requiring measurement at fair value involve estimation uncertainty. For example, this may be the case for some financial statement items when an active and open market exists that provides readily available and reliable information on the prices at which actual exchanges occur, in which case the existence of published price quotations ordinarily is the best audit evidence of fair value. However, estimation uncertainty may exist even when the valuation technique and data are well-defined. For example, valuation of securities quoted on an active and open market at the listed market price may require adjustment if the holding is significant in relation to the market or is subject to restrictions in marketability. In addition, general economic circumstances prevailing at the time (for example, illiquidity in a particular market) may affect estimation uncertainty.

.A6 Additional examples of situations when accounting estimates, other than fair value accounting estimates, may be required include the following:

- Allowance for doubtful accounts
- Inventory obsolescence
- Warranty obligations
- Depreciation method or asset useful life
- Provision against the carrying amount of an investment when uncertainty regarding its recoverability exists
- Outcome of long-term contracts
- Costs arising from litigation settlements and judgments

.A7 Additional examples of situations when fair value accounting estimates may be required include the following:

- Complex financial instruments, which are not traded in an active and open market
- Share-based payments
- Property or equipment held for disposal
- Certain assets or liabilities acquired in a business combination, including goodwill and intangible assets
- Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration (for example, a nonmonetary exchange of plant facilities in different lines of business)

.A8 Estimation involves judgments based on information available when the financial statements are prepared. For many accounting estimates, these include making assumptions about matters that are uncertain at the time of estimation. The auditor is not responsible for predicting future conditions, transactions, or events that, if known at the time of the audit, might have significantly affected management's actions or the assumptions used by management.

Management Bias

.A9 Financial reporting frameworks often call for neutrality (that is, freedom from bias). However, accounting estimates are imprecise and can be influenced by management judgment. Such judgment may involve unintentional or intentional management bias (for example, as a result of motivation to achieve a desired result). The susceptibility of an accounting estimate to management bias increases with the subjectivity involved in making it. Unintentional management bias and the potential for intentional management bias are inherent in subjective decisions that are often required in making an accounting estimate. For continuing audits, indicators of possible management bias identified during the audit of the preceding periods influence the planning and risk identification and assessment activities of the auditor in the current period.

.A10 Management bias can be difficult to detect at an account level. It may only be identified when considered in the aggregate of groups of accounting estimates or all accounting estimates or when observed over a number of accounting periods. Although some form of management bias is inherent in subjective decisions, in making such judgments, there may be no intention by management to mislead the users of financial statements. However, when intention to mislead exists, management bias is fraudulent in nature.

Risk Assessment Procedures and Related Activities (Ref: par. .08)

.A11 The risk assessment procedures and related activities required by paragraphs .08–.09 assist the auditor in developing an expectation of the nature and type of accounting estimates that an entity may have. The nature and extent of the risk assessment procedures and activities are matters of professional judgment. The auditor's primary consideration is whether the understanding that has been obtained is sufficient to identify and assess the risks of material misstatement related to accounting estimates and to plan the nature, timing, and extent of further audit procedures. When the risk of material misstatement related to an accounting estimate has been significantly reduced by audit evidence relating to events occurring after management has made the estimate (for example, if litigation has been settled, the entity has sold an impaired asset, or receivables have been collected), the nature and extent of the procedures and activities required by paragraphs .08c and .09 may be significantly reduced or may not be necessary at all.

Obtaining an Understanding of the Requirements of the Applicable Financial Reporting Framework (Ref: par. .08a)

.A12 Obtaining an understanding of the requirements of the applicable financial reporting framework assists the auditor in determining, for example, whether it

- prescribes certain conditions for the recognition,⁸ or methods for the measurement, of accounting estimates.
- specifies certain conditions that permit or require measurement at a fair value.
- specifies required or permitted disclosures.

Obtaining this understanding also provides the auditor with a basis for discussion with management about how management has applied those requirements relevant to the accounting estimate and the auditor's determination of whether they have been appropriately applied.

.A13 Financial reporting frameworks may provide guidance for management on determining point estimates when alternatives exist. For example, some financial reporting frameworks require that the point estimate selected be the alternative that reflects management's judgment of the most likely outcome;⁹ others may require the use of a discounted probability-weighted expected value. In some cases, management may be able to make a point estimate directly. In other cases, management may be able to make a reliable point estimate only after considering alternative assumptions or outcomes from which it is able to determine a point estimate.

.A14 Financial reporting frameworks may require the disclosure of information concerning the significant assumptions to which the accounting estimate is particularly sensitive. Furthermore, when a high degree of estimation uncertainty exists, some financial reporting frameworks do not permit an accounting estimate to be recognized in the financial statements, but certain disclosures may be required in the notes to the financial statements.

⁸ Most financial reporting frameworks require incorporation in the balance sheet or income statement of items that satisfy their criteria for recognition. Disclosure of accounting policies or adding notes to the financial statements does not rectify a failure to recognize such items, including accounting estimates.

⁹ Different financial reporting frameworks may use different terminology to describe point estimates determined in this way.

Obtaining an Understanding of How Management Identifies the Need for Accounting Estimates (Ref: par. .08b)

.A15 The preparation and fair presentation of the financial statements requires management to determine whether a transaction, an event, or a condition gives rise to the need to make an accounting estimate and that all necessary accounting estimates have been recognized, measured, and disclosed in the financial statements in accordance with the applicable financial reporting framework.

.A16 Management's identification of transactions, events, and conditions that give rise to the need for accounting estimates is likely to be based on

- management's knowledge of the entity's business and the industry in which it operates.
- management's knowledge of the implementation of business strategies in the current period.
- when applicable, management's cumulative experience of preparing the entity's financial statements in prior periods.

In such cases, the auditor may obtain an understanding of how management identifies the need for accounting estimates primarily through inquiry of management. In other cases, when management's process is more structured (for example, when management has a formal risk management function), the auditor may perform risk assessment procedures directed at the methods and practices followed by management for periodically reviewing the circumstances that give rise to the accounting estimates and reestimating the accounting estimates as necessary. The completeness of accounting estimates is often an important consideration of the auditor, particularly accounting estimates relating to liabilities.

.A17 The auditor's understanding of the entity and its environment obtained during the performance of risk assessment procedures, together with other audit evidence obtained during the course of the audit, assist the auditor in identifying circumstances or changes in circumstances that may give rise to the need for an accounting estimate.

.A18 Inquiries of management about changes in circumstances may include, for example, inquiries about whether

- the entity has engaged in new types of transactions that may give rise to accounting estimates.
- terms of transactions that gave rise to accounting estimates have changed.
- accounting policies relating to accounting estimates have changed as a result of changes within the requirements of the applicable financial reporting framework or otherwise.
- regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- new conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

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

.A19 During the audit, the auditor may identify transactions, events, and conditions that give rise to the need for accounting estimates that management

failed to identify. Section 315A addresses circumstances in which the auditor identifies risks of material misstatement that management failed to identify, including determining whether a significant deficiency or material weakness in internal control exists with regard to the entity's risk assessment processes.¹⁰

Considerations Specific to Smaller, Less Complex Entities

.A20 Obtaining this understanding for smaller entities is often less complex because their business activities are often limited, and transactions are less complex. Further, often, a single person (for example, the owner-manager) identifies the need to make an accounting estimate, and the auditor may focus inquiries accordingly.

Obtaining an Understanding of How Management Makes the Accounting Estimates (Ref: par. .08c)

.A21 The preparation and fair presentation of the financial statements also requires management to establish financial reporting processes for making accounting estimates, including adequate internal control. Such processes include the following:

- Selecting appropriate accounting policies and prescribing estimation processes, including appropriate estimation or valuation techniques, including, when applicable, the appropriate models
- Developing or identifying relevant data and assumptions that affect accounting estimates
- Periodically reviewing the circumstances that give rise to the accounting estimates and reestimating the accounting estimates as necessary

.A22 Matters that the auditor may consider in obtaining an understanding of how management makes the accounting estimates include, for example

- the types of accounts or transactions to which the accounting estimates relate (for example, whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from nonrecurring or unusual transactions).
- whether and, if so, how management has used recognized measurement techniques for making particular accounting estimates.
- whether the accounting estimates were made based on data available at an interim date and, if so, whether and how management has taken into account the effect of events, transactions, and changes in circumstances occurring between that date and the period end.

Method of Measurement, Including the Use of Models (Ref: par. .08c(i))

.A23 In some cases, the applicable financial reporting framework may prescribe the method of measurement for an accounting estimate (for example, a particular model that is to be used in measuring a fair value estimate). In many cases, however, the applicable financial reporting framework does not prescribe the method of measurement or may specify alternative methods for measurement.

.A24 When the applicable financial reporting framework does not prescribe a particular method to be used in the circumstances, matters that the

¹⁰ Paragraph .17 of section 315A.

auditor may consider in obtaining an understanding of the method or, when applicable, the model used to make accounting estimates include, for example

- how management considered the nature of the asset or liability being estimated when selecting a particular method.
- whether the entity operates in a particular business, industry, or environment in which methods commonly used to make the particular type of accounting estimate exist.

.A25 There may be greater risks of material misstatement, for example, in cases when management has internally developed a model to be used to make the accounting estimate or is departing from a method commonly used in a particular business, industry, or environment.

Relevant Controls (Ref: par. .08c(ii))

.A26 Matters that the auditor may consider in obtaining an understanding of relevant controls include, for example, the experience and competence of those who make the accounting estimates and controls related to

- how management determines the completeness, relevance, and accuracy of the data used to develop accounting estimates.
- the review and approval of accounting estimates, including the assumptions or inputs used in their development, by appropriate levels of management and, when appropriate, those charged with governance.
- the segregation of duties between those committing the entity to the underlying transactions and those responsible for making the accounting estimates, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services (for example, in the case of a large financial institution, relevant segregation of duties may include an independent function responsible for estimation and validation of fair value pricing of the entity's proprietary financial products staffed by individuals whose remuneration is not tied to such products).
- services provided by a service organization, if any, to provide fair value or other accounting estimates measurements or the data that supports the measurement. When an entity uses a service organization, section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, applies.

.A27 Other controls may be relevant to making the accounting estimates, depending on the circumstances. For example, if the entity uses specific models for making accounting estimates, management may put into place specific policies and procedures around such models. These may include, for example, those established over

- the design and development or selection of a particular model for a particular purpose.
- the use of the model.
- the maintenance and periodic validation of the integrity of the model.
- security, such as controls that prevent changes to the model or data without authorization.

*Management's Use of Specialists*¹¹ (Ref: par. .08c(iii))

.A28 Management may have, or the entity may employ individuals with, the experience and competence necessary to make estimates. In some cases, however, management may need to engage a specialist to make estimates or assist in making them. This need may arise because of, for example

- the specialized nature of the matter requiring estimation (for example, the measurement of mineral or hydrocarbon reserves in extractive industries).
- the technical nature of the models required to meet the relevant requirements of the applicable financial reporting framework, as may be the case in certain measurements at fair value.
- the unusual or infrequent nature of the condition, transaction, or event requiring an accounting estimate.

.A29 *Considerations specific to smaller, less complex entities.* Discussion with the owner-manager early in the audit process about the nature of any accounting estimates, the completeness of the required accounting estimates, and the adequacy of the estimating process may assist the owner-manager in determining the need to use a specialist.

Assumptions (Ref: par. .08c(iv))

.A30 Assumptions may be characterized by predictions of future conditions, transactions, or events used in making an estimate and are integral components of accounting estimates. Matters that the auditor may consider in obtaining an understanding of the assumptions underlying the accounting estimates include, for example

- the nature of the assumptions, including which of the assumptions are likely to be significant assumptions.
- how management assesses whether the assumptions are relevant and complete (that is, that all relevant variables have been taken into account).
- when applicable, how management determines that the assumptions used are internally consistent.
- whether the assumptions relate to matters within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life) and how they conform to the entity's business plans and the external environment or to matters that are outside its control (for example, assumptions about interest rates, mortality rates, potential judicial or regulatory actions, or the variability and timing of future cash flows).
- the nature and extent of documentation, if any, supporting the assumptions.

Assumptions may be made or identified by a specialist to assist management in making the accounting estimates. Such assumptions, when used by management, become management's assumptions.

.A31 In some cases, assumptions may be referred to as *inputs* (for example, when management uses a model to make an accounting estimate), though the term *inputs* may also be used to refer to the underlying data to which specific assumptions are applied.

¹¹ See paragraph .08 of section 500, *Audit Evidence*, which addresses management's specialists.

A32 Management may support assumptions with different types of information drawn from internal and external sources, the relevance and reliability of which will vary. In some cases, an assumption may be reliably based on applicable information from either external sources (for example, published interest rate or other statistical data) or internal sources (for example, historical information or previous conditions experienced by the entity). In other cases, an assumption may be more subjective (for example, when the entity has no experience or external sources from which to draw).

A33 In the case of fair value accounting estimates, assumptions reflect, or are consistent with, what knowledgeable, willing arm's length parties (sometimes referred to as *market participants* or equivalent) would use in determining fair value when exchanging an asset or settling a liability. Specific assumptions also will vary with the characteristics of the asset or liability being valued; the valuation technique used (for example, a market approach or an income approach); and the requirements of the applicable financial reporting framework.

A34 With respect to fair value accounting estimates, assumptions or inputs vary in terms of their source and bases, as follows:

- a. Those that reflect what market participants would use in pricing an asset or a liability, developed based on market data obtained from sources independent of the reporting entity (sometimes referred to as *observable inputs* or equivalent)
- b. Those that reflect the entity's own judgments about what assumptions market participants would use in pricing the asset or liability, developed based on the best information available in the circumstances (sometimes referred to as *unobservable inputs* or equivalent)

In practice, however, the distinction between *a* and *b* is not always apparent. Further, it may be necessary for management to select from a number of different assumptions used by different market participants.

A35 The extent of subjectivity, such as whether an assumption or input is observable, influences the degree of estimation uncertainty and, thereby, the auditor's assessment of the risks of material misstatement for a particular accounting estimate.

Changes in Methods or Assumptions for Making Accounting Estimates (Ref: par. .08c(v))

A36 In obtaining an understanding of how management makes the accounting estimates, the auditor is required to obtain an understanding about whether there has been or ought to have been a change from the prior period in the methods or assumptions for making the accounting estimates. A specific estimation method or assumption may need to be changed in response to changes in the environment or circumstances affecting the entity or in the requirements of the applicable financial reporting framework. If management has changed the method or assumption for making an accounting estimate, it is important that management can demonstrate that the new method or assumption is more appropriate or is responsive to such changes. For example, if management changes the basis of making an accounting estimate from a liquid market approach to an illiquid market approach, the auditor challenges whether management's assumptions about the marketplace are reasonable in light of economic circumstances.

Estimation Uncertainty (Ref: par. .08c(vi))

.A37 Matters that the auditor may consider in obtaining an understanding of whether and, if so, how management has assessed the effect of estimation uncertainty include, for example,

- whether and, if so, how management has considered alternative assumptions or outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the assumptions on an accounting estimate.
- how management determines the accounting estimate when analysis indicates a number of outcome scenarios.
- whether management monitors the outcome of accounting estimates made in the prior period and whether management has appropriately responded to the outcome of that monitoring procedure.

Reviewing Prior Period Accounting Estimates (Ref: par. .09)

.A38 The nature and extent of the review of the outcome of accounting estimates included in the prior period financial statements is a matter of professional judgment. In performing the procedures required in paragraph .09, it may not be necessary to review the outcome of every accounting estimate included in the prior period.

.A39 The outcome of an accounting estimate will often differ from the accounting estimate recognized in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain

- information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process;
- audit evidence that is pertinent to the reestimation, in the current period, of prior period accounting estimates; or
- audit evidence of matters that may be required to be disclosed in the financial statements, such as estimation uncertainty.

.A40 The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing, and extent of further audit procedures.

.A41 A retrospective review of management judgments and assumptions related to significant accounting estimates is also required by section 240, *Consideration of Fraud in a Financial Statement Audit*.¹² That review is conducted as part of the requirement for the auditor to design and perform procedures to review accounting estimates for biases that could represent a risk of material misstatement due to fraud, in response to the risks of management override of controls. As a practical matter, the auditor's review of prior period accounting estimates as a risk assessment procedure in accordance with this section may be carried out in conjunction with the review required by section 240.

.A42 The auditor may judge that a more detailed review is required for those accounting estimates that were identified during the prior period audit as

¹² Paragraph .32 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

having high estimation uncertainty or for those accounting estimates that have changed significantly from the prior period. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

.A43 For fair value accounting estimates and other accounting estimates based on current conditions at the measurement date, more variation may exist between the fair value amount recognized in the prior period financial statements and the outcome (or the amount reestimated for the purpose of the current period). This is because the measurement objective for such accounting estimates deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. Therefore, the auditor may focus the review on obtaining information that would be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in market participant assumptions that affected the outcome of a prior period fair value accounting estimate may be unlikely to provide relevant information for audit purposes. If so, then the auditor's consideration of the outcome of prior period fair value accounting estimates may be more appropriately directed toward understanding the effectiveness of management's prior estimation process (that is, management's track record) from which the auditor can judge the likely effectiveness of management's current process.

.A44 A difference between the outcome of an accounting estimate and the amount recognized in the prior period financial statements does not necessarily represent a misstatement of the prior period financial statements. However, it may do so if, for example, the difference arises from information that was available to management when the prior period's financial statements were finalized or that could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements. Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses situations when facts become known to the auditor after the date of the auditor's report that, had they been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report. The applicable financial reporting framework may contain guidance on distinguishing between changes in accounting estimates that constitute misstatements and changes that do not and the accounting treatment required to be followed.

Identifying and Assessing the Risks of Material Misstatement

Estimation Uncertainty (Ref: par. .10)

.A45 The degree of estimation uncertainty associated with an accounting estimate may be influenced by factors such as

- the extent to which the accounting estimate depends on judgment.
- the sensitivity of the accounting estimate to changes in assumptions.
- the existence of recognized measurement techniques that may mitigate the estimation uncertainty (though the subjectivity of the assumptions used as inputs may, nevertheless, give rise to estimation uncertainty).
- the length of the forecast period and the relevance of data drawn from past events to forecast future events.
- the availability of reliable data from external sources.

- the extent to which the accounting estimate is based on observable or unobservable inputs.

The degree of estimation uncertainty associated with an accounting estimate may influence the estimate's susceptibility to bias.

.A46 Matters that the auditor considers in assessing the risks of material misstatement may also include the following:

- The actual or expected magnitude of an accounting estimate
- The recorded amount of the accounting estimate (that is, management's point estimate) in relation to the amount expected by the auditor to be recorded
- Whether management has used a specialist in making the accounting estimate
- The outcome of the review of prior period accounting estimates

High Estimation Uncertainty and Significant Risks (Ref: par. .11)

.A47 Examples of accounting estimates that may have high estimation uncertainty include the following:

- Accounting estimates that are highly dependent upon judgment (for example, judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future)
- Accounting estimates that are not calculated using recognized measurement techniques
- Accounting estimates in which the results of the auditor's review of similar accounting estimates made in the prior period financial statements indicate a substantial difference between the original accounting estimate and the actual outcome
- Fair value accounting estimates for which a highly specialized, entity-developed model is used or for which there are no observable inputs

.A48 A seemingly immaterial accounting estimate may have the potential to result in a material misstatement due to the estimation uncertainty associated with the estimation (that is, the size of the amount recognized or disclosed in the financial statements for an accounting estimate may not be an indicator of its estimation uncertainty).

.A49 In some circumstances, the estimation uncertainty is so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may, therefore, preclude recognition of the item in the financial statements or its measurement at fair value. In such cases, the significant risks relate not only to whether an accounting estimate should be recognized or whether it should be measured at fair value but also to the adequacy of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the high estimation uncertainty associated with them (see paragraphs .A128–.A131).

.A50 If the auditor determines that an accounting estimate gives rise to a significant risk, the auditor is required by section 315A to obtain an understanding of the entity's controls, including control activities.¹³

¹³ Paragraph .30 of section 315A.

.A51 In some cases, the estimation uncertainty of an accounting estimate may lead the auditor to consider whether such estimation uncertainty indicates that substantial doubt could exist about the entity's ability to continue as a going concern. Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, addresses such circumstances. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.]

Responding to the Assessed Risks of Material Misstatement (Ref: par. .12)

.A52 Section 330 requires the auditor to design and perform audit procedures whose nature, timing, and extent are responsive to the assessed risks of material misstatement related to accounting estimates at both the financial statement and relevant assertion levels.¹⁴ Paragraphs .A53–.A121 focus on specific responses at the relevant assertion level only. Based on the assessed risks of material misstatement, the auditor is required to exercise professional judgment¹⁵ in determining the nature, timing, and extent of the procedures necessary to conclude whether management appropriately applied the requirements of the financial reporting framework, including that the methods used for making the estimates are appropriate.

Application of the Requirements of the Applicable Financial Reporting Framework (Ref: par. .12a)

.A53 Many financial reporting frameworks prescribe certain conditions for the recognition of accounting estimates and specify the methods for making them and required disclosures. Such requirements may be complex and require the application of judgment. Based on the understanding obtained in performing risk assessment procedures, the requirements of the applicable financial reporting framework that may be susceptible to misapplication or differing interpretations become the focus of the auditor's attention.

.A54 Determining whether management has appropriately applied the requirements of the applicable financial reporting framework is based, in part, on the auditor's understanding of the entity and its environment. For example, the measurement of the fair value of some items, such as intangible assets acquired in a business combination, may involve special considerations that are affected by the nature of the entity and its operations.

.A55 In some situations, additional audit procedures, such as the inspection by the auditor of the current physical condition of an asset, may be necessary to determine whether management has appropriately applied the requirements of the applicable financial reporting framework.

.A56 Collateral often is assigned for certain types of investments in debt instruments that either are required to be measured at fair value or are evaluated for possible impairment. If the collateral is an important factor in measuring the fair value of the investment or evaluating its carrying amount, it may be necessary for the auditor — in determining whether management has appropriately applied the requirements of the applicable financial reporting framework — to obtain sufficient appropriate audit evidence regarding the existence; value; rights; and access to, or transferability of, such collateral (including consideration of whether all appropriate liens have been filed and appropriate disclosures have been made).

¹⁴ Paragraph .18 of section 330.

¹⁵ Paragraph .18 of section 200.

.A57 The application of the requirements of the applicable financial reporting framework requires management to consider changes in the environment or circumstances that affect the entity. For example, the introduction of an active market for a particular class of asset or liability may indicate that the use of discounted cash flows to estimate the fair value of such asset or liability is no longer appropriate.

Consistency in Methods and Basis for Changes (Ref: par. .12b)

.A58 The auditor's consideration of a change in an accounting estimate or in the method for making it from the prior period is important because a change that is not based on a change in circumstances or new information is considered arbitrary. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time and may give rise to a financial statement misstatement or be an indicator of possible management bias.

.A59 Management often is able to demonstrate good reason for a change in an accounting estimate or the method for making an accounting estimate from one period to another based on a change in circumstances. What constitutes a good reason and the adequacy of support for management's contention that there has been a change in circumstances that warrants a change in an accounting estimate or the method for making an accounting estimate are matters of judgment.

Responses to the Assessed Risks of Material Misstatements (Ref: par. .13)

.A60 The auditor's decision about which response, individually or in combination, in paragraph .13 to undertake to respond to the risks of material misstatement may be influenced by such matters as the following:

- The nature of the accounting estimate, including whether it arises from routine or nonroutine transactions
- Whether the procedure(s) is expected to effectively provide the auditor with sufficient appropriate audit evidence
- The assessed risk of material misstatement, including whether the assessed risk is a significant risk

.A61 For example, when evaluating the reasonableness of the allowance for doubtful accounts, an effective procedure for the auditor may be to review subsequent cash collections in combination with other procedures. When the estimation uncertainty associated with an accounting estimate is high (for example, an accounting estimate based on a proprietary model for which unobservable inputs exist), it may be that a combination of the responses to assessed risks in paragraph .13 is necessary in order to obtain sufficient appropriate audit evidence.

.A62 Additional guidance explaining the circumstances in which each of the responses may be appropriate is provided in paragraphs .A63–.A101.

Events Occurring Up to the Date of the Auditor's Report (Ref: par. .13a)

.A63 Determining whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate may be an appropriate response when such events are expected to

- occur and
- provide audit evidence that confirms or contradicts the accounting estimate.

.A64 Events occurring up to the date of the auditor's report may sometimes provide sufficient appropriate audit evidence about an accounting estimate. For example, sale of the complete inventory of a superseded product shortly after the period-end may provide audit evidence relating to the estimate of its net realizable value. In such cases, there may be no need to perform additional audit procedures on the accounting estimate, provided that sufficient appropriate evidence about the events is obtained.

.A65 For some accounting estimates, events occurring up to the date of the auditor's report are unlikely to provide audit evidence regarding the accounting estimate. For example, the conditions or events relating to some accounting estimates develop only over an extended period. Also, because of the measurement objective of fair value accounting estimates, information after the period-end may not reflect the events or conditions existing at the balance sheet date and, therefore, may not be relevant to the measurement of the fair value accounting estimate. Paragraph .13 identifies other responses to the risks of material misstatement that the auditor may undertake.

.A66 In some cases, events that contradict the accounting estimate may indicate that the amount recorded is misstated, that management has ineffective processes for making accounting estimates, or that management bias exists in the making of accounting estimates.

.A67 Even though the auditor may decide not to undertake the approach referred to in paragraph .13a with respect to specific accounting estimates, the auditor is required to comply with section 560. The auditor is required to perform audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that require adjustment of, or disclosure in, the financial statements have been identified.¹⁶ Because the measurement of many accounting estimates, other than fair value accounting estimates, usually depends on the outcome of future conditions, transactions, or events, the auditor's work under section 560 is particularly relevant.

Testing How Management Made the Accounting Estimate (Ref: par. .13b)

.A68 Testing how management made the accounting estimate and the data on which it is based may be an appropriate response when the accounting estimate is a fair value accounting estimate developed on a model that uses observable and unobservable inputs. It may also be appropriate when, for example

- the accounting estimate is derived from the routine processing of data by the entity's accounting system.
- the auditor's review of similar accounting estimates made in the prior period financial statements suggests that management's current period process is likely to be effective.
- the accounting estimate is based on a large population of items of a similar nature that individually are not significant.

.A69 Testing how management made the accounting estimate and the data on which it is based may involve, for example, the following:

- Testing the extent to which data on which the accounting estimate is based is accurate, complete, and relevant and whether the accounting estimate has been properly determined using such data and management assumptions

¹⁶ Paragraphs .09 and .11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

- Considering the source, relevance, and reliability of external data or information, including that received from management's specialists,¹⁷ to assist in making an accounting estimate
- Determining how management has taken into account the effect of events, transactions, and changes in circumstances occurring between the date that the estimate or inputs to the estimate were determined and the reporting date, if the estimate was not made as of a date that coincides with the reporting date (for example, a valuation by an independent appraiser may be as of a different date)
- Recalculating the accounting estimate and reviewing, for internal consistency, information used to determine the estimate
- Considering management's review and approval processes

.A70 In accordance with section 500, *Audit Evidence*, the auditor is required to evaluate whether the data on which the estimate is based is sufficiently reliable for the auditor's purposes, including, as necessary¹⁸

- a. obtaining audit evidence about the accuracy and completeness of the data.
- b. evaluating whether the data is sufficiently precise and detailed for the auditor's purposes.

.A71 *Considerations specific to smaller, less complex entities.* In smaller entities, the process for making accounting estimates is likely to be less structured than in larger entities. Smaller entities with active management involvement may have limited descriptions of accounting procedures, unsophisticated accounting records, or few written policies. Even if the entity has no formal established process, management may still be able to provide a basis upon which the auditor can test the accounting estimate.

.A72 *Evaluating the method of measurement (Ref: par. .13b(i)).* When the applicable financial reporting framework does not prescribe the method of measurement, evaluating whether the method used (including any applicable model) is appropriate in the circumstances is a matter of professional judgment.

.A73 For this purpose, matters that the auditor may consider include, for example, whether

- management's rationale for the method selected is reasonable.
- management sufficiently and appropriately has evaluated and applied the criteria, if any, provided in the applicable financial reporting framework to support the selected method.
- the method is appropriate and sufficient data is available in the circumstances, given the nature of the asset or liability being estimated and the requirements of the applicable financial reporting framework relevant to accounting estimates.
- the method is appropriate with regard to the business, industry, and environment in which the entity operates.

.A74 In some cases, management may have determined that different methods result in a range of significantly different estimates. In such cases,

¹⁷ Paragraph .05 of section 500 defines a *management's specialist* as "[a]n individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements."

¹⁸ Paragraph .09 of section 500.

obtaining an understanding of how the entity has investigated the reasons for these differences may assist the auditor in evaluating the appropriateness of the method selected.

.A75 *Evaluating the use of models.* In some cases, particularly when making fair value accounting estimates, management may use a model. Whether the model used is appropriate in the circumstances may depend on a number of factors, such as the nature of the entity and its environment, including the industry in which it operates and the specific asset or liability being measured.

.A76 The extent to which the considerations in paragraph .A77 are relevant depends on the circumstances, including whether the model is one that is commercially available for use in a particular sector or industry, or a proprietary model. In some cases, an entity may use a management specialist¹⁹ to develop and test a model.

.A77 Depending on the circumstances, matters that the auditor may also consider in testing the model include, for example, whether

- the model is validated prior to usage, with periodic reviews to ensure it is still suitable for its intended use. The entity's validation process may include evaluation of
 - the model's theoretical soundness and mathematical integrity, including the appropriateness of model parameters.
 - the consistency and completeness of the model's inputs with market practices.
 - the model's output compared with actual transactions.
- appropriate change control policies and procedures exist.
- the model is periodically calibrated and tested for validity, particularly when inputs are subjective.
- adjustments are made to the output of the model, including in the case of fair value accounting estimates whether such adjustments reflect the assumptions that market participants would use in similar circumstances.
- the model is adequately documented, including the model's intended applications and limitations and its key parameters, required inputs, and results of any validation analysis performed.

.A78 *Assumptions used by management (Ref: par. .13b(ii)).* The auditor's evaluation of the assumptions used by management is based only on information available to the auditor at the time of the audit. Audit procedures dealing with management assumptions, including those used as inputs to valuation models, are performed in the context of the audit of the entity's financial statements and not for the purpose of providing an opinion on the assumptions themselves.

.A79 Matters that the auditor may consider in evaluating the reasonableness of the assumptions used by management include, for example

- whether individual assumptions appear reasonable.
- whether the assumptions are interdependent and internally consistent.

¹⁹ Paragraph .08 of section 500.

- whether the assumptions appear reasonable when considered collectively or in conjunction with other assumptions, either for that accounting estimate or for other accounting estimates.
- in the case of fair value accounting estimates, whether the assumptions appropriately reflect observable market assumptions.

.A80 In evaluating the reasonableness of the assumptions supporting an accounting estimate, the auditor may identify one or more significant assumptions. If so, the existence of one or more significant assumptions may be an indicator that the accounting estimate has high estimation uncertainty and may, therefore, give rise to a significant risk related to recognition, measurement, or disclosure. Additional responses to significant risks are described in paragraphs .A108–.A121.

.A81 The assumptions on which accounting estimates are based may reflect what management expects will be the outcome of specific objectives and strategies. In such cases, the auditor may perform audit procedures to evaluate the reasonableness of such assumptions by considering, for example, whether the assumptions are consistent with

- the general economic environment and the entity's economic circumstances.
- the plans of the entity.
- assumptions made in prior periods, if relevant.
- the experience of, or previous conditions experienced by, the entity to the extent this historical information may be considered representative of future conditions or events.
- other assumptions used by management relating to the financial statements.

.A82 The reasonableness of the assumptions used may depend on management's intent and ability to carry out certain courses of action. Management often documents plans and intentions relevant to specific assets or liabilities, and the financial reporting framework may require it to do so. Although the extent of audit evidence to be obtained about management's intent and ability is a matter of professional judgment, the auditor's procedures may include the following:

- Review of management's history of carrying out its stated intentions
- Review of written plans and other documentation, including, when applicable, formally approved budgets, authorizations, or minutes
- Inquiry of management about its reasons for a particular course of action
- Review of events occurring subsequent to the date of the financial statements and up to the date of the auditor's report
- Evaluation of the entity's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its existing commitments

Certain financial reporting frameworks, however, may not permit management's intentions or plans to be taken into account when making an accounting estimate. This is often the case for fair value accounting estimates because their measurement objective requires that assumptions reflect those used by market participants.

.A83 Matters that the auditor may consider in evaluating the reasonableness of assumptions used by management underlying fair value accounting estimates, in addition to those discussed previously, when applicable, may include, for example

- when relevant, whether and, if so, how management has incorporated market-specific inputs into the development of assumptions.
- whether the assumptions are consistent with observable market conditions and the characteristics of the asset or liability being measured at fair value.
- whether the sources of market-participant assumptions are relevant and reliable and how management has selected the assumptions to use when a number of different market participant assumptions exist.
- when appropriate, whether and, if so, how management considered assumptions used in, or information about, comparable transactions, assets, or liabilities.

.A84 Further, fair value accounting estimates may comprise observable inputs, as well as unobservable inputs. When fair value accounting estimates are based on unobservable inputs, matters that the auditor may consider include, for example, how management supports

- the identification of the characteristics of market participants relevant to the accounting estimate.
- modifications it has made to its own assumptions to reflect its view of assumptions market participants would use.
- whether it has incorporated appropriate information.
- when applicable, how its assumptions take account of comparable transactions, assets, or liabilities.

If there are unobservable inputs, it is more likely that the auditor's evaluation of the assumptions will need to be combined with other responses to assessed risks in paragraph .13 in order to obtain sufficient appropriate audit evidence. In such cases, it may be necessary for the auditor to perform other audit procedures (for example, examining documentation supporting the review and approval of the accounting estimate by appropriate levels of management and, when appropriate, those charged with governance).

.A85 Challenges may exist for management when fair value accounting estimates have unobservable inputs, in particular, as a result of illiquid markets. Management may not have the expertise internally to value illiquid or complex financial instruments, and there may be limited sources of information available to establish their values. It may be necessary for management to make assumptions, including assumptions utilized by management based upon the work of a specialist, to develop fair value measurements for illiquid assets.

.A86 The reliability of audit evidence is influenced by its source and nature. For example, management may use a broker quote to support a fair value measurement; however, when the quote is obtained from the institution that initially sold the instrument, this evidence may be less objective and may need to be supplemented with evidence from one or more other brokers or information from a pricing service. Pricing services and brokers may use methods of valuation that are not known to management or the auditor. In accordance with paragraph .08c(i), the auditor is required to obtain an understanding of how such information was developed. For example, the auditor might inquire

whether the value is based on private trades, trades of similar instruments, a cash flow model, or some combination of inputs. Inquiry into the nature of a broker quote is directed at its reliability and consistency with the objective of fair value measurement.

.A87 Changes in market conditions may require changes in valuation techniques. Consistency is generally a desirable quality in financial information but may be inappropriate if circumstances change. Paragraph .A57 gives the example of the introduction of an active market as an illustration of changed circumstances leading to a move from valuation by model to valuation by market price. In a period of market instability, the changes could be in the opposite direction because markets could become inactive. Even when models have been consistently used, a need for management to examine the continuing appropriateness of the assumptions exists. Further, models may have been calibrated in times when reasonable market information was available but may not provide reasonable valuations in times of unanticipated stress. Consequently, the degree of consistency of valuation techniques and the appropriateness of changes in technique or assumptions require the auditor's attention.

.A88 A change in valuation technique does not, however, justify a change in the underlying measurement objective (that is, fair value as defined in the financial reporting framework) to a different standard of value, such as an individual opinion of value. Section 500 addresses what constitutes audit evidence, the quantity and quality of audit evidence to be obtained, and the audit procedures that the auditor uses for obtaining that audit evidence. Unless management is able to support its valuations, it will be difficult for the auditor to obtain sufficient appropriate audit evidence. However, as evidence about assumptions and the validity of models is necessarily less reliable than evidence of a market price taken from an active market, it may be necessary to look at more sources of evidence to accumulate sufficient appropriate evidence because the audit evidence needed is affected by the risk of misstatement (the greater the risk, the more audit evidence is likely to be required). For example, an auditor or auditor's specialist may use an independent model to compare its results with those of the model used by management in order to evaluate whether the values determined by management's model are reasonable.

.A89 In addition, the auditor may consider whether external sources provide audit evidence to which the auditor could benchmark an entity's practices. For example, sources that track losses recorded by institutions may provide the auditor with audit evidence about whether the entity's valuations are reasonable if it has invested in similar instruments as those institutions.

Testing the Operating Effectiveness of Controls (Ref: par. .13c)

.A90 Testing the operating effectiveness of the controls over how management made the accounting estimate may be an appropriate response when management's process has been well-designed, implemented, and maintained. For example

- when controls exist for the review and approval of the accounting estimates by appropriate levels of management and, when appropriate, those charged with governance.
- when the accounting estimate is derived from the routine processing of data by the entity's accounting system.

.A91 Testing the operating effectiveness of the controls is required by section 330 when²⁰

²⁰ Paragraph .08 of section 330.

- a. the auditor's assessment of risks of material misstatement at the relevant assertion level includes an expectation that controls over the process are operating effectively or
- b. substantive procedures alone do not provide sufficient appropriate audit evidence at the relevant assertion level.

.A92 *Considerations specific to smaller, less complex entities.* Controls over the process to make an accounting estimate may exist in smaller entities, but the formality with which they operate varies. Further, smaller entities may determine that certain types of controls are not necessary because of active management involvement in the financial reporting process. In the case of very small entities, however, there may not be many controls that the auditor can identify. For this reason, the auditor's response to the assessed risks is likely to be substantive in nature, with the auditor performing one or more of the other responses in paragraph .13.

Developing a Point Estimate or Range (Ref: par. .13d)

.A93 Developing a point estimate or range to evaluate management's point estimate may be an appropriate response when, for example

- an accounting estimate is not derived from the routine processing of data by the accounting system.
- the auditor's review of similar accounting estimates made in the prior period financial statements suggests that management's current period process is unlikely to be effective.
- the entity's controls within and over management's processes for determining accounting estimates are not well-designed or properly implemented.
- events or transactions between the period-end and the date of the auditor's report contradict management's point estimate.
- there are alternative sources of relevant data available to the auditor that can be used in developing a point estimate or range.

.A94 Even when the entity's controls are well-designed and properly implemented, developing a point estimate or range may be an effective and efficient response to the assessed risks. In other situations, the auditor may consider this approach as part of determining whether further procedures are necessary and, if so, their nature and extent.

.A95 The approach taken by the auditor in developing either a point estimate or range may vary based on what is considered most effective in the circumstances. For example, the auditor may initially develop a preliminary point estimate and then assess its sensitivity to changes in assumptions to ascertain a range with which to evaluate management's point estimate. Alternatively, the auditor may begin by developing a range for purposes of determining, when possible, a point estimate.

.A96 The ability of the auditor to develop a point estimate, as opposed to a range, depends on several factors, including the model used, the nature and extent of data available, and the estimation uncertainty involved with the accounting estimate. Further, the decision to develop a point estimate or range may be influenced by the applicable financial reporting framework, which may prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions or prescribe a specific measurement method (for example, the use of a discounted probability-weighted expected value).

.A97 The auditor may develop a point estimate or range in a number of ways. For example, by

- using a model (for example, one that is commercially available for use in a particular sector or industry or a proprietary or an auditor-developed model).
- further developing management's consideration of alternative assumptions or outcomes (for example, by introducing a different set of assumptions).
- employing or engaging a person with specialized expertise to develop or execute the model or provide relevant assumptions.
- making reference to other comparable conditions, transactions, or events or, when relevant, markets for comparable assets or liabilities.

Understanding Management's Assumptions or Method (Ref: par. .13d(i))

.A98 When the auditor develops a point estimate or range and uses assumptions or a method different from those used by management, paragraph .13d(i) requires the auditor to obtain a sufficient understanding of the assumptions or method used by management in making the accounting estimate. This understanding provides the auditor with information that may be relevant to the auditor's development of an appropriate point estimate or range. Further, it assists the auditor to understand and evaluate any significant differences from management's point estimate. For example, a difference may arise because the auditor used different, but equally valid, assumptions, compared with those used by management. This may reveal that the accounting estimate is highly sensitive to certain assumptions and, therefore, subject to high estimation uncertainty, indicating that the accounting estimate may be a significant risk. Alternatively, a difference may arise as a result of a factual error made by management. Depending on the circumstances, the auditor may find it helpful in drawing conclusions to discuss with management the basis for the assumptions used and their validity and the difference, if any, in the approach taken to making the accounting estimate.

Narrowing a Range (Ref: par. .13d(ii))

.A99 When the auditor concludes that it is appropriate to use a range to evaluate the reasonableness of management's point estimate (the auditor's range), paragraph .13d(ii) requires that range to encompass all reasonable outcomes, rather than all possible outcomes. The range cannot be one that comprises all possible outcomes if it is to be useful because such a range would be too wide to be effective for purposes of the audit. The auditor's range is useful and effective when it is sufficiently narrow to enable the auditor to conclude whether the accounting estimate is materially misstated.

.A100 Ordinarily, a range that has been narrowed to be equal to or less than performance materiality (see section 320, *Materiality in Planning and Performing an Audit*) is adequate for the purposes of evaluating the reasonableness of management's point estimate.²¹ However, particularly in certain industries, it may not be possible to narrow the range to below such an amount. This does not necessarily preclude recognition of the accounting estimate. It may indicate, however, that the estimation uncertainty associated with the accounting estimate is such that it gives rise to a significant risk. Additional responses to significant risks are described in paragraphs .A108–.A121.

²¹ Paragraph .11 of section 320, *Materiality in Planning and Performing an Audit*.

.A101 Narrowing the range to a position at which all outcomes within the range are considered reasonable may be achieved by

- a. eliminating from the range those outcomes at the extremities of the range judged by the auditor to be unlikely to occur and
- b. continuing to narrow the range, based on audit evidence available, until the auditor concludes that all outcomes within the range are considered reasonable. In some rare cases, the auditor may be able to narrow the range until the audit evidence indicates a point estimate.

Considering Whether Specialized Skills or Knowledge Are Required
(Ref: par. .14)

.A102 In planning the audit, the auditor is required by section 300, *Planning an Audit*, to ascertain the nature, timing, and extent of resources necessary to perform the audit engagement.²² This may include, as necessary, the involvement of those with specialized skills or knowledge. In addition, section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires the engagement partner to be satisfied that the engagement team and any auditor's specialists who are not part of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement.²³ During the course of the audit of accounting estimates, the auditor may identify, in light of the experience of the auditor and the circumstances of the engagement, the need for specialized skills or knowledge to be applied regarding one or more aspects of the accounting estimates.

.A103 Matters that may affect the auditor's consideration of whether specialized skills or knowledge is required include, for example, the following:

- The nature of the underlying asset, liability, or component of equity in a particular business or industry (for example, mineral deposits, agricultural assets, or complex financial instruments)
- A high degree of estimation uncertainty
- Complex calculations or specialized models are involved (for example, when estimating fair values when no observable market exists)
- The complexity of the requirements of the applicable financial reporting framework relevant to accounting estimates, including whether there are areas known to be subject to differing interpretation or practice is inconsistent or developing
- The procedures that the auditor intends to undertake in responding to assessed risks

.A104 For the majority of accounting estimates, even when estimation uncertainty exists, it is unlikely that specialized skills or knowledge will be required. For example, it is unlikely that specialized skills or knowledge would be necessary for an auditor to evaluate an allowance for doubtful accounts.

.A105 However, the auditor may not possess the specialized skills or knowledge required when the matter involved is in a field other than accounting or auditing and may need to obtain it from an auditor's specialist. Section

²² Paragraph .08 of section 300, *Planning an Audit*.

²³ Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

620, *Using the Work of an Auditor's Specialist*, addresses determining the need to employ or engage an auditor's specialist and the auditor's responsibilities when using the work of an auditor's specialist.

.A106 Further, in some cases, the auditor may conclude that it is necessary to obtain specialized skills or knowledge related to specific areas of accounting or auditing. Individuals with such skills or knowledge may be employed by the auditor's firm or engaged from an external organization outside of the auditor's firm. When such individuals perform audit procedures on the engagement, they are part of the engagement team, and accordingly, they are subject to the requirements in section 220A.

.A107 Depending on the auditor's understanding of, and experience working with, the auditor's specialist or those other individuals with specialized skills or knowledge, the auditor may consider it appropriate to discuss matters such as the requirements of the applicable financial reporting framework with the individuals involved to establish that their work is relevant for audit purposes.

Further Substantive Procedures to Respond to Significant Risks (Ref: par. .15–.17 and .20)

.A108 In auditing accounting estimates that give rise to significant risks, the auditor's further substantive procedures are focused on the evaluation of

- a. how management has assessed the effect of estimation uncertainty on the accounting estimate and the effect that such uncertainty may have on the appropriateness of the recognition of the accounting estimate in the financial statements and
- b. the adequacy of related disclosures.

For estimates that give rise to significant risks, the procedures that the auditor is required to perform to address the requirements in paragraphs .12–.13 may be performed in conjunction with the procedures performed to address the requirements in paragraphs .15–.17.

Estimation Uncertainty

Management's Consideration of Estimation Uncertainty (Ref: par. .15a)

.A109 Management may evaluate alternative assumptions or outcomes of the accounting estimates through a number of methods, depending on the circumstances. One possible method used by management is to undertake a sensitivity analysis. This might involve determining how the monetary amount of an accounting estimate varies with different assumptions. Even for accounting estimates measured at fair value, there can be variation because different market participants will use different assumptions. A sensitivity analysis could lead to the development of a number of outcome scenarios, sometimes characterized as a range of outcomes by management, such as "pessimistic" and "optimistic" scenarios.

.A110 A sensitivity analysis may demonstrate that an accounting estimate is not sensitive to changes in particular assumptions. Alternatively, it may demonstrate that the accounting estimate is sensitive to one or more assumptions that then become the focus of the auditor's attention.

.A111 This is not intended to suggest that one particular method of addressing estimation uncertainty (such as sensitivity analysis) is more suitable than another or that management's consideration of alternative assumptions

or outcomes needs to be conducted through a detailed process supported by extensive documentation. Rather, it is whether management has assessed how estimation uncertainty may affect the accounting estimate that is important, not the specific manner in which it is done. Accordingly, when management has not considered alternative assumptions or outcomes, it may be necessary for the auditor to discuss with management, and request support for how it has addressed, the effects of estimation uncertainty on the accounting estimate.

.A112 *Considerations specific to smaller, less complex entities.* Smaller entities may use simple means to assess the estimation uncertainty. In addition to the auditor's review of available documentation, the auditor may obtain other audit evidence of management consideration of alternative assumptions or outcomes by inquiry of management. In addition, management may not have the expertise to consider alternative outcomes or otherwise address the estimation uncertainty of the accounting estimate. In such cases, the auditor may explain to management the process or the different methods available for doing so and the documentation thereof. This would not, however, change the responsibilities of management for the preparation and fair presentation of the financial statements.

Significant Assumptions (Ref: par. .15b)

.A113 An assumption used in making an accounting estimate may be deemed to be significant if a reasonable variation in the assumption would materially affect the measurement of the accounting estimate.

.A114 Support for significant assumptions derived from management's knowledge may be obtained from management's continuing processes of strategic analysis and risk management. Even without formal established processes, such as may be the case in smaller entities, the auditor may be able to evaluate the assumptions through inquiries of, and discussions with, management, along with other audit procedures, in order to obtain sufficient appropriate audit evidence.

.A115 The auditor's considerations in evaluating assumptions made by management are described in paragraphs .A78–.A89.

Management Intent and Ability (Ref: par. .15c)

.A116 The auditor's considerations regarding assumptions made by management and management's intent and ability are described in paragraphs .A12 and .A82.

Development of a Range (Ref: par. .16)

.A117 In preparing the financial statements, management may be satisfied that it has adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks. In some circumstances, however, the auditor may view the efforts of management as inadequate. This may be the case, for example, when, in the auditor's professional judgment

- sufficient appropriate audit evidence could not be obtained through the auditor's evaluation of how management has addressed the effects of estimation uncertainty.
- it is necessary to explore further the degree of estimation uncertainty associated with an accounting estimate (for example, when the auditor is aware of wide variation in outcomes for similar accounting estimates in similar circumstances).
- it is unlikely that other audit evidence can be obtained (for example, through the review of events occurring up to the date of the auditor's report).

- indicators of management bias in the making of accounting estimates may exist.

.A118 The auditor's considerations in determining a range for this purpose are described in paragraphs .A93–.A101.

Recognition and Measurement Criteria

Recognition of the Accounting Estimates in the Financial Statements (Ref: par. .17a)

.A119 When management has recognized an accounting estimate in the financial statements, the focus of the auditor's evaluation is on whether the measurement of the accounting estimate is sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework.

.A120 With respect to accounting estimates that have not been recognized, the focus of the auditor's evaluation is on whether the recognition criteria of the applicable financial reporting framework have, in fact, been met. Even when an accounting estimate has not been recognized and the auditor concludes that this treatment is appropriate, there may be a need for disclosure of the circumstances in the notes to the financial statements. When applicable, the auditor may also determine that an accounting estimate that has been identified as having a high estimation uncertainty is a key audit matter to be communicated in the auditor's report in accordance section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, or the auditor may consider it necessary to include an emphasis-of-matter paragraph in the auditor's report (see section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*). If the matter is determined to be a key audit matter, section 706 prohibits the auditor from including that matter in an emphasis-of-matter paragraph in the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Measurement Basis for the Accounting Estimates (Ref: par. .17b)

.A121 With respect to fair value accounting estimates, some financial reporting frameworks presume that fair value can be measured reliably as a prerequisite to either requiring or permitting fair value measurements and disclosures. In some cases, this presumption may be overcome when, for example, no appropriate method or basis for measurement exists. In such cases, the focus of the auditor's evaluation is on whether management's basis for overcoming the presumption relating to the use of fair value set forth under the applicable financial reporting framework is appropriate.

Evaluating the Reasonableness of the Accounting Estimates and Determining Misstatements (Ref: par. .18)

.A122 Based on the audit evidence obtained, the auditor may conclude that the evidence points to an accounting estimate that differs from management's point estimate. When the audit evidence supports a point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement. When the auditor has concluded that using the auditor's range provides sufficient appropriate audit evidence, a management point estimate that lies outside the auditor's range would not be supported by audit evidence. In such cases, the misstatement is no less than the difference between management's point estimate and the nearest point of the auditor's range.

.A123 When management has changed an accounting estimate, or the method in making it, from the prior period based on a subjective assessment that there has been a change in circumstances, the auditor may conclude, based on the audit evidence, that the accounting estimate is misstated as a result of an arbitrary change by management or may regard it as an indicator of possible management bias (see paragraphs .A133–.A134).

.A124 Section 450, *Evaluation of Misstatements Identified During the Audit*, provides guidance on distinguishing misstatements for purposes of the auditor's evaluation of the effect of uncorrected misstatements on the financial statements.²⁴ With regard to accounting estimates, a misstatement, whether caused by fraud or error, may arise as a result of

- misstatements about which no doubt exists (factual misstatements).
- differences arising from management's judgments concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate (judgmental misstatements).
- the auditor's best estimate of misstatements in populations involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn (projected misstatements).

In some cases involving accounting estimates, a misstatement could arise as a result of a combination of these circumstances, making separate identification difficult or impossible.

.A125 Evaluating the reasonableness of accounting estimates and related disclosures included in the notes to the financial statements, whether required by the applicable financial reporting framework or disclosed voluntarily, involves essentially the same types of considerations applied when auditing an accounting estimate recognized in the financial statements.

Written Representations

.A126 Part of the auditor's audit evidence includes obtaining representations from management about whether management believes significant assumptions used in making accounting estimates are reasonable. See section 580, *Written Representations*.²⁵

Communication With Those Charged With Governance

.A127 Section 260, *The Auditor's Communication With Those Charged With Governance*, addresses the auditor's communications of certain matters related to the conduct of an audit to those charged with governance. The auditor is required by section 260 to communicate the auditor's views about the qualitative aspects of the entity's significant accounting practices, including accounting estimates, and, when applicable, is required to determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.²⁶

²⁴ Paragraph .A6 of section 450, *Evaluation of Misstatements Identified During the Audit*.

²⁵ Paragraph .16 of section 580, *Written Representations*.

²⁶ Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

Disclosures Related to Accounting Estimates

Disclosures in Accordance With the Applicable Financial Reporting Framework (Ref: par. .19)

.A128 The presentation of financial statements in accordance with the applicable financial reporting framework includes adequate disclosure of material matters. The applicable financial reporting framework may permit or prescribe disclosures related to accounting estimates, and some entities may disclose voluntarily additional information in the notes to the financial statements. These disclosures may include, for example

- the assumptions used.
- the method of estimation used, including any applicable model(s).
- the basis for the selection of the method of estimation.
- the effect of any changes to the method of estimation from the prior period.
- the sources and implications of estimation uncertainty.

Such disclosures are relevant to users in understanding the accounting estimates recognized or disclosed in the financial statements, and sufficient appropriate audit evidence needs to be obtained about whether the disclosures are in accordance with the requirements of the applicable financial reporting framework.

.A129 In some cases, the applicable financial reporting framework may require specific disclosures regarding uncertainties. For example, some financial reporting frameworks prescribe the following:

- The disclosure of key assumptions and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities. Such requirements may be described using terms such as *key sources of estimation uncertainty* or *critical accounting estimates*.
- The disclosure of the range of possible outcomes and the assumptions used in determining the range.
- The disclosure of information regarding the significance of fair value accounting estimates to the entity's financial position and performance.
- Qualitative disclosures, such as the exposures to risk and how they arise; the entity's objectives, policies, and procedures for managing the risk; and the methods used to measure the risk, and any changes from the previous period of these qualitative concepts.
- Quantitative disclosures, such as the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel, including credit risk, liquidity risk, and market risk.

Disclosures of Estimation Uncertainty for Accounting Estimates That Give Rise to Significant Risks (Ref: par. .20)

.A130 Regarding accounting estimates having significant risk, even when the disclosures are in accordance with the applicable financial reporting framework, the auditor may conclude that the disclosure of estimation uncertainty is inadequate in light of the circumstances and facts involved. The auditor's evaluation of the adequacy of disclosure of estimation uncertainty increases

in importance the greater the range of possible outcomes of the accounting estimate in relation to materiality (see the related discussion in paragraphs .A98–.A101).

.A131 In some cases, the auditor may consider it appropriate to encourage management to describe the circumstances relating to the estimation uncertainty in the notes to the financial statements.

.A132 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, addresses the implications for the auditor's opinion when the auditor believes that management's disclosure of estimation uncertainty in the financial statements is inadequate or misleading.

Indicators of Possible Management Bias (Ref: par. .21)

.A133 During the audit, the auditor may become aware of judgments and decisions made by management that give rise to indicators of possible management bias (see paragraph .A9). Such indicators may affect the auditor's conclusion about whether the auditor's risk assessment and related responses remain appropriate, and the auditor may need to consider the implications for the rest of the audit. Further, they may affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement, as discussed in section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A134 Examples of indicators of possible management bias with respect to accounting estimates include the following:

- Changes in an accounting estimate, or the method for making it, when management has made a subjective assessment that there has been a change in circumstances
- The use of an entity's own assumptions for fair value accounting estimates when they are inconsistent with observable market assumptions
- The selection or construction of significant assumptions that yield a point estimate favorable for management objectives
- The selection of a point estimate that may indicate a pattern of optimism or pessimism

Documentation (Ref: par. .22)

.A135 Documentation of indicators of possible management bias identified during the audit assists the auditor in concluding whether the auditor's risk assessment and related responses remain appropriate and in evaluating whether the financial statements as a whole are free from material misstatement. See paragraph .A134 for examples of indicators of possible management bias.

.A136

Exhibit—Examples of Accounting Estimates (Ref: par. .02)

The following are examples of accounting estimates that are included in financial statements. The list is presented for information only. It is not considered to be all-inclusive.

- **Receivables**
 - Uncollectible receivables
 - Allowance for loan losses
 - Valuation of long-term unconditional promises to give
- **Inventories**
 - Obsolete inventory
 - Net realizable value of inventories when future selling prices and future costs are involved
 - Losses on purchase commitments
- **Financial instruments**
 - Valuation of securities
 - Probability of high correlation of a hedge
 - Sales of securities with puts and calls
- **Productive facilities, natural resources, and intangibles**
 - Useful lives and residual values
 - Depreciation and amortization methods
 - Impairment analysis
 - Recoverability of costs
 - Recoverable reserves
- **Accruals**
 - Property and casualty insurance company loss reserves
 - Compensation in stock option plans and deferred plans
 - Warranty claims
 - Taxes on real and personal property
 - Renegotiation refunds
 - Actuarial assumptions in benefit costs
- **Revenues**
 - Airline passenger revenue
 - Subscription income
 - Freight and cargo revenue
 - Dues income
 - Losses on sales contracts
- **Contracts**

- Revenue to be earned
 - Costs to be incurred
 - Percent of completion
 - **Leases**
 - Initial direct costs
 - Executory costs
 - **Litigation**
 - Probability of loss
 - Amount of loss
 - **Rates**
 - Annual effective tax rate in interim reporting
 - Imputed interest rates on receivables and payables
 - Gross profit rates under program method of accounting
 - **Other**
 - Losses and net realizable value on disposal of segment or restructuring of a business
 - Fair values in nonmonetary exchanges
 - Interim period costs in interim reporting
 - Current values in personal financial statements
-

AU-C Section 550

Related Parties

Source: SAS No. 122; SAS No. 128; SAS No. 135; SAS No. 136.

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

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements.¹ Specifically, it expands on how section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; and section 240, *Consideration of Fraud in a Financial Statement Audit*, are to be applied regarding risks of material misstatement associated with related party relationships and transactions.

.02 Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, requires the auditor to evaluate whether the financial statements achieve fair presentation.² Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, requires that, in audits of special purpose financial statements that contain related party transactions, the auditor evaluate whether the financial statements include informative disclosures similar to those required by generally accepted accounting

¹ The phrase "related party relationships and transactions" as used in generally accepted auditing standards is intended to have the same meaning as the phrase "related parties and relationships and transactions with related parties" as used in the auditing standards of the PCAOB. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

² Paragraph .16 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .41 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. [Footnote renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

principles (GAAP).³ Section 800 also requires the auditor to evaluate whether additional disclosures beyond those specifically required by the framework and related to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the financial statements to achieve fair presentation.⁴ Thus, this section applies to all audits of financial statements. (Ref: par. .A1–.A3) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Nature of Related Party Relationships and Transactions (Ref: par. .A1–.A6)

.03 Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. For example

- related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
- related party transactions may not be conducted under normal market terms and conditions (for example, some related party transactions may be conducted with no exchange of consideration).
- related party transactions may be motivated solely or in large measure to engage in fraudulent financial reporting or conceal misappropriation of assets.

Responsibilities of the Auditor

.04 Because related parties are not independent of each other, financial reporting frameworks establish specific accounting and disclosure requirements for related party relationships, transactions, and balances to enable users of the financial statements to understand their nature and actual or potential effects on the financial statements. Therefore, the auditor has a responsibility to perform audit procedures to identify, assess, and respond to the risks of material misstatement arising from the entity's failure to appropriately account for or disclose related party relationships, transactions, or balances. (Ref: par. .A3)

.05 In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether one or more fraud risk factors are present, as required by section 240, because fraud may be more easily committed through related parties.⁵

³ Paragraph .17 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

⁴ Paragraph .17 of section 800. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

⁵ Paragraph .24 of section 240, *Consideration of Fraud in a Financial Statement Audit*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

.06 Owing to the inherent limitations of an audit, an unavoidable risk exists that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with generally accepted auditing standards (GAAS).⁶ In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater because of reasons such as the following:

- Management may be unaware of the existence of all related party relationships and transactions.
- Related party relationships may present a greater opportunity for collusion, concealment, or manipulation by management.

.07 Planning and performing the audit with professional skepticism as required by section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, is, therefore, particularly important in this context, given the potential for undisclosed related party relationships and transactions.⁷ The requirements in this section are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions and in designing audit procedures to respond to the assessed risks.

Effective Date

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

Objectives

.09 The objectives of the auditor are to

- a. obtain an understanding of related party relationships and transactions sufficient to be able to
 - i. recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud.
 - ii. conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions, achieve fair presentation.
- b. obtain sufficient appropriate audit evidence about whether related party relationships and transactions have been appropriately identified, accounted for, and disclosed in the financial statements.

Definitions

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

⁶ Paragraph .A56 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

⁷ Paragraph .17 of section 200. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

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

Related party. A party defined as a related party in GAAP. (Ref: par. .A1)

.11 Reference to GAAP in GAAS means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Risk Assessment Procedures and Related Activities

.12 As part of the risk assessment procedures and related activities that section 240 and section 315A require the auditor to perform during the audit, the auditor should perform the audit procedures and related activities set out in paragraphs .13–.19 to obtain information relevant to identifying the risks of material misstatement associated with related party relationships and transactions.^{8, 9}

Understanding the Entity's Related Party Relationships and Transactions

.13 In connection with the engagement team discussion(s) that section 240 and section 315A require, the auditor should include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.^{10, 11} (Ref: par. .A7–.A8)

.14 The auditor should inquire of management and others within the entity regarding the following:

- a. The identity of the entity's related parties, including changes from the prior period (Ref: par. .A9–.A15)
- b. The nature of the relationships (including ownership structure) between the entity and these related parties
- c. The business purpose of entering into a transaction with a related party versus an unrelated party
- d. Whether the entity entered into, modified, or terminated any transactions with these related parties during the period and, if so, the type and business purpose of the transactions

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

⁸ Paragraph .16 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

⁹ Paragraph .05 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

¹⁰ Paragraph .15 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

¹¹ Paragraph .11 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

.15 The auditor should inquire of management and others within the entity and perform other risk assessment procedures¹² considered appropriate to obtain an understanding of the controls, if any, that management has established to (Ref: par. .A16–.A21)

- a. identify, account for, and disclose related party relationships and transactions.
- b. authorize and approve significant transactions and arrangements with related parties. (Ref: par. .A22)
- c. authorize and approve significant unusual transactions, and arrangements outside the normal course of business.

Inquiries should include asking about any related party transactions

- a. that have not been authorized and approved in accordance with the entity's established policies or procedures regarding the authorization and approval of transactions with related parties.
- b. for which exceptions to the entity's established policies or procedures were granted and the reasons for granting those exceptions. (Ref: par. .A44–.A45)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.16 Unless all of those charged with governance are involved in managing the entity, the auditor should inquire of those charged with governance (or the audit committee or, at least, its chair) regarding

- a. their understanding of the entity's relationships and transactions with related parties that are significant to the entity and
- b. whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Remaining Alert for Related Party Information When Reviewing Records or Documents

.17 During the audit, the auditor should remain alert when inspecting records or documents for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. In particular, the auditor should inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: (Ref: par. .A23–.A25)

- a. Bank and legal confirmations obtained as part of the auditor's procedures
- b. Minutes of meetings of shareholders and of those charged with governance and summaries of actions of recent meetings for which minutes have not yet been prepared
- c. Such other records or documents as the auditor considers necessary in the circumstances of the entity

¹² Paragraph .06 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.18 If the auditor identifies significant unusual transactions when performing the audit procedures required by paragraph .17 or through other audit procedures, the auditor should inquire of management about the following: (Ref: par. .A26–.A27)

- a. The nature of these transactions (Ref: par. .A28)
- b. Whether related parties could be involved (Ref: par. .A29)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Sharing Related Party Information With the Engagement Team

.19 The auditor should share with the other members of the engagement team the identity of the entity's related parties and other relevant information obtained about the related parties. (Ref: par. .A30–.A31) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identification and Assessment of the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

.20 In meeting the requirement of section 315A to identify and assess the risks of material misstatement, the auditor should identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks.¹³ In making this determination, the auditor should treat identified related party transactions that are also significant unusual transactions as giving rise to significant risks. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.21 If the auditor identifies fraud risk factors (including circumstances relating to the existence of a related party with dominant influence) when performing the risk assessment procedures and related activities in connection with related parties, the auditor should consider such information when identifying and assessing the risks of material misstatement due to fraud, in accordance with section 240.¹⁴ (Ref: par. .A32–.A34) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

.22 As part of the requirement in section 330 that the auditor respond to assessed risks, the auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions. The auditor should evaluate whether the entity has properly identified its related party relationships and transactions. Evaluating whether an

¹³ Paragraph .26 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

¹⁴ Paragraph .24 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

entity has properly identified its related party relationships and transactions involves more than assessing the process used by the entity. The evaluation should include procedures to test the accuracy and completeness of the related party relationships and transactions identified by the entity, taking into account the information gathered during the audit.¹⁵ (Ref: par. .A35–.A38) [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.23 The auditor should perform procedures on balances with affiliated entities as of concurrent dates, even if fiscal years of the respective entities differ. The procedures performed should address the risks of material misstatement associated with the entity's accounts with affiliates. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

.24 If the auditor identifies arrangements or information that suggests the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor, the auditor should determine whether the underlying circumstances confirm the existence of those relationships or transactions. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.25 If the auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to the auditor, the auditor should

- a. promptly communicate the relevant information to the other members of the engagement team. (Ref: par. .A30 and .A39)
- b. request management to identify all transactions with the newly identified related parties for the auditor's further evaluation.
- c. inquire why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationships or transactions.
- d. perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions. (Ref: par. .A40)
- e. reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor and perform additional audit procedures as necessary.
- f. evaluate the implications for the audit if the nondisclosure by management appears intentional (and, therefore, indicative of a risk of material misstatement due to fraud). (Ref: par. .A41)

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

¹⁵ Paragraphs .05–.06 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

Identified Related Party Transactions That Are Required to Be Disclosed or Determined to be a Significant Risk

.26 For identified significant related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk, the auditor should¹⁶

- a. read the underlying contracts or agreements, if any, and evaluate whether
 - i. the business purpose (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.¹⁷ (Ref: par. .A42–.A43)
 - ii. the terms of the transactions are consistent with management's explanations.
 - iii. the transactions have been appropriately accounted for and disclosed.
- b. obtain audit evidence that the transactions have been appropriately authorized and approved. (Ref: par. .A44–.A45)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction

.27 If management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor should obtain sufficient appropriate audit evidence about the assertion. (Ref: par. .A46–.A50) [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of the Accounting for, and Disclosure of, Identified Related Party Relationships and Transactions

.28 In forming an opinion on the financial statements, in accordance with section 700, or section 703, the auditor should evaluate the following:¹⁸ (Ref: par. .A51)

- a. Whether the identified related party relationships and transactions have been appropriately accounted for and disclosed (Ref: par. .A52)
- b. Whether the effects of the related party relationships and transactions prevent the financial statements from achieving fair presentation (Ref: par. .A3)

[Paragraph renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹⁶ See paragraph .21, which requires the auditor to treat identified related party transactions that are also significant unusual transactions as giving rise to significant risks. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

¹⁷ Paragraph .32c of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

¹⁸ Paragraphs .12–.17 of section 700, or paragraphs .37–.42 of section 703, as applicable. [Footnote renumbered by the issuance of SAS No. 135, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Communication With Those Charged With Governance

.29 Unless all of those charged with governance are involved in managing the entity, the auditor should communicate with those charged with governance significant findings or issues arising during the audit in connection with the entity's related parties.¹⁹ (Ref: par. .A53) [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Documentation

.30 The auditor should include in the audit documentation the names of the identified related parties and the nature of the related party relationships.²⁰ [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Application and Other Explanatory Material

Nature of Related Party Relationships and Transactions (Ref: par. .02–.04, .10, and .28b)

.A1 GAAP frameworks include or refer to specific disclosure requirements for related party relationships and transactions. If the applicable financial reporting framework does not have specific disclosure requirements, the auditor, nonetheless, evaluates whether related party information is disclosed in a manner comparable to GAAP in order for the financial statements to achieve fair presentation.²¹

.A2 Certain accounting pronouncements prescribe the accounting treatment when related parties are involved; however, established accounting principles ordinarily do not require transactions with related parties to be accounted for on a basis different from that which would be appropriate if the parties were not related. In addition, the substance of a particular transaction may be significantly different from its form. Accordingly, financial statements prepared in accordance with GAAP generally recognize the substance of particular transactions rather than merely their legal form.

.A3 Related party relationships and transactions may cause the financial statements to fail to achieve fair presentation if, for example, the economic substance of such relationships and transactions is not appropriately reflected in the financial statements. For instance, fair presentation may not be achieved if the sale of a property by the entity to a controlling shareholder at a price above or below fair market value has been accounted for as a transaction involving a profit or loss for the entity when it may constitute a contribution or return of capital or the payment of a dividend. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A4 Transactions that because of their nature may be indicative of the existence of related parties include the following:

¹⁹ Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

²⁰ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

²¹ Paragraph .17 of section 800. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- a. Borrowing or lending on an interest free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction
- b. Selling real estate at a price that differs significantly from its appraised value
- c. Exchanging property for similar property in a nonmonetary transaction
- d. Making loans with no scheduled terms for when or how the funds will be repaid

.A5 Although many related party transactions are in the normal course of business, a possibility exists that transactions with related parties may have been motivated solely or in large measure by conditions similar to the following:

- a. Lack of sufficient working capital or credit to continue the business
- b. An overly optimistic earnings forecast
- c. Dependence on a single or relatively few products, customers, or transactions for the continued success of the venture
- d. A declining industry characterized by a large number of business failures
- e. Excess capacity
- f. Significant litigation, especially litigation between stockholders and management
- g. Significant obsolescence dangers because the company is in a high technology industry

For these reasons, related party transactions may indicate an increased risk of material misstatement of the financial statements.

Considerations Specific to Governmental Entities

.A6 For state and local governmental entities, related party relationships and transactions can result from interactions with other governments, not-for-profit entities, for-profit entities, and individuals. The applicable financial reporting framework used by most state and local governmental entities addresses related party relationships and transactions using terms that include *related parties*, *related organizations*, and *component units*, and can result in the inclusion of the related parties' financial statements as a reporting unit, inclusion within a reporting unit, disclosure of the related party transactions, or disclosure about why the related party or its transactions are not included. In all such cases, the objectives described in paragraph .09 are relevant to the auditor.

Risk Assessment Procedures and Related Activities

Understanding the Entity's Related Party Relationships and Transactions

Discussion Among the Engagement Team (Ref: par. .13)

.A7 Matters that may be addressed in the discussion among the engagement team include the following:

- The nature and extent of the entity's relationships and transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit)

- An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships and transactions
- The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (for example, a complex organizational structure, use of entities formed to accomplish specific purposes,²² or an inadequate information system)
- The records or documents that may indicate the existence of related party relationships or transactions
- The importance that management and those charged with governance attach to the identification of, appropriate accounting for, and disclosure of related party relationships and transactions and the related risk of management override of relevant controls

.A8 In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:

- Entities formed to accomplish specific purposes and that are controlled by management might be used to facilitate earnings management.
- Transactions between the entity and a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.
- As indicated in paragraph .A2, the form of a related party transaction may mask its substance. For example, equity distributions or capital contributions may be structured as loans.
- Related party transactions may be subject to period-end window dressing. For example, a stockholder may pay a loan shortly before period-end, but the entity loans the same amount to the stockholder shortly after period-end.
- Certain entities, such as governmental entities or entities operating in regulated industries, may circumvent laws or regulations that limit or restrict their ability to engage in transactions with related parties.

The Identity of the Entity's Related Parties (Ref: par. .14a)

.A9 Information regarding the identity of the entity's related parties is likely to be readily available to management if the entity's information systems record, process, and summarize related party relationships and transactions to enable the entity to meet applicable disclosure requirements. Therefore, management may have a comprehensive list of related parties and changes from the prior period. For recurring engagements, making the inquiries specified by paragraph .14 provides a basis for comparing the information supplied by management with the auditor's record of related parties noted in previous audits.

.A10 However, if the entity does not have such information systems in place, management may not be aware of the existence of all related parties. Nevertheless, the requirement to make the inquiries specified by paragraph

²² Entities formed to accomplish specific purposes are discussed in paragraphs .A27–.A28 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

.14 still applies because management may be aware of parties that meet the related party definition set out in GAAP. In such a case, however, the auditor's inquiries regarding the identity of the entity's related parties are likely to form part of the auditor's risk assessment procedures and related activities performed in accordance with section 315A to obtain information regarding the following:²³

- The entity's ownership and governance structures
- The types of investments that the entity is making and plans to make
- The way the entity is structured and how it is financed

In the particular case of common control relationships, because management is more likely to be aware of such relationships if they have economic significance to the entity, the auditor's inquiries are likely to be more effective if they are focused on whether parties with which the entity engages in significant transactions or shares resources to a significant degree are related parties.

.A11 In the context of a group audit, section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, requires the group engagement team to provide each component auditor with information about related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties.²⁴ When the entity is a component within a group, this information provides a useful basis for the auditor's inquiries of management regarding the identity of the entity's related parties. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A12 The auditor also may obtain some information regarding the identity of the entity's related parties through inquiries of management during the engagement acceptance or continuance process.

.A13 Section 580, *Written Representations*, addresses requirements to obtain management representations, including representations that management and, when appropriate, those charged with governance have²⁵

- a. disclosed to the auditor the identity of the entity's related parties and all the related party relationships of which they are aware.
- b. appropriately accounted for and disclosed such relationships and transactions.

.A14 The inquiry about the identity of the entity's related parties may include background information concerning the related parties, for example, physical location, industry, size, and extent of operations. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A15 *Considerations specific to governmental entities.* Because of the variety of the types of relationships and transactions among governmental and other entities, some of which are highly complex, identifying the nature of the

²³ Paragraph .12 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

²⁴ Paragraph .41c of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

²⁵ Paragraph .17 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

related party relationship and its appropriate treatment in the financial statements relies heavily on a governmental entity's application of its financial reporting framework. Further, in some circumstances, the governmental entity may have no legal jurisdiction over the related party even when the application of the financial reporting framework concludes that the related party's financial statements are to be included in the governmental entity's financial statements. In such cases, the auditor's inquiries regarding the identity of the entity's related parties are likely to include the concepts and guidance from the applicable financial reporting framework to assist in making appropriate assessments about the existence and nature of related party relationships. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

The Entity's Controls Over Related Party Relationships and Transactions (Ref: par. .15)

.A16 Others within the entity are those considered likely to have knowledge of the entity's related party relationships and transactions and the entity's controls over such relationships and transactions, as well as the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor, and whether such relationships or transactions were with known or previously unknown related parties. These may include, to the extent that they do not form part of management, the following:

- Those charged with governance
- Personnel in a position to initiate, authorize, process, or record significant unusual transactions and those who supervise or monitor such personnel
- The internal audit function
- In-house legal counsel
- The chief ethics officer or equivalent person
- Chief compliance officer
- The human resources director or equivalent person

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A17 The audit is conducted on the premise that management and, when appropriate, those charged with governance have acknowledged and understand that they have responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.²⁶ Accordingly, the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement, and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed. In their oversight role, those charged with governance monitor how management is discharging its responsibility for such controls. Those charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business purpose of the

²⁶ Paragraphs .05 and .A2 of section 200. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

entity's related party relationships and transactions. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

A18 In meeting the requirement of section 315A to obtain an understanding of internal control, the auditor may consider features or elements relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as the following:²⁷

- Internal ethical codes, appropriately communicated to the entity's personnel and enforced, governing the circumstances in which the entity may enter into specific types of related party transactions
- Policies and procedures for open and timely disclosure of the interests that management and those charged with governance have in related party transactions
- The assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing related party transactions
- Timely disclosure and discussion between management and those charged with governance of related party transactions that are also significant unusual transactions, including whether those charged with governance have appropriately challenged the business purpose of such transactions (for example, by seeking advice from external professional advisors)
- Clear guidelines for the approval of related party transactions involving actual or perceived conflicts of interest, such as approval by a subcommittee of those charged with governance comprising individuals independent of management
- Periodic reviews by the internal audit function, when applicable
- Proactive action taken by management to resolve related party disclosure issues, such as by seeking advice from the auditor or external legal counsel
- The existence of whistle-blowing policies and procedures, when applicable

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

A19 Controls over related party relationships and transactions within some entities may be deficient or nonexistent for a number of reasons, such as the following:

- The low importance attached by management to identifying and disclosing related party relationships and transactions
- The lack of appropriate oversight by those charged with governance
- An intentional disregard for such controls because related party disclosures may reveal information that management considers sensitive (for example, the existence of transactions involving family members of management)

²⁷ Paragraph .13 of section 315A. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- An insufficient understanding by management of the applicable related party disclosure requirements

When such controls are ineffective or nonexistent, the auditor may be unable to obtain sufficient appropriate audit evidence about related party relationships and transactions. If this were the case, the auditor would, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, consider the implications for the audit, including the opinion in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A20 Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.²⁸ The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management's financial interests in certain related parties may provide incentives for management to override controls by (a) directing the entity, against its interests, to conclude transactions for the benefit of these parties, or (b) colluding with such parties or controlling their actions. Examples of possible fraud include the following:

- Creating fictitious terms of transactions with related parties designed to misrepresent the business purpose of these transactions
- Fraudulently organizing the transfer of assets from or to management or others at amounts significantly above or below market value
- Engaging in complex transactions with related parties, such as entities formed to accomplish specific purposes, that are structured to misrepresent the financial position or financial performance of the entity

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A21 *Considerations specific to smaller entities.* Control activities in smaller entities are likely to be less formal, and smaller entities may have no documented processes for dealing with related party relationships and transactions. An owner-manager may mitigate some of the risks arising from related party transactions or potentially increase those risks through active involvement in all the main aspects of the transactions. For such entities, the auditor may obtain an understanding of the related party relationships and transactions, and any controls that may exist over these, through inquiry of management combined with other procedures, such as observation of management's oversight and review activities and inspection of available relevant documentation. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A22 *Authorization and approval of significant transactions and arrangements (Ref: par. .15b).* Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance, or the entity's shareholders) for the entity to enter into specific transactions in accordance with predetermined criteria, whether or not judgmental. Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted. Examples of controls the entity may have established

²⁸ Paragraph .31 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

to authorize and approve significant transactions and arrangements with related parties or significant unusual transactions and arrangements outside the normal course of business include the following:

- Monitoring controls to identify such transactions and arrangements for authorization and approval
- Approval of the terms and conditions of the transactions and arrangements by management, those charged with governance, or, when applicable, shareholders

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Remaining Alert for Related Party Information When Reviewing Records or Documents

Records or Documents That the Auditor May Inspect (Ref: par. .17)

.A23 During the audit, the auditor may inspect records or documents that indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. Examples of those records or documents include the following:

- Third party confirmations obtained by the auditor (in addition to bank and legal confirmations)
- Entity income tax returns
- Information supplied by the entity to regulatory authorities
- Shareholder registers to identify the entity's principal shareholders
- Statements of conflicts of interest from management and those charged with governance
- Records of the entity's investments and those of its benefit plans
- Contracts and agreements with key management or those charged with governance
- Significant contracts and agreements not in the entity's ordinary course of business
- Specific invoices and correspondence from the entity's professional advisors
- Life insurance policies acquired by the entity
- Significant contracts renegotiated by the entity during the period
- Reports of the internal audit function
- Capital financing arrangements with entities other than financial institutions (for example, construction of a governmental entity facility associated with the issuance of debt by a related not-for-profit entity)
- Economic development arrangements for capital additions (for example, a governmental entity's use and eventual ownership of properties and facilities financed and operated by a company or another governmental entity)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A24 Additionally, the auditor may review the prior years' audit documentation for information about related party relationships and transactions. If applicable, the auditor may inquire of a predecessor auditor about the predecessor's knowledge of existing relationships and the extent of management involvement in material transactions. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A25 *Arrangements that may indicate the existence of previously unidentified or undisclosed related party relationships or transactions.* An arrangement involves a formal or informal agreement between the entity and one or more other parties for such purposes as the following:

- The establishment of a business relationship through appropriate vehicles or structures
- The conduct of certain types of transactions under specific terms and conditions
- The provision of designated services or financial support

Examples of arrangements that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor include the following:

- Participation in unincorporated partnerships with other parties
- Agreements for the provision of services to certain parties under terms and conditions that are outside the entity's normal course of business
- Guarantees and guarantor relationships

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identification of Significant Unusual Transactions (Ref: par. .18)

.A26 Obtaining further information on significant unusual transactions enables the auditor to evaluate whether fraud risk factors, if any, are present and to identify the risks of material misstatement due to fraud. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A27 Examples of transactions that may be significant unusual transactions include the following:

- Complex equity transactions, such as corporate restructurings or acquisitions
- Transactions with offshore entities in jurisdictions with less rigorous corporate governance structures, laws, or regulations
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged
- Sales transactions with unusually large discounts or returns
- Transactions with circular arrangements (for example, sales with a commitment to repurchase)
- Transactions under contracts whose terms are changed before expiration

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A28 *Understanding the nature of significant unusual transactions (Ref: par. .18a).* Inquiring into the nature of the significant unusual transactions

involves obtaining an understanding of the business purpose of the transactions and the terms and conditions under which these have been entered into.²⁹ [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A29 *Inquiring into whether related parties could be involved (Ref: par. .18b).* A related party could be involved in a significant unusual transaction not only by directly influencing the transaction by being a party to the transaction but also by indirectly influencing it through an intermediary. Such influence may indicate the presence of a fraud risk factor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Sharing Related Party Information With the Engagement Team (Ref: par. .19 and .25a)

.A30 Relevant related party information shared with the engagement team members may include the following:

- The nature of the related party relationships and transactions
- Significant or complex related party relationships or transactions that may require special audit consideration, particularly transactions in which management or those charged with governance are financially involved

The exchange of information is most useful if made at an early stage of the audit. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A31 Section 600 addresses the communications that apply to group audits, particularly those that involve component auditors. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identification and Assessment of the Risks of Material Misstatement Associated With Related Party Relationships and Transactions

Fraud Risk Factors Associated With a Related Party With Dominant Influence (Ref: par. .21)

.A32 Related parties with the ability to exert control or significant influence may be in a position to exert dominant influence over the entity or its management. Consideration of such behavior is relevant when identifying and assessing the risks of material misstatement due to fraud, as further explained in paragraphs .A33–.A34. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A33 Domination of management by a single person or small group of persons without compensating controls is a fraud risk factor.³⁰ Indicators of dominant influence exerted by a related party include the following:

- The related party has vetoed significant business decisions taken by management or those charged with governance.

²⁹ Paragraph .32c of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

³⁰ Paragraph .A76 of section 240. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- Significant transactions are referred to the related party for final approval.
- Little or no debate occurs among management and those charged with governance regarding business proposals initiated by the related party.
- Transactions involving the related party (or a close family member of the related party) are rarely independently reviewed and approved.

Dominant influence also may exist, in some cases, if the related party has played a leading role in founding the entity and continues to play a leading role in managing the entity. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A34 In the presence of other risk factors, the existence of a related party with dominant influence may indicate significant risks of material misstatement due to fraud. For example

- an unusually high turnover of senior management or professional advisors may suggest unethical or fraudulent business practices that serve the related party's purposes.
- the use of business intermediaries for significant transactions for which there appears to be no clear business justification may suggest that the related party could have an interest in such transactions through control of such intermediaries for fraudulent purposes.

Evidence of the related party's excessive participation in, or preoccupation with, the selection of accounting policies or the determination of significant estimates may suggest the possibility of fraudulent financial reporting. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions (Ref: par. .22)

.A35 The nature, timing, and extent of the further audit procedures that the auditor may select to respond to the assessed risks of material misstatement associated with related party relationships and transactions depend upon the nature of those risks and the circumstances of the entity. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A36 Examples of substantive audit procedures that the auditor may perform when the auditor has assessed a significant risk that management has not appropriately accounted for or disclosed specific related party transactions (whether due to fraud or error) include the following:

- Confirming the business purposes, specific terms, or amounts of the transactions with the related parties (this audit procedure may be less effective when the auditor judges that the entity is likely to influence the related parties in their responses to the auditor).
- Inspecting evidence in possession of the other party or parties to the transaction.
- Confirming or discussing significant information with intermediaries, such as banks, guarantors, agents, or attorneys, to obtain a better understanding of the transaction.

- Referring to financial publications, trade journals, credit agencies, and other information sources when there is reason to believe that unfamiliar customers, suppliers, or other business enterprises with which material amounts of business have been transacted may lack substance.
- With respect to material uncollected balances, guarantees, and other obligations, evaluating information about the financial capability of the other party or parties to the transaction. Such information may be obtained from audited financial statements, unaudited financial statements, income tax returns, and reports issued by regulatory agencies, taxing authorities, financial publications, or credit agencies.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A37 If the auditor has assessed a significant risk of material misstatement due to fraud as a result of the presence of a related party with dominant influence, the auditor may, in addition to the general requirements of section 240, perform audit procedures such as the following to obtain an understanding of the business relationships that such a related party may have established directly or indirectly with the entity and to determine the need for further appropriate substantive audit procedures:

- Inquiries of, and discussion with, management and those charged with governance
- Inquiries of the related party
- Inspection of significant contracts with the related party
- Appropriate background research, such as through the Internet or specific external business information databases
- Review of employee whistle-blowing reports when these are retained

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A38 Depending upon the results of the auditor's risk assessment procedures, the auditor may consider it appropriate to obtain audit evidence without testing the entity's controls over related party relationships and transactions. In some circumstances, however, it may not be possible to obtain sufficient appropriate audit evidence from substantive audit procedures alone, regarding the risks of material misstatement associated with related party relationships and transactions. For example, when intragroup transactions between the entity and its components are numerous and a significant amount of information regarding these transactions is initiated, authorized, recorded, processed, or reported electronically in an integrated system, the auditor may determine that it is not possible to design effective substantive audit procedures that by themselves would reduce the risks of material misstatement associated with these transactions to an acceptably low level. In such a case, in meeting the requirement of section 330 to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls, the auditor is required to test the entity's controls over the completeness and accuracy of the recording of the related party relationships and transactions.³¹ [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

³¹ Paragraph .08b of section 330. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

Identification of Previously Unidentified or Undisclosed Related Parties or Significant Related Party Transactions

Communicating Newly Identified Related Party Information to the Engagement Team (Ref: par. .25a)

.A39 Promptly communicating any newly identified related parties to the other members of the engagement team assists them in determining whether this information affects the results of, and conclusions drawn from, risk assessment procedures already performed, including whether the risks of material misstatement need to be reassessed. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Substantive Procedures Relating to Newly Identified Related Parties or Significant Related Party Transactions (Ref: par. .25d)

.A40 Examples of substantive audit procedures that the auditor may perform relating to newly identified related parties or significant related party transactions include the following:

- Making inquiries regarding the nature of the entity's relationships with the newly identified related parties, including inquiring of parties outside the entity who are presumed to have significant knowledge of the entity and its business, such as legal counsel, principal agents, major representatives, consultants, guarantors, or other close business partners.
- Conducting an analysis of accounting records for transactions with the newly identified related parties. Such an analysis may be facilitated using computer assisted audit techniques.
- Verifying the terms and conditions of the newly identified related party transactions and evaluating whether the transactions have been appropriately accounted for and disclosed.

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Intentional Nondisclosure by Management (Ref: par. .25f)

.A41 The requirements and guidance in section 240 regarding the auditor's responsibilities relating to fraud in an audit of financial statements are relevant when management appears to have intentionally failed to disclose related parties or significant related party transactions to the auditor. The auditor also may consider whether it is necessary to reevaluate the reliability of management's responses to the auditor's inquiries and management's representations to the auditor.³² [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Identified Related Party Transactions Required To Be Disclosed or Determined to be a Significant Risk

Evaluating the Business Purpose (Ref: par. .26a(i))

.A42 In evaluating the business purpose of a related party transaction that is required to be disclosed in the financial statements or determined to be a significant risk, the auditor may consider the following:

- Whether the transaction

³² Paragraphs .22–.24 and .26 of section 580. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- is overly complex (for example, it may involve multiple related parties within a consolidated group)
- has unusual terms of trade, such as unusual prices, interest rates, guarantees, and repayment terms
- lacks an apparent logical business reason for its occurrence
- involves previously unidentified related parties
- is processed in an unusual manner
- Whether management has discussed the nature of, and accounting for, such a transaction with those charged with governance
- Whether management is placing more emphasis on a particular accounting treatment rather than giving due regard to the economic substance of the transaction

If management's explanations are materially inconsistent with the terms of the related party transaction, the auditor is required to consider the reliability of management's explanations and representations on other significant matters.³³ [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A43 The auditor also may seek to understand the business purpose of such a transaction from the related party's perspective because this may help the auditor to better understand the economic substance of the transaction and why it was carried out. A business purpose from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Authorization and Approval of Significant Related Party Transactions (Ref: par. .26b)

.A44 Authorization and approval by management, those charged with governance, or, when applicable, the shareholders of related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk may provide audit evidence that these have been duly considered at the appropriate levels within the entity, and that their terms and conditions have been appropriately reflected in the financial statements. The existence of transactions of this nature that were not subject to such authorization and approval, in the absence of rational explanations based on discussion with management or those charged with governance, may indicate risks of material misstatement due to fraud or error. In these circumstances, the auditor may need to be alert for other transactions of a similar nature. Authorization and approval alone, however, may not be sufficient in concluding whether risks of material misstatement due to fraud are absent because authorization and approval may be ineffective if there has been collusion between the related parties or if the entity is subject to the dominant influence of a related party. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A45 *Considerations specific to smaller entities.* A smaller entity may not have the same controls provided by different levels of authority and approval that may exist in a larger entity. Accordingly, when auditing a smaller entity,

³³ Paragraph .10 of section 500A, *Audit Evidence*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

the auditor may rely to a lesser degree on authorization and approval for audit evidence regarding the validity of related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk. Instead, the auditor may consider performing other audit procedures, such as inspecting relevant documents, confirming specific aspects of the transactions with relevant parties, or observing the owner-manager's involvement with the transactions. The discussion of management domination in paragraph .A33 and the fraud considerations discussed in paragraph .A8 provide further relevant guidance. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Assertions That Related Party Transactions Were Conducted on Terms Equivalent to Those Prevailing in an Arm's Length Transaction (Ref: par. .27)

.A46 It will generally not be possible to determine whether a particular transaction would have taken place if the parties had not been related or, assuming it would have taken place, what the terms and manner of settlement would have been. Accordingly, it is difficult to substantiate representations that a transaction was consummated on terms equivalent to those that prevail in arm's length transactions. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A47 Although audit evidence may be readily available regarding how the price of a related party transaction compares to that of a similar arm's length transaction, practical difficulties ordinarily limit the auditor's ability to obtain audit evidence that all other aspects of the transaction are equivalent to those of the arm's length transaction. For example, although the auditor may be able to confirm that a related party transaction has been conducted at a market price, it may be impracticable to confirm whether other terms and conditions of the transaction (such as credit terms, contingencies, and specific charges) are equivalent to those that would ordinarily be agreed between independent parties. Accordingly, there may be a risk that management's assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction may be materially misstated. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A48 The preparation and fair presentation of the financial statements requires management to substantiate an assertion included in financial statements that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, giving appropriate consideration to the difficulties described in paragraphs .A46–.A47. Management's support for the assertion may include the following:

- Comparing the terms of the related party transaction to those of an identical or similar transaction with one or more unrelated parties
- Engaging an external specialist to determine a market value and confirm market terms and conditions for the transaction
- Comparing the terms of the transaction to known market terms for broadly similar transactions on an open market

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A49 Evaluating management's support for this assertion may involve one or more of the following:

- Considering the appropriateness of management's process for supporting the assertion

- Verifying the source of the internal or external data supporting the assertion and testing the data to determine their accuracy, completeness, and relevance

[Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

.A50 If the auditor believes that management's assertion is unsubstantiated or the auditor cannot obtain sufficient appropriate audit evidence to support the assertion, the auditor, in accordance with section 705, considers the implications for the audit, including the opinion in the auditor's report. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of the Accounting for, and Disclosure of, Identified Related Party Relationships and Transactions

Materiality Considerations in Evaluating Misstatements (Ref: par. .28)

.A51 Section 450, *Evaluation of Misstatements Identified During the Audit*, requires the auditor to consider both the size and nature of a misstatement and the particular circumstances of its occurrence when evaluating whether the misstatement is material.³⁴ The significance of the transaction to the financial statement users may not depend solely on the recorded amount of the transaction but also on other specific relevant factors, such as the nature of the related party relationship. [Paragraph renumbered by the issuance of SAS No. 135, May 2019.]

Evaluation of Related Party Disclosures (Ref: par. .28a)

.A52 Evaluating the related party disclosures means considering whether the facts and circumstances of the entity's related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if

- a. the business purpose and the effects of the transactions on the financial statements are unclear or misstated.
- b. key terms, conditions, or other important elements of the transactions necessary for understanding them are not appropriately disclosed.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Communication With Those Charged With Governance (Ref: par. .29)

.A53 Communicating significant findings or issues arising during the audit in connection with the entity's related parties helps the auditor establish a common understanding with those charged with governance of the nature and resolution of these matters.³⁵ Examples of significant related party findings or issues include the following:

³⁴ Paragraph .11a of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

³⁵ Paragraph .A10 of section 230 provides further guidance on the nature of significant findings or issues arising during the audit. [Footnote renumbered by the issuance of SAS No. 135, May 2019.]

- Nondisclosure (whether or not intentional) by management to the auditor of related parties or significant related party transactions, which may alert those charged with governance to significant related party relationships and transactions of which they may not have been previously aware
- The identification of significant related party transactions that have not been appropriately authorized and approved, which may give rise to suspected fraud
- The identification of significant related party transactions that appear to lack a business purpose
- Disagreement with management regarding the accounting for, and disclosure of, significant related party transactions
- The inclusion of a statement in the financial statements that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction
- Noncompliance with applicable laws or regulations prohibiting or restricting specific types of related party transactions
- Difficulties in identifying the party that ultimately controls the entity

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

AU-C Section 560

Subsequent Events and Subsequently Discovered Facts

Source: SAS No. 122; SAS No. 133; SAS No. 135; SAS No. 136.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. It also addresses a predecessor auditor's responsibilities for subsequent events and subsequently discovered facts when reissuing the auditor's report on previously issued financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period. (Ref: par. .A1)

Subsequent Events and Subsequently Discovered Facts

.02 Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

- a. Those that provide evidence of conditions that existed at the date of the financial statements
- b. Those that provide evidence of conditions that arose after the date of the financial statements

.03 Section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, explain that the date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.¹ Accordingly, this section addresses the auditor's responsibilities relating to subsequent events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements. It also addresses the auditor's responsibilities relating to subsequently discovered facts that become known to the auditor after the date of the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹ Paragraph .A55 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .A119 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

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

Objectives

.05 The objectives of the auditor are to

- a. obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework and
- b. respond appropriately to facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

.06 The objective of a predecessor auditor who is requested to reissue a previously issued auditor's report on financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period is to perform specified procedures to determine whether the previously issued auditor's report is still appropriate before such report is reissued.

Definitions

.07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Date of the auditor's report. The date that the auditor dates the report on the financial statements, in accordance with sections 700 or 703.² (Ref: par. .A14)

Date of the financial statements. The date of the end of the latest period covered by the financial statements.

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

Subsequently discovered facts. Facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136]

.08 Reference to *audited financial statements* in this section means *the financial statements, together with the auditor's report thereon*.

Requirements

Subsequent Events

.09 The auditor should perform audit procedures designed to obtain sufficient appropriate audit evidence that all subsequent events that require

² Paragraph .43 of section 700, or paragraphs .82 and .126 of section 703. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: par. .A2–.A3)

.10 The auditor should perform the procedures required by paragraph .09 so that they cover the period from the date of the financial statements to the date of the auditor's report or as near as practicable thereto. The auditor should take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which should include the following: (Ref: par. .A4–.A5 and .A8–.A10)

- a. Obtaining an understanding of any procedures that management has established to ensure that subsequent events are identified
- b. Inquiring of management and, when appropriate, those charged with governance about whether any subsequent events have occurred that might affect the financial statements (Ref: par. .A6)
- c. Reading minutes, if any, of the meetings of the entity's owners, management, and those charged with governance that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available (Ref: par. .A4 and .A7)
- d. Reading the entity's latest subsequent interim financial statements, if any

.11 If, as a result of the procedures performed as required by paragraphs .09–.10, the auditor identifies subsequent events that require adjustment of, or disclosure in, the financial statements, the auditor should determine whether each such event is appropriately reflected in the financial statements in accordance with the applicable financial reporting framework.

Subsequently Discovered Facts That Become Known to the Auditor Before the Report Release Date

.12 The auditor is not required to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, if a subsequently discovered fact becomes known to the auditor before the report release date,³ the auditor should

- a. discuss the matter with management and, when appropriate, those charged with governance.
- b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.⁴

.13 If management revises the financial statements, the auditor should perform the audit procedures necessary in the circumstances on the revision. The auditor also should either (Ref: par. .A11–.A16)

³ The term *report release date* is defined in paragraph .06 of section 230, *Audit Documentation*.

⁴ There may be instances in which the auditor applies the relevant requirements in this section after the date of the auditor's report as described in section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, and section 945, *Auditor Involvement With Exempt Offering Documents*. [Footnote added, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133.]

- a. date the auditor's report as of a later date; extend the audit procedures referred to in paragraphs .09–.10 to the new date of the auditor's report on the revised financial statements; and request written representations from management as of the new date of the auditor's report, in accordance with the requirements of section 580, *Written Representations*, or
- b. include an additional date in the auditor's report on the revised financial statements that is limited to the revision (that is, dual-date the auditor's report for that revision), thereby indicating that the auditor's procedures subsequent to the original date of the auditor's report are limited solely to the revision of the financial statements described in the relevant note to the financial statements. In this circumstance, the auditor should request written representations from management as of the additional date in the auditor's report about whether
 - i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified.
 - ii. any other events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements.

.14 If management does not revise the financial statements in circumstances when the auditor believes they need to be revised, the auditor should modify the opinion (express a qualified opinion or an adverse opinion), as required by section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A17)

Subsequently Discovered Facts That Become Known to the Auditor After the Report Release Date

.15 If a subsequently discovered fact becomes known to the auditor after the report release date, the auditor should (Ref: par. .A18–.A20)

- a. discuss the matter with management and, when appropriate, those charged with governance.
- b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

.16 If management revises the financial statements, the auditor should

- a. apply the requirements of paragraph .13.
- b. if the audited financial statements (before revision) have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the audited financial statements are not to be relied upon. If management does not take the necessary steps, the auditor should apply the requirements of paragraph .18. (Ref: par. .A21–.A22)
- c. if the auditor's opinion on the revised financial statements differs from the opinion the auditor previously expressed, disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706, *Emphasis-of-Matter*

Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report:

- i. The date of the auditor's previous report
- ii. The type of opinion previously expressed
- iii. The substantive reasons for the different opinion
- iv. That the auditor's opinion on the revised financial statements is different from the auditor's previous opinion

.17 If management does not revise the financial statements in circumstances when the auditor believes they need to be revised, then

- a. if the audited financial statements have not been made available to third parties, the auditor should notify management and those charged with governance—unless all of those charged with governance are involved in managing the entity⁵—not to make the audited financial statements available to third parties before the necessary revisions have been made and a new auditor's report on the revised financial statements has been provided. If the audited financial statements are, nevertheless, subsequently made available to third parties without the necessary revisions, the auditor should apply the requirements of paragraph .17b.
- b. if the audited financial statements have been made available to third parties, the auditor should assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the audited financial statements is informed of the situation, including that the audited financial statements are not to be relied upon. If management does not take the necessary steps, the auditor should apply the requirements of paragraph .18. (Ref: par. .A21–.A22)

.18 If management does not take the necessary steps to ensure that anyone in receipt of the audited financial statements is informed of the situation, as provided by paragraphs .16b or .17b, the auditor should notify management and those charged with governance—unless all of those charged with governance are involved in managing the entity⁶—that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take the necessary steps, the auditor should take appropriate action to seek to prevent reliance on the auditor's report. (Ref: par. .A23–.A26)

Predecessor Auditor's Reissuance of the Auditor's Report in Comparative Financial Statements (Ref: par. .A27–.A28)

Predecessor Auditor's Report Reissued (Ref: par. .A29–.A30)

.19 Before reissuing a previously issued auditor's report on financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period, the predecessor auditor should perform the following procedures to determine whether the previously issued auditor's report is still appropriate:

⁵ Paragraph .14 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

⁶ Paragraph .14 of section 260. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

- a. Read the financial statements of the subsequent period to be presented on a comparative basis
- b. Compare the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis
- c. Inquire of, and request written representations from, management of the former client, at or near the date of reissuance, about whether
 - i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified
 - ii. any events have occurred subsequent to the date of the latest prior period financial statements reported on by the predecessor auditor that would require adjustment to, or disclosure in, those financial statements
- d. Obtain a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor

.20 If, in performing the procedures in paragraph .19, a subsequently discovered fact becomes known to the predecessor auditor, then

- a. the predecessor auditor should apply the requirements of paragraph .15.
- b. if management revises the financial statements and the predecessor auditor plans to issue a new auditor's report on the revised financial statements, the predecessor auditor should apply the requirements of paragraph .16.
- c. if management revises the financial statements and the predecessor auditor does not plan to issue a new auditor's report on the revised financial statements, or if management does not revise the financial statements in circumstances when the predecessor auditor believes they need to be revised, the predecessor auditor should assess the steps taken by management, as required by paragraph .17b.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 When audited financial statements are included in other documents subsequent to their issuance, the auditor may have additional responsibilities to consider, such as legal or regulatory requirements involving private placement offerings, exempt public offerings (including offerings pursuant to Securities and Exchange Commission [SEC] Rule 144A), or other offerings of securities to the public in jurisdictions outside the United States. Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, may be applied, adapted as necessary in the circumstances, to such other documents. Section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, addresses the auditor's responsibilities in connection with financial statements of a nonissuer included in a registration statement filed with the SEC under the Securities Act of 1933, as amended. Section 945, *Auditor Involvement With Exempt Offering Documents*,

addresses the auditor's responsibilities when an auditor is involved with an exempt offering document. [As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133. Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

Subsequent Events (Ref: par. .09–.11)

.A2 The period between the date of the financial statements and the date of the auditor's report may vary from a relatively short period to one or more months. Some phases of the audit will be performed during this period, whereas other phases will be substantially completed on or before the date of the financial statements. As an audit approaches completion, the auditor is not expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. New information, however, may be inconsistent with the audit evidence obtained, in which case the auditor is required to determine what modifications or additions to audit procedures are necessary to resolve the matter and consider the effect of the matter, if any, on other aspects of the audit.⁷

.A3 Depending on the auditor's risk assessment, the audit procedures required by paragraphs .09–.10 may include procedures necessary to obtain sufficient appropriate audit evidence involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor's report. The audit procedures required by paragraphs .09–.10 are in addition to procedures that the auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events (for example, to obtain audit evidence for account balances as of the date of the financial statements, such as cut-off procedures or procedures regarding subsequent receipts of accounts receivable).

.A4 Paragraph .10 stipulates certain audit procedures that the auditor is required to perform pursuant to paragraph .09. However, the subsequent events procedures that the auditor performs may depend on the information that is available and, in particular, the manner in which the accounting records have been maintained and the extent to which information has been prepared since the date of the financial statements. When interim financial statements (whether for internal or external purposes) or minutes of meetings of management or those charged with governance have not been prepared, relevant audit procedures may take the form of inspection of available books and records.

.A5 In addition to the audit procedures required by paragraphs .09–.10, the auditor may consider it necessary and appropriate to read the entity's latest available budgets, cash flow forecasts, and other related management reports for periods after the date of the financial statements. Paragraphs .A6–.A10 provide guidance on additional matters that the auditor may consider in the course of performing subsequent events procedures.

Inquiry (Ref: par. .10b)

.A6 In inquiring of management and, when appropriate, those charged with governance about whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire about the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

⁷ Paragraph .10 of section 500A, *Audit Evidence*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

- Whether new commitments, borrowings, or guarantees have been entered into
- Whether sales or acquisitions of assets have occurred or are planned
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned
- Whether any assets have been appropriated by the government or destroyed (for example, by fire or flood)
- Whether there have been any developments regarding contingencies
- Whether any unusual accounting adjustments have been made or are contemplated
- Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption
- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements
- Whether any events have occurred that are relevant to the recoverability of assets
- Whether there have been any changes in the entity's related parties
- Whether there have been any significant new related party transactions
- Whether the entity has entered into any significant unusual transactions

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Reading Minutes (Ref. par. .10c)

Considerations Specific to Governmental Entities

.A7 In audits of governmental entities, the auditor may, in performing the requirement in paragraph .10c, read the official records of relevant proceedings of the legislative or governing body, or other relevant regulatory or oversight body, and inquire about matters addressed in proceedings for which official records are not yet available.

Inquiries of Legal Counsel

.A8 Section 501, *Audit Evidence—Specific Considerations for Selected Items*, addresses the auditor's responsibility to seek direct communication with the entity's legal counsel concerning litigation, claims, and assessments through the date of the auditor's report.

Written Representations

.A9 Section 580 requires the auditor to request that management and, when appropriate, those charged with governance provide written representations as of the date of the auditor's report that all events occurring subsequent

to the date of the financial statements, and for which the applicable financial reporting framework requires adjustment or disclosure, have been adjusted or disclosed.⁸ The auditor may consider whether written representations covering particular subsequent events or significant matters disclosed to the auditor in the performance of the audit procedures required by paragraphs .09–.10 may be necessary to support other audit evidence to obtain sufficient appropriate audit evidence.

.A10 The applicable financial reporting framework may require management to evaluate subsequent events through the date the financial statements are issued or available to be issued and to disclose the date through which subsequent events were evaluated in the financial statements. In most cases, this will result in the date that management discloses as the date through which management has evaluated subsequent events being the same date as the auditor's report. This is because section 700 or section 703 requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that the audit documentation has been reviewed; that all the statements that comprise the financial statements, including related notes, have been prepared; and that management has asserted that they have taken responsibility for those financial statements.⁹ Also, the auditor is concerned with subsequent events that require adjustment of, or disclosure in, the financial statements through the date of the auditor's report or as near as practicable thereto. Therefore, management's representations concerning events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure are required to be made as of the date of the auditor's report on the financial statements.¹⁰ To align the date disclosed by management in the financial statements, the representation letter date, and the auditor's report date, the auditor may discuss the dating requirements with management and may also include, in the terms of the audit engagement,¹¹ that management will not date the subsequent event disclosure earlier than the date of the representation letter (also the date of the auditor's report). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Subsequently Discovered Facts That Become Known to the Auditor Before the Report Release Date (Ref: par. .12–.14)

Dating the Auditor's Report on the Revised Financial Statements (Ref: par. .13)

.A11 The auditor has two methods available for dating the auditor's report when the financial statements are revised after the original date of the auditor's report. The auditor may include an additional date limited to the revision (that is, dual-date the auditor's report for that revision) or date the auditor's report

⁸ Paragraph .18 of section 580, *Written Representations*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

⁹ Paragraph .43 of section 700, or paragraphs .82 and .126 of section 703. [Footnote renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹⁰ Paragraph .20 of section 580. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

¹¹ Paragraph .A24 of section 210A, *Terms of Engagement*. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

as of a later date. In the former instance, the auditor's responsibility for events occurring subsequent to the original date of the auditor's report is limited to the specific event described in the relevant note to the financial statements. In the latter instance, the auditor's responsibility for subsequent events extends to the new date of the auditor's report on the revised financial statements.

.A12 Generally, when the revision of the financial statements is specifically limited to the effects of the specific event described in the relevant note to the financial statements, the auditor may decide to limit the audit procedures to that revision, as provided by paragraph .13*b*. Even when the financial statements are revised and disclosure of the revision is made, the auditor is not precluded from extending the audit procedures referred to in paragraphs .09–.10 to the new date of the auditor's report on the revised financial statements, as provided by paragraph .13*a*.

.A13 When, in the circumstances described in paragraph .13*b*, the auditor includes an additional date limited to the revision (a dual date), the original date of the auditor's report on the financial statements prior to their subsequent revision by management remains unchanged because this date informs the reader about when the auditor obtained sufficient appropriate audit evidence with respect to those financial statements prior to their subsequent revision. However, an additional date is included in the auditor's report to inform users that the auditor's procedures subsequent to the original date of the auditor's report were limited to the subsequent revision of the financial statements. The following is an illustration of such wording:

(Date of auditor's report), except as to note Y, which is as of (date of completion of audit procedures limited to revision described in note Y).

.A14 As discussed in paragraph .A10, section 700 or section 703, as applicable, requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.¹² When management revises the financial statements and the auditor reports on the revised financial statements, the new date (or the dual date) included in the auditor's report cannot be earlier than the date on which the auditor carried out the audit procedures necessary in the circumstances on the revision, including that the documentation has been reviewed and management has prepared and asserted that they have taken responsibility for the revised financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Updated Written Representations

.A15 Section 580 requires the date of the written representations to be as of the date of the auditor's report on the financial statements.¹³ If management revises the financial statements and, in accordance with paragraph .13*a*, the auditor dates the auditor's report on the revised financial statements as of a later date, written representations from management are required as of the later date to comply with section 580. The auditor may request management to provide a new representation letter or may agree with management on a form of written representations that update the written representations previously provided by addressing whether there are any changes to such written representations and, if so, what they are. An updated written representation letter

¹² Paragraph .43 of section 700, or paragraphs .82 and .126 of section 703. [Footnote renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹³ Paragraph .20 of section 580. [Footnote renumbered by the issuance of SAS No. 133, June 2018.]

may be in the form of the representations required by paragraph .13b when the auditor dual-dates the auditor's report for the revision.

Unaudited Events

.A16 To prevent the financial statements from being misleading, management may revise the financial statements by disclosing an event that arose after the original date of the auditor's report. When such event is included in a separate financial statement note that is labeled as unaudited (for example, when the event is captioned "Event (Unaudited) Subsequent to the Date of the Independent Auditor's Report"), the auditor is not required to perform any procedures on the revision, and the auditor's report carries the original date of the auditor's report.

Considerations Specific to Governmental Entities (Ref: par. .14)

.A17 In audits of governmental entities in which management does not revise the financial statements, the actions taken in accordance with paragraph .14 may also include reporting separately to the legislative or governing body, or other relevant regulatory or oversight body, on the implications of the subsequent event for the financial statements and the auditor's report and, if applicable, for the entity's internal control over financial reporting and compliance with law or regulation.

Subsequently Discovered Facts That Become Known to the Auditor After the Report Release Date (Ref: par. .15–.18)

Auditor's Responsibility After the Report Release Date (Ref: par. .15)

.A18 New information may come to the auditor's attention that, had such information been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report. When such information becomes known to the auditor after the report release date, the requirements in paragraphs .15–.18 apply, even if the auditor has withdrawn or been discharged.

.A19 Because of the variety of conditions that might be encountered, the specific procedures or actions to be taken in a particular case may vary somewhat in light of the circumstances. For example, in determining whether the financial statements need revision, as required by paragraph .15b, the auditor may consider, in addition to the requirements of the applicable financial reporting framework, whether the auditor believes there are persons currently relying or likely to rely on the financial statements who would attach importance to the subsequently discovered facts. Consideration may be given, among other things, to the issuance of audited financial statements for a subsequent period, the time elapsed since the financial statements were issued and the auditor's report released, and any legal implications.

.A20 Section 708, *Consistency of Financial Statements*, addresses the auditor's evaluation of the consistency of the financial statements, including changes to previously issued financial statements, and the effect of that evaluation on the auditor's report.

Revision of Financial Statements by Management (Ref: par. .16b and .17b)

.A21 The steps taken by management to ensure that anyone in receipt of the audited financial statements is informed of the situation, including that the audited financial statements are not to be relied upon, depend on the circumstances. Management's steps may include the following:

- Notification to anyone who is known to be relying or who is likely to rely on the financial statements and the auditor's report that they are not to be relied upon and that revised financial statements, together with a new auditor's report, will be issued. This may be necessary when the issuance of revised financial statements and a new auditor's report is not imminent.
- Issuing, as soon as practicable, revised financial statements with appropriate disclosure of the matter.
- Issuing the subsequent period's financial statements with appropriate disclosure of the matter. This may be appropriate when issuance of the subsequent period's audited financial statements is imminent.

Considerations Specific to Governmental Entities

.A22 For audits performed under *Government Auditing Standards*, additional requirements exist, such as those pertaining to the evaluation of the timeliness and appropriateness of management's disclosure and actions to determine and correct misstatements in previously issued financial statements, reporting on the revised financial statements, and reporting directly to appropriate officials when management does not take the necessary steps.

Auditor Action to Seek to Prevent Reliance on the Auditor's Report **(Ref: par. .18)**

.A23 If management made the audited financial statements available to third parties despite the auditor's notification not to do so, or if the auditor believes that management or those charged with governance have failed to take the necessary steps to prevent reliance on the auditor's report on the previously issued audited financial statements despite the auditor's prior notification that the auditor will take action to seek to prevent such reliance, the auditor's course of action depends upon the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

.A24 The actions that the auditor may take to seek to prevent reliance on the auditor's report may depend upon the degree of certainty of the auditor's knowledge that persons or entities exist who are currently relying or who will rely on the audited financial statements, and who would attach importance to the information, and the auditor's ability as a practical matter to communicate with them. In addition to seeking legal advice, the auditor may consider taking the following steps to the extent applicable:

- Notify management and those charged with governance that the auditor's report is not to be relied upon.
- Notify regulatory agencies having jurisdiction over the entity that the auditor's report is not to be relied upon, including a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.
- Notify anyone known to the auditor to be relying on the financial statements that the auditor's report is not to be relied upon. In some instances, it will not be practicable for the auditor to give appropriate individual notification to stockholders or investors at large whose identities are unknown to the auditor; notification to a regulatory agency having jurisdiction over the entity will usually be the only practical means for the auditor to provide appropriate disclosure, together with a request that the agency take whatever

steps it may deem appropriate to accomplish the necessary disclosure.

.A25 Depending on the circumstances, if the auditor is able to determine that the financial statements need revision, the auditor's notification to anyone in receipt of the audited financial statements may, if permitted by law, regulation, and relevant ethical requirements,

- include a description of the nature of the matter and of its effect on the financial statements, avoiding comments concerning the conduct or motives of any person.
- describe the effect that the matter would have had on the auditor's report if it had been known to the auditor at the date of the report and had not been reflected in the financial statements.

.A26 If the auditor was not able to determine whether the financial statements need revision, the notification to anyone in receipt of the audited financial statements may indicate that information became known to the auditor and that, if the information is true, the auditor believes that the auditor's report is not to be relied upon. The specific matter need not be detailed in the notification.

Predecessor Auditor's Reissuance of the Auditor's Report in Comparative Financial Statements (Ref: par. .19-.20)

.A27 An auditor may be requested by management or those charged with governance to furnish additional copies of the auditor's report after the report release date. Providing additional copies of the auditor's report is not a report reissuance. In such cases, the auditor has no responsibility to make further investigation or inquiry about events that may have occurred during the period between the date of the auditor's report and the date of the release of the additional copies.

.A28 Additional responsibilities relating to the reissuance of a previously issued auditor's report in connection with financial statements of a nonissuer included in a registration statement filed with the SEC under the Securities Act of 1933, as discussed in paragraph .A1, are addressed in section 925.

Predecessor Auditor's Report Reissued

.A29 A predecessor auditor may be requested to reissue the auditor's report by a former client when prior period financial statements audited by the predecessor auditor are to be presented on a comparative basis with audited financial statements of a subsequent period. A predecessor auditor's knowledge of the current affairs of the former client is limited in the absence of a continuing relationship. Accordingly, a predecessor auditor may be in a position to reissue the report if the predecessor auditor is able to make satisfactory arrangements with the former client to perform this service and if the predecessor auditor complies with paragraph .19 to determine whether the previous auditor's report is still appropriate. A predecessor auditor is not required to reissue the auditor's report. Either the current form or manner of presentation of the financial statements of the prior period or one or more events might make a predecessor auditor's previous report inappropriate.

.A30 Section 700 and section 703, as applicable, address the auditor's responsibilities when the auditor is engaged to audit and report on a revision to

prior period financial statements audited by the predecessor auditor.¹⁴ It also addresses the auditor's responsibilities when the predecessor auditor's report will not be presented.¹⁵ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹⁴ Paragraph .A75 of section 700, and paragraph .A129 of section 703, as applicable. [Footnote renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

¹⁵ Paragraph .57 of section 700, and paragraph .93 of section 703, as applicable. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Renumbered by the issuance of SAS No. 133, June 2018. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

AU-C Section 570

The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

(Supersedes SAS No. 126.)

Source: SAS No. 132; SAS No. 134; SAS No. 136.

Effective for audits of financial statements for periods ending on or after December 15, 2017, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities in the audit of financial statements relating to the entity's ability to continue as a going concern and the implications for the auditor's report. This section applies to all audits of a complete set of financial statements, regardless of whether the financial statements are prepared in accordance with a general purpose or a special purpose framework.¹

.02 Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for a reasonable period of time. A complete set of general purpose financial statements is prepared using the going concern basis of accounting, unless the liquidation basis of accounting is appropriate. (Ref: par. .A1–.A2)

.03 Special purpose financial statements² may or may not be prepared in accordance with an applicable financial reporting framework for which the going concern basis of accounting is relevant. As a result, when the going concern basis of accounting is not relevant, the requirement of this section to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting do not apply. However, irrespective of whether the going concern basis of accounting is relevant in the preparation of special purpose financial statements, the requirements of this section apply regarding the auditor's responsibilities to perform the following:

- a. Conclude, based on the audit evidence obtained, whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time
- b. Evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time

¹ *General purpose* and *special purpose frameworks* are defined in section 700, *Forming an Opinion and Reporting on Financial Statements*, and section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, respectively.

² Section 800 addresses audits of a complete set of financial statements prepared in accordance with special purpose frameworks.

.04 The auditor's responsibilities under this section apply even if the applicable financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific evaluation of the entity's ability to continue as a going concern.

Responsibility for the Evaluation of the Entity's Ability to Continue as a Going Concern

When Management Is Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework

.05 Some financial reporting frameworks explicitly require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time and provide disclosures related to the entity's ability to continue as a going concern. For example, FASB *Accounting Standards Codification*® (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).³ Similarly, GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, requires financial statement preparers to evaluate whether there is substantial doubt about a governmental entity's ability to continue as a going concern for 12 months beyond the date of the financial statements. GASB Statement No. 56 further requires that, if information is currently known to the governmental entity that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.⁴ Law or regulation may also set forth requirements regarding management's responsibility to evaluate the entity's ability to continue as a going concern for a defined period of time and related financial statement disclosures. (Ref: par. .A3)

.06 Management's evaluation of the entity's ability to continue as a going concern for a reasonable period of time involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of conditions or events. The following factors are relevant to that judgment:

- a. The degree of uncertainty associated with the outcome of a condition or event increases significantly the further into the future a condition or event or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management evaluation specify the period for which management is required to take into account all available information.
- b. The size and complexity of the entity, the nature and condition of its business, and the degree to which it is affected by external factors affect the judgment regarding the outcome of conditions or events.
- c. Any judgment about the future is based on conditions or events that are known and reasonably knowable at the date that the financial statements are issued (or at the date that the financial

³ "Pending Content" in FASB *Accounting Standards Codification* (ASC) 205-40-50-1.

⁴ Paragraph 16 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*.

statements are available to be issued, when applicable). Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made. (Ref. par. .A4–.A5)

When Management Is Not Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework

.07 In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, when the going concern basis of accounting is a fundamental principle in the preparation of financial statements, as discussed in paragraphs .02–.03, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

Inherent Limitations in Evaluating the Entity's Ability to Continue as a Going Concern

.08 The potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The auditor cannot predict such future conditions or events. Accordingly, the absence of any reference to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in an auditor's report cannot be viewed as a guarantee of the entity's ability to continue as a going concern for a reasonable period of time.

Effective Date

.09 This section is effective for audits of financial statements for periods ending on or after December 15, 2017.

Objectives

.10 The objectives of the auditor are as follows:

- a. To obtain sufficient appropriate audit evidence regarding, and to conclude on, the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements
- b. To conclude, based on the audit evidence obtained, whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists
- c. To evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time
- d. To report in accordance with this section

Definition

.11 For purposes of this section, the following term has the meaning attributed as follows:

Reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). (Ref: par. .A6)

Requirements

Risk Assessment Procedures and Related Activities

Conditions or Events That Raise Substantial Doubt About an Entity's Ability to Continue as a Going Concern

.12 When performing risk assessment procedures as required by section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,⁵ the auditor should consider whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. In doing so, the auditor should determine whether management has performed a preliminary evaluation of whether such conditions or events exist: (Ref: par .A7–.A16)

- a. If such an evaluation has been performed, the auditor should discuss the evaluation with management and determine whether management has identified conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time and, if so, understand management's plans to address them.
- b. If such an evaluation has not yet been performed, the auditor should discuss with management the basis for the intended use of the going concern basis of accounting and inquire of management whether conditions or events exist that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Remaining Alert Throughout the Audit for Audit Evidence About Conditions or Events

.13 The auditor should remain alert throughout the audit for audit evidence of conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A17)

Management's Evaluation and Supporting Analysis, and the Auditor's Evaluation

.14 The auditor's evaluation should

- a. address management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A18–.A24)

⁵ Paragraph .05 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

- b. cover the same period as that used by management in its evaluation as required by the applicable financial reporting framework. (Ref: par. .A19)
- c. include consideration of whether management's evaluation includes all relevant information of which the auditor is aware as a result of the audit.

Period Beyond Management's Evaluation

.15 The auditor should inquire of management regarding its knowledge of conditions or events beyond the period of management's evaluation that may have an effect on the entity's ability to continue as a going concern. (Ref: par. .A23, .A25–.A27)

Additional Audit Procedures When Events or Conditions Are Identified

.16 The auditor should obtain sufficient appropriate audit evidence to determine whether conditions and events identified, considered in the aggregate, raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time by performing additional audit procedures, including consideration of mitigating factors. These procedures should include the following: (Ref: par. .A28)

- a. Requesting management to make an evaluation when management has not yet performed an evaluation
- b. Evaluating management's plans in relation to its going concern evaluation, with regard to whether it is probable that (Ref: par. .A29)
 - i. management's plans can be effectively implemented and
 - ii. the plans would mitigate the relevant conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- c. When the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in evaluating management's plans, (Ref: par. .A30–.A31)
 - i. evaluating the reliability of the underlying data generated to prepare the forecast and
 - ii. determining whether there is adequate support for the assumptions underlying the forecast, which includes considering contradictory audit evidence
- d. Considering whether any additional facts or information have become available since the date on which management made its evaluation

Financial Support by Third Parties or the Entity's Owner-Manager

.17 When management's plans include financial support by third parties or the entity's owner-manager (hereinafter referred to as "supporting parties") and such support is necessary in supporting management's assertions about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should obtain sufficient appropriate audit evidence about the following:

- a. The intent of such supporting parties to provide the necessary financial support, including written evidence of such intent, and (Ref: par. .A32–.A37)
- b. The ability of such supporting parties to provide the necessary financial support (Ref: par. .A24, .A38)

The failure to obtain the written evidence required by item (a) constitutes a lack of sufficient appropriate audit evidence regarding the intent of the supporting parties to provide financial support. Therefore, the auditor should conclude that management's plans are insufficient to alleviate the determination that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A32–.A34)

Written Representations

.18 If the auditor believes, before consideration of management's plans pursuant to paragraph .16, that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, the auditor should request the following written representations from management: (Ref: par. .A39–.A40)

- a. A description of management's plans that are intended to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and the probability that those plans can be effectively implemented
- b. That the financial statements disclose all the matters of which management is aware that are relevant to the entity's ability to continue as a going concern for a reasonable period of time, including principal conditions or events and management's plans

Auditor Conclusions

Use of the Going Concern Basis of Accounting

.19 The auditor should evaluate whether sufficient appropriate audit evidence has been obtained and conclude on the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

.20 Based on the audit evidence obtained, the auditor should conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.21 If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time, the auditor should evaluate the adequacy of the financial statement disclosures as required by the applicable financial reporting framework. (Ref: par. .A41–.A44)

Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management's Plans

.22 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans, the auditor should evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. (Ref: par. .A45–.A47)

Implications for the Auditor's Report

Use of Going Concern Basis of Accounting Is Inappropriate

.23 If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor should express an adverse opinion. (Ref: par. .A48–.A50)

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified

.24 If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should include a separate section in the auditor's report^[6] with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that does the following: (Ref: par. .A53–.A58)

- a. Draws attention to the note in the financial statements that discloses
 - i. the conditions or events identified and management's plans that deal with these conditions or events and
 - ii. that these conditions or events indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
- b. States that the auditor's opinion is not modified with respect to the matter

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

.25 The description in the "Going Concern" section about the entity's ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The auditor should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

^[6] [Footnote deleted by the issuance of SAS No. 134, May 2019.]

Adequate Disclosure About an Entity's Ability to Continue as a Going Concern Is Not Made in the Financial Statements

.26 If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should do the following:

- a. Express a qualified opinion or adverse opinion, as appropriate, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.
- b. In the "Basis for Qualified (Adverse) Opinion" section of the auditor's report, state that
 - i. substantial doubt exists about the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter or
 - ii. substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.

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

Management Unwilling to Perform or Extend Its Evaluation

.27 If management is unwilling to perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework when requested to do so by the auditor, the auditor should consider the implications for the auditor's report. (Ref: par. .A59)

Communication With Those Charged With Governance

.28 Unless all those charged with governance are involved in managing the entity,⁷ the auditor should communicate with those charged with governance regarding conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Such communication with those charged with governance should include the following:

- a. Whether the conditions or events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time constitute substantial doubt
- b. The auditor's consideration of management's plans
- c. Whether management's use of the going concern basis of accounting, when relevant, is appropriate in the preparation of the financial statements
- d. The adequacy of related disclosures in the financial statements
- e. The implications for the auditor's report

Comparative Presentations

.29 If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis and that doubt

⁷ Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

has been removed in the current period, the going concern section included in the auditor's report on the financial statements of the prior period should not be repeated. (Ref: par. .A60–.A61) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Eliminating a Going Concern Section From a Reissued Report

.30 Management may request that the auditor reissue an auditor's report and eliminate a "Going Concern" section contained therein. Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, the auditor should reassess the going concern status of the entity by doing the following:

- a. Performing audit procedures related to the events or transactions that prompted the request to reissue the report without the "Going Concern" section
- b. Performing the procedures listed in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or near the date of reissuance, including procedures to evaluate the adequacy of the proposed disclosures regarding management's plans to mitigate the conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time⁸
- c. Considering the matters described in paragraphs .16–.18 of this section based on the conditions or circumstances at the date of reissuance
- d. Considering the implications for the auditor's report in accordance with section 560⁹ (Ref: par. .A62–.A63)

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

Significant Delay in the Issuance of Financial Statements

.31 If there is significant delay in the expected issuance of the financial statements by management or those charged with governance, the auditor should inquire about the reasons for the delay. If the auditor believes that the delay could be related to the evaluation of whether there is substantial doubt about the entity's ability to continue as a going concern, the auditor should perform additional audit procedures as necessary, as described in paragraph .16, as well as consider the effect on the auditor's conclusion regarding the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, as described in paragraph .21.

Documentation

.32 If conditions or events are identified that, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time before consideration of management's plans, the auditor should document the following: (Ref: par. .A63)

- a. The conditions or events that led the auditor to believe that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

⁸ Paragraphs .09–.11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

⁹ Paragraph .13 of section 560.

- b. The elements of management's plans that the auditor considered to be particularly significant to overcoming the conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, if applicable.
- c. The audit procedures performed to evaluate the significant elements of management's plans and evidence obtained, if applicable.
- d. The auditor's conclusion regarding whether substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains or is alleviated. If substantial doubt remains, the auditor should also document the possible effects of the conditions or events on the financial statements and the adequacy of the related disclosures. If substantial doubt is alleviated, the auditor should also document the auditor's conclusion regarding the need for, and, if applicable, the adequacy of, disclosure of the principal conditions or events that initially caused the auditor to believe there was substantial doubt and management's plans that alleviated the substantial doubt.
- e. The auditor's conclusion with respect to the effects on the auditor's report.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02)

.A1 The applicable financial reporting framework might contain explicit requirements regarding when the liquidation basis of accounting is appropriate. For example, FASB ASC requires that if and when an entity's liquidation becomes imminent financial statements should be prepared under the liquidation basis of accounting.¹⁰ Accordingly, this section does not apply to an audit of a complete set of general purpose financial statements prepared under the liquidation basis of accounting.

Considerations Specific to Governmental Entities

.A2 Management's use of the going concern basis of accounting is also relevant to financial statements of governmental entities. For example, GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, addresses the issue of the ability of governmental entities to continue as a going concern for 12 months beyond the financial statement date, and requires consideration of information known to the government that may raise substantial doubt shortly thereafter (for example, within an additional three months).¹¹ Going concern indicators may arise in, but are not limited to, situations in which governmental entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Conditions or events that raise substantial doubt about a governmental entity's ability to continue as a going concern for a reasonable period of time may include situations in which the governmental entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the governmental entity.

¹⁰ FASB ASC 205-30.

¹¹ Paragraphs 16–19 of GASB Statement No. 56.

Responsibility for the Evaluation of the Entity's Ability to Continue as a Going Concern

When Management Is Required to Make a Specific Evaluation Under the Applicable Financial Reporting Framework (Ref: par. .05–.06)

.A3 FASB ASC defines *substantial doubt about an entity's ability to continue as a going concern* as follows:

Substantial doubt about an entity's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). The term *probable* is used consistently with its use in topic 450 on contingencies.¹²

Other financial reporting frameworks may use different terms that are similar to the concept of substantial doubt. For example, International Financial Reporting Standards (IFRS) use the terms *material uncertainty* and *significant doubt*. Also, other financial reporting frameworks may not use *probable* as their threshold. For example, IFRS uses "may cast significant doubt on the entity's ability to continue as a going concern."¹³ This section uses the terminology of FASB ASC and the GASB statements; if an audit is performed on financial statements prepared under another financial reporting framework, the requirements and application material may need to be adapted as necessary.

.A4 In addition to the factors in paragraph .06, FASB ASC requires management to consider quantitative and qualitative information about the following conditions and events:¹⁴

- a. The entity's current financial condition, including its liquidity sources at the date that the financial statements are issued (for example, available liquid funds and available access to credit)
- b. The entity's conditional and unconditional obligations due or anticipated within one year after the date that the financial statements are issued (regardless of whether those obligations are recognized in the entity's financial statements)
- c. The funds necessary to maintain the entity's operations considering its current financial condition, obligations, and other expected cash flows within one year after the date that the financial statements are issued
- d. The other conditions and events, when considered in conjunction with the preceding items, that may adversely affect the entity's ability to meet its obligations within one year after the date the financial statements are issued. See paragraph .A7 for examples of those conditions and events.

.A5 As explained by FASB, *reasonably knowable* means that an entity should make a reasonable effort to identify conditions and events that it may not readily know but would be able to identify without undue cost and effort.¹⁵

¹² "Pending Content" in FASB ASC 205-40-20.

¹³ See paragraph 25 of International Accounting Standard (IAS) 1, *Presentation of Financial Statements*.

¹⁴ "Pending Content" in FASB ASC 205-40-50-5.

¹⁵ See paragraph BC26 of the "Background Information and Basis for Conclusions" section of "Pending Content" in FASB ASC 205-40.

Definition (Ref: par. .11)

.A6 Most financial reporting frameworks requiring an explicit management evaluation of the entity's ability to continue as a going concern specify the period of time to be evaluated. For example, the financial reporting frameworks of the following standard-setting bodies specify such period of time as follows:

- a. *FASB*. Within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).¹⁶
- b. *GASB*. 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.¹⁷
- c. *International Accounting Standards Board*. At least, but not limited to, one year from the end of the reporting period.¹⁸

Risk Assessment Procedures and Related Activities***Conditions or Events That Raise Substantial Doubt About an Entity's Ability to Continue as a Going Concern (Ref: par. .12)***

.A7 The following list includes examples of adverse conditions and events that may raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. This list is not all-inclusive. The existence of one or more of these conditions or events does not establish that there is substantial doubt about the entity's ability to continue as a going concern. Similarly, the absence of these conditions or events does not establish that there is no substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Determining whether there is substantial doubt depends on an assessment of relevant conditions and events, in the aggregate, that are known and reasonably knowable at the date that the financial statements are issued (or at the date the financial statements are available to be issued, when applicable). An entity should weigh the likelihood and magnitude of the potential effects of the relevant conditions and events and consider their anticipated timing.¹⁹

- a. Negative financial trends, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios
- b. Other indications of possible financial difficulties, for example, default on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- c. Internal matters, for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular

¹⁶ "Pending Content" in FASB ASC 205-40-50-1.

¹⁷ Paragraph 16 of GASB Statement No. 56.

¹⁸ Paragraph 26 of IAS 1.

¹⁹ "Pending Content" in FASB ASC 205-40-55-2.

project, uneconomic long-term commitments, and a need to significantly revise operations

- d. External matters, for example, legal proceedings, legislation, or similar matters that might jeopardize the entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood

.A8 The significance of such events or conditions can often be mitigated by other factors. The following list includes examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The examples are not all-inclusive. Following each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is probable²⁰ that the plan will be effectively implemented within one year after the date that the financial statements are issued.²¹

- a. Plans to dispose of an asset or business
 - i. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loan or similar agreements, or encumbrances against the asset or business
 - ii. Marketability of the asset or business that management plans to sell
 - iii. Possible direct or indirect effects of disposal of the asset or business
- b. Plans to borrow money or restructure debt
 - i. Availability and terms of new debt financing or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback of assets
 - ii. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
 - iii. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures
 - i. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
 - ii. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures
- d. Plans to increase ownership equity
 - i. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital

²⁰ The FASB ASC master glossary defines *probable* as "the future event or events are likely to occur."

²¹ "Pending Content" in FASB ASC 205-40-55-3.

- ii. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors

Considerations Specific to Governmental Entities

.A9 The GASB statements also include the following examples of indicators that there may be substantial doubt about a governmental entity's ability to continue as a going concern:²²

- a. *Negative trends.* For example, recurring periods in which expenses or expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities, consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios
- b. *Other indications of possible financial difficulties.* For example, default on bonds, loans, or similar agreements; proximity to debt and tax limitations; denial of usual trade credit from suppliers; restructuring of debt (other than refundings); noncompliance with statutory capital or reserve requirements; or the need to seek new sources or methods of financing or to dispose of substantial assets
- c. *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program, uneconomic long-term commitments (burdensome labor contracts, for example), or the need to significantly revise operations
- d. *External matters.* For example, legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key governmental programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood

.A10 The indicators listed in paragraph .A9 may be mitigated by other factors. For example, taxing power and borrowing capabilities together with the constant demand for the provision of public services are factors that may diminish the possibility that a governmental entity would be unable to continue as a going concern.²³

Other Considerations

.A11 The risk assessment procedures required by paragraph .12 are intended to assist the auditor in determining whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is likely to be an important issue in planning and performing the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans for addressing any potential going concern matters identified.

.A12 In the absence of guidance provided by the applicable financial reporting framework that illustrates adverse conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time or plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability

²² Paragraph 17 of GASB Statement No. 56.

²³ Paragraph 18 of GASB Statement No. 56.

to continue as a going concern for a reasonable period of time, the auditor may consider the guidance in paragraphs .A7–.A10.

.A13 As discussed in paragraph .A7, FASB ASC contains guidance for determining whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time. Other financial reporting frameworks may contain other relevant guidance.

.A14 If management is preparing interim financial statements, FASB ASC requires management to perform a going concern evaluation for the interim periods.²⁴ As a result, the auditor may consider management's interim evaluation(s) of whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern in completing the risk assessment procedures in paragraph .12.

Considerations Specific to Smaller, Less Complex Entities

.A15 The size of an entity may affect its ability to withstand adverse conditions. Smaller, less complex entities may be able to respond quickly to exploit opportunities but may lack reserves to sustain operations.

.A16 Conditions of particular relevance to smaller entities include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise, or other legal agreement.

Remaining Alert Throughout the Audit for Audit Evidence About Conditions or Events (Ref: par. .13)

.A17 Section 315A requires the auditor to revise the auditor's risk assessment and modify the further planned audit procedures accordingly when additional audit evidence that affects the auditor's assessment of risk is obtained during the course of the audit.²⁵ If conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time are identified after the auditor's initial risk assessments are made, in addition to performing the procedures in paragraph .16 of this section, the auditor's assessment of the risks of material misstatement may need to be revised. The existence of such conditions or events may also affect the nature, timing, and extent of the auditor's further procedures in response to the assessed risks. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, establishes requirements and provides guidance on this issue.

Management's Evaluation and Supporting Analysis, and the Auditor's Evaluation (Ref: par. .14)

.A18 Management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is an important consideration with respect to the auditor's conclusion on management's use of the going concern basis of accounting and whether substantial doubt exists.

.A19 If management is not required by the applicable financial reporting framework to make an evaluation about whether there are conditions or events,

²⁴ "Pending Content" in FASB ASC 205-40-50-1.

²⁵ Paragraph .32 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, then the period that the auditor's evaluation covers is within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable), as discussed in paragraph .11.

.A20 It is not the auditor's responsibility to rectify the lack of analysis by management to support its evaluation. In some circumstances, however, the auditor may be able to conclude whether substantial doubt exists in the circumstances despite the lack of detailed analysis by management. For example, when a history of profitable operations and a ready access to financial resources exists, management may make its evaluation without a detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's evaluation may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether there is substantial doubt in the circumstances. However, in situations in which management is required by the applicable financial reporting framework to make an evaluation about the entity's ability to continue as a going concern for a reasonable period of time, a lack of a detailed analysis when needed may be an indicator of a deficiency in internal control. An auditor's evaluation is required to determine whether this constitutes a significant deficiency or material weakness, in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

.A21 In other circumstances, evaluating management's evaluation of whether there is substantial doubt, as required by paragraph .14, may include an evaluation of the process management followed to make its evaluation, the assumptions on which the evaluation is based, management's plans, and whether management's plans are feasible in the circumstances to alleviate substantial doubt.

.A22 For financial reporting frameworks that require the entity to perform an evaluation about whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, for example, FASB ASC and the GASB statements,²⁶ the auditor's conclusions might be primarily based on the auditor's procedures performed to evaluate management's compliance with the applicable financial reporting framework.

Considerations Specific to Smaller, Less Complex Entities (Ref: par. .14)

.A23 In many cases, management of smaller entities may not have prepared a detailed evaluation of whether there is substantial doubt, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this section, the auditor is required to evaluate management's evaluation of whether there is substantial doubt. For smaller entities, it may be appropriate to discuss the medium and long-term financing of the entity with management.

.A24 Financial support by owner-managers is often important to smaller entities' ability to continue as a going concern. When a smaller entity is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. For example, the continuance of a smaller entity in financial difficulty may be dependent on the owner-manager subordinating a loan to the entity in favor of banks or other creditors, or the owner-manager supporting a loan for the entity by providing a guarantee with the owner-manager's

²⁶ "Pending Content" in FASB ASC 205-40 and paragraphs 16–19 of GASB Statement No. 56.

personal assets as collateral. See paragraphs .A32–.A38 for further guidance about financial support from the owner-manager.

Period Beyond Management's Evaluation (Ref: par. .15)

.A25 The inquiry required by paragraph .15 is not intended to require management to extend its evaluation beyond the requirements of the applicable financial reporting framework. Other than inquiry of management, the auditor does not have a responsibility to perform any other audit procedures to identify conditions or events that may raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time beyond the period evaluated by management.

.A26 The applicable financial reporting framework may provide guidance about whether or how conditions or events that occur after the period required by the applicable financial reporting framework may affect the evaluation of whether substantial doubt about an entity's ability to continue as a going concern exists. For example, the GASB statements require that, if a governmental entity currently knows of information that may raise substantial doubt shortly after one year beyond the financial statement date, such information should be considered in the evaluation of substantial doubt.²⁷

.A27 FASB ASC requires the evaluation to include events and conditions that may raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).²⁸ Therefore, the conditions or events known after this time period will not affect the evaluation of whether substantial doubt exists but may affect other disclosure requirements or consideration of whether the financial statements are fairly presented.

Additional Audit Procedures When Events or Conditions Are Identified (Ref: par. .16)

.A28 Audit procedures that may be relevant to performing the requirements in paragraph .16 include the following:

- a. Analyzing and discussing cash flow, profit, and other relevant forecasts with management
- b. Analyzing and discussing the entity's latest available interim financial statements
- c. Reading the terms of debentures and loan agreements and determining whether any have been breached
- d. Reading minutes of the meetings of shareholders, those charged with governance, and relevant committees, for reference to financial difficulties
- e. Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's evaluations of their outcome and the estimate of their financial implications
- f. Evaluating the entity's plans to deal with unfilled customer orders

²⁷ Paragraph 16 of GASB Statement No. 56.

²⁸ "Pending Content" in FASB ASC 205-40-50-1.

- g. Performing audit procedures regarding subsequent events to identify those that either mitigate or exacerbate substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- h. Confirming the existence, terms, and adequacy of borrowing facilities
- i. Obtaining and reviewing reports of regulatory actions
- j. Determining the adequacy of support for any planned disposals of assets

Evaluating Management's Plans (Ref: par. .16b–c)

.A29 Evaluating management's plans may include performing audit procedures that the auditor considers necessary in the circumstances regarding management's plans for future action, including, for example, its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital. For governmental entities, evaluating management's plans may also include management's plans for future actions, including, for example, its plans to increase taxes to the extent allowable by law (as well as obtaining the necessary approvals to do so) or to issue additional debt up to the legal debt limit. See paragraphs .A8–.A10 for examples of other plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time.

.A30 In addition to the procedures required in paragraph .16c, the auditor may compare

- a. the prospective financial information used in recent prior periods with historical results and
- b. the prospective financial information used in the current period with results achieved to date.

.A31 When evaluating a cash flow forecast, an example of contradictory evidence may include assumptions in the cash flow forecasts that are inconsistent with assumptions used for other purposes, such as forecasts used to evaluate the recoverability of deferred tax assets or potential impairment of goodwill or long-lived assets.

Financial Support by Third Parties or the Entity's Owner-Manager

Intent

Support Letters or Written Confirmations

.A32 The auditor's evaluation of the support letter (as further described in paragraph .A33) or written confirmation includes consideration of the terms and conditions of the commitment and may include, as applicable, considerations of the legality and enforceability of the commitments.

.A33 The intent of supporting parties to provide the necessary financial support may be evidenced by either of the following:

- a. Obtaining from management written evidence of a commitment from the supporting party to provide or maintain the necessary financial support (sometimes referred to as a "support letter").
- b. Confirming directly with the supporting parties (as described in paragraph .A35) the existence of commitments to provide or maintain the necessary financial support. Confirmation may be

necessary if management only has oral evidence of such financial support.

.A34 When the financial support is provided by an owner-manager, the evidence regarding intent may be in the form of a support letter or a written representation.²⁹

Obtaining Written Confirmations

.A35 If the auditor obtains a support letter as described in paragraph .A33a, the auditor may still request a written confirmation in accordance with section 505, *External Confirmations*, from the supporting parties regarding the contents of the support letter. For example, such written confirmation may be requested when, in the auditor's professional judgment, a written confirmation is necessary to determine the validity of the support letter as well as the accuracy and completeness of the related terms and conditions.

Illustration of the Third-Party Support Letter

.A36 The purpose of the support letter from supporting parties is to provide sufficient appropriate audit evidence about the supporting parties' intent to provide financial support to the entity. The support letter may also include additional material facts and circumstances that may be pertinent to the determination of whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time. The following is an illustration of a support letter that may be requested from the supporting parties when the applicable financial reporting framework is FASB ASC. The illustrative wording also includes an assertion about the supporting party's ability to provide financial support, but such wording does not, by itself, provide sufficient appropriate audit evidence regarding ability.

(*Supporting party name*) will, and has the ability to, fully support the operating, investing, and financing activities of (*entity name*) through at least one year and a day beyond [insert date]³⁰ (*the date the financial statements are issued or available for issuance, when applicable*).

Depending on the facts and circumstances, this written support letter may be adapted, for example, by adding the following wording:

This also applies to any amounts that may ultimately be due to the Internal Revenue Service as a result of the recent judgment against (*entity name*) and also applies should (*entity name's*) debt not be refinanced when the debt becomes due in the next year.

.A37 In accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor is required to date the auditor's report no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.³¹ Accordingly, in order to cover the assessment period required by the applicable financial reporting framework, the support letter or the written confirmation defines a specific date through which the supporting party intends to provide support. For

²⁹ See section 580, *Written Representations*.

³⁰ See paragraph .A37.

³¹ Paragraph .43 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .82 and .126 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

example, for financial statements prepared in accordance with FASB ASC, the date would be a year and a day beyond the date that the financial statements are issued (or available to be issued, when applicable). Specifying a date in the support letter or written confirmation that is later than the expected date that the financial statements will be issued (or will be available to be issued, when applicable) may obviate the need to obtain updated information from the supporting parties. The period covered by the support letter or written confirmation may be shorter if there is another source of support that management intends to utilize in order to continue as a going concern through the assessment period. Such other support would be subjected to the same auditing procedures discussed in this section. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Ability

.A38 With respect to the supporting party's ability to provide support, matters to which the auditor may give consideration include the following:

- a. Audit evidence of past support obtained from the supporting party when such support was needed.
- b. The solvency of the supporting party and the sufficiency of the evidence supporting the solvency assertion. The auditor may obtain financial statements of the supporting party audited by a reputable auditor as evidence of the ability of the supporting party to provide the needed support. If the financial statements have not been audited, the auditor may perform other procedures, such as obtaining bank statements and evidence regarding the valuation of assets held by the supporting party that may be used to provide the needed support. However, these procedures might not provide evidence regarding other claims on the pledged assets that would limit the ability of the supporting party to use the assets to provide the support to the reporting entity.
- c. The ability to provide the needed support in a timely manner for the reporting entity to meet its obligations.
- d. When the entity and supporting party are in different countries, the ability of the supporting party to transfer the necessary funds (or other financial support) to the entity. Factors such as trade embargos, financial transfer restrictions, and war may limit the ability to transfer the necessary financial support.

Given the nature of these matters, the auditor may consult with legal counsel, as appropriate.

Written Representations (Ref: par. .18)

.A39 The auditor may consider it appropriate to request specific written representations beyond those required in paragraph .18 in support of audit evidence obtained regarding management's plans in relation to its going concern evaluation and the feasibility of those plans to alleviate substantial doubt.

.A40 Paragraph .26 of section 580, *Written Representations*, addresses situations in which management does not provide one or more of the requested written representations.

Auditor Conclusions

Substantial Doubt About the Entity's Ability to Continue as a Going Concern (Ref: par. .20–.21)

Adequacy of Disclosure When Conditions or Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.A41 Some financial reporting frameworks provide requirements about management's responsibilities to evaluate whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time and provide explicit requirements about financial statement disclosures.

.A42 For example, under FASB ASC, if, after considering management's plans, substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is not alleviated — that is, substantial doubt exists — the entity is required to include a statement in the notes to the financial statements indicating that there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or within one year after the date the financial statements are available to be issued, when applicable). Additionally, the entity is required to disclose information that enables users of the financial statements to understand³²

- a. principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- b. management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations.
- c. management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

.A43 For example, under the GASB statements, if it is determined that there is substantial doubt about a governmental entity's ability to continue as a going concern, the notes to the financial statements are required to include disclosure of the following, as appropriate:³³

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the governmental entity's ability to continue as a going concern for a reasonable period of time
- b. The possible effects of such conditions and events
- c. Government officials' evaluation of the significance of those conditions and events and any mitigating factors
- d. Possible discontinuance of operations
- e. Government officials' plans (including relevant prospective financial information)
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

.A44 Under the GASB statements, management's discussion and analysis (MD&A) is required to include a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the governmental entity's financial position or results of operations. If it is determined that there is substantial doubt about a governmental entity's ability to continue as a

³² "Pending Content" in FASB ASC 205-40-50-13.

³³ Paragraph 19 of GASB Statement No. 56.

going concern, it may be necessary to include a discussion of going concern issues in the MD&A, depending on the facts and circumstances.³⁴ This discussion of going concern issues is presented as required supplementary information, and the auditor is required to perform procedures on the required supplementary information in accordance with section 730, *Required Supplementary Information*, as applicable.³⁵

Adequacy of Disclosures When Conditions or Events Have Been Identified But Substantial Doubt Has Been Alleviated by Management's Plans (Ref: par. .22)

.A45 Even in situations when events or conditions that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time have been identified, but management concludes that no substantial doubt exists after considering its plans, the auditor is required by paragraph .22 to evaluate the adequacy of the financial statement disclosures required by the applicable financial reporting framework. For example, FASB ASC states that, if substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time is alleviated as a result of consideration of management's plans, an entity shall disclose in a note to the financial statements information that enables users of the financial statements to understand all of the following (or shall refer to similar information disclosed elsewhere in the footnotes):³⁶

- a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time (before consideration of management's plans)
- b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations
- c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time

.A46 The auditor's evaluation about whether the financial statements achieve fair presentation includes the consideration of the overall presentation, structure, and content of the financial statements and whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.³⁷ Depending on the facts and circumstances, the auditor may determine that additional disclosures are necessary to achieve fair presentation.

.A47 In the absence of disclosures explicitly required by the applicable financial reporting framework that address management's evaluation of the entity's ability to continue as a going concern for a reasonable period of time, the auditor may consider the disclosure guidance set out in paragraphs .A42–.A46 in considering whether the financial statements are fairly presented.

Implications for the Auditor's Report

Use of Going Concern Basis of Accounting Is Inappropriate (Ref: par. .23)

.A48 The requirement in paragraph .23 for the auditor to express an adverse opinion applies regardless of whether the financial statements include

³⁴ Paragraph 11h of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and paragraph 19 of GASB Statement No. 56.

³⁵ Paragraph 129 of GASB Statement No. 34.

³⁶ "Pending Content" in FASB ASC 205-40-50-12.

³⁷ Paragraph .17 of section 700.

disclosure of the inappropriateness of management's use of the going concern basis of accounting.

.A49 When the use of the going concern basis of accounting is not appropriate in the circumstances, management may be required, or may elect, to prepare the financial statements on another basis (for example, under FASB ASC, the entity is required to comply with FASB ASC 205-30 and prepare the financial statements using the liquidation basis of accounting when an entity's liquidation becomes imminent).

.A50 Interpretation No. 1, "Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting", of section 700, *Forming an Opinion and Reporting on Financial Statements* (sec. 9700 par. .01–.05), addresses the situation in which an auditor issues an unmodified opinion on the entity's financial statements prepared under the liquidation basis of accounting and the auditor determines an emphasis-of-matter paragraph is appropriate.

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified (Ref: par. .24–.25)

Conditions and Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.A51 The identification of substantial doubt is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as going concern alerts users to this circumstance. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A52 The exhibit to this section provides an illustration of the statements that are required to be included in the auditor's report on the financial statements (illustration 1) and an illustration of the circumstances described in paragraph .A54 (illustration 2). Illustration 1 and illustration 2 provide examples in which FASB ASC is the applicable financial reporting framework. If an applicable financial reporting framework other than FASB ASC is used, the wording in the illustrative reports in the exhibit to this section may need to be adapted to reflect the application of the other financial reporting framework in the circumstances. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A53 When FASB ASC or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the auditor's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Conditions and Events Have Been Identified and Substantial Doubt Has Been Alleviated

.A54 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial

statements, the auditor may include an emphasis-of-matter paragraph in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.³⁸ In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the auditor concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the auditor is required by paragraph .24 of this section to include a separate "Going Concern" section in the auditor's report. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A55 As indicated in section 706, the use of an emphasis-of-matter paragraph is not appropriate if either of the following applies:

- a. The matter has been determined to be a key audit matter when section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies.
- b. The auditor would be required to modify the opinion in accordance with section 705³⁹ as a result of the matter.

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

.A56 As indicated in section 705, in circumstances in which conditions and events have been identified and the auditor concludes that, based on the audit evidence obtained, the disclosures are materially misstated, the auditor is required to modify the auditor's report.⁴⁰ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Inappropriate Use of Conditional Language

.A57 Examples of conditional language that are inappropriate to use in the "Going Concern" section include the following:

- a. If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- b. The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

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

Communication With Regulators

.A58 When the auditor of a regulated entity considers that it may be necessary to include a reference to going concern matters in the auditor's report,

³⁸ Paragraphs .08–.09 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

³⁹ Paragraph .08 of section 706. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

⁴⁰ Paragraph .07 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

the auditor may have a duty to communicate with the applicable regulatory, enforcement, or supervisory authorities. (Ref: par. .24) [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Management Unwilling to Perform or Extend Its Evaluation (Ref: par. .27)

.A59 In certain circumstances, the auditor may believe it necessary to request that management perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework. If management is unwilling to do so, a qualified or adverse opinion in the auditor's report may be appropriate. For example, management may be unwilling to extend its evaluation because it believes it has satisfied the requirements to conclude whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time when the applicable financial reporting framework requires management to make this evaluation. If, in the auditor's judgment, management's conclusion is not adequately supported, the auditor may conclude that a qualified or adverse opinion for a departure from the applicable financial reporting framework is appropriate in these circumstances. Section 705 provides guidance related to the modification of the auditor's opinion. In addition, management's unwillingness to make or extend its evaluation to meet the period of time required by the applicable financial reporting framework may be an indicator of a deficiency in internal control that is required to be evaluated to determine whether it constitutes a significant deficiency or material weakness in accordance with section 265. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Comparative Presentations (Ref: par. .29)

.A60 Substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time that arose in the current period does not imply that a basis for such doubt existed in the prior period and, therefore, does not affect the auditor's report on the financial statements of the prior period that are presented on a comparative basis. Section 700 and section 703 provide guidance on reporting when financial statements of one or more prior periods are presented on a comparative basis with financial statements of the current period. [Paragraph renumbered by the issuance of SAS No. 134, May 2019. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A61 A financial reporting framework may contain disclosure requirements in a subsequent period in which substantial doubt no longer exists. For example, FASB ASC states that for the period in which substantial doubt no longer exists (before or after consideration of management's plans), an entity shall disclose how the relevant conditions or events that raised substantial doubt were resolved.⁴¹ [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Eliminating a Going Concern Emphasis-of-Matter Paragraph From a Reissued Report (Ref: par. .30)

.A62 After the auditor has issued the auditor's report containing a "Going Concern" section, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the "Going Concern" section that appeared in the original report. Such requests may occur after the conditions or events

⁴¹ "Pending Content" in FASB ASC 205-40-50-14. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

that gave rise to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time have been resolved. For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

.A63 The auditor may perform procedures in addition to those required by paragraph .30 that the auditor deems necessary in the circumstances. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

Documentation (Ref: par. .32)

.A64 Section 230, *Audit Documentation*, addresses the auditor's responsibility to prepare audit documentation for an audit of financial statements.⁴² The documentation requirements of paragraph .32 of this section are incremental to section 230 and apply when the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time before consideration of management's plans. [Paragraph renumbered by the issuance of SAS No. 134, May 2019.]

⁴² Paragraph .01 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 134, May 2019.]

.A65

Exhibit — Illustrations of Auditor's Reports Relating to Going Concern (Ref: par. .A52–.A56)

Illustration 1 — An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate

Illustration 2 — An Auditor's Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated

Illustration 1 — An Auditor's Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with FASB ASC. The audit is not a group audit.
- The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.
- The auditor has concluded, after considering identified conditions or events and management's plans, that substantial doubt remains and the disclosures of the conditions or events and management's plans are adequate.
- Management is required under FASB ASC to include an explicit statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.

Independent Auditor's Report

To the Shareholders of ABC Company *[or Other Appropriate Addressee]*

The auditor's report is presented in accordance with paragraphs .21–.42 of section 700, *Forming an Opinion and Reporting on Financial Statements*. For illustrative purposes, the Going Concern section is presented immediately after the "Basis for Opinion of the Auditor's Report" section.

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about

the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Illustration 2 — An Auditor's Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated (Ref: par. .A52)

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements prepared in accordance with FASB ASC. The audit is not a group audit.
- Management has disclosed conditions or events, considered in the aggregate, that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- Management has disclosed its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity's ability to meet its obligations.
- Management has disclosed that the substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans.
- The auditor has concluded that management's disclosures are adequate.

Independent Auditor's Report

To the Shareholders of ABC Company [*or Other Appropriate Addressee*]

Report on the Audit of the Financial Statements

The auditor's report is presented in accordance with paragraph .09 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

Emphasis-of-Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

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

AU-C Section 580

Written Representations

Source: SAS No. 122; SAS No. 135; SAS No. 136.

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

NOTE

In July 2020, the Auditing Standards Board issued Statement on Auditing Standards No. 143, *Auditing Accounting Estimates and Related Disclosures*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to obtain written representations from management and, when appropriate, those charged with governance in an audit of financial statements.

.02 Exhibit D, "List of AU-C Sections Containing Requirements for Written Representations," lists other AU-C sections containing subject matter-specific requirements for written representations. The specific requirements for written representations of other AU-C sections do not limit the application of this section.

Written Representations as Audit Evidence

.03 *Audit evidence* is the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.¹ Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. (Ref: par. .A1)

.04 Although written representations provide necessary audit evidence, they complement other auditing procedures and do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, obtaining reliable written representations does not affect the nature or extent of other audit procedures that the auditor applies to obtain audit evidence about the fulfillment of management's responsibilities or about specific assertions.

¹ Paragraph .05 of section 500A, *Audit Evidence*.

Effective Date

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

Objectives

.06 The objectives of the auditor are to

- a. obtain written representations from management and, when appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation and fair presentation of the financial statements and for the completeness of the information provided to the auditor;
- b. support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other AU-C sections; and
- c. respond appropriately to written representations provided by management and, when appropriate, those charged with governance or if management or, when appropriate, those charged with governance do not provide the written representations requested by the auditor.

Definition

.07 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

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

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

Requirements

Management From Whom Written Representations Are Requested

.09 The auditor should request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: par. .A2–.A6)

Written Representations About Management's Responsibilities

Preparation and Fair Presentation of the Financial Statements

.10 The auditor should request management to provide a written representation that it has fulfilled its responsibility, as set out in the terms of the audit engagement,

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; and
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error;² (Ref: par. .A7–.A10, .A22, and .A29)

Information Provided and Completeness of Transactions

.11 The auditor should request management to provide written representations that

- a. it has provided the auditor with all relevant information and access, as agreed upon in the terms of the audit engagement, and
- b. all transactions have been recorded and are reflected in the financial statements. (Ref: par. .A7–.A10, .A22, and .A29)

Other Written Representations

Fraud

.12 The auditor should request management to provide written representations that it

- a. acknowledges its responsibility for the design, implementation, and maintenance of internal controls to prevent and detect fraud;
- b. has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud;
- c. has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving
 - i. management,
 - ii. employees who have significant roles in internal control, or
 - iii. others when the fraud could have a material effect on the financial statements; and
- d. has disclosed to the auditor its knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others. (Ref: par. .A11)

Laws and Regulations

.13 The auditor should request management to provide written representations that all instances of identified or suspected noncompliance with laws and regulations whose effects should be considered by management when preparing financial statements have been disclosed to the auditor.³

Uncorrected Misstatements

.14 The auditor should request management to provide written representations about whether it believes the effects of uncorrected misstatements are

² Paragraph .06b(i–ii) of section 210A, *Terms of Engagement*.

³ Paragraph .A18 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation. (Ref: par. .A12)

Litigation and Claims

.15 The auditor should request management to provide written representations that all known actual or possible litigation and claims whose effects should be considered by management when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

Estimates

.16 The auditor should request management to provide written representations about whether it believes significant assumptions used by it in making accounting estimates are reasonable. (Ref: par. .A13–.A14)

Related Party Transactions

.17 The auditor should request management to provide written representations that (Ref: par. .A15–.A16)

- a. it has disclosed to the auditor the identity of all the entity's related parties and all the related party relationships and transactions of which it is aware and
- b. it has appropriately accounted for and disclosed such relationships and transactions.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Subsequent Events

.18 The auditor should request management to provide written representations that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. (Ref: par. .A17)

Additional Written Representations About the Financial Statements

.19 Other AU-C sections require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor should request such other written representations. (Ref: par. .A18–.A22 and .A29)

Date of, and Period(s) Covered by, Written Representations

.20 The date of the written representations should be as of the date of the auditor's report on the financial statements. The written representations should be for all financial statements and period(s) referred to in the auditor's report. (Ref: par. .A23–.A26)

Form of Written Representations

.21 The written representations should be in the form of a representation letter addressed to the auditor. (Ref: par. .A27–.A28)

Doubt About the Reliability of Written Representations and Requested Written Representations Not Provided

Doubt About the Reliability of Written Representations

.22 If the auditor has concerns about the competence, integrity, ethical values, or diligence of management or about management's commitment to, or enforcement of, these, the auditor should determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: par. .A30)

.23 In particular, if written representations are inconsistent with other audit evidence, the auditor should perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor should reconsider the assessment of the competence, integrity, ethical values, or diligence of management or of management's commitment to, or enforcement of, these and should determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: par. .A31)

.24 If the auditor concludes that the written representations are not reliable, the auditor should take appropriate action, including determining the possible effect on the opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, considering the requirement in paragraph .25 of this section.

Written Representations About Management's Responsibilities

.25 The auditor should disclaim an opinion on the financial statements in accordance with section 705 or withdraw from the engagement if (Ref: par. .A32–.A33)

- a. the auditor concludes that sufficient doubt exists about the integrity of management such that the written representations required by paragraphs .10–.11 are not reliable or
- b. management does not provide the written representations required by paragraphs .10–.11.

Requested Written Representations Not Provided

.26 If management does not provide one or more of the requested written representations, the auditor should

- a. discuss the matter with management;
- b. reevaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- c. take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with section 705, considering the requirement in paragraph .25 of this section. (Ref: par. .A34)

Application and Other Explanatory Material

Written Representations as Audit Evidence (Ref: par. .03)

.A1 Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written rather than oral representations, in many cases, may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

Management From Whom Written Representations Are Requested (Ref: par. .09)

.A2 Written representations are requested from those with overall responsibility for financial and operating matters whom the auditor believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, also are responsible for the preparation and fair presentation of the financial statements.

.A3 Due to its responsibility for the preparation and fair presentation of the financial statements and its responsibility for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements and the assertions therein on which to base the written representations.

.A4 In some cases, however, management may decide to make inquiries of others who participate in preparing the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include the following:

- An actuary responsible for actuarially determined accounting measurements
- Staff engineers who may have responsibility for environmental liability measurements
- Internal counsel who may provide information essential to provisions for legal claims

.A5 To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations. It is not expected that such inquiries would usually require a formal internal process beyond those already established by the entity.

.A6 In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if, in the auditor's professional judgment, the representations are being

made by those with appropriate responsibilities and knowledge of the matters included in the representations.

Written Representations About Management's Responsibilities (Ref: par. .10–.11)

.A7 Audit evidence obtained during the audit that management has fulfilled the responsibilities referred to in paragraphs .10–.11 is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and fairly presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgment and understanding of its responsibilities. For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed upon in the terms of the audit engagement without asking management whether, and receiving confirmation that, such information has been provided.

.A8 The written representations required by paragraphs .10–.11 draw on the agreed acknowledgment and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. In addition to requesting management to confirm that it has fulfilled its responsibilities, the auditor also may ask management to reconfirm its acknowledgment and understanding of those responsibilities in written representations. This is common but, in any event, may be particularly appropriate when

- those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities,
- the terms of the audit engagement were prepared in a previous year,
- any indication exists that management misunderstands those responsibilities, or
- changes in circumstances make it appropriate to do so.

Consistent with the requirement of section 210A, *Terms of Engagement*, such reconfirmation of management's acknowledgment and understanding of its responsibilities is unconditional and is not made subject to the best of management's knowledge and belief (as discussed in paragraph .A6 of this section).

.A9 Relevant information may include such matters as the following:

- Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors or summaries of actions of recent meetings for which minutes have not yet been prepared
- Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices

Considerations Specific to Governmental Entities

.A10 The legal or regulatory requirements for audits of the financial statements of governmental entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a governmental entity is conducted may give rise to additional written representations. These may include written

representations confirming that transactions and events have been carried out in accordance with applicable law or regulation.

Other Written Representations

Fraud (Ref: par. .12)

.A11 The written representations relating to fraud required by paragraph .12 are important for the auditor to obtain, regardless of the size of the entity, because of the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud.

Uncorrected Misstatements (Ref: par. .14)

.A12 Because the preparation of the financial statements requires management to adjust the financial statements to correct material misstatements, the auditor is required to request management to provide a written representation about uncorrected misstatements. In some circumstances, management may not believe that certain uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as "We do not agree that items . . . and . . . constitute misstatements because [*description of reasons*]." Obtaining this representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*.

Estimates (Ref: par. .16)

.A13 Depending on the nature, materiality, and extent of estimation uncertainty, written representations about accounting estimates recognized or disclosed in the financial statements may include representations

- about the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework and the consistency in the application of the processes.
- that the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity when relevant to the accounting estimates and disclosures.
- that disclosures related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
- that no subsequent event has occurred that would require adjustment to the accounting estimates and disclosures included in the financial statements.

.A14 For those accounting estimates not recognized or disclosed in the financial statements, written representations also may include representations about the following:

- The appropriateness of the basis used by management for determining that the criteria of the applicable financial reporting framework for recognition or disclosure have not been met⁴

⁴ Paragraph .A121 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

- The appropriateness of the basis used by management to overcome a presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework for those accounting estimates not measured or disclosed at fair value

Related Parties (Ref: par. .17)

.A15 Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that (a) materially affect the financial statements or (b) involve management
- When they have made specific oral representations to the auditor on details of certain related party transactions
- When they have financial or other interests in the related parties or the related party transactions

.A16 The auditor also may decide to obtain written representations regarding specific assertions that management may have made, such as a representation that specific related party transactions do not involve undisclosed side agreements, or that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Subsequent Events (Ref: par. .18)

.A17 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses circumstances when the auditor includes an additional date on the auditor's report (that is, dual-dates the auditor's report for a revision relating to a subsequent event).⁵ In such circumstances, the auditor may determine that obtaining additional representations relating to the subsequent event is appropriate.

Additional Written Representations About the Financial Statements (Ref: par. .19)

.A18 In addition to the written representations required by paragraphs .10–.18, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representations required by paragraphs .10–.18. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate
- Whether matters such as the following, when relevant under the applicable financial reporting framework, have been recognized, measured, presented, or disclosed in accordance with that framework:
 - Plans or intentions that may affect the carrying value or classification of assets and liabilities
 - Liabilities, both actual and contingent

⁵ Paragraph .13 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

- Title to, or control over, assets and the liens or encumbrances on assets and assets pledged as collateral
- Aspects of laws, regulations, and contractual agreements that may affect the financial statements, including noncompliance
- Whether any side agreements or other arrangements (either written or oral) exist that have not been disclosed to the auditor

Exhibit B, "Illustrative Specific Written Representations," contains illustrations of additional representations that may be appropriate in certain situations. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

Additional Written Representations About Information Provided to the Auditor

.A19 In addition to the written representation required by paragraph .11, the auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

Written Representations About Specific Assertions

.A20 When obtaining evidence about or evaluating judgments and intentions, the auditor may consider one or more of the following:

- The entity's past history in carrying out its stated intentions
- The entity's reasons for choosing a particular course of action
- The entity's ability to pursue a specific course of action
- The existence, or lack thereof, of any other information obtained during the course of the audit that may be inconsistent with management's judgment or intent

.A21 In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent regarding, or the completeness of, a specific assertion. For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Communicating a Threshold Amount (Ref: par. .10-.11 and .19)

.A22 Management's representations may be limited to matters that are considered either individually or collectively material to the financial statements, provided management and the auditor have reached an understanding on materiality for this purpose. Materiality may be different for different representations. A discussion of materiality may be included explicitly in the representation letter in either qualitative or quantitative terms. Materiality considerations do not apply to those representations that are not directly related to amounts included in the financial statements (for example, management's representations about the premise underlying the audit). In addition, because of the possible effects of fraud on other aspects of the audit, materiality would not apply to management's acknowledgment regarding its responsibility for the

design, implementation, and maintenance of internal control to prevent and detect fraud.

Date of, and Period(s) Covered by, Written Representations (Ref: par. .20)

.A23 Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to, or disclosure in, the financial statements, the written representations are dated as of the date of the auditor's report on the financial statements.

.A24 In some circumstances, it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. When this is the case, it may be necessary to request an updated written representation.

.A25 The written representations cover all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

.A26 Situations may arise in which current management was not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Form of Written Representations (Ref: par. .21)

.A27 Occasionally, circumstances may prevent management from signing the representation letter and returning it to the auditor on the date of the auditor's report. In those circumstances, the auditor may accept management's oral confirmation, on or before the date of the auditor's report, that management has reviewed the final representation letter and will sign the representation letter without exception as of the date of the auditor's report thereby providing sufficient appropriate audit evidence for the auditor to date the report. However, possession of the signed management representation letter prior to releasing the auditor's report is necessary because paragraph .21 requires that the representations be in the form of a written letter from management. Furthermore, when there are delays in releasing the report, a fact may become known to the auditor that, had it been known to the auditor at the date of the auditor's report, might affect the auditor's report and result in the need for updated representations. Section 560 addresses the auditor's responsibilities in such circumstances.

.A28 Exhibit A, "Illustrative Representation Letter," provides an illustrative example of a representation letter.

Communication With Those Charged With Governance (Ref: par. .10–.11 and .19)

.A29 Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate with those charged with governance the written representations that the auditor has requested from management.⁶

Doubt About the Reliability of Written Representations and Requested Written Representations Not Provided

Doubt About the Reliability of Written Representations (Ref: par. .22–.23)

.A30 Concerns about the competence, integrity, ethical values, or diligence of management or about its commitment to, or enforcement of, these may cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted. In such a case, the auditor may consider withdrawing from the engagement, when withdrawal is possible under applicable law or regulation, unless those charged with governance put in place appropriate corrective measures. Such measures, however, may not be sufficient to enable the auditor to issue an unmodified audit opinion.

.A31 In the case of identified inconsistencies between one or more written representations and audit evidence obtained from another source, the auditor may consider whether the risk assessment remains appropriate and, if not, may revise the risk assessment and determine the nature, timing, and extent of further audit procedures to respond to the assessed risks.

Written Representations About Management's Responsibilities (Ref: par. .25)

.A32 As explained in paragraph .A7, the auditor is not able to judge solely on other audit evidence whether management has fulfilled the responsibilities referred to in paragraphs .10–.11. Therefore, if, as described in paragraph .25a, the auditor concludes that the written representations about these matters are unreliable or if management does not provide those written representations, the auditor is unable to obtain sufficient appropriate audit evidence. The possible effects on the financial statements of such inability are not confined to specific elements, accounts, or items of the financial statements and are hence pervasive. Section 705 requires the auditor to disclaim an opinion on the financial statements in such circumstances.⁷

.A33 A written representation that has been modified from that requested by the auditor does not necessarily mean that management did not provide the written representation. However, the underlying reason for such modification may affect the opinion in the auditor's report. For example

- the written representation about management's fulfillment of its responsibility for the preparation and fair presentation of the financial statements may state that management believes that, except for material noncompliance with a particular requirement of the applicable financial reporting framework, the financial statements are prepared and fairly presented in accordance with that

⁶ Paragraph .14d of section 260, *The Auditor's Communication With Those Charged With Governance*.

⁷ Paragraph .10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

framework. The requirement in paragraph .25 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effect of the noncompliance on the opinion in the auditor's report in accordance with section 705.

- the written representation about the responsibility of management to provide the auditor with all relevant information agreed upon in the terms of the audit engagement may state that management believes that, except for information destroyed in a fire, it has provided the auditor with such information. The requirement in paragraph .25 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effects of the pervasiveness of the information destroyed in the fire on the financial statements and the effect thereof on the opinion in the auditor's report in accordance with section 705.

Requested Written Representations Not Provided (Ref: par. .26)

.A34 Management's refusal to furnish written representations constitutes a limitation on the scope of the audit. Such refusal is often sufficient to preclude an unmodified opinion and, in particular with respect to the representations in paragraphs .12–.18, may cause an auditor to disclaim an opinion or withdraw from the engagement when withdrawal is possible under applicable law or regulation. However, based on the nature of the representations not obtained or the circumstances of the refusal, the auditor may conclude that a qualified opinion is appropriate.

.A35

Exhibit A—Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other AU-C sections in effect for audits of financial statements for periods ending on or after December 15, 2012. It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States, that the requirement in section 570A, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, to obtain a written representation is not relevant, and that no exceptions exist to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor)

(Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, for the purpose of expressing an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States (U.S. GAAP).

Certain representations in this letter are described as being limited to matters that are material. Items are considered to be material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of the surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

Except where otherwise stated below, immaterial matters less than \$[insert amount] collectively are not considered to be exceptions that require disclosure for the purpose of the following representations. This amount is not necessarily indicative of amounts that would require adjustment to or disclosure in the financial statements.

We confirm that [, *to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*] [as of (date of auditor's report)],]:

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation and fair presentation of the financial statements in accordance with U.S. GAAP. (par. .10a)
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. (par. .10b)
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud. (par. .12a)

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (par. .16)
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP. (par. .17b)
- All events subsequent to the date of the financial statements and for which U.S. GAAP requires adjustment or disclosure have been adjusted or disclosed. (par. .18)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (par. .14)
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with U.S. GAAP. (par. .15)

[Any other matters that the auditor may consider appropriate (see paragraph .A21).]

Information Provided

- We have provided you with:
 - Access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters; (par. .11a)
 - Additional information that you have requested from us for the purpose of the audit; (par. .11a) and
 - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence. (par. .11a)
- All transactions have been recorded in the accounting records and are reflected in the financial statements. (par. .11b)
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (par. .12b)
- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* fraud or suspected fraud that affects the entity and involves:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others when the fraud could have a material effect on the financial statements (par. .12c)
- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (par. .12d)

- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (par. .13)
- We [*have disclosed to you all known actual or possible*] [*are not aware of any pending or threatened*] litigation, claims, and assessments whose effects should be considered when preparing the financial statements [and we have not consulted legal counsel concerning litigation, claims, or assessments] (par. .15)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (par. .17a)

[*Any other matters that the auditor may consider necessary (see paragraph .A21).*]

[*Name of Chief Executive Officer and Title*]

[*Name of Chief Financial Officer and Title*]

[Revised, March 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.]

.A36

Exhibit B—Illustrative Specific Written Representations

As discussed in paragraph .19, the auditor may determine that a specific written representation is necessary to corroborate other audit evidence. Certain AICPA Audit and Accounting Guides recommend that the auditor obtain written representations concerning matters that are unique to a particular industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The existence of a condition listed subsequently does not mean that the representation is required; professional judgment is necessary to determine whether corroborative audit evidence in the form of a specific written representation is necessary.

<i>Condition</i>	<i>Illustrative Specific Written Representation</i>
General	
Unaudited interim information accompanies the financial statements.	The unaudited interim financial information accompanying [<i>presented in Note X to</i>] the financial statements for the [<i>identify all related periods</i>] has been prepared and fairly presented in conformity with generally accepted accounting principles applicable to interim financial information. The accounting principles used to prepare the unaudited interim financial information are consistent with those used to prepare the audited financial statements.
The effect of a new accounting principle is not known.	We have not completed the process of evaluating the effect that will result from adopting the guidance in Financial Accounting Standards Board (FASB) Accounting Standards Update 20YY-XX, as discussed in Note [X]. The company is therefore unable to disclose the effect that adopting the guidance in FASB Accounting Standards Update 20YY-XX will have on its financial position and the results of operations when such guidance is adopted.
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	Note [X] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired.	We have reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of the assets might not be recoverable and have appropriately recorded the adjustment.

(continued)

<i>Condition</i>	<i>Illustrative Specific Written Representation</i>
<i>General</i>	
The entity has a variable interest in another entity.	Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with generally accepted accounting principles. We have considered both implicit and explicit variable interests in (a) determining whether potential VIEs should be considered VIEs, (b) calculating expected losses and residual returns, and (c) determining which party, if any, is the primary beneficiary. We have provided you with lists of all identified variable interests in (i) VIEs, (ii) potential VIEs that we considered but judged not to be VIEs, and (iii) entities that were afforded the scope exceptions of Financial Accounting Standards Board (FASB) <i>Accounting Standards Codification</i> (ASC) 810, <i>Consolidation</i>. We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FASB ASC 810. We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents and other entities, including but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements. The information we provided about financial interests and contractual arrangements with related parties, de facto agents and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements. Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes. Regarding entities in which the company has variable interests (implicit and explicit), we have provided all information

<i>Condition</i>	<i>Illustrative Specific Written Representation</i>
<i>General</i>	
	about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the company is the primary beneficiary or has a significant variable interest in the entity. We have made and continue to make exhaustive efforts to obtain information about entities in which the company has an implicit or explicit interest but that were excluded from complete analysis under FASB ASC 810 due to lack of essential information to determine one or more of the following: whether the entity is a VIE, whether the company is the primary beneficiary, or the accounting required to consolidate the entity.
The work of a specialist has been used by the entity.	We agree with the findings of specialists in evaluating the [<i>describe assertion</i>] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.
<i>Assets</i>	
<i>Cash</i> Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements have been properly disclosed.
<i>Financial Instruments</i> Management intends to and has the ability to hold to maturity debt securities classified as held-to-maturity.	Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities, to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or trading.
Management considers the decline in value of debt or equity securities to be temporary.	We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.

(continued)

<i>Condition</i>	<i>Illustrative Specific Written Representation</i>
<i>Assets</i>	
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to determine fair values of financial instruments are as follows: <i>[describe methods and significant assumptions used to determine fair values of financial instruments]</i> . The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.
Financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk exist.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements: 1. The extent, nature, and terms of financial instruments with off-balance-sheet risk 2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments 3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments
<i>Investments</i> Unusual considerations are involved in determining the application of equity accounting.	<i>[For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:]</i> • The equity method is used to account for the company's investment in the common stock of <i>[investee]</i> because the company has the ability to exercise significant influence over the investee's operating and financial policies. • The cost method is used to account for the company's investment in the common stock of <i>[investee]</i> because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.

Condition	<i>Illustrative Specific Written Representation</i>
<i>Assets</i>	
The entity had loans to executive officers, nonaccrued loans or zero interest rate loans.	Loans to executive officers have been properly accounted for and disclosed.
<i>Liabilities</i>	
<i>Debt</i> Short-term debt could be refinanced on a long-term basis and management intends to do so.	The company has excluded short-term obligations totaling \$[amount] from current liabilities because it intends to refinance the obligations on a long-term basis. <i>[Complete with appropriate wording detailing how amounts will be refinanced as follows:]</i> • The company has issued a long-term obligation [debt security] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long-term basis. • The company has the ability to consummate the refinancing, by using the financing agreement referred to in Note [X] to the financial statements.
Tax-exempt bonds have been issued.	Tax-exempt bonds issued have retained their tax-exempt status.
<i>Taxes</i> Management intends to reinvest undistributed earnings of a foreign subsidiary.	We intend to reinvest the undistributed earnings of [name of foreign subsidiary].
<i>Pension and Postretirement Benefits</i> An actuary has been used to measure pension liabilities and costs.	We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.
Involvement with a multiemployer plan exists.	We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of \$[XX].

(continued)

<i>Condition</i>	<i>Illustrative Specific Written Representation</i>
<i>Liabilities</i>	
Postretirement benefits have been eliminated.	We do not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of \$[XX].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to the pension or other postretirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to the pension or other postretirement benefit plans.
<i>Equity</i>	
Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements exist.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

.A37

Exhibit C—Illustrative Updating Management Representation Letter

The following letter is presented for illustrative purposes only. It may be used in the circumstances described in paragraph .A17 of this section. Management need not repeat all of the representations made in the previous representation letter.

If matters to be disclosed to the auditor exist, they may be listed following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred. . . ."

[Date]

To [Auditor]

In connection with your audit(s) of the [identification of financial statements] of [name of entity] as of [dates] and for the [periods] for the purpose of expressing an opinion as to whether the [consolidated] financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of [name of entity] in accordance with accounting principles generally accepted in the United States of America, you were previously provided with a representation letter under date of [date of previous representation letter]. No information has come to our attention that would cause us to believe that any of those previous representations should be modified.

To the best of our knowledge and belief, no events have occurred subsequent to [date of latest balance sheet reported on by the auditor] and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

[Paragraph added, March 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A38

Exhibit D—List of AU-C Sections Containing Requirements for Written Representations

This exhibit identifies paragraphs in other AU-C sections that require specific written representations that may not be required for every audit. The list is not a substitute for considering the requirements and related application and other explanatory material in AU-C sections:

- Paragraph .19 of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraph .55 of section 700, *Forming an Opinion and Reporting on Financial Statements*, or paragraphs .36, .91, and .131 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable
- Paragraph .07g of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Paragraph .23 of section 935, *Compliance Audits*

In addition, certain AICPA Audit and Accounting Guides suggest written representations concerning matters that are unique to a particular industry.

[Paragraph renumbered, March 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

AU-C Section 585

Consideration of Omitted Procedures After the Report Release Date

Source: SAS No. 122.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when, subsequent to the report release date, the auditor becomes aware that one or more auditing procedures that the auditor considered necessary in the circumstances existing at the time of the audit were omitted from the audit of the financial statements. Section 560, *Subsequent Events and Subsequently Discovered Facts*, is applicable when a fact becomes known to the auditor after the report release date that, had it been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

.02 The provisions of this section do not apply to an engagement in which an auditor's work is at issue in a threatened or pending legal proceeding or regulatory investigation. A *threatened legal proceeding* means that a potential claimant has manifested to the auditor an awareness of, and a present intention to assert, a possible claim.

Effective Date

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

Objectives

.04 The objectives of the auditor are to

- a. assess the effect of omitted procedures of which the auditor becomes aware on the auditor's present ability to support the previously expressed opinion on the financial statements, and
- b. respond appropriately.

Definition

.05 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

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

Requirements

.06 If, subsequent to the report release date, the auditor becomes aware of an omitted procedure, the auditor should assess the effect of the omitted procedure on the auditor's present ability to support the previously expressed opinion on the financial statements. (Ref: par. .A1–.A4)

.07 If the auditor concludes that an omitted procedure of which the auditor has become aware impairs the auditor's present ability to support a previously expressed opinion on the financial statements and the auditor believes that there are users currently relying, or likely to rely, on the previously released report, the auditor should promptly perform the omitted procedure, or alternative procedures, to determine whether there is a satisfactory basis for the auditor's previously expressed opinion. The auditor should include in the audit documentation the procedures performed, in accordance with the provisions of section 230, *Audit Documentation*.¹ (Ref: par. .A3–.A5)

.08 When, as a result of the subsequent performance of an omitted procedure or alternative procedures, the auditor becomes aware of facts regarding the financial statements that existed at the report release date that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report, the auditor should apply the provisions of section 560²

Application and Other Explanatory Material

.A1 The auditor's present ability to support the previously expressed opinion on the financial statements is dependent on whether the omitted procedure affects the auditor's conclusion that sufficient appropriate audit evidence was obtained. In accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the auditor is required to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.³ (Ref: par. .06)

.A2 After the report release date, the auditor has no responsibility to carry out any retrospective review of the audit work performed. However, situations may arise in which the auditor becomes aware that an auditing procedure considered necessary by the auditor in the circumstances existing at the time of the audit was omitted. For example, after the report release date, reports and supporting audit documentation for particular engagements may be subjected to review in connection with a firm's inspection or monitoring process,⁴ or otherwise, and the omission of a necessary audit procedure may be identified. (Ref: par. .06)

.A3 Procedures that the auditor may perform in connection with assessing the effect of an omitted procedure on the auditor's present ability to support a previously expressed opinion on financial statements include the following:

- Review of the audit documentation

¹ Paragraph .14 of section 230, *Audit Documentation*.

² Paragraphs .15–.18 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

³ Paragraph .19 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

⁴ See QM section 10A, *A Firm's System of Quality Control*, regarding inspection in the context of the monitoring element of quality control.

- Discussion of the circumstances with engagement personnel and others within the firm
- Reevaluation of the overall scope of the audit

The results of other audit procedures that were performed may tend to compensate for the omitted procedure or make the effect of its omission less significant. Additionally, subsequent audits may provide audit evidence in support of the previously expressed opinion. (Ref: par. .06–.07)

.A4 The period of time during which the auditor considers whether this section applies to the circumstances of a particular engagement and then takes the actions, if any, that are required hereunder may be important. Because of the legal implications that may be involved in taking the actions contemplated herein, the auditor may decide to seek legal advice in determining an appropriate course of action. (Ref: par. .06–.07)

.A5 If, in the circumstances addressed in paragraph .07, the auditor is unable to perform a previously omitted procedure, or alternative procedures, to determine that there is a satisfactory basis for the auditor's previously expressed opinion, the auditor may decide to seek legal advice to determine an appropriate course of action concerning the auditor's responsibilities to the entity; regulatory authorities, if any, having jurisdiction over the entity; and users relying, or likely to rely, on the auditor's report. (Ref: par. .07)

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AU-C Section 600

Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)

Source: SAS No. 122; SAS No. 127; SAS No. 128; SAS No. 130; SAS No. 134; SAS No. 135; SAS No. 137; SAS No. 138.

See section 9600 for interpretations of this section.

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

NOTE

In October 2021, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 Generally accepted auditing standards (GAAS) apply to group audits. This section addresses special considerations that apply to group audits, in particular those that involve component auditors.

.02 An auditor may find this section, adapted as necessary in the circumstances, useful when that auditor involves other auditors in the audit of financial statements that are not group financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location.

.03 A component auditor may be required by law or regulation or may have been engaged by component management for another reason to express an audit opinion on the financial statements of a component. The requirements of this section apply, nonetheless, regardless of whether the group engagement

partner decides to make reference to the component auditor in the auditor's report on the group financial statements or to assume responsibility for the work of component auditors.

.04 Governmental entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.

.05 In accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively possess the appropriate competence and capabilities.¹ The group engagement partner also is responsible for the direction, supervision, and performance of the group audit engagement. In this section, requirements to be undertaken by the group engagement partner are addressed to the group engagement partner. When the group engagement team may assist the group engagement partner in fulfilling a requirement, the requirement is addressed to the group engagement team. When it may be appropriate in the circumstances for the firm to fulfill a requirement, the requirement is addressed to the auditor of the group financial statements.

.06 The requirements of section 220A apply regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This section assists the group engagement partner to meet the requirements of section 220A when component auditors perform work on the financial information of components.

.07 Audit risk is a function of the risk of material misstatement of the financial statements and the risk that the auditor will not detect such misstatements.² In a group audit, detection risk includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements and the risk that the group engagement team may not detect this misstatement. This section explains the matters that the group engagement team considers when determining the nature, timing, and extent of its involvement in the risk assessment procedures and further audit procedures performed by the component auditors on the financial information of the components. The purpose of this involvement is to obtain sufficient appropriate audit evidence on which to base the audit opinion on the group financial statements.

.08 The group engagement partner is responsible for deciding, individually for each component, to either

- assume responsibility for, and thus be required to be involved in, the work of a component auditor, insofar as that work relates to the expression of an opinion on the group financial statements, or
- not assume responsibility for, and accordingly make reference to, the audit of a component auditor in the auditor's report on the group financial statements.

¹ Paragraph .16 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

² Paragraph .A36 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

The requirements in paragraphs .51–.65 are applicable only when the auditor of the group financial statements is assuming responsibility for the work of component auditors. All other requirements in this section apply to all audits of group financial statements.

Effective Date

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

Objectives

.10 The objectives of the auditor are to determine whether to act as the auditor of the group financial statements and, if so, to

- a. determine whether to make reference to the audit of a component auditor in the auditor's report on the group financial statements;
- b. communicate clearly with component auditors; and
- c. obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion about whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Definitions

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

Component. An entity or business activity for which group or component management prepares financial information that is required by the applicable financial reporting framework to be included in the group financial statements. (Ref: par. .A1–.A5)

Component auditor. An auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. A component auditor may be part of the group engagement partner's firm, a network firm of the group engagement partner's firm, or another firm. (Ref: par. .A9–.A11)

Component management. Management responsible for preparing the financial information of a component.

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

Group. All the components whose financial information is included in the group financial statements. A group always has more than one component.

Group audit. The audit of group financial statements.

Group audit opinion. The audit opinion on the group financial statements.

Group engagement partner. The partner or other person in the firm³ who is responsible for the group audit engagement and its

³ Group engagement partner and firm refer to their governmental equivalents when relevant.

performance and for the auditor's report on the group financial statements that is issued on behalf of the firm. When joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team. This section does not, however, address the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.

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

Group financial statements. Financial statements that include the financial information of more than one component. The term *group financial statements* also refers to combined financial statements aggregating the financial information prepared by components that are under common control.

Group management. Management responsible for the preparation and fair presentation of the group financial statements.

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

Significant component. A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements. (Ref: par. .A6–.A8)

.12 Reference to *the applicable financial reporting framework* means the financial reporting framework that applies to the group financial statements. Reference to *the consolidation process* includes the following:

- a. The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial statements by way of inclusion, consolidation, proportionate consolidation, or the equity or cost methods of accounting (Ref: par. .A12)
- b. The aggregation in combined financial statements of the financial information of components that are under common control

Requirements

Responsibility

.13 In accordance with section 220A, the group engagement partner is responsible for (1) the direction, supervision, and performance of the group audit engagement in compliance with professional standards, applicable regulatory and legal requirements, and the firm's policies and procedures; and (2) determining whether the auditor's report that is issued is appropriate in the circumstances.⁴ (Ref: par. .A13–.A14)

⁴ Paragraph .17 of section 220A.

Acceptance and Continuance

.14 The group engagement partner should determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained regarding the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team should obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. (Ref: par. .A15–.A17)

.15 The group engagement partner should evaluate whether the group engagement team will be able to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or through making reference to the audit of a component auditor in the auditor's report), to act as the auditor of the group financial statements and report as such on the group financial statements. (Ref: par. .A18–.A21)

.16 In some circumstances, the group engagement partner may conclude that it will not be possible, due to restrictions imposed by group management, for the group engagement team to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors, and the possible effect of this inability, will result in a disclaimer of opinion on the group financial statements.⁵ In such circumstances, the auditor of the group financial statements should

- in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement when withdrawal is possible under applicable law or regulation, or
- when the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: par. .A22–.A27)

Terms of Engagement

.17 The auditor of the group financial statements is required, in accordance with section 210A, *Terms of Engagement*, to agree upon the terms of the group audit engagement.⁶ (Ref: par. .A28–.A29)

Overall Audit Strategy and Audit Plan

.18 The group engagement team should establish an overall group audit strategy and should develop a group audit plan. In developing the group audit plan, the group engagement team should assess the extent to which the group engagement team will use the work of component auditors and whether the auditor's report on the group financial statements will make reference to the audit of a component auditor, as discussed in paragraphs .24–.30.

.19 The group engagement partner should review and approve the overall group audit strategy and group audit plan. (Ref: par. .A30)

⁵ Paragraphs .11–.14 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

⁶ Paragraph .09 of section 210A, *Terms of Engagement*.

Understanding the Group, Its Components, and Their Environments

.20 The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment.⁷ The group engagement team should

- a. enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage.
- b. obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: par. .A31–.A37)

.21 The group engagement team should obtain an understanding that is sufficient to

- a. confirm or revise its initial identification of components that are likely to be significant.
- b. assess the risks of material misstatement of the group financial statements, whether due to fraud or error.⁸ (Ref: par. .A38–.A39)

Understanding a Component Auditor

.22 Regardless of whether reference will be made in the auditor's report on the group financial statements to the audit of a component auditor, the group engagement team should obtain an understanding of the following: (Ref: par. .A40–.A44)

- a. Whether a component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent (Ref: par. .A46)
- b. A component auditor's professional competence (Ref: par. .A47–.A48)
- c. The extent, if any, to which the group engagement team will be able to be involved in the work of the component auditor
- d. Whether the group engagement team will be able to obtain information affecting the consolidation process from a component auditor
- e. Whether a component auditor operates in a regulatory environment that actively oversees auditors (Ref: par. .A45)

.23 When a component auditor does not meet the independence requirements that are relevant to the group audit or the group engagement team has serious concerns about the other matters listed in paragraph .22a–b, the group engagement team should obtain sufficient appropriate audit evidence relating to the financial information of the component without making reference to the audit of that component auditor in the auditor's report on the group financial statements or otherwise using the work of that component auditor. (Ref: par. .A49–.A51)

⁷ See section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁸ See section 315A.

Determining Whether to Make Reference to a Component Auditor in the Auditor's Report on the Group Financial Statements

.24 Having gained an understanding of each component auditor, the group engagement partner should decide whether to make reference to a component auditor in the auditor's report on the group financial statements. (Ref: par. .A52)

.25 Reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

- a. the group engagement partner has determined that the component auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS (Ref: par. .A53), and
- b. the component auditor has issued an auditor's report that is not restricted as to use.⁹

[As amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.26 If the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

- a. the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group, and
- b. the group engagement team has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for, and, thus, be involved in, the work of the component auditor. (Ref: par. .A54–.A57)

[Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.27 When the group engagement partner decides to make reference in the auditor's report on the group financial statements to the audit of a component auditor, the group engagement team should obtain sufficient appropriate audit evidence with regard to such components by performing the following procedures:

- a. The procedures required by this section, except for those required by paragraphs .51–.65
- b. Reading the component's financial statements and the component auditor's report thereon to identify significant findings and issues and, when considered necessary, communicating with the component auditor in this regard

⁹ See section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 125.]

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Making Reference in the Auditor's Report

.28 When the group engagement partner decides to make reference to the audit of a component auditor in the auditor's report on the group financial statements, the report on the group financial statements should clearly indicate

- a. that the component was not audited by the auditor of the group financial statements but was audited by the component auditor.
- b. the magnitude of the portion of the financial statements audited by the component auditor.
- c. when the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements
 - i. the financial reporting framework used by the component and
 - ii. that the auditor of the group financial statements is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group.
- d. when
 - i. the component auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and
 - ii. the group engagement partner has determined that the component auditor performed additional audit procedures in order to meet the relevant requirements of GAAS
 - (1) the set of auditing standards used by the component auditor and
 - (2) that additional audit procedures were performed by the component auditor to meet the relevant requirements of GAAS. (Ref: par. A58–A60)

[Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.29 If the group engagement partner decides to name a component auditor in the auditor's report on the group financial statements

- a. the component auditor's express permission should be obtained.
- b. the component auditor's report should be presented together with that of the auditor's report on the group financial statements.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.30 If the opinion of a component auditor is modified or that report includes an emphasis-of-matter or other-matter paragraph, the auditor of the group financial statements should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the auditor of the group financial statements should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph or an other-matter paragraph in the auditor's report on the group financial statements. (Ref: par. A61) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.31 If the group engagement partner decides to assume responsibility for work of a component auditor, no reference should be made to the component auditor in the auditor's report on the group financial statements. (Ref: par. .A62) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Materiality

.32 The group engagement team should determine the following: (Ref: par. .A63)

- a. Materiality, including performance materiality, for the group financial statements as a whole when establishing the overall group audit strategy.¹⁰
- b. Whether, in the specific circumstances of the group, particular classes of transactions, account balances, or disclosures in the group financial statements exist for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the group financial statements as a whole would influence the judgment made by a reasonable user based on the group financial statements. In such circumstances, the group engagement team should determine materiality to be applied to those particular classes of transactions, account balances, or disclosures.
- c. Component materiality for those components on which the group engagement team will perform, or for which the auditor of the group financial statements will assume responsibility for the work of a component auditor who performs, an audit or a review. Component materiality should be determined taking into account all components, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of a component auditor. To reduce the risk that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds the materiality for the group financial statements as a whole, component materiality should be lower than the materiality for the group financial statements as a whole, and component performance materiality should be lower than performance materiality for the group financial statements as a whole. (Ref: par. .A64–.A66)
- d. The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: par. .A67)

See paragraph .51 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

Responding to Assessed Risks

.33 The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial

¹⁰ See section 320, *Materiality in Planning and Performing an Audit*.

statements.¹¹ If the nature, timing, and extent of the work to be performed on the consolidation process or the financial information of the components is based on an expectation that group-wide controls are operating effectively or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the group engagement team should test, or have a component auditor test on the group engagement team's behalf, the operating effectiveness of those controls. See paragraphs .52–.58 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. (Ref: par. .A68) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Consolidation Process

.34 In accordance with paragraph .20, the group engagement team obtains an understanding of group-wide controls and the consolidation process, including the instructions issued by group management to components. In accordance with paragraph .33, the group engagement team, or component auditor at the request of the group engagement team, tests the operating effectiveness of group-wide controls if the nature, timing, and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.35 The group engagement team should design and perform further audit procedures on the consolidation process to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This should include evaluating whether all components have been included in the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.36 The group engagement team should evaluate the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications and should evaluate whether any fraud risk factors or indicators of possible management bias exist. (Ref: par. .A69) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.37 If the financial information of a component has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group engagement team should evaluate whether the financial information of that component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. (Ref: par. .A57) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.38 The group engagement team should determine whether the financial information identified in a component auditor's communication (see paragraph .42b) is the financial information that is incorporated in the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.39 If the group financial statements include the financial statements of a component with a financial reporting period-end that differs from that of the group, the group engagement team should evaluate whether appropriate adjustments have been made to those financial statements in accordance with

¹¹ See section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events

.40 When the group engagement team or component auditors perform audits on the financial information of components, the group engagement team or the component auditors should perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements and that may require adjustment to, or disclosure in, the group financial statements. See paragraph .59 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. (Ref: par. .A70) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor

.41 The group engagement team should communicate its requirements to a component auditor on a timely basis. This communication should include the following:

- a. A request that the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, confirm that the component auditor will co-operate with the group engagement team.
- b. The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.
- c. A list of related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties. The group engagement team should request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team should identify such additional related parties to other component auditors.
- d. Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.42 The group engagement team should request a component auditor to communicate matters relevant to the group engagement team's conclusion, with regard to the group audit. Such communication should include the following:

- a. Whether the component auditor has complied with ethical requirements relevant to the group audit, including independence and professional competence
- b. Identification of the financial information of the component on which the component auditor is reporting
- c. The component auditor's overall findings, conclusions, or opinion

See paragraphs .60–.61 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Evaluating a Component Auditor's Communication and Adequacy of Their Work

.43 The group engagement team should evaluate a component auditor's communication (see paragraph .42). The group engagement team should discuss significant findings and issues arising from that evaluation with the component auditor, component management, or group management, as appropriate. See paragraphs .60–.63 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Sufficiency and Appropriateness of Audit Evidence

.44 The auditor is required to obtain sufficient appropriate audit evidence on which to base the audit opinion.¹² The group engagement team should evaluate whether sufficient appropriate audit evidence on which to base the group audit opinion has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the component auditors on the financial information of the components. (Ref: par. .A71) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.45 The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (either identified by the group engagement team or communicated by component auditors) and any instances in which there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. .A72) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management and Those Charged With Governance

.46 The group engagement team should communicate to group management and those charged with governance of the group material weaknesses and significant deficiencies in internal control that are relevant to the group (either identified by the group engagement team or brought to its attention by a component auditor during the audit), in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.47 If fraud has been identified by the group engagement team or brought to its attention by a component auditor or information indicates that a fraud

¹² Paragraph .19 of section 200.

may exist, the group engagement team should communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: par. .A73) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.48 When a component auditor has been engaged to express an audit opinion on the financial statements of a component, the group engagement team should request group management to inform component management of any matter of which the group engagement team becomes aware that may be significant to the financial statements of the component, but of which component management may be unaware. If group management refuses to communicate the matter to component management, the group engagement team should discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group engagement team, subject to legal and professional confidentiality considerations, should consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the component until the matter is resolved and whether to withdraw from the engagement. (Ref: par. .A74) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Those Charged With Governance of the Group

.49 The group engagement team should communicate the following matters with those charged with governance of the group, in addition to those required by section 260, *The Auditor's Communication With Those Charged With Governance*, and other AU-C sections: (Ref: par. .A75)

- a. An overview of the type of work to be performed on the financial information of the components, including the basis for the decision to make reference to the audit of a component auditor in the auditor's report on the group financial statements
- b. An overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components
- c. Instances in which the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work
- d. Any limitations on the group audit (for example, when the group engagement team's access to information may have been restricted)
- e. Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls, or others in which a material misstatement of the group financial statements has or may have resulted from fraud

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Documentation

.50 The group engagement team should include in the audit documentation the following:¹³

¹³ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- a. An analysis of components indicating those that are significant and the type of work performed on the financial information of the components
- b. Those components for which reference to the reports of component auditors is made in the auditor's report on the group financial statements
- c. Written communications between the group engagement team and the component auditors about the group engagement team's requirements
- d. For those components for which reference is made in the auditor's report on the group financial statements to the audit of a component auditor
 - i. the financial statements of the component and the report of the component auditor thereon
 - ii. when the component auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the component auditor met the relevant requirements of GAAS

See paragraph .65 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Additional Requirements Applicable When Assuming Responsibility for the Work of a Component Auditor

Materiality (See paragraph .32)

.51 In the case of an audit of the financial information of a component in which the auditor of the group financial statements is assuming responsibility for the component auditor's work, the group engagement team should evaluate the appropriateness of performance materiality at the component level. (Ref: par. .A76–.A77) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Determining the Type of Work to Be Performed on the Financial Information of Components (See paragraph .33)

.52 For components for which the auditor of the group financial statements is assuming responsibility for the work of component auditors, the group engagement team should determine the type of work to be performed by the group engagement team or by component auditors on its behalf on the financial information of the components (see paragraphs .53–.56). The group engagement team also should determine the nature, timing, and extent of its involvement in the work of component auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Significant Components

.53 For a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on

its behalf, should perform an audit of the financial information of the component, adapted as necessary to meet the needs of the group engagement team, using component materiality. (Ref: par. .A78) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.54 For a component that is significant not due to its individual financial significance but because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, should perform one or more of the following: (Ref: par. .A79)

- a. An audit, adapted as necessary to meet the needs of the group engagement team, of the financial information of the component, using component materiality
- b. An audit, adapted as necessary to meet the needs of the group engagement team, of one or more account balances, classes of transactions, or disclosures relating to the likely significant risks of material misstatement of the group financial statements (Ref: par. .A80)
- c. Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements (Ref: par. .A81)

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Components That Are Not Significant Components

.55 For components that are not significant components, the group engagement team should perform analytical procedures at the group level. (Ref: par. .A82) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.56 In some circumstances, the group engagement team may determine that sufficient appropriate audit evidence on which to base the group audit opinion will not be obtained from the following:

- a. The work performed on the financial information of significant components
- b. The work performed on group-wide controls and the consolidation process
- c. The analytical procedures performed at group level

In such circumstances, the group engagement team should select additional components that are not significant components and should perform or request a component auditor to perform one or more of the following on the financial information of the individual components selected: (Ref: par. .A83–.A86)

- An audit, adapted as necessary to meet the needs of the group engagement team, of the financial information of the component, using component materiality
- An audit, adapted as necessary to meet the needs of the group engagement team, of one or more account balances, classes of transactions, or disclosures
- A review of the financial information of the component, adapted as necessary to meet the needs of the group engagement team, using component materiality
- Specified audit procedures

The group engagement team should vary the selection of such individual components over a period of time. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

***Involvement in the Work Performed by Component Auditors
(Ref: par. .A87–.A88)******Significant Components — Risk Assessment***

.57 When a component auditor performs an audit or other specified audit procedures of the financial information of a significant component for which the auditor of the group financial statements is assuming responsibility for the component auditor's work, the group engagement team should be involved in the risk assessment of the component to identify significant risks of material misstatement of the group financial statements. The nature, timing, and extent of this involvement are affected by the group engagement team's understanding of the component auditor but, at a minimum, should include the following:

- a. Discussing with the component auditor or component management the component's business activities of significance to the group.
- b. Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error.
- c. Reviewing the component auditor's documentation of identified significant risks of material misstatement of the group financial statements. Such documentation may take the form of a memorandum that reflects the component auditor's conclusion with regard to the identified significant risks.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Identified Significant Risks of Material Misstatement of the Group Financial Statements — Further Audit Procedures

.58 When significant risks of material misstatement of the group financial statements have been identified in a component for which the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the group engagement team should evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial statements. Based on its understanding of the component auditor, the group engagement team should determine whether it is necessary to be involved in the further audit procedures. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events (See paragraph .40)

.59 When component auditors perform work other than audits of the financial information of components at the request of the group engagement team, the group engagement team should request the component auditors to notify the group engagement team if they become aware of events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements that may require an adjustment to, or disclosure in, the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor (See paragraph .42)

.60 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the communication required in paragraph .41 should set out the work to be performed and the form and content of the component auditor's communication with the group engagement team. It also should include, in the case of an audit or review of the financial information

of the component, component materiality (and the amount or amounts lower than the materiality for particular classes of transactions, account balances, or disclosures, if applicable) and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: par. .A89–.A92) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.61 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the communication requested from the component auditor, as required in paragraph .42, also should include the following:

- a. Whether the component auditor has complied with the group engagement team's requirements.
- b. Information on instances of noncompliance with laws or regulations at the component or group level that could give rise to a material misstatement of the group financial statements.
- c. Significant risks of material misstatement of the group financial statements, due to fraud or error, identified by the component auditor in the component and the component auditor's responses to such risks. The group engagement team should request the component auditor to communicate such significant risks on a timely basis.
- d. A list of corrected and uncorrected misstatements of the financial information of the component (the list need not include misstatements that are below the threshold for clearly trivial misstatements communicated by the group engagement team).
- e. Indicators of possible management bias regarding accounting estimates and the application of accounting principles.
- f. Description of any identified material weaknesses and significant deficiencies in internal control at the component level.
- g. Other significant findings and issues that the component auditor communicated or expects to communicate to those charged with governance of the component, including fraud or suspected fraud involving component management, employees who have significant roles in internal control at the component level, or others that resulted in a material misstatement of the financial information of the component.
- h. Any other matters that may be relevant to the group audit or that the component auditor wishes to draw to the attention of the group engagement team, including exceptions noted in the written representations that the component auditor requested from component management.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating a Component Auditor's Communication and Adequacy of Their Work (See paragraph .43)

.62 The group engagement team should determine, based on the evaluation required in paragraph .43, whether it is necessary to review other relevant parts of a component auditor's audit documentation. (Ref: par. .A93) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.63 If the group engagement team concludes that the work of a component auditor is insufficient, the group engagement team should determine additional

procedures to be performed and whether they are to be performed by the component auditor or by the group engagement team. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group (See paragraphs .46–.49)

.64 The group engagement team should determine which material weaknesses and significant deficiencies in internal control that component auditors have brought to the attention of the group engagement team should be communicated to group management and those charged with governance of the group. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Documentation (See paragraph .50)

.65 The group engagement team should include in the audit documentation the nature, timing, and extent of the group engagement team's involvement in the work performed by the component auditors on significant components, including, when applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Application and Other Explanatory Material

Definitions

Component (Ref: par. .11)

.A1 The structure of a group affects how components are identified. For example, the group financial reporting system may be based on an organizational structure that provides for financial information to be prepared by a parent and one or more subsidiaries, joint ventures, or investees accounted for by the equity or cost methods of accounting; by a head office and one or more divisions or branches; or by a combination of both. Some groups, however, may organize their financial reporting system by function, process, product or service (or by groups of products or services), or geographical locations. In these cases, the entity or business activity for which group or component management prepares financial information that is included in the group financial statements may be a function, process, product or service (or group of products or services), or geographical location.

.A2 An investment accounted for under the equity method constitutes a component for purposes of this section. Investments accounted for under the cost method may be analogous to a component for purposes of this section when the work and reports of other auditors constitute a major element of evidence for such investments.

.A3 Various levels of components may exist within the group financial reporting system, in which case it may be more appropriate to identify components at certain levels of aggregation rather than individually.

.A4 Components aggregated at a certain level may constitute a component for purposes of the group audit; however, such a component also may prepare group financial statements that incorporate the financial information of the components it encompasses (that is, a subgroup). This section may, therefore, be applied by different group engagement partners and teams for different subgroups within a larger group.

Considerations Specific to Audits of Governmental Entities

.A5 In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

Significant Component (Ref: par. .11)

.A6 As the individual financial significance of a component increases, the risks of material misstatement of the group financial statements ordinarily increase. The group engagement team may apply a percentage to a chosen benchmark as an aid to identify components that are of individual financial significance. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgment. Depending on the nature and circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, revenues, expenditures, or net income. For example, the group engagement team may consider that components exceeding a specified percentage of the chosen benchmark are significant components.

.A7 The group engagement team also may identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances (that is, risks that require special audit consideration¹⁴). For example, a component could be responsible for foreign exchange trading and, thus, expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

Considerations Specific to Governmental Entities

.A8 In audits of governmental entities, appropriate quantitative benchmarks for identifying significant components might include net costs or total budget. Qualitative considerations in audits of governmental entities may involve matters of heightened public sensitivity, such as national security issues, donor funded projects, or reporting of tax revenue.

Component Auditor (Ref: par. .11)

.A9 For purposes of this section, auditors who do not meet the definition of a member of the group engagement team are considered to be component auditors. However, an auditor who performs work on a component when the group engagement team will not use that work to provide audit evidence for the group audit is not considered a component auditor.

.A10 When two or more component auditors exist, the provisions of this section are applicable to each component auditor.

.A11 A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. When this is the case, such a member of the group engagement team also is a component auditor.

Consolidation Process (Ref: par. .12)*Considerations Specific to Governmental Entities*

.A12 In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

¹⁴ Paragraphs .28–.30 of section 315A.

Responsibility (Ref: par. .13)

.A13 Component auditors may perform work on the financial information of the components for the group audit and, as such, are responsible for their overall findings, conclusions, or opinions. However, regardless of whether reference is made in the auditor's report on the group financial statements to the report of a component auditor, the auditor of the group financial statements is responsible for the group audit opinion.

Considerations Specific to Governmental Entities

.A14 When the auditor of the group financial statements is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements, the auditor's reporting responsibilities with respect to the separate financial statements are the same as the auditor's responsibilities with respect to the group financial statements.

Acceptance and Continuance

Obtaining an Understanding at the Acceptance or Continuance Stage (Ref: par. .14)

.A15 In the case of a new engagement, the group engagement team's understanding of the group, its components, and their environments may be obtained from the following:

- Information provided by group management
- Communication with group management
- When applicable, communication with the previous group engagement team, component management, or component auditors

.A16 The group engagement team's understanding may include matters such as the following:

- The group structure, including both the legal and organizational structure (that is, how the group financial reporting system is organized)
- Components' business activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place
- The use of service organizations, including shared service centers
- A description of group-wide controls
- The complexity of the consolidation process
- Whether component auditors that are not from the group engagement partner's firm or network will perform work on the financial information of any of the components and group management's rationale for engaging more than one auditor, if applicable
- Whether the group engagement team
 - will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management, component information, and the component audi-

tors (including relevant audit documentation sought by the group engagement team)

- will be able to perform necessary work on the financial information of the components

.A17 In the case of a continuing engagement, the group engagement team's ability to obtain sufficient appropriate audit evidence may be affected by significant changes, such as the following:

- Changes in the group structure (for example, acquisitions, disposals, reorganizations, or changes in how the group financial reporting system is organized)
- Changes in components' business activities that are significant to the group
- Changes in the composition of those charged with governance of the group, group management, or key management of significant components
- Concerns the group engagement team has with regard to the integrity and competence of group or component management
- Changes in group-wide controls
- Changes in the applicable financial reporting framework

Expectation to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .15)

.A18 Relevant factors in determining whether to act as the auditor of the group financial statements include, among other things, the following:

- The individual financial significance of the components, as determined in accordance with the guidance in paragraph .A6, for which the auditor of the group financial statements will be assuming responsibility
- The extent to which significant risks of material misstatement of the group financial statements are included in the components for which the auditor of the group financial statements will be assuming responsibility
- The extent of the group engagement team's knowledge of the overall financial statements

.A19 A group may consist only of components not considered significant components. In these circumstances, the group engagement partner can reasonably expect to obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team will be able to

- a. perform the work on the financial information of some of these components.
- b. use the work performed by component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.

.A20 When the auditor of the group financial statements is assuming responsibility for the work performed by a component auditor, the group engagement team is required by the provisions of this section to be involved in the work of the component auditor. Paragraph .27 describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner decides to make reference in the auditor's report on the group financial statements to the audit of a component auditor.

Considerations Specific to Governmental Entities

.A21 Additional factors in determining whether to act as the auditor of the group financial statements in audits of state and local governments include, the following:

- Engagement by the primary government as the auditor of the financial reporting entity
- Responsibility for auditing the primary government's general fund (or other primary operating fund)

Access to Information (Ref: par. .16)

.A22 The group engagement team's access to information may be restricted by group management, or it may be restricted by circumstances that cannot be overcome by group management (for example, laws relating to confidentiality and data privacy or denial by a component auditor of access to relevant audit documentation sought by the group engagement team).

.A23 When access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a component that is accounted for by the equity method of accounting. If the component is not a significant component and the group engagement team has a complete set of financial statements of the component, including the auditor's report thereon, and has access to information kept by group management regarding that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence regarding that component. If the component is a significant component, however, and the auditor of the group financial statements is not making reference to the audit of a component auditor in the auditor's report on the group financial statements, then the group engagement team will not be able to comply with the requirements of this section that are relevant in the circumstances of the group audit. For example, the group engagement team will not be able to comply with the requirement in paragraphs .57–.58 to be involved in the work of a component auditor. Therefore, the group engagement team will not be able to obtain sufficient appropriate audit evidence regarding that component. The effect on the auditor's report of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.A24 The group engagement team will not be able to obtain sufficient appropriate audit evidence if group management restricts the access of the group engagement team or a component auditor to the information of a significant component.

.A25 Although the group engagement team may be able to obtain sufficient appropriate audit evidence if such restriction relates to a component considered not a significant component, the reason for the restriction may affect the group audit opinion. For example, it may affect the reliability of group management's responses to the group engagement team's inquiries and group management's representations to the group engagement team.

.A26 Section 210A addresses circumstances when an entity is required by law or regulation to have an audit.¹⁵ In these circumstances, this section still applies to the group audit, and the effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of section 705.

.A27 Exhibit A, "Illustrations of Auditor's Reports on Group Financial Statements," contains an example of an auditor's report containing a qualified opinion based on the group engagement team's inability to obtain sufficient appropriate audit evidence regarding a significant component accounted for by the equity method of accounting when, in the group engagement team's professional judgment, the effect is material but not pervasive.

Terms of Engagement (Ref: par. .17)

.A28 The terms of engagement identify the applicable financial reporting framework.¹⁶ Additional matters that may be included in the terms of a group audit engagement include whether reference will be made to the audit of a component auditor in the auditor's report on the group financial statements, when relevant, or arrangements to facilitate the following:

- Unrestricted communication between the group engagement team and component auditors to the extent permitted by law or regulation
- Communication to the group engagement team of important communications between
 - the component auditors, those charged with governance of the component, and component management, including communications on significant deficiencies and material weaknesses in internal control
 - regulatory authorities and components related to financial reporting matters
- To the extent the group engagement team considers necessary
 - access to component information, those charged with governance of components, component management, and the component auditors (including relevant audit documentation sought by the group engagement team)
 - permission to perform work, or request a component auditor to perform work, on the financial information of the components

.A29 Certain restrictions imposed after acceptance of the group audit engagement result in an inability to obtain sufficient appropriate audit evidence that may affect the group audit opinion including, specifically, restrictions imposed on the following:

- The group engagement team's access to component information, those charged with governance of components, component management, or the component auditors (including relevant audit documentation sought by the group engagement team)

¹⁵ Paragraphs .07 and .A19 of section 210A.

¹⁶ Paragraph .10 of section 210A.

- The work to be performed on the financial information of the components

These restrictions may even lead to withdrawal from the engagement unless that is not possible under law or regulation. Section 705 addresses the auditor's responsibilities when management has imposed a limitation on the scope of the audit after the auditor has accepted the engagement.¹⁷

Overall Audit Strategy and Audit Plan (Ref: par. .19)

.A30 The group engagement partner's review of the overall group audit strategy and group audit plan is an important part of fulfilling the group engagement partner's responsibility for the direction of the group audit engagement.

Understanding the Group, Its Components, and Their Environments

Matters About Which the Group Engagement Team Obtains an Understanding (Ref: par. .20)

.A31 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance.¹⁸ Appendix A, "Understanding the Group, Its Components, and Their Environments — Examples of Matters About Which the Group Engagement Team Obtains an Understanding," of this section contains guidance on matters specific to a group, including the consolidation process.

Instructions Issued by Group Management to Components (Ref: par. .20)

.A32 To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components. Such instructions specify the requirements for financial information of the components to be included in the group financial statements and often include financial reporting procedures manuals and a reporting package. A reporting package ordinarily consists of standard formats for providing financial information for incorporation in the group financial statements. Reporting packages generally do not, however, take the form of complete financial statements prepared and presented in accordance with the applicable financial reporting framework.

.A33 The instructions ordinarily cover the following:

- The accounting policies to be applied
- Statutory and other disclosure requirements applicable to the group financial statements, including the following:
 - The identification and reporting of segments
 - Related party relationships and transactions
 - Intragroup transactions and unrealized profits or losses

¹⁷ Paragraphs .11–.14 and .A15–.A16 of section 705.

¹⁸ Paragraphs .A17–.A41 of section 315A.

— Intragroup account balances

- A reporting timetable

.A34 The group engagement team's understanding of the instructions may include the following:

- The clarity and practicality of the instructions for completing the reporting package
- Whether the instructions
 - adequately describe the characteristics of the applicable financial reporting framework
 - provide for disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework (for example, disclosure of related party relationships, related party transactions, and segment information)
 - provide for the identification of consolidation adjustments (for example, intragroup account balances, transactions, and unrealized profits or losses)
 - provide for the approval of the financial information by component management

Fraud (Ref: par. .20)

.A35 The auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud and to design and implement appropriate responses to the assessed risks.¹⁹ Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risks that the group financial statements may be materially misstated as a result of fraud
- Group management's process for identifying and responding to the risks of fraud in the group, including any specific fraud risks identified by group management or account balances, classes of transactions, or disclosures for which a risk of fraud is likely
- Whether particular components exist for which a risk of fraud is likely
- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group and the controls group management has established to mitigate these risks
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and, if considered appropriate, component management, the component auditors, and others) to the group engagement team's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

¹⁹ See section 240, *Consideration of Fraud in a Financial Statement Audit*.

Discussion Among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: par. .20)

.A36 The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasizing the risks due to fraud. In a group audit, these discussions also may include the component auditors.^{20, 21} The group engagement partner's determination of who to include in the discussions, how and when they occur, and their extent is affected by factors, such as prior experience with the group.

.A37 The discussions provide an opportunity to

- share knowledge of the components and their environments, including group-wide controls.
- exchange information about the business risks of the components or the group.
- exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error; how group management and component management could perpetrate and conceal fraudulent financial reporting; and how assets of the components could be misappropriated.
- identify practices followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting (for example, revenue recognition practices that do not comply with the applicable financial reporting framework).
- consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud; provide the opportunity for fraud to be perpetrated; or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.
- consider the risk that group or component management may override controls.
- consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).
- discuss fraud that has been identified in components or information that indicates the existence of a fraud in a component.
- share information that may indicate noncompliance with laws or regulations (for example, payments of bribes and improper transfer pricing practices).

Risk Factors (Ref: par. .21)

.A38 Appendix B, "Examples of Conditions or Events That May Indicate Risks of Material Misstatement of the Group Financial Statements," sets out

²⁰ Paragraph .15 of section 240.

²¹ Paragraph .11 of section 315A.

examples of conditions or events that, individually or together, may indicate risks of material misstatement of the group financial statements, including risks due to fraud.

Risk Assessment (Ref: par. .21)

.A39 The group engagement team's assessment at group level of the risks of material misstatement of the group financial statements is based on information, such as the following:

- Information obtained from the understanding of the group, its components, and their environments and of the consolidation process, including audit evidence obtained in evaluating the design and implementation of group-wide controls and controls that are relevant to the consolidation
- Information obtained from the component auditors

Understanding a Component Auditor (Ref: par. .22)

Group Engagement Team's Procedures to Obtain an Understanding of a Component Auditor and Sources of Audit Evidence (Ref: par. .22)

.A40 Factors that may affect the group engagement partner's decisions whether to use the work of a component auditor to provide audit evidence for the group audit and whether to make reference to the audit of a component auditor in the auditor's report on the group financial statements include the following:

- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable
- Differences in the auditing and other standards applied by the component auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group engagement team to be involved in the work of a component auditor

.A41 It will not be necessary to obtain an understanding of the auditors of those components for which the group engagement team plans to perform analytical procedures at group level only.

.A42 The nature, timing, and extent of the group engagement team's procedures to obtain an understanding of a component auditor are affected by factors, such as previous experience with, or knowledge of, the component auditor and the degree to which the group engagement team and the component auditor are subject to common policies and procedures, such as the following:

- Whether the group engagement team and a component auditor share the following:
 - Common policies and procedures for performing the work (for example, audit methodologies)
 - Common quality control policies and procedures
 - Common monitoring policies and procedures
- The consistency or similarity of the following:

- Laws and regulations or legal system
- Professional oversight, discipline, and external quality assurance
- Education and training
- Professional organizations and standards
- Language and culture

.A43 These factors interact and are not mutually exclusive. For example, the extent of the group engagement team's procedures to obtain an understanding of component auditor A, who consistently applies common quality control and monitoring policies and procedures and a common audit methodology or operates in the same jurisdiction as the auditor of the group financial statements, may be less than the extent of the group engagement team's procedures to obtain an understanding of component auditor B, who does not consistently apply common quality control and monitoring policies and procedures and a common audit methodology or operates in a different jurisdiction. The nature of the procedures performed regarding component auditors A and B also may be different.

.A44 The group engagement team may obtain an understanding of a component auditor in a number of ways. In the first year of involving a component auditor, the group engagement team may, for example

- determine through communication with a component auditor that
 - the component auditor is aware that
 - the financial statements of the component are to be included in the group financial statements on which the auditor of the group financial statements will report.
 - the component auditor's report thereon will be relied upon by the auditor of the group financial statements.
 - either the auditor of the group financial statements will make reference to the component auditor's report in the opinion on the group financial statements or the group engagement team will be involved in the work of the component auditor.
- a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.
- evaluate the results of the quality control monitoring system when the group engagement team and component auditor are from a firm or network that operates under, and complies with, common monitoring policies and procedures.²²
- visit a component auditor to discuss the matters in paragraph .22a–d.
- request a component auditor to confirm the matters referred to in paragraph .22a–d in writing. Exhibit B, "Illustrative Compo-

²² Paragraph .57 of QM section 10A, *A Firm's System of Quality Control*.

nent Auditor's Confirmation Letter," contains an example of written confirmations by a component auditor.

- request a component auditor to complete questionnaires about the matters in paragraph .22a–d.
- discuss a component auditor with colleagues in the group engagement partner's firm or with a reputable third party that has knowledge of the component auditor, such as other practitioners or bankers and other credit grantors.

In subsequent years, the understanding of a component auditor may be based on the group engagement team's previous experience with that component auditor. The group engagement team may request the component auditor to confirm whether anything regarding the matters listed in paragraph .22a–d has changed since the previous year.

.A45 Where independent oversight bodies have been established to oversee the auditing profession and monitor the quality of audits, awareness of the regulatory environment may assist the group engagement team in evaluating the independence and competence of a component auditor. Information about the regulatory environment and the public results of any inspections performed by oversight bodies may be obtained from the component auditor or information provided by the independent oversight bodies.

Ethical Requirements That Are Relevant to the Group Audit (Ref: par. .22a)

.A46 When performing work on the financial information of a component for a group audit, the component auditor is subject to ethical requirements that are relevant to the group audit. Such requirements may be different or in addition to those applying to the component auditor when performing an audit in the component auditor's jurisdiction. The group engagement team, therefore, obtains an understanding about the component auditor's understanding of, and compliance with, the ethical requirements that are relevant to the group audit and whether that is sufficient to fulfill the component auditor's responsibilities in the group audit. When the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants is sufficient to fulfill the component auditor's ethical responsibilities in the group audit.²³

A Component Auditor's Professional Competence (Ref: par. .22b)

.A47 Inquiries about the professional reputation and standing of a component auditor may be made of the AICPA, the state board of accountancy by which the component auditor is licensed, the applicable state society of CPAs, or the local chapter, or, in the case of an auditor from a foreign jurisdiction, the corresponding professional organization, and if applicable, the PCAOB. The group engagement team may obtain the peer review report, if available, on the component auditor's firm. Exhibit C, "Sources of Information," provides information about specific inquiries that may be directed to the AICPA.

²³ ET section 0.200.020, *Application of the AICPA Code*, of the AICPA Code of Professional Conduct explains that an AICPA member who is the group engagement partner of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA Code of Professional Conduct, provided that component auditors that are not subject to the AICPA Code are in compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A48 The group engagement team's understanding of a component auditor's professional competence may include whether the component auditor

- possesses an understanding of the auditing and other standards applicable to the group audit, such as U.S. GAAS, that is sufficient to fulfill the component auditor's responsibilities.
- possesses the special skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies) necessary to perform the work on the financial information of the particular component.
- when relevant, possesses an understanding of the applicable financial reporting framework that is sufficient to fulfill the component auditor's responsibilities in the group audit (instructions issued by group management to components often describe the characteristics of the applicable financial reporting framework).

Application of the Group Engagement Team's Understanding of a Component Auditor (Ref: par. .23)

.A49 The group engagement team cannot overcome the fact that a component auditor is not independent by being involved in the work of the component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component or by making reference in the auditor's report on the group financial statements to the audit of the component auditor.

.A50 However, the group engagement team may be able to overcome less than serious concerns about a component auditor's professional competency (for example, lack of industry-specific knowledge) or the fact that a component auditor does not operate in an environment that actively oversees auditors by being involved in the work of that component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.

.A51 When law or regulation prohibits access to relevant parts of the audit documentation of a component auditor, the group engagement team may request the component auditor to overcome this by preparing a memorandum that covers the relevant information.

Determining Whether to Make Reference to a Component Auditor in the Auditor's Report on the Group Financial Statements (Ref: par. .24)

.A52 In group audits involving two or more component auditors, the decision to make reference to the audit of a component auditor is made individually for each component auditor, regardless of the decision whether to refer to any other component auditor. The auditor of the group financial statements may make reference to any, all, or none of the component auditors. For example, if significant components are audited by a component auditor from a network firm and one component is audited by another firm, the group engagement partner may decide to assume responsibility for the work of the component auditor from the network firm and to make reference to the work of the component auditor from the other firm.

Determining Whether the Audit Was Conducted in Accordance With GAAS (Ref: par. .25a)

.A53 A component auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph .25a. When the component auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the component auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph .25a, relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group engagement team may provide the component auditor with appendix B, *Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards*, that identifies substantive requirements of GAAS that are not requirements in the ISAs. The component auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the component auditor required by paragraph .42 may address whether the audit of the component auditor met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the component auditor, may decide to make reference to the audit of that component auditor in the auditor's report on the group financial statements. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same (Ref: par. .26)

.A54 When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group engagement team is required by paragraph .37 to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the auditor of the group financial statements assumes responsibility for, and, thus, is involved in, the work of the component auditor. In rare circumstances, however, the group engagement partner may conclude that the group engagement team can reasonably expect to obtain sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for, and, thus, be involved in, the work of the component auditor. [Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

A55 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of all material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and *International Financial Reporting Standard for Small and Medium-sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP. [Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

A56 Additional considerations in determining whether it may be appropriate to make reference to the audit of a component auditor in the auditor's report on the group financial statements when the component prepares financial statements using a different financial reporting framework than that used by the group include the

- effectiveness of groupwide controls and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments.
- depth of the group engagement team's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments.
- extent of the group engagement team's knowledge of the financial reporting framework used to prepare the component financial statements.
- group engagement team's ability to obtain information from group or component management that is relevant to the adjustments.
- need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments.

[Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Considerations for Governmental Entities

A57 When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by the Governmental Accounting Standards Board and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such

provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs .26 and .28c are not relevant. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Making Reference in the Auditor's Report (Ref: par. .28–.31)

.A58 The disclosure of the magnitude of the portion of the financial statements audited by a component auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a component auditor. When two or more component auditors participate in the audit, the dollar amounts or the percentages covered by the component auditors may be stated in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A59 Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a component auditor is not to be construed as a qualification of the opinion, but rather is intended to communicate (1) that the auditor of the group financial statements is not assuming responsibility for the work of the component auditor, and (2) the source of the audit evidence with respect to those components for which reference to the audit of component auditors is made. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A60 Exhibit A contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A61 If the modified opinion, emphasis-of-matter paragraph, or other-matter paragraph in the component auditor's report does not affect the report on the group financial statements and the component auditor's report is not presented, the auditor of the group financial statements need not make reference to those paragraphs in the auditor's report on the group financial statements. If the component auditor's report is presented, the auditor of the group financial statements may make reference to those paragraphs and their disposition. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A62 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, no reference is made to the component auditor in the report on the group audit because to do so may cause a reader to misinterpret the degree of responsibility being assumed. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Materiality (Ref: par. .32)

.A63 The auditor is required²⁴

- a.* when establishing the overall audit strategy
 - i.* to determine materiality for the financial statements as a whole.

²⁴ Paragraphs .10–.11 of section 320.

- ii. to consider whether, in the specific circumstances of the entity, particular classes of transactions, account balances, or disclosures exist for which there is a substantial likelihood that misstatements of lesser amounts than materiality for the financial statements as a whole would influence the judgment made by a reasonable user based on the financial statements. In such circumstances, the auditor determines materiality to be applied to those particular classes of transactions, account balances, or disclosures.
- b. to determine performance materiality for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks.

In the context of a group audit, materiality is established for both the group financial statements as a whole and the financial information of those components on which the group engagement team will perform, or request a component auditor to perform, an audit or review. Materiality for the group financial statements as a whole is used when establishing the overall group audit strategy. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A64 Different materiality may be established for different components. The aggregate of component materiality may exceed group materiality. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A65 Consideration of all components, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of a component auditor, is necessary when determining component materiality to reduce the risk that the aggregate of detected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole. Determining component materiality is necessary for the group engagement team to determine the overall group audit plan for the components for which the auditor of the group financial statements is not making reference to the component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A66 When the component is subject to an audit required by law or regulation or performed for another reason, the materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group materiality and, accordingly, be acceptable for purposes of the group audit. In the case of an equity method investment, the investee may be larger than the investor, and the auditor's evidence to support the investor's share of earnings from the investment may consist largely of the audited financial statements of the investee. In such cases, the materiality used by the investee's auditor may be larger than the materiality used by the investor's auditor. When such circumstances exist, the group engagement team may take into consideration matters such as the group's ownership percentage and its share of the investee's profits and losses when determining whether the component materiality used by the investee's auditor is appropriate for purposes of the audit of the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A67 A threshold for misstatements is determined in addition to component materiality. Misstatements identified in the financial information of the component that are above the threshold for misstatements of the group are

communicated to the group engagement team. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Responding to Assessed Risks (Ref: par. .33)

.A68 In an audit of group financial statements, appropriate responses to assessed risks of material misstatement for some or all classes of transactions or account balances may be implemented at the group level, without the involvement of component auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Consolidation Process

Consolidation Adjustments and Reclassifications (Ref: par. .36)

.A69 The consolidation process may require adjustments to amounts reported in the group financial statements that do not pass through the usual transaction processing systems and may not be subject to the same internal controls to which other financial information is subject. The group engagement team's evaluation of the appropriateness, completeness, and accuracy of the adjustments may include the following:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them
- Determining whether significant adjustments have been correctly calculated, processed, and authorized by group management and, when applicable, by component management
- Determining whether significant adjustments are properly supported and sufficiently documented
- Checking the reconciliation and elimination of intragroup account balances, transactions, and unrealized profits or losses
- Communicating with the component auditor, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of the component auditor.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events (Ref: par. .40)

.A70 When the auditor's report on the group financial statements will make reference to the audit of a component auditor, procedures designed to identify subsequent events between the date of the component auditor's report and the date of the auditor's report on the group financial statements may include

- obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified.
- requesting the component auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements.
- requesting written representation from component management regarding subsequent events.

- reading available interim financial information of the component and making inquiries of group management.
- reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date.
- reading the subsequent year's capital and operating budgets.
- inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events.
- considering the implications for the auditor's report on the group financial statements if the group engagement team has been unable to obtain sufficient appropriate audit evidence regarding subsequent events.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Sufficiency and Appropriateness of Audit Evidence (Ref: par. .44–.45)

.A71 If the group engagement team concludes that sufficient appropriate audit evidence on which to base the group audit opinion has not been obtained, the group engagement team may request a component auditor to perform additional procedures. Alternatively, the group engagement team may perform its own procedures on the financial information of the component. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A72 The group engagement partner's evaluation of the aggregate effect of any misstatements (either identified by the group engagement team or communicated by component auditors) allows the group engagement partner to determine whether the group financial statements as a whole are materially misstated. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management (Ref: par. .46–.48)

.A73 Section 240, *Consideration of Fraud in a Financial Statement Audit*, contains requirements and guidance on communication of fraud to management and, when management may be involved in the fraud, those charged with governance.²⁵ [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A74 Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

²⁵ Paragraphs .39–.41 of section 240.

- Potential litigation
- Plans for abandonment of material operating assets
- Subsequent events
- Significant legal agreements

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Those Charged With Governance of the Group
(Ref: par. .49)

.A75 The matters the group engagement team communicates to those charged with governance of the group may include those brought to the attention of the group engagement team by component auditors that the group engagement team judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group takes place at various times during the group audit. For example, the matters referred to in paragraph .49a–b may be communicated after the group engagement team has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph .49c may be communicated at the end of the audit, and the matters referred to in paragraph .49d–e may be communicated when they occur. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Additional Requirements Applicable When Assuming Responsibility for the Work of a Component Auditor

Materiality (Ref: par. .51)

.A76 Component materiality for those components whose financial information will be audited or reviewed as part of the group audit in accordance with paragraphs .53, .54a, and .56, is communicated to the component auditor and is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A77 In the case of an audit of the financial information of a component, section 320, *Materiality in Planning and Performing an Audit*, requires the component auditor (or group engagement team) to determine performance materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks.²⁶ This is necessary to reduce the risk that the aggregate of detected and undetected misstatements in the financial information of the component exceeds component materiality. In practice, the group engagement team may set component materiality at the level of performance materiality for the component. When this is the case, the component auditor uses component materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks, as well as for evaluating whether detected misstatements are material individually or in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

²⁶ Paragraph .11 of section 320.

Determining the Type of Work to Be Performed on the Financial Information of Components

Significant Components (Ref: par. .53–.54)

.A78 Adapting an audit of the financial information of a significant component to meet the specific needs of the group engagement team may include requesting the component auditor to

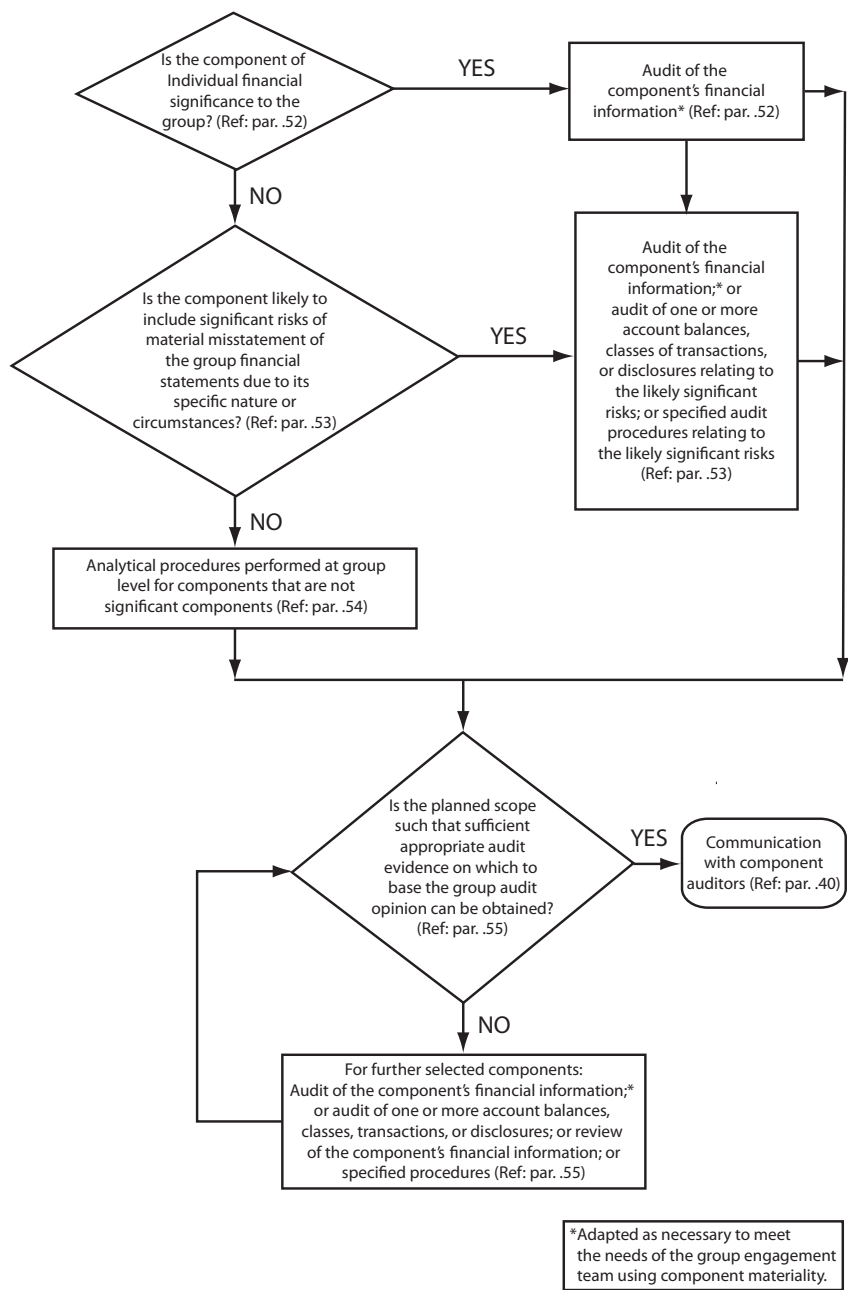
- perform an audit, using component materiality, in accordance with GAAS, with the exception of performing audit procedures on, for example, tax accounts or litigation, claims, and assessments because those procedures are performed at the group level.
- communicate the results of the audit in a form that is responsive to the needs of the group engagement team.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A79 The group engagement team's determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by the following:

- a. The significance of the component
- b. The identified significant risks of material misstatement of the group financial statements
- c. The group engagement team's evaluation of the design of group-wide controls and the determination of whether they have been implemented
- d. The group engagement team's understanding of the component auditor

The following diagram shows how the significance of the component affects the group engagement team's determination of the type of work to be performed on the financial information of the component.



[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A80 The group engagement team may identify a component as a significant component because that component is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances. In that case, the group engagement team may be able to identify the account balances, classes of transactions, or disclosures affected by the likely significant risks. When this is the case, the group engagement team may decide to perform or request a component auditor to perform an audit, adapted as necessary to meet the needs of the group engagement team, of only those account balances, classes of transactions, or disclosures. For example, in the situation described in paragraph .A7, the work on the financial information of the component may be limited to an audit of the account balances, classes of transactions, and disclosures affected by the foreign exchange trading of that component. When the group engagement team requests a component auditor to perform an audit of one or more specific account balances, classes of transactions, or disclosures, the communication of the group engagement team (see paragraph .41) takes account of the fact that many financial statement items are interrelated. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A81 The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial statements. For example, in the case of a likely significant risk of inventory obsolescence, the group engagement team may perform or request a component auditor to perform specified audit procedures on the valuation of inventory at a component that holds a large volume of potentially obsolete inventory but that is not otherwise significant. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Components That Are Not Significant Components (Ref: par. .55–.56)

.A82 Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that no significant risks of material misstatement exist of the aggregated financial information of components that are not significant components. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A83 The group engagement team's decision about how many components to select in accordance with paragraph .56, which components to select, and the type of work to be performed on the financial information of the individual components selected may be affected by factors, such as the following:

- The extent of audit evidence expected to be obtained on the financial information of the significant components
- Whether the component has been newly formed or acquired
- Whether significant changes have taken place in the component
- Whether the internal audit function has performed work at the component and any effect of that work on the group audit
- Whether the components apply common systems and processes
- The operating effectiveness of group-wide controls
- Abnormal fluctuations identified by analytical procedures performed at group level
- The individual financial significance of, or the risk posed by, the component in comparison with other components within this category

- Whether the component is subject to an audit required by law or regulation or performed for another reason

Including an element of unpredictability in selecting components in this category may increase the likelihood of identifying material misstatement of the components' financial information. The selection of components is often varied on a cyclical basis. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A84 An audit of a component that is not a significant component may have already been performed. Once the group engagement team decides to use that work to provide audit evidence for the group audit, the provisions of this section apply. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A85 A review of the financial information of a component may be performed in accordance with Statements on Standards for Accounting and Review Services, adapted as necessary in the circumstances. A review is designed to obtain only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. The group engagement team also may specify additional procedures to supplement this work. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A86 As explained in paragraph .A19, a group may consist only of components that are not significant components. In these circumstances, the group engagement team can obtain sufficient appropriate audit evidence on which to base the group audit opinion by determining the type of work to be performed on the financial information of the components, in accordance with paragraph .56. It is unlikely that the group engagement team will obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team or a component auditor only tests group-wide controls and performs analytical procedures on the financial information of the components. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Involvement in the Work Performed by Component Auditors (Ref: par. .57–.58)

.A87 Factors that may affect the group engagement team's involvement in the work of a component auditor include the following:

- a. The significance of the component
- b. The identified significant risks of material misstatement of the group financial statements
- c. The group engagement team's understanding of the component auditor

In the case of a significant component or identified significant risks, the group engagement team performs the procedures described in paragraphs .57–.58. In the case of a component that is not a significant component, the nature, timing, and extent of the group engagement team's involvement in the work of the component auditor will vary based on the group engagement team's understanding of that component auditor. The fact that the component is not a significant component becomes secondary. For example, even though a component is not considered a significant component, the group engagement team, nevertheless, may decide to be involved in the component auditor's risk assessment because it has concerns (although less than serious concerns) about the component auditor's professional competency (for example, lack of industry-specific knowledge), or the component auditor does not operate in an environment that

actively oversees auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A88 Forms of involvement in the work of a component auditor other than those described in paragraphs .43 and .57–.58 may, based on the group engagement team's understanding of the component auditor, include one or more of the following:

- Meeting with component management or the component auditor to obtain an understanding of the component and its environment.
- Reviewing the component auditor's overall audit strategy and audit plan.
- Performing risk assessment procedures to identify and assess the risks of material misstatement at the component level. These may be performed with the component auditor or by the group engagement team.
- Designing and performing further audit procedures. These may be designed and performed with the component auditor or by the group engagement team.
- Participating in the closing and other key meetings between the component auditor and component management.
- Reviewing other relevant parts of the component auditor's audit documentation.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor (Ref: par. .60)

.A89 If effective two-way communication does not exist between the group engagement team and component auditors, whose work the auditor of the group financial statements is assuming responsibility for, a risk exists that the group engagement team may not obtain sufficient appropriate audit evidence on which to base the group audit opinion. Clear and timely communication of the group engagement team's requirements forms the basis of effective two-way communication between the group engagement team and a component auditor. This two-way communication also may be initiated by the component auditor regarding matters that may be significant to the component audit such as

- transactions, adjustments, or other matters that have come to the group engagement team's attention that it believes require adjustment to or disclosure in the financial statements of the component being audited by the component auditor.
- any relevant limitation on the scope of the audit performed by the group engagement team.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A90 The group engagement team's requirements often are communicated in a letter of instruction. Appendix C, "Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction," contains guidance on required and additional matters that may be included in such a letter of instruction. A component auditor's communication with the group engagement team often takes the form of a memorandum or report of work performed. Communication between the group engagement team and a component auditor, however, may not necessarily be in writing. For example, the group engagement team may visit the component auditor to discuss identified significant risks or review relevant parts of the component auditor's audit documentation. Nevertheless, the documentation requirements of this section and other AU-C

sections apply. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A91 In cooperating with the group engagement team, a component auditor, for example, would provide the group engagement team with access to relevant audit documentation, if not prohibited by law or regulation. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A92 When a member of the group engagement team is also a component auditor, the objective for the group engagement team to communicate clearly with the component auditor often can be achieved by means other than specific written communication. For example

- access by the component auditor to the overall audit strategy and audit plan may be sufficient to communicate the group engagement team's requirements set out in paragraph .41.
- a review of the component auditor's audit documentation by the group engagement team may be sufficient to communicate matters relevant to the group engagement team's conclusion set out in paragraph .42.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Reviewing a Component Auditor's Audit Documentation (Ref: par. .62)

.A93 The parts of the audit documentation of a component auditor that will be relevant to the group audit may vary depending on the circumstances. Often, the focus is on audit documentation that is relevant to the significant risks of material misstatement of the group financial statements. The extent of the review may be affected by the fact that a component auditor's audit documentation has been subjected to the review procedures of the component auditor's firm. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Appendix A — Understanding the Group, Its Components, and Their Environments — Examples of Matters About Which the Group Engagement Team Obtains an Understanding (Ref: par. .A31)

The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement, and the list of examples is not necessarily complete.

Group-Wide Controls

Group-wide controls may include a combination of the following:

- Regular meetings between group and component management to discuss business developments and review performance
- Monitoring of components' operations and their financial results, including regular reporting routines, which enables group management to monitor components' performance against budgets and take appropriate action
- Group management's risk assessment process (that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements)
- Monitoring, controlling, reconciling, and eliminating intragroup account balances, transactions, and unrealized profits or losses at group level
- A process for monitoring the timeliness and assessing the accuracy and completeness of financial information received from components
- A central IT system controlled by the same general IT controls for all or part of the group
- Control activities within an IT system that are common for all or some components
- Monitoring of controls, including activities of the internal audit function and self-assessment programs
- Consistent policies and procedures, including a group financial reporting procedures manual
- Group-wide programs, such as codes of conduct and fraud prevention programs
- Arrangements for assigning authority and responsibility to component management

The internal audit function may be regarded as part of group-wide controls, for example, when the function is centralized. Section 610, *Using the Work of Internal Auditors*, addresses the group engagement team's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the function applies a

systematic and disciplined approach when the group engagement team expects to use the function's work.¹

Consolidation Process

The group engagement team's understanding of the consolidation process may include matters such as the following:

- Matters relating to the applicable financial reporting framework, such as the following:
 - The extent to which component management has an understanding of the applicable financial reporting framework
 - The process for identifying and accounting for components, in accordance with the applicable financial reporting framework
 - The process for identifying reportable segments for segment reporting, in accordance with the applicable financial reporting framework
 - The process for identifying related party relationships and related party transactions for reporting, in accordance with the applicable financial reporting framework
 - The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework
 - The procedures for dealing with components with financial year-ends different from the group's year-end
- Matters relating to the consolidation process, such as the following:
 - Group management's process for obtaining an understanding of the accounting policies used by components and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the components for the group financial statements and that differences in accounting policies are identified and adjusted, when required, in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the components use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.
 - Group management's process for ensuring complete, accurate, and timely financial reporting by the components for the consolidation.

¹ Paragraphs .14–.15 of section 610, *Using the Work of Internal Auditors*. [Footnote amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

- The process for translating the financial information of foreign components into the currency of the group financial statements.
- How IT is organized for the consolidation, including the manual and automated stages of the process and the manual and programmed controls in place at various stages of the consolidation process.
- Group management's process for obtaining information on subsequent events.
- Matters relating to consolidation adjustments, such as the following:
 - The process for recording consolidation adjustments, including the preparation, authorization, and processing of related journal entries and the experience of personnel responsible for the consolidation
 - The consolidation adjustments required by the applicable financial reporting framework
 - Business purpose for the events and transactions that gave rise to the consolidation adjustments
 - Frequency, nature, and size of transactions between components
 - Procedures for monitoring, controlling, reconciling, and eliminating intragroup account balances, transactions, and unrealized profits or losses
 - Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework
 - Arrangements with a controlling interest or noncontrolling interest regarding losses incurred by a component (for example, an obligation of the noncontrolling interest to compensate such losses)

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. As amended, effective for audits of group financial statements for periods ending on or after December 15, 2021, by SAS No. 135.]

.A95

Appendix B — Examples of Conditions or Events That May Indicate Risks of Material Misstatement of the Group Financial Statements (Ref: par. .A38)

The examples provided cover a broad range of conditions or events; however, not all conditions or events are relevant to every group audit engagement, and the following list of examples is not necessarily complete:

- A complex group structure, especially when there are frequent acquisitions, disposals, or reorganizations
- Poor corporate governance structures, including decision-making processes, that are not transparent
- Nonexistent or ineffective group-wide controls, including inadequate group management information on monitoring of components' operations and their results
- Components operating in foreign jurisdictions that may be exposed to factors, such as unusual government intervention in areas such as trade and fiscal policy, restrictions on currency and dividend movements, and fluctuations in exchange rates
- Business activities of components that involve high risk, such as long-term contracts or trading in innovative or complex financial instruments
- Uncertainties regarding which components' financial information requires incorporation in the group financial statements, in accordance with the applicable financial reporting framework (for example, whether any special purpose entities or nontrading entities exist and require incorporation)
- Unusual related party relationships and transactions
- Prior occurrences of intragroup account balances that did not balance or reconcile on consolidation
- The existence of complex transactions that are accounted for in more than one component
- Components' application of accounting policies that differ from those applied to the group financial statements
- Components with different financial year-ends, which may be utilized to manipulate the timing of transactions
- Prior occurrences of unauthorized or incomplete consolidation adjustments
- Aggressive tax planning within the group or large cash transactions with entities in tax havens
- Frequent changes of auditors engaged to audit the financial statements of components

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A96

Appendix C — Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction (Ref: par. .A90)

The following matters are relevant to the planning of the work of a component auditor:

[Required matters are italicized.]

- *A request for the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, to confirm that the component auditor will cooperate with the group engagement team*
- The timetable for completing the audit
- Dates of planned visits by group management and the group engagement team and dates of planned meetings with component management and the component auditor
- A list of key contacts
- *The work to be performed by the component auditor, the use to be made of that work, and arrangements for coordinating efforts at the initial stage of and during the audit, including the group engagement team's planned involvement in the work of the component auditor*
- *The ethical requirements that are relevant to the group audit and, in particular, the independence requirements*
- *In the case of an audit or review of the financial information of the component, component materiality*
- *In the case of an audit or review of, or specified audit procedures performed on, the financial information of the component, the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements*
- *A list of related parties prepared by group management and any other related parties of which the group engagement team is aware and a request that the component auditor communicates on a timely basis to the group engagement team related parties not previously identified by group management or the group engagement team*
- Work to be performed on intragroup account balances, transactions, and unrealized profits or losses
- Guidance on other statutory reporting responsibilities (for example, reporting on group management's assertion on the effectiveness of internal control)
- When a time lag between completion of the work on the financial information of the components and the group engagement team's conclusion on the group financial statements is likely, specific instructions for a subsequent events review

The following matters are relevant to the conduct of the work of the component auditor:

- The findings of the group engagement team's tests of control activities of a processing system that is common for all or some components and tests of controls to be performed by the component auditor
- *Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor and a request that the component auditor communicates on a timely basis any other significant risks of material misstatement of the group financial statements, due to fraud or error, identified in the component and the component auditor's response to such risks*
- The findings of the internal audit function, based on work performed on controls at or relevant to components
- A request for timely communication of audit evidence obtained from performing work on the financial information of the components that contradicts the audit evidence on which the group engagement team originally based the risk assessment performed at group level
- A request for a written representation on component management's compliance with the applicable financial reporting framework or a statement that differences between the accounting policies applied to the financial information of the component and those applied to the group financial statements have been disclosed
- Matters to be documented by the component auditor

Other information, such as the following:

- A request that the following be reported to the group engagement team on a timely basis:
 - Significant accounting, financial reporting, and auditing matters, including accounting estimates and related judgments
 - Matters relating to the going concern status of the component
 - Matters relating to litigation and claims
 - Material weaknesses in controls that have come to the attention of the component auditor during the performance of the work on the financial information of the component and information that indicates the existence of fraud
- A request that the group engagement team be notified of any significant or unusual events as early as possible
- A request that the matters listed in paragraph .49 be communicated to the group engagement team when the work on the financial information of the component is completed

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A97

Exhibit A — Illustrations of Auditor's Reports on Group Financial Statements

Illustration 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion (Ref: par. .A27)

Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards (Ref: par. .A60)

Illustration 3 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework Than That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS (Ref: par. .A60)

Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS (Ref: par. .A60)

Illustration 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method because the group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

¹ The subtitle "Report on the Audit of Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____ and \$_____ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$_____ and \$_____, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and its subsidiaries and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

Illustration 3— A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134.]

management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A98

Exhibit B — Illustrative Component Auditor's Confirmation Letter (Ref: par. .A44)

The following is not intended to be a standard letter. Confirmations may vary from one component auditor to another and from one period to the next. In this example, confirmations expected only when the auditor of the group financial statements is assuming responsibility have been italicized.

Confirmations often are obtained before work on the financial information of the component commences.

[Component Auditor Letterhead]

[Date]

[To Audit Firm]

This letter is provided in connection with your audit of the group financial statements of *[name of parent]* as of and for the year ended *[date]* for the purpose of expressing an opinion on whether the group financial statements present fairly, in all material respects, the financial position of the group as of *[date]* and of the results of its operations and its cash flows for the year then ended in accordance with *[indicate applicable financial reporting framework]*.

We acknowledge receipt of your instructions dated *[date]*, requesting us to perform the specified work on the financial information of *[name of component]* as of and for the year ended *[date]*.

We confirm that:

1. *We will be able to comply with the instructions. / We advise you that we will not be able to comply with the following instructions [specify instructions] for the following reasons [specify reasons].*
2. *The instructions are clear, and we understand them. / We would appreciate it if you could clarify the following instructions [specify instructions].*
3. *We will cooperate with you and provide you with access to relevant audit documentation.*

We acknowledge that:

1. The financial information of *[name of component]* will be included in the group financial statements of *[name of parent]*.
2. *You may consider it necessary to be further involved in the work you have requested us to perform on the financial information of [name of component] as of and for the year ended [date].*
3. *You intend to evaluate and, if considered appropriate, use our work for the audit of the group financial statements of [name of parent].*

In connection with the work that we will perform on the financial information of *[name of component]*, a *[describe component, e.g., wholly-owned subsidiary, subsidiary, joint venture, investee accounted for by the equity or cost methods of accounting]* of *[name of parent]*, we confirm the following:

1. We have an understanding of *[indicate relevant ethical requirements]* that is sufficient to fulfill our responsibilities in the audit of the group financial statements and will comply therewith. In particular, and with respect to *[name of parent]* and the other components in the group, we are independent within the meaning of

[*indicate relevant ethical requirements*] and comply with the applicable requirements of [*refer to rules*] promulgated by [*name of regulatory agency*].

2. We have an understanding of auditing standards generally accepted in the United States of America and [*indicate other auditing standards applicable to the audit of the group financial statements, such as Government Auditing Standards*] that is sufficient to fulfill our responsibilities in the audit of the group financial statements and will conduct our work on the financial information of [*name of component*] as of and for the year ended [*date*] in accordance with those standards.
3. We possess the special skills (e.g., industry specific knowledge) necessary to perform the work on the financial information of the particular component.
4. We have an understanding of [*indicate applicable financial reporting framework or group financial reporting procedures manual*] that is sufficient to fulfill our responsibilities in the audit of the group financial statements.

We will inform you of any changes in the above representations during the course of our work on the financial information of [*name of component*].

[*Auditor's signature*]

Illustration of Potential Component Auditor Representations in Governmental Entities and Not-for-Profit Organizations

5. We have an understanding of relevant laws and regulations that may have a direct and material effect on the financial statements of [*name of component*]. In particular, we have an understanding of [*indicate relevant laws and regulations*].

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A99

Exhibit C — Sources of Information (Ref: par. .A47)

The AICPA Professional Ethics Team can respond to inquiries about whether individuals are members of the AICPA and whether complaints against members have been adjudicated by the Joint Trial Board. The team cannot respond to inquiries about public accounting firms or provide information about letters of required corrective action issued by the team or pending disciplinary proceedings or investigations. The AICPA Peer Review Program staff or the applicable state CPA society administering entity can respond to inquiries about whether specific public accounting firms are enrolled in the AICPA Peer Review Program and the date of acceptance and the period covered by the firm's most recently accepted peer review. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

AU-C Section 9600***Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors): Auditing Interpretations of Section 600*****New GASB Pension Standards**

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new standards that will substantially change the accounting and financial reporting of public employee pension plans and the state and local governments that participate in such plans. GASB Statement No. 67, *Financial Reporting for Pension Plans*, revises existing guidance for the financial reports of most governmental pension plans. GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises and establishes new financial reporting requirements for most governments that provide their employees with pension benefits. GASB Statement No. 67 is effective for financial statements for periods beginning after June 15, 2013. GASB Statement No. 68 is effective for financial statements for fiscal years beginning after June 15, 2014.

Interpretation No. 1, "Auditor of Participating Employer in a Governmental Pension Plan," (paragraphs .01–.02) is intended to assist both plan and employer auditors who are auditing entities that have implemented the new accounting standards.

1. Auditor of Participating Employer in a Governmental Pension Plan

.01 Question—Many governmental entities (employers) provide pension benefits to their employees through governmental pension plans. In order to report pension amounts in accordance with GASB Statement No. 68, employers obtain certain information (for example, net pension liability) from the governmental pension plan. In this circumstance, is the governmental pension plan considered a component of the employer for purposes of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*?

.02 Interpretation—No. In this circumstance, a governmental pension plan is not a component of the employer for purposes of section 600. Accordingly, it would not be appropriate for an employer auditor to make reference to the audit report of the governmental pension plan auditor.

[Issue Date: April 2014.]

AU-C Section 610

Using the Work of Internal Auditors

Source: SAS No. 128.

Effective for audits of financial statements for periods ending on or after December 15, 2014.

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 This section addresses the external auditor's responsibilities if using the work of internal auditors. Using the work of internal auditors includes (a) using the work of the internal audit function in obtaining audit evidence and (b) using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor.

.02 This section does not apply if the entity does not have an internal audit function. (Ref: par. A1–A2)

.03 If the entity has an internal audit function, the requirements in this section relating to using the work of the internal audit function in obtaining audit evidence do not apply if

- a. the responsibilities and activities of the function are not relevant to the audit, or
- b. based on the external auditor's preliminary understanding of the function obtained as a result of procedures performed under section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the external auditor does not expect to use the work of the function in obtaining audit evidence.

Nothing in this section requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it remains the external auditor's decision to establish the overall audit strategy.

.04 Furthermore, the requirements in this section relating to using internal auditors to provide direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.

Relationship Between Section 315 and This Section

.05 Many entities establish internal audit functions as part of their internal control and governance structures. The objectives and scope of an internal audit function, the nature of its responsibilities, and its organizational status, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. Section 315A addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its environment and identification and assessment of risks of material misstatement. Section 315A¹ also explains how effective communication between the internal and external auditors creates an environment in which the external auditor can be informed by the internal auditor of significant matters that may affect the external auditor's work.

.06 The external auditor may be able to use the work of the internal audit function in obtaining audit evidence in a constructive and complementary manner depending on

- the level of competency of the internal audit function,
- whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, and
- whether the function applies a systematic and disciplined approach, including quality control.

This section addresses the external auditor's responsibilities when, based on the external auditor's understanding of the internal audit function obtained as a result of procedures performed under section 315A, the external auditor expects to use the work of the internal audit function in obtaining audit evidence (see paragraphs .13–.24 of this section). Such use of that work modifies the nature or timing, or reduces the extent, of audit procedures to be performed directly by the external auditor.

.07 This section also addresses the external auditor's responsibilities if the external auditor is considering using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor (see paragraphs .25–.32).

.08 There may be individuals in an entity that perform procedures similar to those performed by an internal audit function. However, unless performed by an objective and competent function that applies a systematic and disciplined approach, including quality control, such procedures would be considered control activities, and obtaining evidence regarding the effectiveness of such controls would be part of the external auditor's responses to assessed risks in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

The External Auditor's Responsibility for the Audit

.09 The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function in obtaining audit evidence or use

¹ Paragraph .A120 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

of internal auditors to provide direct assistance on the engagement. Although the function may perform audit procedures similar to those performed by the external auditor, neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.² This section, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors. It also defines the necessary work effort to obtain sufficient appropriate evidence that the work of the internal audit function or internal auditors providing direct assistance is adequate for the purposes of the audit. The requirements are designed to provide a framework for the external auditor's judgments regarding the use of the work of internal auditors to prevent over or undue use of such work.

Effective Date

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2014.

Objectives

.11 The objectives of the external auditor, when the entity has an internal audit function and the external auditor expects to use the work of internal auditors to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, are as follows:

- a. To determine whether to use the work of the internal audit function in obtaining audit evidence or to use internal auditors to provide direct assistance, and if so, in which areas and to what extent
- b. If using the work of the internal audit function in obtaining audit evidence, to determine whether that work is adequate for purposes of the audit
- c. If using internal auditors to provide direct assistance, to appropriately direct, supervise, and review their work

Definitions

.12 For purposes of generally accepted auditing standards, the following terms have the meaning attributed as follows:

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

Internal audit function. A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes. (Ref: par. .A1–.A4)

² Paragraph .15 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Requirements

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence

Evaluating the Internal Audit Function

.13 The external auditor should determine whether the work of the internal audit function can be used in obtaining audit evidence by evaluating

- a. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; (Ref: par. .A5–.A11)
- b. the level of competence of the internal audit function; and (Ref: par. .A5–.A9)
- c. the application by the internal audit function of a systematic and disciplined approach, including quality control. (Ref: par. .A12–.A14)

.14 The external auditor should not use the work of the internal audit function in obtaining audit evidence if the external auditor determines that

- a. the function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- b. the function lacks sufficient competence; or
- c. the function does not apply a systematic and disciplined approach, including quality control. (Ref: par. .A15–.A17)

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

.15 As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor should consider the nature, timing, and extent of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan. (Ref: par. .A18–.A23)

.16 The external auditor should make all significant judgments in the audit engagement, including when using the work of the internal audit function in obtaining audit evidence. (Ref: par. .A18)

.17 To prevent undue use of the internal audit function in obtaining audit evidence, the external auditor should plan to use less of the work of the function and perform more of the work directly: (Ref: par. .A19–.A24)

- a. The more judgment is involved in
 - i. planning and performing relevant audit procedures or
 - ii. evaluating the audit evidence obtained (Ref: par. .A24)
- b. the higher the assessed risk of material misstatement at the assertion level, with special consideration given to significant risks; (Ref: par. .A25–.A27)
- c. the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and

- d. the lower the level of competence of the internal audit function.

.18 The external auditor should also evaluate whether, in aggregate, using the work of the internal audit function in obtaining audit evidence to the extent planned, together with any planned use of internal auditors to provide direct assistance, would result in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: par. .A18–.A27 and .A44)

Communicating With Those Charged With Governance

.19 In communicating an overview of the planned scope and timing of the audit to those charged with governance in accordance with section 260, *The Auditor's Communication With Those Charged With Governance*,³ the external auditor should communicate how the external auditor has planned to use the work of the internal audit function in obtaining audit evidence. (Ref: par. .A28)

Using the Work of the Internal Audit Function in Obtaining Audit Evidence

.20 If the external auditor plans to use the work of the internal audit function in obtaining audit evidence, the external auditor should discuss the planned use of the work with the function as a basis for coordinating their respective activities. (Ref: par. .A29–.A32)

.21 The external auditor should read the reports of the internal audit function, which relate to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures the internal audit function performed and the related findings.

.22 The external auditor should perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether

- a. the work of the function was properly planned, performed, supervised, reviewed, and documented;
- b. sufficient appropriate evidence was obtained to enable the function to draw reasonable conclusions; and
- c. conclusions reached are appropriate in the circumstances, and the reports prepared by the function are consistent with the results of the work performed. (Ref: par. .A33–.A36)

.23 The nature and extent of the external auditor's audit procedures should be responsive to the external auditor's evaluation of

- a. the amount of judgment involved in
 - i. planning and performing relevant audit procedures and
 - ii. evaluating the audit evidence obtained;
- b. the assessed risk of material misstatement;
- c. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; and
- d. the level of competence of the function. (Ref: par. .A33–.A35) (see paragraphs .16–.17)

³ Paragraph .11 of section 260, *The Auditor's Communication With Those Charged With Governance*.

The external auditor should also reperform some of the body of work of the internal audit function that the external auditor intends to use in obtaining audit evidence. (Ref: par. .A36)

.24 Before the conclusion of the audit, the external auditor should evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph .13 and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs .16–.18 remain appropriate.

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit

.25 If the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor should evaluate the existence and significance of threats to the objectivity of the internal auditors who will be providing direct assistance, as well as any safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors who will be providing such assistance. (Ref: par. .A37–.A41)

.26 The external auditor should not use an internal auditor to provide direct assistance if

- a. the internal auditor lacks the necessary objectivity to perform the proposed work, or
- b. the internal auditor lacks the necessary competence to perform the proposed work. (Ref: par. .A37–.A41)

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance

.27 In determining the nature and extent of work that may be assigned to internal auditors providing direct assistance and the nature, timing, and extent of direction, supervision, and review that is appropriate in the circumstances, the external auditor should consider

- a. the external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity, the effectiveness of the safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors who will be providing such assistance;
- b. the assessed risk of material misstatement; and
- c. the amount of judgment involved in
 - i. planning and performing relevant audit procedures and
 - ii. evaluating the audit evidence obtained. (Ref: par. .A42–.A43)

Communicating With Those Charged With Governance

.28 In communicating an overview of the planned scope and timing of the audit with those charged with governance in accordance with section 260,⁴ the

⁴ See footnote 3.

external auditor should communicate how the external auditor plans to use internal auditors to provide direct assistance.

Using Internal Auditors to Provide Direct Assistance

.29 The external auditor should evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with any planned use of the work of the internal audit function in obtaining audit evidence, would result in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: par. .A44)

.30 Prior to using internal auditors to provide direct assistance, the external auditor should obtain written acknowledgment from management or those charged with governance, as appropriate, that internal auditors providing direct assistance to the external auditor will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor. (Ref: par. .A45)

.31 The external auditor should direct, supervise, and review the work performed by internal auditors on the engagement in accordance with section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. In so doing

- a. the nature, timing, and extent of direction, supervision, and review should be responsive to the outcome of the evaluation of the factors in paragraph .27 of this section;
- b. the external auditor should instruct the internal auditors to bring accounting and auditing issues identified during the audit to the attention of the external auditor; and
- c. the review procedures should include the external auditor testing some of the work performed by the internal auditors. (Ref: par. .A46–.A47)

.32 When directing, supervising, and reviewing the work performed by internal auditors, the external auditor should remain alert for indications that the external auditor's evaluations in paragraphs .25 and .29 are no longer appropriate.

Documentation

.33 If the external auditor uses the work of the internal audit function in obtaining audit evidence, the external auditor should include the following in the audit documentation:⁵

- a. The results of the evaluation of
 - i. the function's organizational status and relevant policies and procedures to adequately support the objectivity of the internal auditors;
 - ii. the level of competence of the function; and
 - iii. the application by the function of a systematic and disciplined approach, including quality control
- b. The nature and extent of the work used (including the period covered by, and the results of, such work) and the basis for that decision

⁵ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- c. The audit procedures performed by the external auditor to evaluate the adequacy of the work used, including the procedures performed by the external auditor to reperform some of the body of work of the internal audit function in obtaining audit evidence

.34 If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor should include the following in the audit documentation:

- a. The evaluation of the existence and significance of threats to the objectivity of the internal auditors, as well as any safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors used to provide direct assistance
- b. The basis for the decision regarding the nature and extent of the work performed by the internal auditors
- c. The nature and extent of the external auditor's review of the internal auditors' work (including the testing, by the external auditor, of some of the work performed by the internal auditors) in accordance with section 230, *Audit Documentation*
- d. The working papers prepared by the internal auditors who provided direct assistance on the audit engagement

.35 If the external auditor uses either the work of the internal audit function in obtaining audit evidence or internal auditors to provide direct assistance, or both, the external auditor should include in the audit documentation the external auditor's evaluation of (see paragraphs .18 and .29) whether, either individually or in aggregate as applicable, using the work of the internal audit function in obtaining audit evidence and use of internal auditors to provide direct assistance resulted in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.

Application and Other Explanatory Material

Definition of *Internal Audit Function* (Ref: par. .02 and .12)

.A1 The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes, such as the following:

Activities Relating to Governance Process

- The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization, and effectiveness of communication among those charged with governance, external and internal auditors, and management.

Activities Relating to Risk Management Process

- The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
- The internal audit function may perform procedures to assist the entity in the detection of fraud.

Activities Relating to Internal Control Process

- *Evaluation of internal control.* The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation, and operating effectiveness of internal control, including those controls that are relevant to the audit.
- *Examination of financial and operating information.* The internal audit function may be assigned to review the means used to identify, recognize, measure, classify, and report financial and operating information and to make specific inquiry into individual items, including detailed testing of transactions, balances, and procedures.
- *Review of operating activities.* The internal audit function may be assigned to review the economy, efficiency, and effectiveness of operating activities, including nonfinancial activities of an entity.
- *Review of compliance with laws and regulations.* The internal audit function may be assigned to review compliance with laws, regulations, and other external requirements and with management policies and directives and other internal requirements.

Not all the activities discussed in this paragraph need to be present for an internal audit function to be used in the audit of the financial statements. The external auditor may be able to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor in obtaining audit evidence if the nature of the internal audit function's responsibilities and assurance activities is related to the entity's financial reporting, as further discussed in section 315A.⁶

.A2 Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function nor whether it is performed by the entity or a third-party service provider are sole determinants of whether the external auditor can use the work of internal auditors. Rather, it is the nature of the activities, the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, competence of the internal auditors, and systematic and disciplined approach of the function that are relevant. References in this section to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

.A3 However, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this section, although they may perform control activities that can be tested in accordance with section 330.⁷ For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.

⁶ Paragraph .A117 of section 315A.

⁷ Paragraph .10 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

.A4 Although the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or both of the following ways:

- To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud. In this regard, section 315A⁸ requires the external auditor to obtain an understanding of the nature of the internal audit function's responsibilities, its status within the organization, and the activities performed, or to be performed, and make inquiries of appropriate individuals within the internal audit function (if the entity has such a function).
- The external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function that is relevant to the period being audited to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor (that is, the external auditor can use the work of the internal audit function in partial substitution for audit evidence to be obtained directly by the external auditor) (see paragraphs .13–.24 of this section).

In addition, the external auditor may use internal auditors to perform audit procedures under the direction, supervision, and review of the external auditor (referred to as *direct assistance* in this section) (see paragraphs .25–.32 of this section).

Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence

Evaluating the Internal Audit Function

Objectivity and Competence (Ref: par. .13a–b)

.A5 The external auditor exercises professional judgment in determining whether the work of the internal audit function can be used in obtaining audit evidence and the nature and extent to which the work of the internal audit function can be used in the circumstances.

.A6 The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors and the level of competence of the function are particularly important in determining whether to use the work of the internal audit function in obtaining audit evidence and, if so, the nature and extent of the use of the work of the function that is appropriate in the circumstances.

.A7 *Objectivity* refers to the ability to perform tasks without allowing bias, conflict of interest, or undue influence of others to override professional judgments. Factors that may affect the external auditor's evaluation of objectivity include the following:

- Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the

⁸ Paragraphs .06a and .24 of section 315A.

ability of the function to be free from bias, conflict of interest, or undue influence of others to override professional judgments (for example, whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the function reports to management, whether it has direct access to those charged with governance)

- Whether the internal audit function is free of any conflicting responsibilities (for example, having managerial or operational duties or responsibilities that are outside of the internal audit function)
- Whether those charged with governance oversee employment decisions related to the internal audit function (for example, determining the appropriate remuneration policy)
- Whether any constraints or restrictions placed on the internal audit function by management or those charged with governance exist (for example, in communicating the internal audit function's findings to the external auditor)
- Whether the internal auditors are members of relevant professional bodies and their memberships obligate their compliance with relevant professional standards relating to objectivity or whether their internal policies achieve the same objectives

.A8 *Competence* of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and with the appropriate level of quality. Factors that may affect the external auditor's determination about competence include the following:

- Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
- Whether established policies for hiring, training, and assigning internal auditors to internal audit engagements exist.
- Whether the internal auditors have adequate technical training and proficiency in auditing. Relevant criteria that may be considered by the external auditor in making the assessment may include, for example, the internal auditors' possession of a relevant professional designation and experience.
- Whether the internal auditors possess the required knowledge relating to the entity's financial reporting and the applicable financial reporting framework and whether the internal audit function possesses the necessary skills (for example, industry-specific knowledge) to perform work related to the entity's financial statements.
- Whether the internal auditors are members of relevant professional bodies or have certifications that oblige them to comply with the relevant professional standards, including continuing professional education requirements.

.A9 Objectivity and competence may be viewed as a continuum. The more the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the higher the level of competence of the function, the more likely the external auditor may make use of the work of the function in obtaining audit evidence and

make use of it in more areas. However, an organizational status and relevant policies and procedures that provide strong support for the objectivity of the internal auditors cannot compensate for the lack of sufficient competence of the internal audit function. Equally, a high level of competence of the internal audit function cannot compensate for an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors. Additionally, neither a high level of competence nor strong support for the objectivity of the internal auditors compensate for the lack of a systematic and disciplined approach.

Considerations Specific to Governmental Entities (Ref: par. .13a)

.A10 *Generally Accepted Government Auditing Standards (GAGAS)*, established by the U.S. Government Accountability Office, addresses the evaluation of the internal audit function in a government environment, including consideration of whether the internal audit function

- reports to senior management, such as a city manager or finance director,
- reports to the governing body,
- is elected, and, thus, is accountable to the citizens, or
- reports to an audit committee, which may comprise the governing body or a subcommittee thereof, members of senior management, appointed citizens, or any combination thereof.

.A11 The GAGAS conceptual framework approach provides auditors a practicable approach to address threats to independence and can be applied to varying circumstances that could potentially create threats to independence. The GAGAS conceptual framework may be useful in evaluating the objectivity of the internal audit function of a governmental entity.

Application of a Systematic and Disciplined Approach, Including Quality Control (Ref: par. .13c)

.A12 The application of a systematic and disciplined approach to planning, performing, supervising, reviewing, and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.

.A13 Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:

- The existence, adequacy, and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation, and reporting, the nature and extent of which is commensurate with the nature and size of the internal audit function relative to the complexity of the entity.
- Whether the internal audit function has appropriate quality control policies and procedures (for example, those relating to leadership, human resources, and engagement performance) or quality control requirements in standards set by relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements, such as conducting periodic external quality assessments.

.A14 The external auditor's determination of whether the internal audit function applies a systematic and disciplined approach is intended to address the risk that the external auditor inappropriately uses internal audit-like work performed in an informal, unstructured, or ad hoc manner. However, the level

of formality of an acceptable approach may vary depending on the nature and size of the internal audit function relative to the complexity of the entity.

Circumstances in Which Work of the Internal Audit Function Cannot Be Used (Ref: par. .14)

.A15 The external auditor's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competence of the internal audit function, and whether it applies a systematic and disciplined approach may indicate that the risks to the quality of the work of the function are too significant and, therefore, it is not appropriate to use any of the work of the function as audit evidence.

.A16 Consideration of the factors in paragraphs .A7–.A8 and .A13, individually and in aggregate, is important because an individual factor is often not sufficient to conclude that the work of the internal audit function cannot be used for purposes of the audit. For example, the internal audit function's organizational status is particularly important in evaluating threats to the objectivity of the internal auditors. If the internal audit function reports to management other than in an administrative capacity, this may impair the function's objectivity absent safeguards applied to reduce or eliminate the threat (for example, having direct access and performance accountability to those charged with governance).

.A17 In addition, when the external auditor accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the audit, a self-review threat is created in regards to the external auditor's independence. This is because of the possibility that the engagement team will use the results of the internal audit service without properly evaluating those results or without exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm.

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function That Can Be Used (Ref: par. .15–.18)

.A18 Because the external auditor has sole responsibility for the audit opinion expressed, the external auditor is required to make the significant judgments in the audit engagement in accordance with paragraph .16. Significant judgments include, but are not limited to, the following:

- Assessing the risks of material misstatement
- Evaluating the sufficiency of tests performed
- Evaluating the appropriateness of management's use of the going concern assumption and whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
- Evaluating significant accounting estimates
- Evaluating the adequacy of disclosures in the financial statements and other matters affecting the external auditor's report

.A19 Once the external auditor has determined that the work of the internal audit function can be used for purposes of the audit, a first consideration is whether the planned nature and scope of the work of the internal audit function that has been performed, or is planned to be performed, is relevant to the

overall audit strategy and audit plan that the external auditor has established in accordance with section 300, *Planning an Audit*.

.A20 In accordance with section 330, the external auditor is required to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.⁹ Further audit procedures comprise tests of controls and substantive procedures. Procedures planned or performed by the internal audit function may be the same as, or be similar to, the further audit procedures that the external auditor would design and perform. Accordingly, subject to the requirements of this section, the external auditor may determine that it is appropriate to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of further audit procedures to be performed directly by the external auditor. The internal audit function may have performed, or may be planning to perform

- tests of relevant controls upon which the external auditor intends to rely in determining the nature, timing, and extent of substantive procedures. For example, the work of the internal audit function may include tests of relevant controls that address the risks of material misstatement related to the completeness of accounts payable. The results of the internal audit function's tests may provide evidence about the effectiveness of controls and, accordingly, the external auditor may be able to use such tests of controls performed by the internal audit function to modify the nature or timing, or reduce the extent of, testing of controls the external auditor would otherwise have performed directly.
- substantive procedures. For example, the internal audit function, as part of its work, may confirm certain accounts receivable and observe certain physical inventories. By using such work of the internal audit function in obtaining audit evidence, the external auditor may be able to change the timing of the confirmation procedures, the number of accounts receivable to be confirmed, or the number of locations of physical inventories to be observed.

The internal audit function's plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) and reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures in accordance with the requirements of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

.A21 Other examples of work of the internal audit function that can be used in obtaining audit evidence by the external auditor include the following:

- Tracing transactions through the information system relevant to financial reporting
- Testing of compliance with regulatory requirements

.A22 The external auditor's determination of the planned nature and extent of use of the work of the internal audit function in obtaining audit evidence will be influenced by the external auditor's evaluation of the extent to which the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the level of competence of the internal audit function in paragraph .13. In addition,

⁹ Paragraph .06 of section 330.

the amount of judgment needed in planning, performing, and evaluating such work and the assessed risk of material misstatement at the assertion level are inputs to the external auditor's determination. Further, as described in paragraph .14, circumstances exist in which the external auditor cannot use the work of the internal audit function in obtaining audit evidence for purpose of the audit.

.A23 When evaluating whether, in aggregate, using the work of the internal audit function to the extent planned, together with any use of internal auditors to provide direct assistance, would result in the external auditor still being sufficiently involved in the audit, the external auditor may consider the external auditor's responsibility to address all relevant requirements of this section, as well as the other standards (for example, in accordance with paragraph .16, the external auditor is required to make all significant judgments). It is not anticipated that the external auditor's evaluation of using work of the internal audit function would be based on a quantitative analysis (for example, percentage of hours spent by internal audit personnel in respect of the work being used by the external auditor relative to total engagement hours).

Judgments in Planning and Performing Audit Procedures and Evaluating Results (Ref: par. .17a)

.A24 As the degree of judgment involved in planning and performing the audit procedures or evaluating the audit evidence increases, the need for the external auditor to perform more procedures directly in accordance with paragraph .17 increases.

Assessed Risk of Material Misstatement (Ref: par. .17b)

.A25 For a particular account balance, class of transaction, or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In such circumstances, the external auditor will need to perform more procedures directly in accordance with paragraph .17 and, accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. Furthermore, as explained in section 200,¹⁰ the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be and, therefore, the external auditor will need to perform more of the work directly.

.A26 As explained in section 315A,¹¹ significant risks require special audit consideration and, therefore, the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgment. In addition, when the risks of material misstatement is other than low, the use of the work of the internal audit function in obtaining audit evidence alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests directly.

.A27 Carrying out procedures in accordance with this section may cause the external auditor to reevaluate the assessment of the risks of material misstatement. Consequently, this may affect the external auditor's determination of whether and how to use the work of the internal audit function in obtaining audit evidence.

¹⁰ Paragraph .A33 of section 200.

¹¹ Paragraph .04 of section 315A.

Communicating With Those Charged With Governance (Ref: par. .19)

.A28 In accordance with section 260,¹² the external auditor is required to communicate an overview of the planned scope and timing of the audit with those charged with governance. The planned use of the work of the internal audit function in obtaining audit evidence is an integral part of the external auditor's overall audit strategy and, therefore, is relevant to those charged with governance for their understanding of the proposed audit approach.

Using the Work of the Internal Audit Function in Obtaining Audit Evidence***Discussion and Coordination With the Internal Audit Function in Obtaining Audit Evidence (Ref: par. .20)***

.A29 In discussing the planned use of the work of the internal audit function in obtaining audit evidence, as a basis for coordinating the respective activities, it may be useful to address the following:

- The timing of such work
- The nature of the work performed
- The extent of audit coverage
- Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances, or disclosures) and performance materiality
- Proposed methods of item selection and sample sizes
- Documentation of the work performed
- Review and reporting procedures

.A30 Coordination between the external auditor and the internal audit function is effective when, for example

- discussions take place at appropriate intervals throughout the period.
- the external auditor informs the internal audit function of significant matters that may affect the function.
- the external auditor is advised of, and has access to, relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

Although the external auditor is not precluded from using work that the internal audit function has already performed, coordination of activities between the external auditor and internal audit function is likely to be most effective when appropriate interaction occurs before the internal audit function performs the work.

.A31 Section 200¹³ addresses the importance of the external auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.

¹² Paragraph .11 of section 260.

¹³ Paragraphs .17 and .A22 of section 200.

.A32 Communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor's attention.¹⁴ The external auditor is then able to take such information into account in the external auditor's identification and assessment of risks of material misstatement. In addition, if such information may be indicative of a heightened risk of a material misstatement of the financial statements or may be regarding any actual, suspected, or alleged fraud, the external auditor can take this into account in the external auditor's identification of risk of material misstatement due to fraud in accordance with section 240, *Consideration of Fraud in a Financial Statement Audit*.

Procedures to Determine the Adequacy of the Work of the Internal Audit Function (Ref: par. .22–.23)

.A33 The external auditor's audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use provide a basis for evaluating the overall quality of the function's work and the objectivity with which it has been performed.

.A34 The procedures the external auditor may perform to evaluate the quality of the work performed and the conclusions reached by the internal audit function, in addition to reperformance in accordance with paragraph .23, include the following:

- Making inquiries of appropriate individuals within the internal audit function
- Observing procedures performed by the internal audit function
- Reviewing the internal audit function's work program and working papers

.A35 The more judgment involved, the higher the assessed risk of material misstatement, the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, or the lower the level of competence of the internal audit function, the more audit procedures are needed to be performed by the external auditor on the overall body of work of the internal audit function to support the decision to use the work of the function in obtaining sufficient appropriate audit evidence on which to base the audit opinion.

Reperformance (Ref: par. .23)

.A36 For purposes of this section, *reperformance* involves the external auditor's independent execution of procedures to validate the conclusions reached by the internal audit function. This objective may be accomplished by examining items already examined by the internal audit function or sufficient other similar items not actually examined by the internal audit function. Reperformance provides more persuasive evidence regarding the adequacy of the work of the internal audit function compared to other procedures the external auditor may perform, as described in paragraph .A34. Although it is not necessary for the external auditor to reperform some of the work of the internal audit function in each area that is being used, some reperformance is required on the body of work of the internal audit function as a whole that the external auditor intends to use in accordance with paragraph .23. The external auditor is more likely to focus reperformance in those areas where more judgment was

¹⁴ Paragraph .A120 of section 315A.

exercised by the internal audit function in planning, performing, and evaluating the results of the audit procedures and in areas of higher risk of material misstatement.

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit (Ref: par. .25–.26)

.A37 The external auditor may obtain direct assistance from the internal auditors to carry out audit procedures that otherwise would be performed directly by the external auditors themselves. In such circumstances, the internal auditors are under the direction, supervision, and review of the external auditor.

.A38 In accordance with paragraph .25, the external auditor evaluates the existence and significance of any threats to the objectivity and level of competence of the internal auditors who will be providing direct assistance on the audit before assigning them to specific tasks. Evaluating the existence and significance of threats to objectivity includes evaluating safeguards applied to reduce or eliminate the threats.

.A39 As stated in paragraph .A7, *objectivity* refers to the ability to perform the proposed work without allowing bias, conflict of interest, or undue influence of others to override professional judgments. In evaluating the existence and significance of any threats to the objectivity of an individual internal auditor, the external auditor may consider the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, including, for example, policies and procedures addressing association with the division or department in the entity to which the work relates. Additionally, other matters may come to the external auditor's attention that may be relevant to the external auditor's evaluation of the objectivity of the internal auditor.

.A40 In evaluating the level of competence of an internal auditor, many of the factors in paragraph .A8 may also be relevant but in the context of individual internal auditors and the work to which they may be assigned.

.A41 The external auditor may determine it is necessary to specifically instruct the internal auditors to keep confidential specific matters, as instructed by the external auditor, and to inform the external auditor of any threat to their objectivity. In some situations, the external auditor may determine it to be necessary to request written acknowledgment from the internal auditors of having understood such instruction by the external auditor.

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance (Ref: par. .27)

.A42 Paragraphs .A18–.A27 also provide relevant guidance in determining the nature and extent of work that may be assigned to the internal auditors providing direct assistance. As the materiality of the financial statement amounts increases and either the assessed risks of material misstatement or the amount of judgment involved increases, the need for the external auditor to perform procedures directly increases. As these factors decrease, the need for the external auditor to perform procedures directly decreases.

.A43 In determining the nature of work that may be assigned to internal auditors providing direct assistance, the external auditor is careful to limit such work to those areas that would be appropriate for internal auditors to be assigned. Examples of activities and tasks that would not be appropriate for internal auditors to provide direct assistance include the following:

- Making required inquiries of entity personnel or those charged with governance related to the identification of fraud risks and determining the procedures to respond to such risks¹⁵
- Determination of unpredictable audit procedures as addressed in section 240

Using Internal Auditors to Provide Direct Assistance
(Ref: par. .18 and .29–.31)

.A44 If the external auditor plans to use the internal audit function in obtaining audit evidence and also plans to use internal auditors to provide direct assistance, only one evaluation would be necessary to address the requirements of paragraphs .18 and .29.

.A45 The written acknowledgment required by paragraph .30 may be included within the audit engagement letter (or other suitable form of written agreement of the terms of engagement)¹⁶ or could be included in a separate document prepared by the external auditor and acknowledged in writing by management or those charged with governance, as appropriate.

.A46 The direction, supervision, and review by the external auditor of the audit procedures performed by the internal auditors need to be sufficient in order for the external auditor to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions based on that work. Because individuals in the internal audit function are not independent of the entity as is required of the external auditor when expressing an opinion on financial statements, the external auditor's involvement in these circumstances may be of a different nature or more extensive than if members of the engagement team perform the work.

.A47 The nature, timing, and extent of direction, supervision, and review of the audit procedures performed by the internal auditors is also dependent on the outcome of the external auditor's evaluation of the objectivity and the level of competence of, and the nature and extent of audit procedures to be performed by, the internal auditors. Directing and supervising the internal auditors involves informing them of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. In reviewing the work performed by the internal auditors, the external auditor's considerations include whether the evidence obtained is sufficient and appropriate in the circumstances, and that it supports the conclusions reached.

¹⁵ Paragraphs .17–.21 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

¹⁶ See paragraph .10 of section 210A, *Terms of Engagement*.

AU-C Section 620

Using the Work of an Auditor's Specialist

Source: SAS No. 122; SAS No. 144; SAS No. 145.

See section 9620 for interpretations of this section.

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

NOTE

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.

.02 This section does not address

- a. situations in which the engagement team includes a member or consults an individual or organization with expertise in a specialized area of accounting or auditing, which are addressed in section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, and section 300, *Planning an Audit*,^{1,2} or
- b. the auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's specialist), which is addressed in section 500A, *Audit Evidence*.³

¹ Paragraphs .A10 and .A20–.A22 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

² Paragraph .12 of section 300, *Planning an Audit*.

³ Paragraphs .A35–.A49 of section 500A, *Audit Evidence*.

The Auditor's Responsibility for the Audit Opinion

.03 The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's specialist. Nonetheless, if the auditor using the work of an auditor's specialist, having followed this section, concludes that the work of that specialist is adequate for the auditor's purposes, the auditor may accept that specialist's findings or conclusions in the specialist's field as appropriate audit evidence.

Effective Date

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

Objectives

.05 The objectives of the auditor are

- a. to determine whether to use the work of an auditor's specialist and
- b. if using the work of an auditor's specialist, to determine whether that work is adequate for the auditor's purposes.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Auditor's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either an auditor's internal specialist (who is a partner⁴ or staff, including temporary staff, of the auditor's firm or a network firm) or an auditor's external specialist. (Ref: par. .A1–.A4)

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

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

Requirements

Determining the Need for an Auditor's Specialist

.07 If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor should determine whether to use the work of an auditor's specialist. (Ref: par. .A5–.A10)

Nature, Timing, and Extent of Audit Procedures

.08 The nature, timing, and extent of the auditor's procedures with respect to the requirements in paragraphs .09–.13 will vary depending on the

⁴ *Partner* and *firm* should be read as referring to their governmental equivalents when relevant.

circumstances. In determining the nature, timing, and extent of those procedures, the auditor should consider matters including (Ref: par. .A11)

- a. the nature of the matter to which the work of the auditor's specialist relates;
- b. the risks of material misstatement in the matter to which the work of the auditor's specialist relates;
- c. the significance of the work of the auditor's specialist in the context of the audit;
- d. the auditor's knowledge of, and experience with, previous work performed by the auditor's specialist; and
- e. whether the auditor's specialist is subject to the auditor's firm's quality control policies and procedures. (Ref: par. .A12–.A14)

The Competence, Capabilities, and Objectivity of the Auditor's Specialist

.09 The auditor should evaluate whether the auditor's specialist has the necessary competence, capabilities, and objectivity for the auditor's purposes. In the case of an auditor's external specialist, the evaluation of objectivity should include inquiry regarding interests and relationships that may create a threat to the objectivity of the auditor's specialist. (Ref: par. .A15–.A22)

Obtaining an Understanding of the Field of Expertise of the Auditor's Specialist

.10 The auditor should obtain a sufficient understanding of the field of expertise of the auditor's specialist to enable the auditor to (Ref: par. .A23–.A24)

- a. determine the nature, scope, and objectives of the work of the auditor's specialist for the auditor's purposes and
- b. evaluate the adequacy of that work for the auditor's purposes.

Agreement With the Auditor's Specialist

.11 The auditor should agree, in writing when appropriate, with the auditor's specialist regarding (Ref: par. .A25–.A29)

- a. the nature, scope, and objectives of the work of the auditor's specialist; (Ref: par. .A30)
- b. the respective roles and responsibilities of the auditor and the auditor's specialist; (Ref: par. .A31–.A32)
- c. the nature, timing, and extent of communication between the auditor and the auditor's specialist, including the form of any report to be provided by the auditor's specialist; and (Ref: par. .A33)
- d. the need for the auditor's specialist to observe confidentiality requirements. (Ref: par. .A34)

Evaluating the Adequacy of the Work of the Auditor's Specialist

.12 The auditor should evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes, including

- a. the relevance and reasonableness of the findings and conclusions of the auditor's specialist and their consistency with other audit evidence. (Ref: par. .A35–.A37)
- b. If the work of the auditor's specialist involves the use of significant assumptions and methods,
 - i. obtaining an understanding of those assumptions and methods and
 - ii. evaluating the relevance and reasonableness of those assumptions and methods in the circumstances, giving consideration to the rationale and support provided by the specialist, and in relation to the auditor's other findings and conclusions. (Ref: par. .A38–.A40)
- c. If the work of the auditor's specialist involves the use of source data that is significant to the work of the auditor's specialist, the relevance, completeness, and accuracy of that source data. (Ref: par. .A41–.A42)

.13 If the auditor determines that the work of the auditor's specialist is not adequate for the auditor's purposes, the auditor should (Ref: par. .A44)

- a. agree with the auditor's specialist on the nature and extent of further work to be performed by the auditor's specialist or
- b. perform additional audit procedures appropriate to the circumstances.

Reference to the Auditor's Specialist in the Auditor's Report

.14 The auditor should not refer to the work of an auditor's specialist in an auditor's report containing an unmodified opinion.

.15 If the auditor makes reference to the work of an auditor's external specialist in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor should indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. (Ref: par. .A46)

Application and Other Explanatory Material

Definitions

Auditor's Specialist (Ref: par. .06)

.A1 Expertise in a field other than accounting or auditing may include expertise regarding such matters as the following:

- The valuation of complex financial instruments and nonfinancial assets and liabilities measured at fair value such as land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations, and assets that may have been impaired
- The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans
- The estimation of oil and other mineral reserves
- The valuation of environmental liabilities and site cleanup costs

- The interpretation of contracts, laws, and regulations
- The analysis of complex or unusual tax compliance issues
- The determination of physical characteristics relating to quantity on hand or condition (for example, quantity or condition of minerals, or materials stored in stockpiles)

.A2 In many cases, distinguishing between expertise in accounting or auditing and expertise in another field will be straightforward, even when this involves a specialized area of accounting or auditing.⁵ For example, an individual with expertise in applying methods of accounting for deferred income tax can often be easily distinguished from a specialist in taxation law. The former is not a specialist for the purposes of this section because this constitutes accounting expertise; the latter is a specialist for the purposes of this section because this constitutes legal expertise. Similar distinctions also may be able to be made in other areas (for example, between expertise in methods of accounting for financial instruments and expertise in complex modeling for the purpose of valuing financial instruments). However, in some cases, particularly those involving an emerging area of accounting or auditing expertise, distinguishing between specialized areas of accounting or auditing and expertise in another field will be a matter of professional judgment. Applicable professional rules and standards regarding education and competency requirements for accountants and auditors may assist the auditor in exercising that judgment.

.A3 An individual may possess expertise in accounting or auditing, as well as expertise in a field other than accounting or auditing (for example, an actuary also may be an accountant). In that circumstance, the determination of whether that individual is an auditor or an auditor's specialist depends on the nature of the work performed by that individual that the auditor is using for purposes of the audit.

.A4 It is necessary to apply professional judgment when considering how the requirements of this section are affected by the fact that an auditor's specialist may be either an individual or an organization. For example, when evaluating the competence, capabilities, and objectivity of an auditor's specialist, it may be that the specialist is an organization the auditor has previously used, but the auditor has no prior experience with the individual specialist assigned by the organization for the particular engagement, or it may be the reverse (that is, the auditor may be familiar with the work of an individual specialist but not with the organization that specialist has joined). In either case, both the personal attributes of the individual and the managerial attributes of the organization (such as systems of quality control the organization implements) may be relevant to the auditor's evaluation.

Determining the Need for an Auditor's Specialist (Ref: par. .07)

.A5 An auditor's specialist may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control
- Identifying and assessing the risks of material misstatement

⁵ Paragraphs .A18–.A19 of section 300 address the auditor's determination of the extent of involvement of professionals possessing specialized skills.

- Determining and implementing overall responses to assessed risks at the financial statement level
- Designing and performing additional audit procedures to respond to assessed risks at the relevant assertion level, which may comprise tests of controls or substantive procedures
- Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements

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

.A6 The risks of material misstatement may increase when expertise in a field other than accounting is needed for management to prepare the financial statements, for example, because this may indicate some complexity or because management may not possess knowledge of the field of expertise. If, in preparing the financial statements, management does not possess the necessary expertise, a management's specialist may be used in addressing those risks. Relevant controls, including controls that relate to the work of a management's specialist, if any, also may reduce the risks of material misstatement.

.A7 If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required by section 220A to be satisfied that the engagement team and any external auditor's specialists who are not part of the engagement team, collectively, have the appropriate competence and capabilities to perform the audit engagement.⁶ Further, the auditor is required by section 300 to ascertain the nature, timing, and extent of resources necessary to perform the engagement.⁷ The auditor's determination of whether to use the work of an auditor's specialist, and, if so, when and to what extent, assists the auditor in meeting these requirements. As the audit progresses or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's specialist.

.A8 An auditor who is not a specialist in a relevant field other than accounting or auditing may nevertheless be able to obtain a sufficient understanding of that field to perform the audit without an auditor's specialist. This understanding may be obtained through, for example

- experience in auditing entities that require such expertise in the preparation of their financial statements.
- education or professional development in the particular field. This may include formal courses or discussion with individuals possessing expertise in the relevant field for the purpose of enhancing the auditor's own capacity to deal with matters in that field. Such discussion differs from consultation with an auditor's specialist regarding a specific set of circumstances encountered on the engagement in which that specialist is given all the relevant facts that will enable the specialist to provide informed advice about the particular matter (see section 220A).⁸

.A9 In other cases, however, the auditor may determine that it is necessary, or may choose, to use an auditor's specialist to assist in obtaining sufficient

⁶ Paragraph .16 of section 220A.

⁷ Paragraph .08e of section 300.

⁸ Paragraph .A21 of section 220A.

appropriate audit evidence. Considerations when deciding whether to use an auditor's specialist may include the following:

- Whether management has used a specialist in preparing the financial statements (see paragraph .A10)
- The nature and significance of the matter, including its complexity
- The risks of material misstatement of the matter
- The expected nature of procedures to respond to identified risks, including the auditor's knowledge of, and experience with, the work of specialists regarding such matters and the availability of alternative sources of audit evidence

.A10 When management uses a management's specialist in preparing the financial statements, the auditor's decision on whether to use an auditor's specialist also may be influenced by such factors as the following:

- The nature, scope, and objectives of the work of the management's specialist
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services
- The extent to which management can exercise control or influence over the management's specialist (including, when applicable, the organization that employs the individual specialist), thereby influencing the work of the management's specialist
- The competence and capabilities of the management's specialist
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements
- Any controls within the entity over the work of the management's specialist
- The auditor's ability to evaluate the work and findings of the management's specialist without the assistance of an auditor's specialist.

Section 500A addresses the effect of the competence, capabilities, and objectivity of management's specialists on the reliability of audit evidence.⁹ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Nature, Timing, and Extent of Audit Procedures (Ref: par. .08)

.A11 The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's specialist relates to a significant finding or issue that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's specialist and has no prior knowledge of that specialist's competence, capabilities, and objectivity.
- The auditor's specialist is performing procedures that are integral to the audit rather than being consulted to provide advice on an individual matter.

⁹ Paragraphs .A38–.A44 of section 500A.

- The specialist is an auditor's external specialist and is not, therefore, subject to the firm's quality control policies and procedures.

The Auditor's Firm's Quality Control Policies and Procedures (Ref: par. .08e)

.A12 An auditor's internal specialist may be a partner or staff, including temporary staff, of the auditor's firm and, therefore, subject to the quality control policies and procedures of that firm in accordance with QM section 10A, *A Firm's System of Quality Control*.¹⁰ An auditor's internal specialist also may be a partner or staff, including temporary staff, of a network firm, which may share common quality control policies and procedures with the auditor's firm.

.A13 In accordance with section 220A, engagement teams are entitled to rely on the firm's system of quality control unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.¹¹ The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the auditor's procedures with respect to such matters as the following:

- Competence and capabilities through recruitment and training programs.
- Objectivity. The auditor's internal specialists are subject to relevant ethical requirements, including those pertaining to independence.
- Agreement with the auditor's specialist.
- The auditor's evaluation of the adequacy of the work of the auditor's specialist. For example, the firm's training programs may provide the auditor's internal specialists with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm processes, such as protocols for scoping the work of the auditor's internal specialists, may affect the nature, timing, and extent of the auditor's procedures to evaluate the adequacy of the work of the auditor's specialist.
- Adherence to regulatory and legal requirements through monitoring processes.

Such reliance does not reduce the auditor's responsibility to meet the requirements of this section.

.A14 An auditor's external specialist is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with QM section 10A.¹²

The Competence, Capabilities, and Objectivity of the Auditor's Specialist (Ref: par. .09)

.A15 The competence, capabilities, and objectivity of an auditor's specialist are factors that significantly affect whether the work of the auditor's specialist will be adequate for the auditor's purposes. Competence relates to the nature

¹⁰ Paragraph .13 of QM section 10A, *A Firm's System of Quality Control*.

¹¹ Paragraph .05 of section 220A.

¹² Paragraph .13 of QM section 10A.

and level of expertise of the auditor's specialist. Capability relates to the ability of the auditor's specialist to exercise that competence in the circumstances of the engagement. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the auditor's specialist.

.A16 Information regarding the competence, capabilities, and objectivity of an auditor's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other auditors or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The quality control policies and procedures of the auditor's firm and such other procedures the auditor considers necessary in the circumstances (see paragraphs .A12–.A13).

.A17 Matters relevant to evaluating the competence, capabilities, and objectivity of the auditor's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements (for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation).

.A18 Other matters that may be relevant include the following:

- The relevance of the competence of the auditor's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations.
- The competence of the auditor's specialist with respect to relevant accounting and auditing requirements (for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework).
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the auditor's specialist as the audit progresses.

.A19 A broad range of circumstances may threaten objectivity (for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats). Safeguards may eliminate or reduce such threats and may be created by external structures (for example, the profession, legislation, or regulation of the auditor's specialist) or by the work environment of the auditor's specialist (for example, quality control policies and procedures). There also may be safeguards specific to the audit engagement.

.A20 The evaluation of the significance of threats to objectivity and of whether a need exists for safeguards may depend upon the role of the auditor's specialist and the significance of the specialist's work in the context of the audit. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level (for example, if a proposed auditor's specialist is an individual or organization that has played a significant role in preparing the information that is being audited [that is, if the proposed auditor's specialist is a management's specialist]). [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A21 When evaluating the objectivity of an auditor's external specialist, in addition to considering information obtained from procedures performed in accordance with section 550, *Related Parties*, the auditor may

- a. inquire of the entity and the auditor's specialist about any known interests or relationships that the entity has with the auditor's external specialist (including, when applicable, the organization that employs the individual specialist) that may affect that specialist's objectivity
- b. discuss with that specialist any applicable safeguards, including any professional requirements that apply to that specialist, and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with the auditor's specialist include the following:
 - i. Financial interests
 - ii. Business and personal relationships between the entity and the individual specialist and between the entity and the organization that employs the individual specialist
 - iii. Provision of other services to the entity by the specialist, including by the organization in the case of an external specialist that is an organization

In some cases, the auditor may obtain a written representation from the auditor's external specialist about any interests or relationships with the entity of which that specialist is aware. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A22 If the auditor believes a relationship between the entity and the auditor's external specialist might impair the objectivity of that specialist, the auditor may perform, or engage another auditor's specialist to perform, additional procedures with respect to some or all of the assumptions, methods, or findings of the auditor's external specialist to determine that the findings are reasonable. The nature and extent of the additional procedures depend on the degree of objectivity of the auditor's external specialist. The need for additional procedures to obtain sufficient appropriate audit evidence increases as the degree of objectivity decreases. For example, if the auditor's external specialist has a low degree of objectivity, it may be necessary for the auditor to perform procedures similar to those used to evaluate the appropriateness of the work of a management's specialist as audit evidence.¹³ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

¹³ See paragraphs .26 and .A69–.A83 of section 501, *Audit Evidence — Specific Considerations for Selected Items*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Obtaining an Understanding of the Field of Expertise of the Auditor's Specialist (Ref: par. .10)

.A23 The auditor may obtain an understanding of the field of expertise of the auditor's specialist through the means described in paragraph .A8 or through discussion with the auditor's specialist.

.A24 Aspects of the field of the auditor's specialist relevant to the auditor's understanding may include the following:

- Whether that field of the auditor's specialist has areas of specialty within it that are relevant to the audit (see paragraph .A18)
- Whether any professional or other standards and regulatory or legal requirements apply
- What assumptions and methods, including models, when applicable, are used by the auditor's specialist, and whether they are generally accepted within that field of the auditor's specialist and appropriate for financial reporting purposes
- The nature of internal and external data or information the auditor's specialist uses

Agreement With the Auditor's Specialist (Ref: par. .11)

.A25 The following matters may vary considerably with the circumstances:

- a. The nature, scope, and objectives of the work of the auditor's specialist
- b. The respective roles and responsibilities of the auditor and the auditor's specialist
- c. The nature, timing, and extent of communication between the auditor and the auditor's specialist.

Therefore, it is required that these matters are agreed between the auditor and the auditor's specialist regardless of whether the specialist is an auditor's external specialist or internal specialist.

.A26 The matters noted in paragraph .08 may affect the level of detail and formality of the agreement between the auditor and the auditor's specialist, including whether it is appropriate that the agreement be in writing. For example, the following factors may suggest the need for a more detailed agreement than would otherwise be the case or for the agreement to be in writing:

- The auditor's specialist will have access to sensitive or confidential entity information.
- The respective roles or responsibilities of the auditor and the auditor's specialist are different from those normally expected.
- Multijurisdictional legal or regulatory requirements apply.
- The matter to which the work of the auditor's specialist relates is highly complex.
- The auditor has not previously used work performed by the auditor's specialist.
- The auditor's use of the work of the auditor's specialist and its significance in the context of the audit is extensive.

.A27 In establishing the agreement with the auditor's specialist, an important consideration is whether the work of the auditor's specialist is subject

to any reservation, limitation, or restriction and whether this has implications for the auditor.

.A28 The agreement between the auditor and an auditor's external specialist is generally in the form of an engagement letter. The appendix "Considerations for Agreement Between the Auditor and an Auditor's External Specialist" lists matters that the auditor may consider for inclusion in such an engagement letter or in any other form of agreement with an auditor's external specialist.

.A29 When no written agreement exists between the auditor and the auditor's specialist, evidence of the agreement may be included in, for example

- planning memoranda or related working papers, such as the audit program.
- the policies and procedures of the auditor's firm. In the case of an auditor's internal specialist, the established policies and procedures to which the auditor's specialist is subject may include particular policies and procedures regarding the work of the auditor's specialist. The extent of documentation in the auditor's working papers depends on the nature of such policies and procedures. For example, no documentation may be required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an auditor's specialist is used.

Nature, Scope, and Objectives of Work (Ref: par. .11a)

.A30 It often may be relevant when agreeing on the nature, scope, and objectives of the work of the auditor's specialist to include discussion of any relevant technical performance standards or other professional or industry requirements that the auditor's specialist will follow. Other matters that could affect the nature, scope, and objectives of the auditor's specialist's work include, as applicable, information about the entity and its environment, the entity's processes for developing the related accounting estimate, the entity's use of specialists in developing the estimate, relevant requirements of the applicable financial reporting framework, and possible accounting and auditing issues. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Respective Roles and Responsibilities (Ref: par. .11b)

.A31 Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist may include the following:

- The degree of responsibility of the auditor's specialist for the following:
 - Testing of source data, for example, testing data produced by the entity, or evaluating the relevance and reliability of data from sources external to the entity
 - Evaluating the significant assumptions used by the entity or management's specialist, or developing the auditor's specialist's own assumptions
 - Evaluating the methods used by the entity or management's specialist, or using the auditor's specialist's own methods
- Consent for the auditor to discuss the findings or conclusions of the auditor's specialist with the entity and others and to include

details of the findings or conclusions of the auditor's specialist in the basis for a modified opinion in the auditor's report, if necessary (see paragraph .A46)

- Any agreement to inform the auditor's specialist of the auditor's conclusions concerning the work of the auditor's specialist

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Working Papers

.A32 Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist also may include agreement about access to, and retention of, each other's working papers. When the auditor uses the work of an internal specialist, the working papers of the auditor's specialist form part of the audit documentation. Subject to any agreement to the contrary, the auditor's external specialist's working papers are its own and do not form part of the audit documentation.

Communication (Ref: par. .11c)

.A33 Effective two way communication facilitates the proper integration of the nature, timing, and extent of the procedures of the auditor's specialist with other work on the audit and appropriate modification of the objectives of the auditor's specialist during the course of the audit. For example, when the work of the auditor's specialist relates to the auditor's conclusions regarding a significant risk, both a formal written report at the conclusion of the work of the auditor's specialist and oral reports as the work progresses may be appropriate. Identification of specific partners or staff who will interact with the auditor's specialist and procedures for communication between the auditor's specialist and the entity assist timely and effective communication, particularly on larger engagements.

Confidentiality (Ref: par. .11d)

.A34 It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor also to apply to the auditor's specialist.¹⁴ Additional requirements may be imposed by law or regulation. The entity also may have requested that specific confidentiality provisions be agreed with the auditor's external specialists.

Evaluating the Adequacy of the Work of the Auditor's Specialist (Ref: par. .12)

.A35 The auditor's evaluation of the competence, capabilities, and objectivity of the auditor's specialist; the auditor's familiarity with the field of expertise of the auditor's specialist; the risk of material misstatement in the matter to which the specialist's work relates; the nature of the work performed by the auditor's specialist; and the significance of the auditor's specialist's work in the context of the audit affect the nature, timing, and extent of audit procedures to evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

¹⁴ ET section 1.700.040, *Disclosing Information to a Third-Party Service Provider*. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Footnote renumbered by the issuance of SAS No. 144, June 2021.]

The Findings and Conclusions of the Auditor's Specialist (Ref: par. .12a)

.A36 Specific procedures to evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes may include the following:

- Making inquiries of the auditor's specialist
- Reviewing the working papers and reports of the auditor's specialist
- Performing corroborative procedures, such as
 - observing the work of the auditor's specialist;
 - examining published data, such as statistical reports from reputable, authoritative sources;
 - confirming relevant matters with third parties;
 - performing detailed analytical procedures; and
 - reperforming calculations
- Engaging in discussion with another specialist with relevant expertise when, for example, the findings or conclusions of the auditor's specialist are not consistent with other audit evidence
- Discussing the report of the auditor's specialist with management

.A37 Relevant factors when evaluating the relevance and reasonableness of the findings or conclusions of the auditor's specialist, whether in a report or other form, may include whether they are

- presented in a manner that is consistent with any standards of the profession or industry of the auditor's specialist;
- clearly expressed, including reference to the objectives agreed with the auditor, the scope of the work performed, and standards applied;
- based on an appropriate period and take into account subsequent events, when relevant; and
- based on appropriate consideration of errors or deviations encountered by the auditor's specialist.

Assumptions, Methods, and Source Data***Assumptions and Methods (Ref: par. .12b)***

.A38 When the purpose of the work of the auditor's specialist is to evaluate underlying assumptions and methods, including models, when applicable, used by management in developing an accounting estimate, the auditor's procedures are likely to be primarily directed to evaluating whether the auditor's specialist has adequately reviewed those assumptions and methods. When the purpose of the work of the auditor's specialist is to develop an auditor's point estimate or an auditor's range for comparison with management's point estimate, the auditor's procedures may be primarily directed to evaluating the assumptions and methods, including models, when appropriate, used by the auditor's specialist.

.A39 Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, discusses the assumptions and methods used by management in making accounting estimates, including the

use, in some cases, of highly specialized, entity-developed models.¹⁵ Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and methods, it also may assist the auditor when evaluating the assumptions and methods of an auditor's specialist.

.A40 When the work of an auditor's specialist involves the use of significant assumptions and methods, the appropriateness and reasonableness of those assumptions and methods used and their application are the responsibility of the auditor's specialist. The auditor is responsible for obtaining an understanding of those assumptions and methods and evaluating the relevance and reasonableness of those assumptions and methods in the circumstances.¹⁶ Factors relevant to the auditor's evaluation of those assumptions and methods include whether they are

- generally accepted within the field of the auditor's specialist;
- consistent with the requirements of the applicable financial reporting framework;
- dependent on the use of specialized models;¹⁷ and
- consistent with those of management and, if not, the reason for, and effects of, the differences.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

Source Data Used by the Auditor's Specialist (Ref: par. .12c)

.A41 Section 500 discusses the auditor's responsibility to consider the relevance and reliability of information to be used as audit evidence, including its source.¹⁸ When the work of an auditor's specialist involves the use of source data that is significant to the work of the auditor's specialist, procedures such as the following may be used to test that data:

- Verifying the origin of the data, including obtaining an understanding of and, when applicable, testing the internal controls over the data and, when relevant, its transmission to the auditor's specialist
- Reviewing the data for completeness and internal consistency

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A42 In many cases, the auditor may test source data. However, in other cases, when the nature of the source data used by an auditor's specialist is highly technical in relation to the field of the auditor's specialist, that specialist may test the source data. If the auditor's specialist has tested the source data, inquiry of the auditor's specialist by the auditor or supervision or review of the

¹⁵ Paragraphs .08, .13, and .15 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*. [Footnote renumbered by the issuance of SAS No. 144, June 2021.]

¹⁶ Paragraph .13 of section 540, *Auditing Accounting Estimates and Related Disclosures*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

¹⁷ Paragraph .14 of section 540A addresses the auditor's consideration of whether specialized skills or knowledge with regard to one or more aspects of the accounting estimates is required in order to obtain sufficient appropriate audit evidence. [Footnote renumbered by the issuance of SAS No. 144, June 2021.]

¹⁸ Paragraphs .07 and .A12–.A24 of section 500, *Audit Evidence*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

test of the auditor's specialist may be an appropriate way for the auditor to evaluate that data's relevance, completeness, and accuracy.

Inadequate Work (Ref: par. .13)

.A43 Examples of situations in which the auditor may conclude that the work of the auditor's specialist is not adequate for the auditor's purposes include the following:

- The specialist's use of data or significant assumptions was not based on consideration of relevant information available to the specialist.
- The methods used by the specialist were not appropriate.
- The specialist's work was not performed in accordance with the auditor's instructions.
- The specialist's findings and conclusions are inconsistent with
 - the results of the work performed by the specialist,
 - other evidence obtained by the auditor, or
 - the auditor's understanding of the entity and its environment.
- The specialist's report, or equivalent documentation, contains restrictions, disclaimers, or limitations that affect the auditor's use of the report or work.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A44 If the auditor concludes that the work of the auditor's specialist is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures required by paragraph .13, which may involve additional work being performed by both the auditor's specialist and the auditor or include employing or engaging another specialist, it may be necessary to express a modified opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

Reference to the Auditor's Specialist in the Auditor's Report (Ref: par. .14–.15)

.A45 When key audit matters are included in the auditor's report, the auditor may decide to refer to the work of an auditor's specialist in the description of a key audit matter (for example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may highlight that the auditor used an auditor's internal or external specialist). Such a reference does not reduce the auditor's responsibility for the opinion on the financial statements and is, therefore, not inconsistent, in and of itself, with paragraphs .14–.15.¹⁹ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

¹⁹ See paragraph .A48 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2023, by SAS No. 144.]

.A46 It may be appropriate to refer to the auditor's external specialist in an auditor's report containing a modified opinion to explain the nature of the modification. In such circumstances, the auditor may need the permission of the auditor's specialist before making such a reference. [Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

.A47

Appendix — Considerations for Agreement Between the Auditor and an Auditor's External Specialist (Ref: par. .A28)

This appendix lists matters that the auditor may consider for inclusion in any agreement with an auditor's external specialist. The following list is illustrative and is not exhaustive; it is intended only to be a guide that may be used in conjunction with the considerations outlined in this section. Whether to include particular matters in the agreement depends on the circumstances of the engagement. The list also may be of assistance in considering the matters to be included in an agreement with an auditor's internal specialist.

Nature, Scope, and Objectives of the Auditor's External Specialist's Work

The following matters are examples of the nature, scope, and objectives of the auditor's external specialist's work:

- The nature and scope of the procedures to be performed by the auditor's external specialist
- The objectives of the auditor's external specialist's work in the context of materiality and risk considerations concerning the matter to which the auditor's external specialist's work relates and, when relevant, the applicable financial reporting framework
- Any relevant technical performance standards or other professional or industry requirements the auditor's external specialist will follow
- The assumptions and methods, including models, when applicable, the auditor's external specialist will use and their authority
- The effective date of, or, when applicable, the testing period for, the subject matter of the auditor's external specialist's work and requirements regarding subsequent events

The Respective Roles and Responsibilities of the Auditor and the Auditor's External Specialist

The following matters are examples of the respective roles and responsibilities of the auditor and the auditor's external specialist:

- Relevant auditing and accounting standards and relevant regulatory or legal requirements
- The consent of the auditor's external specialist to the auditor's intended use of the report of the auditor's specialist, including any reference to it or disclosure of it to others (for example, reference to it in the basis for a modified opinion in the auditor's report, if necessary, or disclosure of it to management or an audit committee)
- The nature and extent of the auditor's review of the auditor's external specialist's work
- Whether the auditor or the auditor's external specialist will test source data

- The auditor's external specialist's access to the entity's records, files, personnel, and specialists engaged by the entity
- Procedures for communication between the auditor's external specialist and the entity
- The auditor's and the auditor's external specialist's access to each other's working papers
- Ownership and control of working papers during and after the engagement, including any file retention requirements
- The auditor's external specialist's responsibility to perform work with due skill and care
- The auditor's external specialist's competence and capability to perform the work
- The expectation that the auditor's external specialist will use all knowledge that the specialist has that is relevant to the audit or, if not, will inform the auditor
- Any restriction on the auditor's external specialist's association with the auditor's report
- Any agreement to inform the auditor's external specialist of the auditor's conclusions concerning the work of the auditor's external specialist

Communications and Reporting

The following matters are examples of communications and reporting:

- Methods and frequency of communications, including the following:
 - How the auditor's external specialist's findings or conclusions will be reported (for example, written report, oral report, ongoing input to the engagement team)
 - Identification of specific persons within the engagement team who will liaise with the auditor's external specialist
- When the auditor's external specialist will complete the work and report findings or conclusions to the auditor
- The auditor's external specialist's responsibility to communicate promptly any potential delay in completing the work and any potential reservation or limitation on the findings and conclusions of the auditor's specialist
- The auditor's external specialist's responsibility to communicate promptly instances in which the entity restricts the access to records, files, personnel of the auditor's external specialist, or management's specialists engaged by the entity
- The auditor's external specialist's responsibility to communicate to the auditor all information that the auditor's external specialist believes may be relevant to the audit, including any changes in circumstances previously communicated
- The auditor's external specialist's responsibility to communicate circumstances that may create threats to the objectivity of the auditor's external specialist and any relevant safeguards that may eliminate or reduce such threats to an acceptable level

Confidentiality

The following matters are examples of confidentiality:

- The need for the auditor's specialist to observe confidentiality requirements, including the following:
 - The confidentiality provisions of relevant ethical requirements that apply to the auditor
 - Additional requirements that may be imposed by law or regulation, if any (for example, specific confidentiality provisions requested by the entity)

[Paragraph renumbered by the issuance of SAS No. 144, June 2021.]

AU-C Section 9620***Using the Work of an Auditor's Specialist:
Auditing Interpretations of Section 620***

Interpretation No. 1, "The Use of Legal Interpretations as Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7–14 of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40," has not been updated to reflect the issuance of Financial Accounting Standards Board (FASB) Statement No. 166, *Accounting for Transfers of Financial Assets*. FASB Statement No. 166 was incorporated into FASB *Accounting Standards Codification* (ASC) by FASB Accounting Standards Update No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*, and is discussed in FASB ASC 860, *Transfers and Servicing*.

In addition, this interpretation has not been updated for changes to the Federal Deposit Insurance Corporation's (FDIC's) safe harbor for financial assets transferred in connection with securitizations and participations. The FDIC's final amendments to the safe harbor, *Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010* (www.fdic.gov/news/news/press/2010/pr10216.html), were issued in September 2010. The safe harbor provides important protections for securitizations and participations by confirming that in the event of a bank failure, the FDIC would not try to reclaim loans transferred into such transactions.

In light of the issuance of FASB Statement No. 166 and the FDIC's changes to the safe harbor, the AICPA's Auditing Standards Board is currently in the process of revising this interpretation. Auditors should be alert for such revisions; however, the guidance in this interpretation continues to be relevant.

1. The Use of Legal Interpretations as Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7–14 of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40

.01 *Introduction*—Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 860,^[1] *Transfers and Servicing*, requires that a transferor of financial assets must surrender control over the financial assets to account for the transfer as a sale. According to FASB ASC 860-10-40-5(a), one of several conditions that must be met to provide evidence

^[1] [Footnote deleted, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

of surrender of control is that the transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.

Paragraphs 8–10 of FASB ASC 860-10-40 describe in greater detail the evidence required to support management's assertion that transferred financial assets have been isolated:

Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any *consolidated affiliate of the transferor*² that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership (see FASB ASC 860-10-55-23(c)). The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. FASB ASC 860 does not provide guidance as to the type and amount of evidence that must be obtained to conclude that transferred financial assets have been isolated from the transferor. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or SPE might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law.

A determination about whether the isolation criterion has been met to support a conclusion regarding surrender of control is largely a matter of law. This aspect of surrender of control, therefore, is assessed primarily from a legal perspective.

.02 Effective Date and Applicability—This interpretation is effective for auditing procedures related to transfers of financial assets that are required to be accounted for under FASB ASC 860.^[3]

.03 Question—What are the auditor's responsibilities in determining whether to use the work of a legal specialist⁴ to obtain persuasive evidence to support management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a)?

.04 Interpretation—Section 500A, *Audit Evidence*, states that the "preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements."⁵

.05 Use of a management's specialist may not be necessary to obtain appropriate audit evidence to support management's assertion that the isolation

² The Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) glossary defines *consolidated affiliate of the transferor* as "an entity whose assets and liabilities are included with those of the transferor in the consolidated, combined, or other financial statements being presented." [Footnote added, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

^[3] [Footnote renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

⁴ Client's internal or external attorney who is knowledgeable about relevant sections of the U.S. Bankruptcy Code and other federal, state, or foreign laws, as applicable. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

⁵ Paragraph .A35 of section 500A, *Audit Evidence*.

criterion is met in certain situations, such as when there is a routine transfer of financial assets that does not result in any continuing involvement by the transferor.⁶

.06 Many transfers of financial assets involve complex legal structures, continuing involvement by the transferor, or other legal issues that, in the auditor's judgment, make it difficult to determine whether the isolation criterion is met. In these situations, use of a legal specialist usually is necessary. A legal specialist formulating an opinion about whether a transfer isolates the transferred assets beyond the reach of the transferor and its creditors may consider, among other things, the structure of the transaction taken as a whole, the nature of any continuing involvement, the type of insolvency or other receivership proceedings to which the transferor might become subject, and other factors pertinent under applicable law.

.07 If a legal opinion is used as evidence to support the accounting conclusion related to multiple transfers under a single structure, and such transfers occur over an extended period of time under that structure, the auditor is required to evaluate the appropriateness of the legal opinion,⁷ which includes evaluating the need for management to obtain periodic updates of that opinion to confirm that there have been no subsequent changes in relevant law or applicable regulations that may change the applicability of the previous opinion to such transfers. The auditor also is required to evaluate the need for management to obtain periodic updates of an opinion to confirm that there have been no subsequent changes in relevant law or applicable regulations that may affect the conclusions reached in the previous opinion in the case of other transfers (see FASB ASC 860-10-40-41 and FASB ASC 860-20-25).

.08 If management's assertion with respect to a new transaction is that the transaction structure is the same as a prior structure for which a legal opinion that complies with this interpretation was used as evidence to support an assertion that the transfer of assets met the isolation criterion, the auditor is required⁸ to determine whether management needs to obtain an update of that opinion to confirm that there have been no changes in relevant law, applicable regulations, or in the pertinent facts of the transaction that may affect the applicability of the previous opinion to the new transaction.

.09 Question—If the auditor determines that the use of a management's legal specialist is required, what should he or she consider in assessing the adequacy of the legal opinion?

.10 Interpretation—In assessing the adequacy of the legal opinion, the auditor is required to evaluate the competence and capabilities⁹ of the legal specialist to determine whether the legal specialist has experience with relevant matters, including knowledge of the U.S. Bankruptcy Code, and other federal, state, or foreign law, as applicable, as well as knowledge of the transaction upon

⁶ FASB ASC 860-10-55-28 characterizes no continuing involvement with the transferred assets as "no servicing responsibilities, no participation in future cash flows, no recourse obligations other than standard representations and warranties that the financial assets transferred met the delivery requirements under the arrangement, no further involvement of any kind. The transferee is significantly limited in its ability to pledge or exchange the transferred assets."

If a contractual provision (such as a call or removal of accounts provision) gives the transferor the unilateral ability to require the return of specific financial assets, the auditor should consider the effect of FASB ASC 860-10-40-5(c). [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

⁷ Paragraph .08c of section 500A.

⁸ Paragraph .10 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁹ Paragraph .08a of section 500A.

which management's assertion is based. For transactions that may be affected by provisions of the Federal Deposit Insurance Act (FDIA), it is important to consider whether the legal specialist has experience with the rights and powers of receivers, conservators, and liquidating agents under that act. The auditor is required to obtain an understanding of the work of the specialist,¹⁰ which includes obtaining an understanding of the assumptions that are used by the legal specialist, and make appropriate tests of any information that management provides to the legal specialist and upon which the specialist indicates it relied. For example, testing management's information underlying a legal specialist's assumption regarding the adequacy of consideration received may depend on the nature of the transaction and the relationship of the parties. When the legal specialist's opinion has assumed the adequacy of consideration for transfers from a particular legal entity to its wholly owned subsidiary, changes in the subsidiary's capital accounts plus other consideration generally would be sufficient audit evidence about the adequacy of consideration. In the case of other transfers, such as those that are not to a wholly owned subsidiary of a particular legal entity that is the transferor, obtaining additional audit evidence may be necessary to evaluate management's assertion with regard to the adequacy of consideration upon which the legal specialist relied, because changes in the transferee's capital accounts do not solely benefit the transferring entity.

.11 The auditor also is required to evaluate the appropriateness of that specialist work as audit evidence for the relevant assertion,¹¹ which includes considering the form and content of the documentation that the legal specialist provides and evaluating whether the legal specialist's findings support management's assertions with respect to the isolation criterion. The requirement in FASB ASC 860 regarding reasonable assurance that the transferred assets would be isolated provides the basis for what the auditor is required to consider in evaluating the work of a legal specialist.

.12 Findings of a legal specialist that relate to the isolation of transferred financial assets are often in the form of a reasoned legal opinion that is restricted to particular facts and circumstances relevant to the specific transaction. The reasoning of such opinion may rely upon analogy to legal precedents that may not involve facts and circumstances that are comparable to that specific transaction. It is important to consider the effect of any limitations or disclaimers of opinion in assessing the adequacy of any legal opinion.

.13 An example of the conclusions in a legal opinion for an entity that is subject to the U.S. Bankruptcy Code that provides persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in bankruptcy or other receivership, follows:

We believe (or it is our opinion) that in a properly presented and argued case, as a legal matter, in the event the Seller were to become a Debtor, the transfer of the Financial Assets from the Seller to the Purchaser would be considered to be a sale (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of the Seller's estate for purposes of [the relevant sections] of the U.S. Bankruptcy Code.

¹⁰ Paragraph .08b of section 500A.

¹¹ Paragraph .08c of section 500A.

The following additional paragraph addressing substantive consolidation applies when the entity to which the assets are sold (as described in the opinion) is an affiliate of the selling entity and may also apply in other situations as noted by the legal specialist. For example, if a so-called two-step structure has been used to achieve isolation, this paragraph usually will be required with respect to the transferee in the first step of such structure (see paragraph .15 [and related footnotes] of this interpretation for additional guidance on the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55). When the transferor has entered into transactions with an affiliate that could affect the issue of substantive consolidation, the opinion should address the effect of that involvement on the opinion.

Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that* in a properly presented and argued case, as a legal matter, in a proceeding under the U.S. Bankruptcy Code,¹² in which the Seller is a Debtor, a court *would not* grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller in a case involving the insolvency of the Seller under the doctrine of substantive consolidation.

In the case of a transferor that is not entitled to become a debtor under the U.S. Bankruptcy Code, a legal opinion regarding whether the isolation criterion is met would consider whether isolation is satisfactorily achieved under the insolvency or receivership laws that apply to the transferor.

.14 Following are two examples of the conclusions in a legal opinion for an entity that is subject to receivership or conservatorship under provisions of the Federal Deposit Insurance Corporation (FDIC). The conclusions in these two examples provide persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in conservatorship or receivership. Insolvency and receivership laws applicable to depository institutions, and how those laws affect the legal isolation criterion, differ depending upon the nature of the depository institution and its chartering authority. Accordingly, legal opinions addressing the legal isolation criterion may be formulated in different ways to accommodate those differences.¹³

Example 1. *We believe (or it is our opinion) that* in a properly presented and argued case, as a legal matter, in the event the Seller were to become subject to receivership or conservatorship, the transfer of the Financial Assets from the Seller to the Purchaser *would be considered to be a sale* (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of, or subject to repudiation, reclamation, recovery, or

¹² For an entity subject to additional regulation (for example, a broker-dealer subject to the Securities Investor Protection Act), the legal opinion also generally should address the effect of such regulation and the policies of the regulators implementing such regulations (for example, the Securities Investor Protection Corporation). [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹³ For an entity subject to conservatorship or liquidation under the National Credit Union Act, the examples and discussion in this paragraph would be modified to make appropriate references to "liquidation" and "liquidating agent" and additional information relating to rights and regulations of the National Credit Union Administration. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

recharacterization by, the receiver or conservator appointed with respect to the Seller.¹⁴

Example 2. The Federal Deposit Insurance Corporation (FDIC) has issued a regulation, 'Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation,' 12 CFR section 360.6 (the Rule). Based on and subject to the discussion, assumptions, and qualifications herein, it is our opinion that:

- A. Following the appointment of the FDIC as the conservator or receiver for the Bank:
 - (i) The Rule will apply to the Transfers,
 - (ii) Under the Rule, the FDIC acting as conservator or receiver for the Bank could not, by exercise of its authority to disaffirm or repudiate contracts under 12 U.S.C. §1821(e), reclaim or recover the Transferred Assets from the Issuer or recharacterize the Transferred Assets as property of the Bank or of the conservatorship or receivership for the Bank,
 - (iii) Neither the FDIC (acting for itself as a creditor or as representative of the Bank or its shareholders or creditors) nor any creditor of the Bank would have the right, under any bankruptcy or insolvency law applicable in the conservatorship or receivership of the Bank, to avoid the Transfers, to recover the Transferred Assets, or to require the Transferred Assets to be turned over to the FDIC or such creditor, and
 - (iv) There is no other power exercisable by the FDIC as conservator or receiver for the Bank that would permit the FDIC as such conservator or receiver to reclaim or recover the Transferred Assets from the Issuer, or to recharacterize the Transferred Assets as property of the Bank or of the conservatorship or receivership for the Bank; provided, however, that we offer no opinion as to whether, in receivership, the FDIC or any creditor of the Bank may take any such actions if the Holders [*holders of beneficial interests in the transferred assets*] receive payment of the principal amount of the Interests and the interest earned thereon (at the contractual yield) through the date the Holders are so paid; and
- B. Prior to the appointment of the FDIC as conservator or receiver for the Bank, the Bank and its other creditors would not have the right to reclaim or recover the Transferred Assets from the Issuer, except by the exercise of a contractual provision [insert appropriate citation] to require the

¹⁴ When the opinion indicates that isolation is achieved without reference to a true sale, the opinion also should provide reasonable assurance that the transferred assets are beyond the reach of the transferor and its creditors other than the transferee to the same extent that is provided in paragraph B of example 2. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

transfer, or return, of the Transferred Assets that exists solely as a result of the contract between the Bank and the Issuer.¹⁵

The following additional paragraph addressing substantive consolidation applies when the entity to which the assets are sold or transferred (as described in the opinion) is an affiliate of the selling entity and may also apply in other situations as noted by the legal specialist.¹⁶ For example, if a so-called two-step structure has been used to achieve isolation, the following paragraph usually will be required with respect to the transferee in the first step of the structure (see paragraph .15 [and related footnotes] of this interpretation for additional guidance on the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55). When the transferor has entered into transactions with an affiliate that could affect the issue of substantive consolidation, the opinion should address the effect of that involvement on the opinion:

Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that* in a properly presented and argued case, as a legal matter, in a receivership, conservatorship, or liquidation proceeding in respect of the Seller, a court *would not* grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller.

Certain powers to repudiate contracts, recover, reclaim, or recharacterize transferred assets as property of a transferor that are exercisable by the FDIC under the FDIA may, as of the date of the transfer, be limited by a regulation that may be repealed or amended only in respect of transfers occurring on or after the effective date of such repeal or amendment.¹⁷ With respect to the powers of a receiver or conservator that may not be exercised under that regulation, it is acceptable for attorneys to rely upon the effectiveness of the limitation on such powers set forth in the applicable regulation, provided that the attorney states, based on reasonable assumptions, that (a) the affected transfer of financial assets meets all qualification requirements of the regulation, and (b) the regulation had not, as of the date of the opinion, been amended, repealed, or held inapplicable by a court with jurisdiction with respect to such transfer. The opinion should separately address any powers of repudiation, recovery, reclamation, or recharacterization exercisable by a receiver or conservator notwithstanding that regulation (for example, rights, powers, or remedies regarding transfers specifically excluded from the regulation) in a manner that provides the same level of assurance as would be provided in the case of opinions that conform with requirements of paragraph .13 of this interpretation, except that such opinion shall address powers arising under the FDIA. The considerations in the immediately preceding three sentences are adequately addressed either by the example 1 opinion or the example 2 opinion described in this paragraph

¹⁵ See the second paragraph of footnote 6.

Paragraph B is not required if the opinion includes both a conclusion, as set forth in example 1, that the transfer constitutes a "true sale" and the conclusions set forth in paragraph A of example 2. It is not necessary to include any provision of example 2 if the opinion is as set forth in example 1. [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹⁶ An additional substantive consolidation opinion is not required if the opinion states that its conclusion includes the inability to recover the transferred financial assets or recharacterize the transfer by application of the doctrine of "substantive consolidation." [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹⁷ The applicable regulation is 12 U.S. *Code of Federal Regulations* 360.6, effective September 11, 2000. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

or by the variations described in the second paragraph of footnote 15 and in footnote 16 of this interpretation.

.15 A legal letter that includes an inadequate opinion, inappropriate limitations, or a disclaimer of opinion, or that effectively limits the scope of the opinion to facts and circumstances that are not applicable to the transaction, does not provide persuasive evidence to support the entity's assertion that the transferred assets have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Likewise, a legal letter that includes conclusions that are expressed using some of the following language would not provide persuasive evidence that a transfer of financial assets has met the isolation criterion of FASB ASC 860-10-40-5(a) (see paragraphs .20–.21 of this interpretation):

- "We are unable to express an opinion..."
- "It is our opinion, based upon limited facts..."
- "We are of the view..." or "it appears..."
- "There is a reasonable basis to conclude that..."
- "In our opinion, the transfer would *either* be a sale or a grant of a perfected security interest..."¹⁸
- "In our opinion, there is a reasonable possibility..."
- "In our opinion, the transfer *should* be considered a sale..."
- "It is our opinion that the company will be able to assert meritorious arguments..."
- "In our opinion, it is more likely than not ..."
- "In our opinion, the transfer would *presumptively* be..."
- "In our opinion, it is probable that..."

Furthermore, conclusions about hypothetical transactions may not be relevant to the transaction that is the subject of management's assertions. Section 500A states that the "auditor should design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence."¹⁹ Additionally, conclusions about hypothetical transactions may not contemplate all of the facts and circumstances or the provisions in the agreements of the transaction that is the subject of management's assertions, and generally would not provide persuasive evidence.²⁰

¹⁸ Certain transferors are subject only to receivership (and not to proceedings under the U.S. Bankruptcy Code or the Federal Deposit Insurance Act) under laws that do not allow a receiver to reach assets in which a security interest has been granted. In such circumstances, an opinion that concludes that the transfer would either be a sale or a grant of a security interest that puts the transferred assets beyond the reach of such receiver and other creditors would provide persuasive evidence that the isolation criterion is met.

In certain circumstances, a legal specialist may provide an opinion on both steps of a two-step structure. Such language would be acceptable in an opinion for a transfer of assets in the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55 provided that the opinion on the transfer in the first step is consistent with paragraphs .13 or .14 of this interpretation. [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹⁹ Paragraph .06 of section 500A.

²⁰ For example, a memorandum of law from a legal specialist usually analyzes (and may make conclusions about) a transaction that may be completed subsequently. Such memorandum generally would not provide persuasive evidence unless the conclusions conform with this interpretation and a legal specialist opines that such conclusions apply to a completed transaction that is the subject of management's assertion. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.16 Question—Are legal opinions that restrict the use of the opinion to the client, or to third parties other than the auditor, acceptable audit evidence?

.17 Interpretation—No. In some cases, the auditor may decide it is necessary to contact the specialist to determine that the specialist is aware that his or her work will be used for evaluating the assertions in the financial statements.²¹ Given the importance of the legal opinion to the assertion in this case, and the precision that legal specialists use in drafting such opinions, an auditor should not use as evidence a legal opinion that he or she deems otherwise adequate if the letter restricts use of the findings expressed therein to the client or to third parties other than the auditor. In that event, the auditor requests that the client obtain the legal specialist's written permission for the auditor to use the opinion for the purpose of evaluating management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a).

.18 An example of a letter from a legal specialist to a client that adequately communicates permission for the auditor to use the legal specialist's opinion for the purpose of evaluating management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a) is as follows:

Notwithstanding any language to the contrary in our opinions of even date with respect to certain bankruptcy issues relating to the previously referenced transaction, you are authorized to make available to your auditors such opinions solely as audit evidence in support of their evaluation of management's assertion that the transfer of the receivables meets the isolation criterion of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40-5(a), provided a copy of this letter is furnished to them in connection therewith. In authorizing you to make copies of such opinions available to your auditors for such purpose, we are not undertaking or assuming any duty or obligation to your auditors or establishing any lawyer-client relationship with them. Further, we do not undertake or assume any responsibility with respect to financial statements of you or your affiliates.²²

.19 A letter from a legal specialist to a client might authorize the client to make copies of the legal opinion available to the auditor to use in his or her evaluation of management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a) but then state that the auditor is not authorized to rely thereon. Such "use but not rely on" language, or other language that similarly restricts the auditor's use of the legal specialist's opinion, does not adequately communicate permission for the auditor to use the legal specialist's opinion as audit evidence. The auditor may consider consulting with his or her legal counsel in circumstances in which it is not clear that the auditor may use the legal specialist's opinion.

.20 Question—If the auditor determines that it is appropriate to use the work of a legal specialist, and either the resulting legal response does not provide persuasive evidence that a transfer of assets has met the isolation criterion or the legal specialist does not grant permission for the auditor to use a legal opinion that is restricted to the client or to third parties other than the auditor, what other steps might an auditor consider?

.21 Interpretation—When other relevant audit evidence exists, the auditor should consider it before reaching a conclusion about the appropriateness

²¹ Paragraph .A39 of section 500A.

²² This language may appear in the legal specialist's opinion rather than in a separate letter. In that case, the wording would be modified slightly to indicate the context. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

of management's accounting for a transfer.²³ However, because the isolation aspect of surrender of control is assessed primarily from a legal perspective, the auditor usually will not be able to obtain persuasive evidence in a form other than a legal opinion. In the absence of persuasive evidence that a transfer has met the isolation criterion, derecognition of the transferred assets is not in conformity with generally accepted accounting principles and the auditor may need to express a qualified or adverse opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.²⁴ However, if permission for the auditor to use a legal opinion that he or she deems otherwise adequate is not granted, this would be a scope limitation and the auditor should consider the need to express a qualified opinion or to disclaim an opinion in accordance with section 705.²⁵

[Issue Date: December 2001; Revised: March 2006; Revised: June 2009;
Revised: October 2011, effective for audits of financial statements for periods
ending on or after December 15, 2012.]

²³ See paragraph .13 of section 620, *Using the Work of an Auditor's Specialist*, regarding additional procedures that may be applied. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

²⁴ Paragraphs .07–.09 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

²⁵ Paragraphs .11–.14 of section 705.

AU-C Section 620A

Using the Work of an Auditor's Specialist

Source: SAS No. 122.

See section 9620A for interpretations of this section.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.

.02 This section does not address

- a. situations in which the engagement team includes a member or consults an individual or organization with expertise in a specialized area of accounting or auditing, which are addressed in section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, and section 300, *Planning an Audit*,^{1,2} or
- b. the auditor's use of the work of an individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (a management's specialist), which is addressed in section 500A, *Audit Evidence*.³

The Auditor's Responsibility for the Audit Opinion

.03 The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's specialist. Nonetheless, if the auditor using the work of an auditor's specialist, having followed this section, concludes that the work of that specialist is adequate for the auditor's purposes, the auditor may accept that specialist's findings or conclusions in the specialist's field as appropriate audit evidence.

Effective Date

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

¹ Paragraphs .A10 and .A20–.A22 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

² Paragraph .12 of section 300, *Planning an Audit*.

³ Paragraphs .A35–.A49 of section 500A, *Audit Evidence*.

Objectives

- .05** The objectives of the auditor are
- to determine whether to use the work of an auditor's specialist and
 - if using the work of an auditor's specialist, to determine whether that work is adequate for the auditor's purposes.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Auditor's specialist. An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's specialist may be either an auditor's internal specialist (who is a partner⁴ or staff, including temporary staff, of the auditor's firm or a network firm) or an auditor's external specialist. (Ref: par. .A1–.A4)

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

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

Requirements

Determining the Need for an Auditor's Specialist

.07 If expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor should determine whether to use the work of an auditor's specialist. (Ref: par. .A5–.A10)

Nature, Timing, and Extent of Audit Procedures

.08 The nature, timing, and extent of the auditor's procedures with respect to the requirements in paragraphs .09–.13 will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the auditor should consider matters including (Ref: par. .A11)

- the nature of the matter to which the work of the auditor's specialist relates;
- the risks of material misstatement in the matter to which the work of the auditor's specialist relates;
- the significance of the work of the auditor's specialist in the context of the audit;
- the auditor's knowledge of, and experience with, previous work performed by the auditor's specialist; and
- whether the auditor's specialist is subject to the auditor's firm's quality control policies and procedures. (Ref: par. .A12–.A14)

⁴ *Partner* and *firm* should be read as referring to their governmental equivalents when relevant.

The Competence, Capabilities, and Objectivity of the Auditor's Specialist

.09 The auditor should evaluate whether the auditor's specialist has the necessary competence, capabilities, and objectivity for the auditor's purposes. In the case of an auditor's external specialist, the evaluation of objectivity should include inquiry regarding interests and relationships that may create a threat to the objectivity of the auditor's specialist. (Ref: par. .A15–.A22)

Obtaining an Understanding of the Field of Expertise of the Auditor's Specialist

.10 The auditor should obtain a sufficient understanding of the field of expertise of the auditor's specialist to enable the auditor to (Ref: par. .A23–.A24)

- a.* determine the nature, scope, and objectives of the work of the auditor's specialist for the auditor's purposes and
- b.* evaluate the adequacy of that work for the auditor's purposes.

Agreement With the Auditor's Specialist

.11 The auditor should agree, in writing when appropriate, with the auditor's specialist regarding (Ref: par. .A25–.A29)

- a.* the nature, scope, and objectives of the work of the auditor's specialist; (Ref: par. .A30)
- b.* the respective roles and responsibilities of the auditor and the auditor's specialist; (Ref: par. .A31–.A32)
- c.* the nature, timing, and extent of communication between the auditor and the auditor's specialist, including the form of any report to be provided by the auditor's specialist; and (Ref: par. .A33)
- d.* the need for the auditor's specialist to observe confidentiality requirements. (Ref: par. .A34)

Evaluating the Adequacy of the Work of the Auditor's Specialist

.12 The auditor should evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes, including

- a.* the relevance and reasonableness of the findings and conclusions of the auditor's specialist and their consistency with other audit evidence. (Ref: par. .A35–.A37)
- b.* If the work of the auditor's specialist involves the use of significant assumptions and methods,
 - i.* obtaining an understanding of those assumptions and methods and
 - ii.* evaluating the relevance and reasonableness of those assumptions and methods in the circumstances, giving consideration to the rationale and support provided by the specialist, and in relation to the auditor's other findings and conclusions. (Ref: par. .A38–.A40)
- c.* If the work of the auditor's specialist involves the use of source data that is significant to the work of the auditor's specialist, the

relevance, completeness, and accuracy of that source data. (Ref: par. .A41–.A42)

.13 If the auditor determines that the work of the auditor's specialist is not adequate for the auditor's purposes, the auditor should (Ref: par. .A43)

- a. agree with the auditor's specialist on the nature and extent of further work to be performed by the auditor's specialist or
- b. perform additional audit procedures appropriate to the circumstances.

Reference to the Auditor's Specialist in the Auditor's Report

.14 The auditor should not refer to the work of an auditor's specialist in an auditor's report containing an unmodified opinion.

.15 If the auditor makes reference to the work of an auditor's external specialist in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor should indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. (Ref: par. .A44)

Application and Other Explanatory Material

Definitions

Auditor's Specialist (Ref: par. .06)

.A1 Expertise in a field other than accounting or auditing may include expertise regarding such matters as the following:

- The valuation of complex financial instruments and nonfinancial assets and liabilities measured at fair value such as land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations, and assets that may have been impaired
- The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans
- The estimation of oil and other mineral reserves
- The valuation of environmental liabilities and site cleanup costs
- The interpretation of contracts, laws, and regulations
- The analysis of complex or unusual tax compliance issues
- The determination of physical characteristics relating to quantity on hand or condition (for example, quantity or condition of minerals, or materials stored in stockpiles)

.A2 In many cases, distinguishing between expertise in accounting or auditing and expertise in another field will be straightforward, even when this involves a specialized area of accounting or auditing.⁵ For example, an individual with expertise in applying methods of accounting for deferred income tax can often be easily distinguished from a specialist in taxation law. The former is not a specialist for the purposes of this section because this constitutes

⁵ Paragraphs .A18–.A19 of section 300 address the auditor's determination of the extent of involvement of professionals possessing specialized skills.

accounting expertise; the latter is a specialist for the purposes of this section because this constitutes legal expertise. Similar distinctions also may be able to be made in other areas (for example, between expertise in methods of accounting for financial instruments and expertise in complex modeling for the purpose of valuing financial instruments). However, in some cases, particularly those involving an emerging area of accounting or auditing expertise, distinguishing between specialized areas of accounting or auditing and expertise in another field will be a matter of professional judgment. Applicable professional rules and standards regarding education and competency requirements for accountants and auditors may assist the auditor in exercising that judgment.

.A3 An individual may possess expertise in accounting or auditing, as well as expertise in a field other than accounting or auditing (for example, an actuary also may be an accountant). In that circumstance, the determination of whether that individual is an auditor or an auditor's specialist depends on the nature of the work performed by that individual that the auditor is using for purposes of the audit.

.A4 It is necessary to apply professional judgment when considering how the requirements of this section are affected by the fact that an auditor's specialist may be either an individual or an organization. For example, when evaluating the competence, capabilities, and objectivity of an auditor's specialist, it may be that the specialist is an organization the auditor has previously used, but the auditor has no prior experience with the individual specialist assigned by the organization for the particular engagement, or it may be the reverse (that is, the auditor may be familiar with the work of an individual specialist but not with the organization that specialist has joined). In either case, both the personal attributes of the individual and the managerial attributes of the organization (such as systems of quality control the organization implements) may be relevant to the auditor's evaluation.

Determining the Need for an Auditor's Specialist (Ref: par. .07)

.A5 An auditor's specialist may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, including its internal control
- Identifying and assessing the risks of material misstatement
- Determining and implementing overall responses to assessed risks at the financial statement level
- Designing and performing additional audit procedures to respond to assessed risks at the relevant assertion level, which may comprise tests of controls or substantive procedures
- Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements

.A6 The risks of material misstatement may increase when expertise in a field other than accounting is needed for management to prepare the financial statements, for example, because this may indicate some complexity or because management may not possess knowledge of the field of expertise. If, in preparing the financial statements, management does not possess the necessary expertise, a management's specialist may be used in addressing those risks. Relevant controls, including controls that relate to the work of a management's specialist, if any, also may reduce the risks of material misstatement.

.A7 If the preparation of the financial statements involves the use of expertise in a field other than accounting, the auditor, who is skilled in accounting and auditing, may not possess the necessary expertise to audit those financial statements. The engagement partner is required by section 220A to be satisfied that the engagement team and any external auditor's specialists who are not part of the engagement team, collectively, have the appropriate competence and capabilities to perform the audit engagement.⁶ Further, the auditor is required by section 300 to ascertain the nature, timing, and extent of resources necessary to perform the engagement.⁷ The auditor's determination of whether to use the work of an auditor's specialist, and, if so, when and to what extent, assists the auditor in meeting these requirements. As the audit progresses or as circumstances change, the auditor may need to revise earlier decisions about using the work of an auditor's specialist.

.A8 An auditor who is not a specialist in a relevant field other than accounting or auditing may nevertheless be able to obtain a sufficient understanding of that field to perform the audit without an auditor's specialist. This understanding may be obtained through, for example

- experience in auditing entities that require such expertise in the preparation of their financial statements.
- education or professional development in the particular field. This may include formal courses or discussion with individuals possessing expertise in the relevant field for the purpose of enhancing the auditor's own capacity to deal with matters in that field. Such discussion differs from consultation with an auditor's specialist regarding a specific set of circumstances encountered on the engagement in which that specialist is given all the relevant facts that will enable the specialist to provide informed advice about the particular matter (see section 220A).⁸

.A9 In other cases, however, the auditor may determine that it is necessary, or may choose, to use an auditor's specialist to assist in obtaining sufficient appropriate audit evidence. Considerations when deciding whether to use an auditor's specialist may include the following:

- Whether management has used a specialist in preparing the financial statements (see paragraph .A10)
- The nature and significance of the matter, including its complexity
- The risks of material misstatement of the matter
- The expected nature of procedures to respond to identified risks, including the auditor's knowledge of, and experience with, the work of specialists regarding such matters and the availability of alternative sources of audit evidence

.A10 When management uses a management specialist in preparing the financial statements, the auditor's decision on whether to use an auditor's specialist also may be influenced by such factors as the following:

- The nature, scope, and objectives of the work of the management's specialist
- Whether the management's specialist is employed by the entity or is a party engaged by it to provide relevant services

⁶ Paragraph .16 of section 220A.

⁷ Paragraph .08e of section 300.

⁸ Paragraph .A21 of section 220A.

- The extent to which management can exercise control or influence over the work of the management's specialist
- The competence and capabilities of the management's specialist
- Whether the management's specialist is subject to technical performance standards or other professional or industry requirements
- Any controls within the entity over the work of the management's specialist
- The auditor's ability to evaluate the work and findings of the management's specialist without the assistance of an auditor's specialist.

Section 500A addresses the effect of the competence, capabilities, and objectivity of management's specialists on the reliability of audit evidence.⁹

Nature, Timing, and Extent of Audit Procedures (Ref: par. .08)

.A11 The following factors may suggest the need for different or more extensive procedures than would otherwise be the case:

- The work of the auditor's specialist relates to a significant finding or issue that involves subjective and complex judgments.
- The auditor has not previously used the work of the auditor's specialist and has no prior knowledge of that specialist's competence, capabilities, and objectivity.
- The auditor's specialist is performing procedures that are integral to the audit rather than being consulted to provide advice on an individual matter.
- The specialist is an auditor's external specialist and is not, therefore, subject to the firm's quality control policies and procedures.

The Auditor's Firm's Quality Control Policies and Procedures (Ref: par. .08e)

.A12 An auditor's internal specialist may be a partner or staff, including temporary staff, of the auditor's firm and, therefore, subject to the quality control policies and procedures of that firm in accordance with QM section 10A, *A Firm's System of Quality Control*.¹⁰ An auditor's internal specialist also may be a partner or staff, including temporary staff, of a network firm, which may share common quality control policies and procedures with the auditor's firm.

.A13 In accordance with section 220A, engagement teams are entitled to rely on the firm's system of quality control unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.¹¹ The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the auditor's procedures with respect to such matters as the following:

- Competence and capabilities through recruitment and training programs.

⁹ Paragraphs .A38–.A44 of section 500A.

¹⁰ Paragraph .13 of QM section 10A, *A Firm's System of Quality Control*.

¹¹ Paragraph .05 of section 220A.

- Objectivity. The auditor's internal specialists are subject to relevant ethical requirements, including those pertaining to independence.
- Agreement with the auditor's specialist.
- The auditor's evaluation of the adequacy of the work of the auditor's specialist. For example, the firm's training programs may provide the auditor's internal specialists with an appropriate understanding of the interrelationship of their expertise with the audit process. Reliance on such training and other firm processes, such as protocols for scoping the work of the auditor's internal specialists, may affect the nature, timing, and extent of the auditor's procedures to evaluate the adequacy of the work of the auditor's specialist.
- Adherence to regulatory and legal requirements through monitoring processes.

Such reliance does not reduce the auditor's responsibility to meet the requirements of this section.

.A14 An auditor's external specialist is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with QM section 10A.¹²

The Competence, Capabilities, and Objectivity of the Auditor's Specialist (Ref: par. .09)

.A15 The competence, capabilities, and objectivity of an auditor's specialist are factors that significantly affect whether the work of the auditor's specialist will be adequate for the auditor's purposes. Competence relates to the nature and level of expertise of the auditor's specialist. Capability relates to the ability of the auditor's specialist to exercise that competence in the circumstances of the engagement. Factors that influence capability may include, for example, geographic location and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest, or the influence of others may have on the professional or business judgment of the auditor's specialist.

.A16 Information regarding the competence, capabilities, and objectivity of an auditor's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other auditors or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership in a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The quality control policies and procedures of the auditor's firm and such other procedures the auditor considers necessary in the circumstances (see paragraphs .A12–.A13).

¹² Paragraph .13 of QM section 10A.

.A17 Matters relevant to evaluating the competence, capabilities, and objectivity of the auditor's specialist include whether that specialist's work is subject to technical performance standards or other professional or industry requirements (for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation).

.A18 Other matters that may be relevant include the following:

- The relevance of the competence of the auditor's specialist to the matter for which that specialist's work will be used, including any areas of specialty within that specialist's field. For example, a particular actuary may specialize in property and casualty insurance but have limited expertise regarding pension calculations.
- The competence of the auditor's specialist with respect to relevant accounting and auditing requirements (for example, knowledge of assumptions and methods, including models, when applicable, that are consistent with the applicable financial reporting framework).
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities, and objectivity of the auditor's specialist as the audit progresses.

.A19 A broad range of circumstances may threaten objectivity (for example, self-interest threats, advocacy threats, familiarity threats, self-review threats, and intimidation threats). Safeguards may eliminate or reduce such threats and may be created by external structures (for example, the profession, legislation, or regulation of the auditor's specialist) or by the work environment of the auditor's specialist (for example, quality control policies and procedures). There also may be safeguards specific to the audit engagement.

.A20 The evaluation of the significance of threats to objectivity and of whether a need exists for safeguards may depend upon the role of the auditor's specialist and the significance of the specialist's work in the context of the audit. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level (for example, if a proposed auditor's specialist is an individual who has played a significant role in preparing the information that is being audited [that is, if the proposed auditor's specialist is a management's specialist]).

.A21 When evaluating the objectivity of an auditor's external specialist, the auditor may

- a. inquire of the entity and the auditor's specialist about any known interests or relationships that the entity has with the auditor's external specialist that may affect that specialist's objectivity or
- b. discuss with that specialist any applicable safeguards, including any professional requirements that apply to that specialist, and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with the auditor's specialist include the following:
 - i. Financial interests
 - ii. Business and personal relationships

- iii. Provision of other services by the specialist, including by the organization in the case of an external specialist that is an organization

In some cases, the auditor may obtain a written representation from the auditor's external specialist about any interests or relationships with the entity of which that specialist is aware.

.A22 If the auditor believes a relationship between the entity and the auditor's specialist might impair the objectivity of the auditor's specialist, the auditor may perform additional procedures with respect to some or all of the assumptions, methods, or findings of the auditor's specialist to determine that the findings are reasonable or may engage another auditor's specialist for that purpose.

Obtaining an Understanding of the Field of Expertise of the Auditor's Specialist (Ref: par. .10)

.A23 The auditor may obtain an understanding of the field of expertise of the auditor's specialist through the means described in paragraph .A8 or through discussion with the auditor's specialist.

.A24 Aspects of the field of the auditor's specialist relevant to the auditor's understanding may include the following:

- Whether that field of the auditor's specialist has areas of specialty within it that are relevant to the audit (see paragraph .A18)
- Whether any professional or other standards and regulatory or legal requirements apply
- What assumptions and methods, including models, when applicable, are used by the auditor's specialist, and whether they are generally accepted within that field of the auditor's specialist and appropriate for financial reporting purposes
- The nature of internal and external data or information the auditor's specialist uses

Agreement With the Auditor's Specialist (Ref: par. .11)

.A25 The following matters may vary considerably with the circumstances:

- a. The nature, scope, and objectives of the work of the auditor's specialist
- b. The respective roles and responsibilities of the auditor and the auditor's specialist
- c. The nature, timing, and extent of communication between the auditor and the auditor's specialist.

Therefore, it is required that these matters are agreed between the auditor and the auditor's specialist regardless of whether the specialist is an auditor's external specialist or internal specialist.

.A26 The matters noted in paragraph .08 may affect the level of detail and formality of the agreement between the auditor and the auditor's specialist, including whether it is appropriate that the agreement be in writing. For example, the following factors may suggest the need for a more detailed agreement than would otherwise be the case or for the agreement to be in writing:

- The auditor's specialist will have access to sensitive or confidential entity information.

- The respective roles or responsibilities of the auditor and the auditor's specialist are different from those normally expected.
- Multijurisdictional legal or regulatory requirements apply.
- The matter to which the work of the auditor's specialist relates is highly complex.
- The auditor has not previously used work performed by the auditor's specialist.
- The auditor's use of the work of the auditor's specialist and its significance in the context of the audit is extensive.

.A27 In establishing the agreement with the auditor's specialist, an important consideration is whether the work of the auditor's specialist is subject to any reservation, limitation, or restriction and whether this has implications for the auditor.

.A28 The agreement between the auditor and an auditor's external specialist is generally in the form of an engagement letter. The appendix "Considerations for Agreement Between the Auditor and an Auditor's External Specialist" lists matters that the auditor may consider for inclusion in such an engagement letter or in any other form of agreement with an auditor's external specialist.

.A29 When no written agreement exists between the auditor and the auditor's specialist, evidence of the agreement may be included in, for example

- planning memoranda or related working papers, such as the audit program.
- the policies and procedures of the auditor's firm. In the case of an auditor's internal specialist, the established policies and procedures to which the auditor's specialist is subject may include particular policies and procedures regarding the work of the auditor's specialist. The extent of documentation in the auditor's working papers depends on the nature of such policies and procedures. For example, no documentation may be required in the auditor's working papers if the auditor's firm has detailed protocols covering the circumstances in which the work of such an auditor's specialist is used.

Nature, Scope, and Objectives of Work (Ref: par. .11a)

.A30 It often may be relevant when agreeing on the nature, scope, and objectives of the work of the auditor's specialist to include discussion of any relevant technical performance standards or other professional or industry requirements that the auditor's specialist will follow.

Respective Roles and Responsibilities (Ref: par. .11b)

.A31 Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist may include the following:

- Whether the auditor or the auditor's specialist will perform detailed testing of source data
- Consent for the auditor to discuss the findings or conclusions of the auditor's specialist with the entity and others and to include details of the findings or conclusions of the auditor's specialist in the basis for a modified opinion in the auditor's report, if necessary (see paragraph .A44)

- Any agreement to inform the auditor's specialist of the auditor's conclusions concerning the work of the auditor's specialist

Working Papers

.A32 Agreement on the respective roles and responsibilities of the auditor and the auditor's specialist also may include agreement about access to, and retention of, each other's working papers. When the auditor uses the work of an internal specialist, the working papers of the auditor's specialist form part of the audit documentation. Subject to any agreement to the contrary, the auditor's external specialist's working papers are its own and do not form part of the audit documentation.

Communication (Ref: par. .11c)

.A33 Effective two way communication facilitates the proper integration of the nature, timing, and extent of the procedures of the auditor's specialist with other work on the audit and appropriate modification of the objectives of the auditor's specialist during the course of the audit. For example, when the work of the auditor's specialist relates to the auditor's conclusions regarding a significant risk, both a formal written report at the conclusion of the work of the auditor's specialist and oral reports as the work progresses may be appropriate. Identification of specific partners or staff who will interact with the auditor's specialist and procedures for communication between the auditor's specialist and the entity assist timely and effective communication, particularly on larger engagements.

Confidentiality (Ref: par. .11d)

.A34 It is necessary for the confidentiality provisions of relevant ethical requirements that apply to the auditor also to apply to the auditor's specialist.¹³ Additional requirements may be imposed by law or regulation. The entity also may have requested that specific confidentiality provisions be agreed with the auditor's external specialists.

Evaluating the Adequacy of the Work of the Auditor's Specialist (Ref: par. .12)

.A35 The auditor's evaluation of the competence, capabilities, and objectivity of the auditor's specialist; the auditor's familiarity with the field of expertise of the auditor's specialist; and the nature of the work performed by the auditor's specialist affect the nature, timing, and extent of audit procedures to evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes.

The Findings and Conclusions of the Auditor's Specialist (Ref: par. .12a)

.A36 Specific procedures to evaluate the adequacy of the work of the auditor's specialist for the auditor's purposes may include the following:

- Making inquiries of the auditor's specialist
- Reviewing the working papers and reports of the auditor's specialist
- Performing corroborative procedures, such as
 - observing the work of the auditor's specialist;

¹³ ET section 1.700.040, *Disclosing Information to a Third-Party Service Provider*. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

- examining published data, such as statistical reports from reputable, authoritative sources;
 - confirming relevant matters with third parties;
 - performing detailed analytical procedures; and
 - reperforming calculations
- Engaging in discussion with another specialist with relevant expertise when, for example, the findings or conclusions of the auditor's specialist are not consistent with other audit evidence
 - Discussing the report of the auditor's specialist with management

.A37 Relevant factors when evaluating the relevance and reasonableness of the findings or conclusions of the auditor's specialist, whether in a report or other form, may include whether they are

- presented in a manner that is consistent with any standards of the profession or industry of the auditor's specialist;
- clearly expressed, including reference to the objectives agreed with the auditor, the scope of the work performed, and standards applied;
- based on an appropriate period and take into account subsequent events, when relevant; and
- based on appropriate consideration of errors or deviations encountered by the auditor's specialist.

Assumptions, Methods, and Source Data

Assumptions and Methods (Ref: par. .12b)

.A38 When the purpose of the work of the auditor's specialist is to evaluate underlying assumptions and methods, including models, when applicable, used by management in developing an accounting estimate, the auditor's procedures are likely to be primarily directed to evaluating whether the auditor's specialist has adequately reviewed those assumptions and methods. When the purpose of the work of the auditor's specialist is to develop an auditor's point estimate or an auditor's range for comparison with management's point estimate, the auditor's procedures may be primarily directed to evaluating the assumptions and methods, including models, when appropriate, used by the auditor's specialist.

.A39 Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, discusses the assumptions and methods used by management in making accounting estimates, including the use, in some cases, of highly specialized, entity-developed models.¹⁴ Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and methods, it also may assist the auditor when evaluating the assumptions and methods of an auditor's specialist.

.A40 When the work of an auditor's specialist involves the use of significant assumptions and methods, the appropriateness and reasonableness of those assumptions and methods used and their application are the responsibility of the auditor's specialist. Factors relevant to the auditor's evaluation of those assumptions and methods include whether they are

¹⁴ Paragraphs .08, .13, and .15 of section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

- generally accepted within the field of the auditor's specialist;
- consistent with the requirements of the applicable financial reporting framework;
- dependent on the use of specialized models;¹⁵ and
- consistent with those of management and, if not, the reason for, and effects of, the differences.

Source Data Used by the Auditor's Specialist (Ref: par. .12c)

.A41 When the work of an auditor's specialist involves the use of source data that is significant to the work of the auditor's specialist, procedures such as the following may be used to test that data:

- Verifying the origin of the data, including obtaining an understanding of and, when applicable, testing the internal controls over the data and, when relevant, its transmission to the auditor's specialist
- Reviewing the data for completeness and internal consistency

.A42 In many cases, the auditor may test source data. However, in other cases, when the nature of the source data used by an auditor's specialist is highly technical in relation to the field of the auditor's specialist, that specialist may test the source data. If the auditor's specialist has tested the source data, inquiry of the auditor's specialist by the auditor or supervision or review of the test of the auditor's specialist may be an appropriate way for the auditor to evaluate that data's relevance, completeness, and accuracy.

Inadequate Work (Ref: par. .13)

.A43 If the auditor concludes that the work of the auditor's specialist is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures required by paragraph .13, which may involve additional work being performed by both the auditor's specialist and the auditor or include employing or engaging another specialist, it may be necessary to express a modified opinion in the auditor's report in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Reference to the Auditor's Specialist in the Auditor's Report (Ref: par. .14–.15)

.A44 It may be appropriate to refer to the auditor's external specialist in an auditor's report containing a modified opinion to explain the nature of the modification. In such circumstances, the auditor may need the permission of the auditor's specialist before making such a reference.

¹⁵ Paragraph .14 of section 540A addresses the auditor's consideration of whether specialized skills or knowledge with regard to one or more aspects of the accounting estimates is required in order to obtain sufficient appropriate audit evidence.

.A45

Appendix—Considerations for Agreement Between the Auditor and an Auditor's External Specialist (Ref: par. .A28)

This appendix lists matters that the auditor may consider for inclusion in any agreement with an auditor's external specialist. The following list is illustrative and is not exhaustive; it is intended only to be a guide that may be used in conjunction with the considerations outlined in this section. Whether to include particular matters in the agreement depends on the circumstances of the engagement. The list also may be of assistance in considering the matters to be included in an agreement with an auditor's internal specialist.

Nature, Scope, and Objectives of the Auditor's External Specialist's Work

The following matters are examples of the nature, scope, and objectives of the auditor's external specialist's work:

- The nature and scope of the procedures to be performed by the auditor's external specialist
- The objectives of the auditor's external specialist's work in the context of materiality and risk considerations concerning the matter to which the auditor's external specialist's work relates and, when relevant, the applicable financial reporting framework
- Any relevant technical performance standards or other professional or industry requirements the auditor's external specialist will follow
- The assumptions and methods, including models, when applicable, the auditor's external specialist will use and their authority
- The effective date of, or, when applicable, the testing period for, the subject matter of the auditor's external specialist's work and requirements regarding subsequent events

The Respective Roles and Responsibilities of the Auditor and the Auditor's External Specialist

The following matters are examples of the respective roles and responsibilities of the auditor and the auditor's external specialist:

- Relevant auditing and accounting standards and relevant regulatory or legal requirements
- The consent of the auditor's external specialist to the auditor's intended use of the report of the auditor's specialist, including any reference to it or disclosure of it to others (for example, reference to it in the basis for a modified opinion in the auditor's report, if necessary, or disclosure of it to management or an audit committee)
- The nature and extent of the auditor's review of the auditor's external specialist's work

- Whether the auditor or the auditor's external specialist will test source data
- The auditor's external specialist's access to the entity's records, files, personnel, and specialists engaged by the entity
- Procedures for communication between the auditor's external specialist and the entity
- The auditor's and the auditor's external specialist's access to each other's working papers
- Ownership and control of working papers during and after the engagement, including any file retention requirements
- The auditor's external specialist's responsibility to perform work with due skill and care
- The auditor's external specialist's competence and capability to perform the work
- The expectation that the auditor's external specialist will use all knowledge that the specialist has that is relevant to the audit or, if not, will inform the auditor
- Any restriction on the auditor's external specialist's association with the auditor's report
- Any agreement to inform the auditor's external specialist of the auditor's conclusions concerning the work of the auditor's external specialist

Communications and Reporting

The following matters are examples of communications and reporting:

- Methods and frequency of communications, including the following:
 - How the auditor's external specialist's findings or conclusions will be reported (for example, written report, oral report, ongoing input to the engagement team)
 - Identification of specific persons within the engagement team who will liaise with the auditor's external specialist
- When the auditor's external specialist will complete the work and report findings or conclusions to the auditor
- The auditor's external specialist's responsibility to communicate promptly any potential delay in completing the work and any potential reservation or limitation on the findings and conclusions of the auditor's specialist
- The auditor's external specialist's responsibility to communicate promptly instances in which the entity restricts the access to records, files, personnel of the auditor's external specialist, or management's specialists engaged by the entity
- The auditor's external specialist's responsibility to communicate to the auditor all information that the auditor's external specialist believes may be relevant to the audit, including any changes in circumstances previously communicated

- The auditor's external specialist's responsibility to communicate circumstances that may create threats to the objectivity of the auditor's external specialist and any relevant safeguards that may eliminate or reduce such threats to an acceptable level

Confidentiality

The following matters are examples of confidentiality:

- The need for the auditor's specialist to observe confidentiality requirements, including the following:
 - The confidentiality provisions of relevant ethical requirements that apply to the auditor
 - Additional requirements that may be imposed by law or regulation, if any (for example, specific confidentiality provisions requested by the entity)
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AU-C Section 9620A***Using the Work of an Auditor's Specialist:
Auditing Interpretations of Section 620A***

Interpretation No. 1, "The Use of Legal Interpretations as Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7–14 of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40," has not been updated to reflect the issuance of Financial Accounting Standards Board (FASB) Statement No. 166, *Accounting for Transfers of Financial Assets*. FASB Statement No. 166 was incorporated into FASB *Accounting Standards Codification* (ASC) by FASB Accounting Standards Update No. 2009-16, *Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets*, and is discussed in FASB ASC 860, *Transfers and Servicing*.

In addition, this interpretation has not been updated for changes to the Federal Deposit Insurance Corporation's (FDIC's) safe harbor for financial assets transferred in connection with securitizations and participations. The FDIC's final amendments to the safe harbor, *Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010* (www.fdic.gov/news/news/press/2010/pr10216.html), were issued in September 2010. The safe harbor provides important protections for securitizations and participations by confirming that in the event of a bank failure, the FDIC would not try to reclaim loans transferred into such transactions.

In light of the issuance of FASB Statement No. 166 and the FDIC's changes to the safe harbor, the AICPA's Auditing Standards Board is currently in the process of revising this interpretation. Auditors should be alert for such revisions; however, the guidance in this interpretation continues to be relevant.

1. The Use of Legal Interpretations as Audit Evidence to Support Management's Assertion That a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraphs 7–14 of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40

.01 Introduction—Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 860,^[1] *Transfers and Servicing*, requires that a transferor of financial assets must surrender control over the financial assets to account for the transfer as a sale. According to FASB ASC 860-10-40-5(a), one of several conditions that must be met to provide evidence of surrender of control is that the transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.

Paragraphs 8–10 of FASB ASC 860-10-40 describe in greater detail the evidence required to support management's assertion that transferred financial assets have been isolated:

Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any *consolidated affiliate of the transferor*² that is not a special-purpose corporation or other entity designed to make remote the possibility that it would enter bankruptcy or other receivership (see FASB ASC 860-10-55-23(c)). The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. FASB ASC 860 does not provide guidance as to the type and amount of evidence that must be obtained to conclude that transferred financial assets have been isolated from the transferor. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or SPE might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law.

A determination about whether the isolation criterion has been met to support a conclusion regarding surrender of control is largely a matter of law. This aspect of surrender of control, therefore, is assessed primarily from a legal perspective.

.02 Effective Date and Applicability—This interpretation is effective for auditing procedures related to transfers of financial assets that are required to be accounted for under FASB ASC 860.^[3]

^[1] [Footnote deleted, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

² The Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) glossary defines *consolidated affiliate of the transferor* as "an entity whose assets and liabilities are included with those of the transferor in the consolidated, combined, or other financial statements being presented." [Footnote added, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

^[3] [Footnote renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.03 Question—What are the auditor's responsibilities in determining whether to use the work of a legal specialist⁴ to obtain persuasive evidence to support management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a)?

.04 Interpretation—Section 500A, *Audit Evidence*, states that the "preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity uses a management's specialist in these fields to obtain the needed expertise to prepare the financial statements."⁵

.05 Use of a management's specialist may not be necessary to obtain appropriate audit evidence to support management's assertion that the isolation criterion is met in certain situations, such as when there is a routine transfer of financial assets that does not result in any continuing involvement by the transferor.⁶

.06 Many transfers of financial assets involve complex legal structures, continuing involvement by the transferor, or other legal issues that, in the auditor's judgment, make it difficult to determine whether the isolation criterion is met. In these situations, use of a legal specialist usually is necessary. A legal specialist formulating an opinion about whether a transfer isolates the transferred assets beyond the reach of the transferor and its creditors may consider, among other things, the structure of the transaction taken as a whole, the nature of any continuing involvement, the type of insolvency or other receivership proceedings to which the transferor might become subject, and other factors pertinent under applicable law.

.07 If a legal opinion is used as evidence to support the accounting conclusion related to multiple transfers under a single structure, and such transfers occur over an extended period of time under that structure, the auditor is required to evaluate the appropriateness of the legal opinion,⁷ which includes evaluating the need for management to obtain periodic updates of that opinion to confirm that there have been no subsequent changes in relevant law or applicable regulations that may change the applicability of the previous opinion to such transfers. The auditor also is required to evaluate the need for management to obtain periodic updates of an opinion to confirm that there have been no subsequent changes in relevant law or applicable regulations that may affect the conclusions reached in the previous opinion in the case of other transfers (see FASB ASC 860-10-40-41 and FASB ASC 860-20-25).

.08 If management's assertion with respect to a new transaction is that the transaction structure is the same as a prior structure for which a legal opinion that complies with this interpretation was used as evidence to support

⁴ Client's internal or external attorney who is knowledgeable about relevant sections of the U.S. Bankruptcy Code and other federal, state, or foreign laws, as applicable. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

⁵ Paragraph .A35 of section 500A, *Audit Evidence*.

⁶ FASB ASC 860-10-55-28 characterizes no continuing involvement with the transferred assets as "no servicing responsibilities, no participation in future cash flows, no recourse obligations other than standard representations and warranties that the financial assets transferred met the delivery requirements under the arrangement, no further involvement of any kind. The transferee is significantly limited in its ability to pledge or exchange the transferred assets."

If a contractual provision (such as a call or removal of accounts provision) gives the transferor the unilateral ability to require the return of specific financial assets, the auditor should consider the effect of FASB ASC 860-10-40-5(c). [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

⁷ Paragraph .08c of section 500A.

an assertion that the transfer of assets met the isolation criterion, the auditor is required⁸ to determine whether management needs to obtain an update of that opinion to confirm that there have been no changes in relevant law, applicable regulations, or in the pertinent facts of the transaction that may affect the applicability of the previous opinion to the new transaction.

.09 Question—If the auditor determines that the use of a management's legal specialist is required, what should he or she consider in assessing the adequacy of the legal opinion?

.10 Interpretation—In assessing the adequacy of the legal opinion, the auditor is required to evaluate the competence and capabilities⁹ of the legal specialist to determine whether the legal specialist has experience with relevant matters, including knowledge of the U.S. Bankruptcy Code, and other federal, state, or foreign law, as applicable, as well as knowledge of the transaction upon which management's assertion is based. For transactions that may be affected by provisions of the Federal Deposit Insurance Act (FDIA), it is important to consider whether the legal specialist has experience with the rights and powers of receivers, conservators, and liquidating agents under that act. The auditor is required to obtain an understanding of the work of the specialist,¹⁰ which includes obtaining an understanding of the assumptions that are used by the legal specialist, and make appropriate tests of any information that management provides to the legal specialist and upon which the specialist indicates it relied. For example, testing management's information underlying a legal specialist's assumption regarding the adequacy of consideration received may depend on the nature of the transaction and the relationship of the parties. When the legal specialist's opinion has assumed the adequacy of consideration for transfers from a particular legal entity to its wholly owned subsidiary, changes in the subsidiary's capital accounts plus other consideration generally would be sufficient audit evidence about the adequacy of consideration. In the case of other transfers, such as those that are not to a wholly owned subsidiary of a particular legal entity that is the transferor, obtaining additional audit evidence may be necessary to evaluate management's assertion with regard to the adequacy of consideration upon which the legal specialist relied, because changes in the transferee's capital accounts do not solely benefit the transferring entity.

.11 The auditor also is required to evaluate the appropriateness of that specialist work as audit evidence for the relevant assertion,¹¹ which includes considering the form and content of the documentation that the legal specialist provides and evaluating whether the legal specialist's findings support management's assertions with respect to the isolation criterion. The requirement in FASB ASC 860 regarding reasonable assurance that the transferred assets would be isolated provides the basis for what the auditor is required to consider in evaluating the work of a legal specialist.

.12 Findings of a legal specialist that relate to the isolation of transferred financial assets are often in the form of a reasoned legal opinion that is restricted to particular facts and circumstances relevant to the specific transaction. The reasoning of such opinion may rely upon analogy to legal precedents that may not involve facts and circumstances that are comparable to that specific

⁸ Paragraph .10 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁹ Paragraph .08a of section 500A.

¹⁰ Paragraph .08b of section 500A.

¹¹ Paragraph .08c of section 500A.

transaction. It is important to consider the effect of any limitations or disclaimers of opinion in assessing the adequacy of any legal opinion.

.13 An example of the conclusions in a legal opinion for an entity that is subject to the U.S. Bankruptcy Code that provides persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in bankruptcy or other receivership, follows:

We believe (or it is our opinion) that in a properly presented and argued case, as a legal matter, in the event the Seller were to become a Debtor, the transfer of the Financial Assets from the Seller to the Purchaser would be considered to be a sale (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of the Seller's estate for purposes of [the relevant sections] of the U.S. Bankruptcy Code.

The following additional paragraph addressing substantive consolidation applies when the entity to which the assets are sold (as described in the opinion) is an affiliate of the selling entity and may also apply in other situations as noted by the legal specialist. For example, if a so-called two-step structure has been used to achieve isolation, this paragraph usually will be required with respect to the transferee in the first step of such structure (see paragraph .15 [and related footnotes] of this interpretation for additional guidance on the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55). When the transferor has entered into transactions with an affiliate that could affect the issue of substantive consolidation, the opinion should address the effect of that involvement on the opinion.

Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that in a properly presented and argued case, as a legal matter, in a proceeding under the U.S. Bankruptcy Code,*¹² *in which the Seller is a Debtor, a court would not grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller in a case involving the insolvency of the Seller under the doctrine of substantive consolidation.*

In the case of a transferor that is not entitled to become a debtor under the U.S. Bankruptcy Code, a legal opinion regarding whether the isolation criterion is met would consider whether isolation is satisfactorily achieved under the insolvency or receivership laws that apply to the transferor.

.14 Following are two examples of the conclusions in a legal opinion for an entity that is subject to receivership or conservatorship under provisions of the Federal Deposit Insurance Corporation (FDIC). The conclusions in these two examples provide persuasive evidence, in the absence of contradictory evidence, to support management's assertion that the transferred financial assets have been put presumptively beyond the reach of the entity and its creditors, even in conservatorship or receivership. Insolvency and receivership laws applicable to depository institutions, and how those laws affect the legal isolation criterion, differ depending upon the nature of the depository institution and its chartering

¹² For an entity subject to additional regulation (for example, a broker-dealer subject to the Securities Investor Protection Act), the legal opinion also generally should address the effect of such regulation and the policies of the regulators implementing such regulations (for example, the Securities Investor Protection Corporation). [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

authority. Accordingly, legal opinions addressing the legal isolation criterion may be formulated in different ways to accommodate those differences.¹³

Example 1. *We believe (or it is our opinion) that* in a properly presented and argued case, as a legal matter, in the event the Seller were to become subject to receivership or conservatorship, the transfer of the Financial Assets from the Seller to the Purchaser *would be considered to be a sale* (or a true sale) of the Financial Assets from the Seller to the Purchaser and not a loan and, accordingly, the Financial Assets and the proceeds thereof transferred to the Purchaser by the Seller in accordance with the Purchase Agreement would not be deemed to be property of, or subject to repudiation, reclamation, recovery, or recharacterization by, the receiver or conservator appointed with respect to the Seller.¹⁴

Example 2. The Federal Deposit Insurance Corporation (FDIC) has issued a regulation, 'Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation,' 12 CFR section 360.6 (the Rule). Based on and subject to the discussion, assumptions, and qualifications herein, it is our opinion that:

- A. Following the appointment of the FDIC as the conservator or receiver for the Bank:
 - (i) The Rule will apply to the Transfers,
 - (ii) Under the Rule, the FDIC acting as conservator or receiver for the Bank could not, by exercise of its authority to disaffirm or repudiate contracts under 12 U.S.C. §821(e), reclaim or recover the Transferred Assets from the Issuer or recharacterize the Transferred Assets as property of the Bank or of the conservatorship or receivership for the Bank,
 - (iii) Neither the FDIC (acting for itself as a creditor or as representative of the Bank or its shareholders or creditors) nor any creditor of the Bank would have the right, under any bankruptcy or insolvency law applicable in the conservatorship or receivership of the Bank, to avoid the Transfers, to recover the Transferred Assets, or to require the Transferred Assets to be turned over to the FDIC or such creditor, and
 - (iv) There is no other power exercisable by the FDIC as conservator or receiver for the Bank that would permit the FDIC as such conservator or receiver to reclaim or recover the Transferred Assets from the Issuer, or to recharacterize the Transferred

¹³ For an entity subject to conservatorship or liquidation under the National Credit Union Act, the examples and discussion in this paragraph would be modified to make appropriate references to "liquidation" and "liquidating agent" and additional information relating to rights and regulations of the National Credit Union Administration. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹⁴ When the opinion indicates that isolation is achieved without reference to a true sale, the opinion also should provide reasonable assurance that the transferred assets are beyond the reach of the transferor and its creditors other than the transferee to the same extent that is provided in paragraph B of example 2. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

Assets as property of the Bank or of the conservatorship or receivership for the Bank; provided, however, that we offer no opinion as to whether, in receivership, the FDIC or any creditor of the Bank may take any such actions if the Holders [*holders of beneficial interests in the transferred assets*] receive payment of the principal amount of the Interests and the interest earned thereon (at the contractual yield) through the date the Holders are so paid; and

- B. Prior to the appointment of the FDIC as conservator or receiver for the Bank, the Bank and its other creditors would not have the right to reclaim or recover the Transferred Assets from the Issuer, except by the exercise of a contractual provision [insert appropriate citation] to require the transfer, or return, of the Transferred Assets that exists solely as a result of the contract between the Bank and the Issuer.¹⁵

The following additional paragraph addressing substantive consolidation applies when the entity to which the assets are sold or transferred (as described in the opinion) is an affiliate of the selling entity and may also apply in other situations as noted by the legal specialist.¹⁶ For example, if a so-called two-step structure has been used to achieve isolation, the following paragraph usually will be required with respect to the transferee in the first step of the structure (see paragraph .15 [and related footnotes] of this interpretation for additional guidance on the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55). When the transferor has entered into transactions with an affiliate that could affect the issue of substantive consolidation, the opinion should address the effect of that involvement on the opinion:

Based upon the assumptions of fact and the discussion set forth previously, and on a reasoned analysis of analogous case law, *we are of the opinion that* in a properly presented and argued case, as a legal matter, in a receivership, conservatorship, or liquidation proceeding in respect of the Seller, a court *would not* grant an order consolidating the assets and liabilities of the Purchaser with those of the Seller.

Certain powers to repudiate contracts, recover, reclaim, or recharacterize transferred assets as property of a transferor that are exercisable by the FDIC under the FDIA may, as of the date of the transfer, be limited by a regulation that may be repealed or amended only in respect of transfers occurring on or after the effective date of such repeal or amendment.¹⁷ With respect to the powers of a receiver or conservator that may not be exercised under that regulation, it

¹⁵ See the second paragraph of footnote 6.

Paragraph B is not required if the opinion includes both a conclusion, as set forth in example 1, that the transfer constitutes a "true sale" and the conclusions set forth in paragraph A of example 2. It is not necessary to include any provision of example 2 if the opinion is as set forth in example 1. [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹⁶ An additional substantive consolidation opinion is not required if the opinion states that its conclusion includes the inability to recover the transferred financial assets or recharacterize the transfer by application of the doctrine of "substantive consolidation." [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

¹⁷ The applicable regulation is 12 U.S. *Code of Federal Regulations* 360.6, effective September 11, 2000. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

is acceptable for attorneys to rely upon the effectiveness of the limitation on such powers set forth in the applicable regulation, provided that the attorney states, based on reasonable assumptions, that (a) the affected transfer of financial assets meets all qualification requirements of the regulation, and (b) the regulation had not, as of the date of the opinion, been amended, repealed, or held inapplicable by a court with jurisdiction with respect to such transfer. The opinion should separately address any powers of repudiation, recovery, reclamation, or recharacterization exercisable by a receiver or conservator notwithstanding that regulation (for example, rights, powers, or remedies regarding transfers specifically excluded from the regulation) in a manner that provides the same level of assurance as would be provided in the case of opinions that conform with requirements of paragraph .13 of this interpretation, except that such opinion shall address powers arising under the FDIA. The considerations in the immediately preceding three sentences are adequately addressed either by the example 1 opinion or the example 2 opinion described in this paragraph or by the variations described in the second paragraph of footnote 15 and in footnote 16 of this interpretation.

.15 A legal letter that includes an inadequate opinion, inappropriate limitations, or a disclaimer of opinion, or that effectively limits the scope of the opinion to facts and circumstances that are not applicable to the transaction, does not provide persuasive evidence to support the entity's assertion that the transferred assets have been put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Likewise, a legal letter that includes conclusions that are expressed using some of the following language would not provide persuasive evidence that a transfer of financial assets has met the isolation criterion of FASB ASC 860-10-40-5(a) (see paragraphs .20–.21 of this interpretation):

- "We are unable to express an opinion . . ."
- "It is our opinion, based upon limited facts . . ."
- "We are of the view . . ." or "it appears . . ."
- "There is a reasonable basis to conclude that . . ."
- "In our opinion, the transfer would *either* be a sale *or* a grant of a perfected security interest . . ."¹⁸
- "In our opinion, there is a reasonable possibility . . ."
- "In our opinion, the transfer *should* be considered a sale . . ."
- "It is our opinion that the company will be able to assert meritorious arguments . . ."
- "In our opinion, it is more likely than not . . ."
- "In our opinion, the transfer would *presumptively* be . . ."
- "In our opinion, it is probable that . . ."

¹⁸ Certain transferors are subject only to receivership (and not to proceedings under the U.S. Bankruptcy Code or the Federal Deposit Insurance Act) under laws that do not allow a receiver to reach assets in which a security interest has been granted. In such circumstances, an opinion that concludes that the transfer would either be a sale or a grant of a security interest that puts the transferred assets beyond the reach of such receiver and other creditors would provide persuasive evidence that the isolation criterion is met.

In certain circumstances, a legal specialist may provide an opinion on both steps of a two-step structure. Such language would be acceptable in an opinion for a transfer of assets in the second step of a two-step structure as described in paragraphs 22–23 of FASB ASC 860-10-55 provided that the opinion on the transfer in the first step is consistent with paragraphs .13 or .14 of this interpretation. [Footnote renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

Furthermore, conclusions about hypothetical transactions may not be relevant to the transaction that is the subject of management's assertions. Section 500A states that the "auditor should design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence."¹⁹ Additionally, conclusions about hypothetical transactions may not contemplate all of the facts and circumstances or the provisions in the agreements of the transaction that is the subject of management's assertions, and generally would not provide persuasive evidence.²⁰

.16 Question—Are legal opinions that restrict the use of the opinion to the client, or to third parties other than the auditor, acceptable audit evidence?

.17 Interpretation—No. In some cases, the auditor may decide it is necessary to contact the specialist to determine that the specialist is aware that his or her work will be used for evaluating the assertions in the financial statements.²¹ Given the importance of the legal opinion to the assertion in this case, and the precision that legal specialists use in drafting such opinions, an auditor should not use as evidence a legal opinion that he or she deems otherwise adequate if the letter restricts use of the findings expressed therein to the client or to third parties other than the auditor. In that event, the auditor requests that the client obtain the legal specialist's written permission for the auditor to use the opinion for the purpose of evaluating management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a).

.18 An example of a letter from a legal specialist to a client that adequately communicates permission for the auditor to use the legal specialist's opinion for the purpose of evaluating management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a) is as follows:

Notwithstanding any language to the contrary in our opinions of even date with respect to certain bankruptcy issues relating to the previously referenced transaction, you are authorized to make available to your auditors such opinions solely as audit evidence in support of their evaluation of management's assertion that the transfer of the receivables meets the isolation criterion of Financial Accounting Standards Board *Accounting Standards Codification* 860-10-40-5(a), provided a copy of this letter is furnished to them in connection therewith. In authorizing you to make copies of such opinions available to your auditors for such purpose, we are not undertaking or assuming any duty or obligation to your auditors or establishing any lawyer-client relationship with them. Further, we do not undertake or assume any responsibility with respect to financial statements of you or your affiliates.²²

.19 A letter from a legal specialist to a client might authorize the client to make copies of the legal opinion available to the auditor to use in his or her evaluation of management's assertion that a transfer of financial assets meets the isolation criterion of FASB ASC 860-10-40-5(a) but then state that the auditor is not authorized to rely thereon. Such "use but not rely on" language, or other language that similarly restricts the auditor's use of the legal specialist's

¹⁹ Paragraph .06 of section 500A.

²⁰ For example, a memorandum of law from a legal specialist usually analyzes (and may make conclusions about) a transaction that may be completed subsequently. Such memorandum generally would not provide persuasive evidence unless the conclusions conform with this interpretation and a legal specialist opines that such conclusions apply to a completed transaction that is the subject of management's assertion. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

²¹ Paragraph .A39 of section 500A.

²² This language may appear in the legal specialist's opinion rather than in a separate letter. In that case, the wording would be modified slightly to indicate the context. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

opinion, does not adequately communicate permission for the auditor to use the legal specialist's opinion as audit evidence. The auditor may consider consulting with his or her legal counsel in circumstances in which it is not clear that the auditor may use the legal specialist's opinion.

.20 Question—If the auditor determines that it is appropriate to use the work of a legal specialist, and either the resulting legal response does not provide persuasive evidence that a transfer of assets has met the isolation criterion or the legal specialist does not grant permission for the auditor to use a legal opinion that is restricted to the client or to third parties other than the auditor, what other steps might an auditor consider?

.21 Interpretation—When other relevant audit evidence exists, the auditor should consider it before reaching a conclusion about the appropriateness of management's accounting for a transfer.²³ However, because the isolation aspect of surrender of control is assessed primarily from a legal perspective, the auditor usually will not be able to obtain persuasive evidence in a form other than a legal opinion. In the absence of persuasive evidence that a transfer has met the isolation criterion, derecognition of the transferred assets is not in conformity with generally accepted accounting principles and the auditor may need to express a qualified or adverse opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.²⁴ However, if permission for the auditor to use a legal opinion that he or she deems otherwise adequate is not granted, this would be a scope limitation and the auditor should consider the need to express a qualified opinion or to disclaim an opinion in accordance with section 705.²⁵

[Issue Date: December 2001; Revised: March 2006; Revised: June 2009;
Revised: October 2011, effective for audits of financial statements
for periods ending on or after December 15, 2012.]

²³ See paragraph .13 of section 620, *Using the Work of an Auditor's Specialist*, regarding additional procedures that may be applied. [Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

²⁴ Paragraphs .07–.09 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

²⁵ Paragraphs .11–.14 of section 705.

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AU-C Section 700

Forming an Opinion and Reporting on Financial Statements

(Supersedes SAS No. 122 section 700; SAS No. 131.)

Source: SAS No. 134; SAS No. 137; SAS No. 138; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

NOTE

In July 2020, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 143, *Auditing Accounting Estimates and Related Disclosures*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to form an opinion on the financial statements. It also addresses the form and content of the auditor's report issued as a result of an audit of financial statements.

.02 This section applies to an audit of a complete set of general purpose financial statements and is written in that context.

.03 This section is not applicable when the auditor is forming an opinion and reporting on financial statements of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). In such circumstances, section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* applies.

.04 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, and section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, address how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion) or includes an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report.

.05 This section does not require the communication of key audit matters. Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, addresses the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so.

.06 Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses special considerations when financial statements are prepared in accordance with a special purpose framework.¹ Section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement. (Ref: par. .A1–.A2)

.07 The requirements of this section promote consistency and comparability in auditor reporting. Consistency in the auditor's report, when the audit has been conducted in accordance with generally accepted auditing standards (GAAS), promotes credibility in the marketplace by making more readily identifiable those audits that have been conducted in accordance with recognized standards. Consistency also helps promote users' understanding and identification of unusual circumstances when they occur.

Effective Date

.08 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objectives

.09 The objectives of the auditor are to do the following:

- a. Form an opinion on the financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements or comparative financial information.
- b. Express clearly the opinion on the financial statements through a written report. (Ref: par. .A3)

Definitions

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

Comparative financial statements. A complete set of financial statements² for one or more prior periods included for comparison with the financial statements of the current period.

Comparative information. Prior period information presented for purposes of comparison with current period amounts or disclosures that is not in the form of a complete set of financial statements. Comparative information includes prior period informa-

¹ See section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, for a definition of special purpose framework.

² See section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for a definition of financial statements.

tion presented as condensed financial statements or summarized financial information.

Condensed financial statements. Historical financial information³ that is presented in less detail than a complete set of financial statements, in accordance with an appropriate financial reporting framework. Condensed financial statements may be separately presented as unaudited financial information or may be presented as comparative information.

General purpose financial statements. Financial statements prepared in accordance with a general purpose framework. (Ref: par. .A4)

General purpose framework. A financial reporting framework designed to meet the common financial information needs of a wide range of users.

Unmodified opinion. The opinion expressed by the auditor when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.⁴

.11 Reference to *financial statements* in this section means a complete set of general purpose financial statements. The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

Requirements

Forming an Opinion on the Financial Statements

.12 The auditor should form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (Ref: par. .A5)

.13 In order to form that opinion, the auditor should conclude whether the auditor has obtained reasonable assurance⁵ about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion should take into account the following: (Ref: par. .A6)

- a. The auditor's conclusion, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, about whether sufficient appropriate audit evidence has been obtained⁶
- b. The auditor's conclusion, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*, about whether uncorrected misstatements are material, individually or in the aggregate⁷
- c. The evaluations required by paragraphs .14–.17

³ Paragraph .14 of section 200 defines the term *historical financial information*.

⁴ Paragraph .14 of section 200 defines the term *applicable financial reporting framework*.

⁵ Paragraph .14 of section 200 defines the term *reasonable assurance*.

⁶ Paragraph .28 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

⁷ Paragraph .11 of section 450, *Evaluation of Misstatements Identified during the Audit*.

.14 The auditor should evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation should include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: par. .A7–.A9)

.15 In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

- a. the financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the entity and whether they have been presented in an understandable manner. (Ref: par. .A10)
- b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
- c. the accounting estimates made by management are reasonable.
- d. the information presented in the financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented. (Ref: par. .A11)
- e. the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. (Ref: par. .A12)
- f. the terminology used in the financial statements, including the title of each financial statement, is appropriate.

.16 The auditor's evaluation about whether the financial statements achieve fair presentation should also include consideration of the following: (Ref: par. .A13–.A15)

- a. The overall presentation, structure, and content of the financial statements
- b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A16)

.17 The auditor should evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A17–.A20)

Form of Opinion

.18 The auditor should express an unmodified opinion when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.19 The auditor should modify the opinion in the auditor's report, in accordance with section 705, in the following circumstances:

- a. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated.
- b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

.20 If the auditor concludes that the financial statements do not achieve fair presentation, the auditor should discuss the matter with management and, depending on how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705. (Ref: par. .A21–.A22)

Auditor's Report

.21 The auditor's report should be in writing. (Ref: par. .A23–.A24)

Auditor's Report for Audits Conducted in Accordance With GAAS

Title

.22 The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A25)

Addressee

.23 The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A26)

Auditor's Opinion

.24 The first section of the auditor's report should include the auditor's opinion and should have the heading "Opinion."

.25 The "Opinion" section of the auditor's report should also do the following: (Ref: par. .A27–.A29)

- a. Identify the entity whose financial statements have been audited.
- b. State that the financial statements have been audited.
- c. Identify the title of each statement that the financial statements comprise.
- d. Refer to the notes.
- e. Specify the dates of or periods covered by each financial statement that the financial statements comprise.

.26 When expressing an unmodified opinion on financial statements, the auditor's opinion should state that, in the auditor's opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [*the applicable financial reporting framework*]. (Ref: par. .A17 and .A30–.A33)

.27 The auditor's opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A34)

Basis for Opinion

.28 The auditor's report should include a section, directly following the "Opinion" section, with the heading "Basis for Opinion," that does the following: (Ref: par. .A35)

- a. States that the audit was conducted in accordance with generally accepted auditing standards and identifies the United States of America as the country of origin of those standards (Ref: par. .A36–.A37)
- b. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS

- c. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref: par. .A38–.A39)
- d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion

Going Concern

.29 When applicable, the auditor should report in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

Key Audit Matters

.30 When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701. (Ref: par. .A40)

Responsibilities of Management for the Financial Statements

.31 The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements."

.32 This section of the auditor's report should describe management's responsibility for the following:

- a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error (Ref: par. .A41)
- b. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern [for the time period set by the applicable financial reporting framework, as applicable].

.33 The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A42)

Auditor's Responsibilities for the Audit of the Financial Statements

.34 The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

.35 This section of the auditor's report should do the following: (Ref: par. .A43)

- a. State that the objectives of the auditor are to
 - i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and (Ref: par. .A44)
 - ii. issue an auditor's report that includes the auditor's opinion.
- b. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. (Ref: par. .A45)

- c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- d. State that misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.⁸ (Ref: par. .A46)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.36 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

- a. Exercise professional judgment and maintain professional skepticism throughout the audit.
- b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, no such opinion is expressed.

In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, no such opinion is expressed."

- d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

.37 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that the auditor identified during the audit.

Other Information

.38 When applicable, the auditor should report in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in*

⁸ Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit*.

Annual Reports. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Other Reporting Responsibilities

.39 If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A47–.A48) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.40 If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of paragraphs .22–.37 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A49) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Signature of the Auditor

.41 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A50–.A52) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Auditor's Address

.42 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A53) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Date of the Auditor's Report

.43 The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence of the following: (Ref: par. .A54)

- a. All the statements and disclosures that the financial statements comprise have been prepared.
- b. Management has asserted that it has taken responsibility for those financial statements. (Ref: par. .A55–.A57)

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards

.44 Paragraph .28 requires that the auditor's report state that the audit was conducted in accordance with GAAS and identify the United States of America as the country of origin of those standards. However, an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards (for example, International Standards on Auditing [ISAs] or Government Auditing Standards). The auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS unless the audit was conducted in accordance with both sets of standards in their entirety. (Ref: par. .A58) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.45 When the auditor's report refers to both GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards as well as its origin.

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB

.46 When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS. (Ref: par. .A59–.A65) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Comparative Financial Statements and Comparative Information

.47 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the auditor's report should refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: par. .A66–.A67) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.48 When expressing an opinion on all periods presented, a continuing auditor should update the report on the financial statements of one or more prior periods presented on a comparative basis with those of the current period. The auditor's report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit. (Ref: par. .A68–.A69) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.49 If comparative information is presented but not covered by the auditor's opinion, the auditor should clearly indicate in the auditor's report the character of the auditor's work, if any, and the degree of responsibility the auditor is taking. (Ref: par. .A70–.A71) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.50 If comparative information is presented and the entity requests the auditor to express an opinion on all periods presented, the auditor should consider whether the information included for the prior periods contains sufficient detail to constitute a fair presentation in accordance with the applicable financial reporting framework. (Ref: par. .A72) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Audit Procedures

.51 The auditor should perform the procedures required by paragraphs .52–.54 if comparative financial statements or comparative information is presented for the prior periods. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.52 The auditor should determine whether the comparative financial statements or comparative information has been presented in accordance with the relevant requirements, if any, of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.53 The auditor should evaluate the following:

- a. Whether the comparative financial statements or comparative information agrees with the amounts and other disclosures

presented in the prior period or, when appropriate, has been restated for the correction of a material misstatement or adjusted for the retrospective application of an accounting principle

- b. Whether the accounting policies reflected in the comparative financial statements or comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed⁹

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.54 If the auditor becomes aware of a possible material misstatement in the comparative financial statements or comparative information while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor audited the prior period's financial statements and becomes aware of a material misstatement in those financial statements, the auditor should also follow the relevant requirements of section 560, *Subsequent Events and Subsequently Discovered Facts*. If the prior period financial statements are restated, the auditor should determine that the comparative financial statements or comparative information agrees with the restated financial statements. [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.55 As required by section 580, *Written Representations*, the auditor should request written representations for all periods referred to in the auditor's opinion. The auditor also should obtain a specific written representation regarding any restatement made to correct a material misstatement in a prior period that affects the comparative financial statements. (Ref: par. .A73) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.56 When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor should disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706:

- a. The date of the auditor's previous report
- b. The type of opinion previously expressed
- c. The substantive reasons for the different opinion
- d. That the auditor's opinion on the amended financial statements is different from the auditor's previous opinion (Ref: par. .A74)

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Prior Period Financial Statements Audited by a Predecessor Auditor

.57 If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued,¹⁰ in addition to expressing an opinion on the current period's financial statements, the auditor should state the following in an other-matter paragraph:¹¹

- a. That the financial statements of the prior period were audited by a predecessor auditor

⁹ See section 708, *Consistency of Financial Statements*.

¹⁰ Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

¹¹ See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

- b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore
- c. The nature of an emphasis-of-matter paragraph, other-matter paragraph, or a going concern section included in the predecessor auditor's report, if any
- d. The date of that report

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.58 If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor should follow the communication requirements in section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.¹² If the prior period financial statements are restated, and the predecessor auditor agrees to issue a new auditor's report on the restated financial statements of the prior period, the auditor should express an opinion only on the current period. (Ref: par. .A75) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Prior Period Financial Statements Not Audited

.59 When current period financial statements are audited and presented in comparative form with financial statements for the prior period for which a compilation or review was performed, and the report on the prior period is not reissued, the auditor should include an other-matter paragraph¹³ in the current period auditor's report that includes the following with respect to the prior period:

- a. The service performed in the prior period
- b. The date of the report on that service
- c. A description of any material modifications noted in that report
- d. For a review engagement, a statement that the service was substantially less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements as a whole (Ref: par. .A76)
- e. For a compilation engagement, a statement that no opinion or other form of assurance is expressed on the financial statements (Ref: par. .A77)

[Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

.60 If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (Ref: par. .A78) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Information Presented in the Financial Statements

.61 Information that is not required by the applicable financial reporting framework but is nevertheless presented as part of the basic financial statements should be covered by the auditor's opinion if it cannot be clearly

¹² Paragraphs .12–.13 of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

¹³ See section 706.

differentiated. (Ref: par. .A79–.A80) [Paragraph renumbered by the issuance of SAS No. 137, July 2019.]

Application and Other Explanatory Material

Scope of This Section (Ref par. .06)

.A1 Section 800 also addresses the auditor's responsibilities when the auditor is reporting on financial statements prepared in accordance with a special purpose framework and is required by law or regulation to use a specific layout, form, or wording of the auditor's report. When reporting on financial statements prepared in accordance with a general purpose framework, and law or regulation requires a specific layout, form, or wording of the auditor's report, the auditor may adapt and apply the requirements in section 800.

.A2 Other AU-C sections that also contain reporting requirements include, but are not limited to, the following:

- Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- Section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Section 730, *Required Supplementary Information*
- Section 810, *Engagements to Report on Summary Financial Statements*
- Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*

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

Objectives

Considerations Specific to Governmental Entities (Ref: par. .09)

.A3 For audits of governmental entities, the objectives of a financial statement audit are often broader than forming and expressing an opinion on the financial statements. Paragraph .A47 discusses the auditor's other reporting responsibilities.

Definitions

General Purpose Financial Statements

Considerations Specific to Governmental Entities (Ref: par. .10)

.A4 For audits of governmental entities, the term *general purpose financial statements*, in the context of this section, would be considered or referred to as basic financial statements using the terms in the governmental entity's applicable financial reporting framework.

Forming an Opinion on the Financial Statements (Ref: par. .12)

.A5 As described in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, a financial reporting framework is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

Considerations Specific to Governmental Entities (Ref: par. .13)

.A6 For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units and, therefore, requires the presentation of financial statements for the governmental entity's activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. In the context of this section, the auditor is responsible for forming an opinion on the financial statements for each opinion unit within a governmental entity.

Qualitative Aspects of the Entity's Accounting Practices (Ref: par. .14)

.A7 Management makes a number of judgments about the amounts and disclosures in the financial statements.

.A8 Section 260, *The Auditor's Communication With Those Charged With Governance*, contains a discussion of the qualitative aspects of accounting practices.¹⁴ In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to management's attention during the audit (for example, correcting misstatements with the effect of increasing reported earnings but not correcting misstatements that have the effect of decreasing reported earnings)
- Possible management bias in the making of accounting estimates

.A9 Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, addresses possible management bias in making accounting estimates. Indicators of possible management bias, themselves, do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Accounting Policies Appropriately Disclosed in the Financial Statements (Ref: par. .15a)

.A10 In evaluating whether the financial statements appropriately disclose the significant accounting policies selected and applied, the auditor's consideration may include matters such as the following:

¹⁴ The appendix "Qualitative Aspects of Accounting Practices" of section 260, *The Auditor's Communication With Those Charged With Governance*.

- Whether the financial statements include all disclosures related to the significant accounting policies that are required by the applicable financial reporting framework
- Whether the information about the significant accounting policies that has been disclosed is relevant and therefore reflects how the recognition, measurement, and presentation criteria in the applicable financial reporting framework have been applied to classes of transactions, account balances, and disclosures in the financial statements in the particular circumstances of the entity's operations and its environment
- The clarity with which the significant accounting policies have been presented

Information Presented in the Financial Statements Is Relevant, Reliable, Comparable, and Understandable (Ref: par. .15d)

.A11 Evaluating the understandability of the financial statements may include consideration of whether the information in the financial statements is presented in a manner that facilitates users' ability to identify necessary information. This may include whether the disclosures are appropriately labeled and cross-referenced.

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: par. .15e)

.A12 It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, results of operations, and cash flows. Evaluating whether, in view of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, results of operations, and cash flows may include consideration of such matters as the following:

- The extent to which the information in the financial statements is relevant and specific to the circumstances of the entity
- Whether the disclosures are adequate to assist the intended users in understanding the following:
 - The nature and extent of the entity's assets and liabilities arising from transactions or events that do not meet the criteria for recognition (or the criteria for derecognition) established by the applicable financial reporting framework
 - The methods used and the assumptions and judgments made, and changes to them, that affect amounts presented or otherwise disclosed, including relevant sensitivity analyses

Evaluating Whether the Financial Statements Achieve Fair Presentation (Ref: par. .16)

.A13 Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. As noted in section 200, a *fair presentation financial reporting framework*¹⁵ not only requires compliance with the requirements of the framework but also acknowledges explicitly or implicitly

¹⁵ Paragraph .14 of section 200.

that it may be necessary for management to provide disclosures beyond those specifically required by the framework.

.A14 The auditor's evaluation about whether the financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the entity, including changes thereto, based on the auditor's understanding of the entity and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if there is a substantial likelihood that, individually, or in the aggregate, they would influence the judgement made by a reasonable user based on the financial statements.¹⁶ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A15 Evaluating whether the financial statements achieve fair presentation may include, for example, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example, the following:

- The degree to which the amounts in the financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information or results in misleading information
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted

.A16 The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the auditor would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements.

Description of the Applicable Financial Reporting Framework (Ref: par. .17)

.A17 As explained in section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.¹⁷ That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

.A18 The description may indicate that the financial statements have been prepared in accordance with that framework. Such a statement is appropriate only when the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

.A19 Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework

¹⁶ See section 320.

¹⁷ Paragraphs .A2–.A3 of section 200.

are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

.A20 The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework. Such information may not be required by the applicable financial reporting framework but may be presented as part of the basic financial statements. As discussed in paragraph .61, such information is considered an integral part of the financial statements if it cannot be clearly differentiated and, accordingly, is covered by the auditor's opinion.

Form of Opinion (Ref: par. .20)

.A21 In some instances, the financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. When this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in unusual circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements, which would be extremely rare.

.A22 The "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct states the following:

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Auditor's Report (Ref: par. .21)

.A23 A written report encompasses reports issued in hard copy format and those using an electronic medium.

.A24 The exhibit "Illustrations of Auditor's Reports on Financial Statements" contains illustrations of auditor's reports on financial statements incorporating the elements required by paragraphs .22–.43. With the exception of the "Opinion" and "Basis for Opinion" sections, this section does not establish requirements for ordering the elements of the auditor's report. However, this section requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with GAAS more recognizable, particularly in situations in which the elements of the auditor's report are presented in an order that differs from the illustrative auditor's reports in the exhibit to this section.

Auditor's Report for Audits Conducted in Accordance With GAAS

Title (Ref: par. .22)

.A25 Section 200 provides guidance on reporting when the auditor is not independent.¹⁸

Addressee (Ref: par. .23)

.A26 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being audited or to those charged with governance. A report on the financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an auditor may be retained to audit the financial statements of an entity that is not a client; in such a case, the report may be addressed to the client and not to those charged with governance of the entity whose financial statements are being audited.

Auditor's Opinion (Ref: par. .25–.27)

.A27 The auditor's report states, for example, that the auditor has "audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements." If the financial statements include a separate statement of changes in stockholders' equity accounts or a separate statement of comprehensive income, paragraph .25c requires such statements to be identified in the "Opinion" section, but they need not be referred to separately in the opinion paragraph because changes in stockholders' equity accounts and comprehensive income are considered part of the presentation of financial position, results of operations, and cash flows.

.A28 The identification of the title and the dates of, or periods covered by, each statement that the financial statements comprise may also be achieved by referencing the table of contents in a document bound with or accompanying the financial statements and auditor's report thereon.

.A29 When the auditor is aware that the audited financial statements will be included in a document that contains information in addition to the financial statements and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users identify the financial statements to which the auditor's report relates.

.A30 When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion because these suggest a conditional opinion or a weakening or modification of the opinion.

.A31 The auditor's opinion covers the complete set of financial statements, as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the financial statements include a balance sheet, an income statement, a statement of changes in equity, and a cash flow statement, including related notes. In some circumstances, additional or different statements, schedules, or information also might be considered an integral part of the financial statements.

¹⁸ Paragraph .A18 of section 200.

A32 The reports in the exhibit "Illustrations of Auditor's Reports on Financial Statements" include example wording that may be used to replace the [...] based on the applicable financial reporting framework.

A33 The title of the financial statements identified in the "Opinion" section (see paragraph .25c) describes the information that is the subject of the auditor's opinion.

A34 *Description of the applicable financial reporting framework and how it may affect the auditor's opinion (Ref: par. .27).* The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph .16. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles or International Financial Reporting Standards promulgated by the International Accounting Standards Board (IASB) or *International Financial Reporting Standard for Small- and Medium-Sized Entities* promulgated by the IASB.

Basis for Opinion (Ref: par. .28)

A35 The "Basis for Opinion" section provides important context about the auditor's opinion. Accordingly, this section requires the "Basis for Opinion" section to directly follow the "Opinion" section in the auditor's report.

A36 The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards. For example, the auditor's report may refer to auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards.

A37 In accordance with section 200, the auditor does not represent compliance with GAAS in the auditor's report unless the auditor has complied with the requirements of section 200 and all other AU-C sections relevant to the audit.¹⁹

A38 *Relevant Ethical Requirements (Ref: par. .28c).* Section 200 explains that ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.²⁰ When the AICPA Code of Professional Conduct applies, the auditor's other ethical responsibilities relate to the principles of professional conduct (ET sec. 0.300, "Principles of Professional Conduct").

A39 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*,²¹ provides

¹⁹ Paragraph .22 of section 200.

²⁰ Paragraph .A15 of section 200.

²¹ Paragraphs .22–.23 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

Key Audit Matters (Ref: par. .30)

.A40 Section 210A, *Terms of Engagement*, requires the audit engagement letter or other suitable form of written agreement to include reference to the expected form and content of any reports to be issued by the auditor.²²

Responsibilities of Management for the Financial Statements (Ref: par. .31–.33)

.A41 Section 200 explains the premise relating to the responsibilities of management and, when appropriate, those charged with governance on which an audit in accordance with GAAS is conducted.²³ Management and, when appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both of these responsibilities because it helps explain to users the premise on which an audit is conducted. Section 260 uses the term *those charged with governance* to describe the persons or organizations with responsibility for overseeing the entity, and provides a discussion about the diversity of governance structures among entities.

.A42 In some instances, a document containing the auditor's report may include a separate statement by management or those charged with governance regarding their responsibility for the preparation of the financial statements. Any elaboration in the auditor's report about the responsibilities of management or those charged with governance regarding the preparation of the financial statements, or reference to a separate statement by management or those charged with governance about such responsibilities if one is included in a document containing the auditor's report, may lead users to erroneously believe that the auditor is providing assurances about representations made by management or those charged with governance about their responsibility for financial reporting, internal control, and other matters that might be discussed in the management report.

Auditor's Responsibilities for the Audit of the Financial Statements (Ref: par. .34–.37)

.A43 The description of the auditor's responsibilities as required by paragraphs .34–.37 of this section may be tailored to reflect the specific nature of the entity, for example, when the auditor's report addresses consolidated financial statements.

.A44 *Objectives of the Auditor (Ref: par. .35a–c)*. The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion. These objectives are in contrast to management's responsibilities for the preparation and fair presentation of the financial statements.

²² Paragraph .10 of section 210A, *Terms of Engagement*.

²³ Paragraphs .05 and .A2 of section 200.

.A45 Because the auditor's opinion is based on obtaining reasonable assurance, the auditor's report does not constitute a guarantee. Because of the inherent limitation of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS.²⁴

.A46 When the applicable financial reporting framework defines materiality differently from the definition in section 320, *Materiality in Planning and Performing an Audit*, the auditor's report may need to reflect the definition or description of materiality from the applicable financial reporting framework.

Other Reporting Responsibilities (Ref: par. .39–.40)

.A47 In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under GAAS to report on the financial statements. The form and content of the "Other Reporting Responsibilities" section of the auditor's report described in paragraph .39 will vary depending on the nature of the auditor's other reporting responsibilities. For example, for audits conducted under *Government Auditing Standards*, the auditor may be required to report on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements, which may be included in the "Other Reporting Responsibilities" section of the auditor's report.²⁵ However, when the auditor is engaged or required by law or regulation to perform a compliance audit in accordance with GAAS, *Government Auditing Standards*, and a governmental audit requirement, reporting requirements in section 935, *Compliance Audits*, apply.

.A48 In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

.A49 These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor's report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

Signature of the Auditor (Ref: par. .41)

.A50 In some cases, law or regulation may allow for the use of electronic signatures in the auditor's report.

.A51 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm.

.A52 *Considerations specific to governmental entities.* This section would not preclude a governmental auditor from including the personal name and signature of the auditor in the auditor's report when, in certain situations, the governmental auditor is required by law or regulation or chooses to do so.

²⁴ Paragraph .A56 of section 200 and paragraph .10d of section 210A.

²⁵ See AICPA Audit and Accounting Guide *Government Auditing Standards and Single Audits* for illustrative auditor reports.

Auditor's Address (Ref: par. .42)

.A53 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date of the Auditor's Report (Ref: par. .43)

.A54 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.²⁶ When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.²⁷

.A55 The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in section 560.

.A56 Because the auditor's opinion is provided on the financial statements, and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements and disclosures that the financial statements comprise have been prepared, and management has accepted responsibility for them.

Considerations Specific to Governmental Entities

.A57 In some circumstances, final approval of the financial statements by governmental legislative bodies (or subsets of such legislative bodies) is required before the financial statements are issued. In these circumstances, final approval by such legislative bodies (or subsets of such legislative bodies) is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements, for purposes of GAAS, is the earlier date on which those with the recognized authority determine that all the statements and disclosures that the financial statements comprise have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards (Ref: par. .43)

.A58 If the audit is performed in accordance with both GAAS and the ISAs, the auditor may find it helpful to refer to appendix B, "Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards." This appendix summarizes substantive differences between the ISAs and GAAS to assist the auditor in planning and performing an engagement in accordance with the ISAs.

²⁶ See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

²⁷ Paragraph .21 of section 220A.

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB (Ref: par. .46)

.A59 Auditors of financial statements of entities whose audits are within the jurisdiction of the PCAOB, which include issuers (as defined by the SEC) and nonissuer brokers and dealers registered with the SEC, are required to be registered with, and subject to inspection by, the PCAOB. In such circumstances, the AICPA Code of Professional Conduct requires AICPA members to conduct the audit in accordance with the standards of the PCAOB, and the audit is not required to also be conducted in accordance with GAAS.²⁸

.A60 As discussed in paragraph .46, because the auditor is required to also conduct the audit in accordance with GAAS, it would be inappropriate for the auditor to issue a report that refers only to the standards of the PCAOB without also referring to GAAS.

.A61 When the auditor follows the standards of the PCAOB regarding the form of the auditor's report, PCAOB reporting requirements for specific circumstances, such as reporting on an integrated audit or supplementary information, may also be applicable.

.A62 The form of the auditor's report required by the standards of the PCAOB states that the audit was conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)." A reference to "the standards" of the PCAOB indicates that the auditor has complied not only with the PCAOB's auditing standards but also with the related professional practice standards of the PCAOB, including its independence rules; whereas a reference to "the auditing standards of the Public Company Accounting Oversight Board (United States)" indicates compliance with only the auditing standards of the PCAOB. The auditor of financial statements of an entity whose audits are not within the jurisdiction of the PCAOB may, nevertheless, be responsible for complying with the independence and other related professional practice standards of the PCAOB if, for example, the engagement is subject to regulatory oversight that requires compliance with those rules. Whether the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB or the auditing standards of the PCAOB depends on the circumstances of the engagement.²⁹

.A63 Examples of situations in which an auditor may be engaged to conduct an audit in accordance with the standards (or auditing standards) of the PCAOB for an entity whose audit is not within the jurisdiction of the PCAOB include audits for clearing agencies and futures commission merchants registered with the U.S. Commodities Futures Trading Commission (CFTC), as well as other entities registered with the CFTC; audits of financial statements included in certain securities offering documents pursuant to Regulation A of the Securities Act of 1933; and circumstances in which a nonissuer company desires, or is required by contractual agreement, to obtain an audit of its financial statements in accordance with the standards of the PCAOB.

.A64 When an audit is being conducted in accordance with the standards of the PCAOB, the auditor would follow the relevant requirements in the PCAOB

²⁸ See the "Compliance With Standards Rule" (ET sec. 1.310.001) and appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of the AICPA Code of Professional Conduct.

²⁹ See Staff Question and Answer, *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board* (PCAOB Staff Guidance, sec. 100.01), dated June 30, 2004, in *PCAOB Standards and Related Rules*.

standards regarding the determination and reporting of critical audit matters. This would not affect the requirement for the auditor to state in the auditor's report that the audit was also conducted in accordance with GAAS, as required by paragraph .46 of this section.

.A65 The exhibit "Illustrations of Auditor's Reports on Financial Statements" contains an example of an auditor's report for the situation described in paragraph .46.

Comparative Financial Statements and Comparative Information (Ref: par. .47–.48)

.A66 The level of information included for the prior periods in comparative financial statements is comparable with that of the financial statements of the current period.

.A67 Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor's opinion on one or more financial statements of another period presented.

Updating the Report

.A68 An updated report on prior period financial statements is distinguished from a reissuance of a previous report.³⁰ When issuing an updated report, the information considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor's report on the current period financial statements.

Other Considerations Relating to Comparative Financial Statements

.A69 If one firm of independent auditors merges with another firm, and the new firm becomes the auditor of a former client of one of the two former firms, the new firm may accept responsibility and express an opinion on the financial statements for the prior periods, as well as on those for the current period. In such circumstances, paragraphs .47–.60 apply. The new firm may indicate in the auditor's report or as part of the signature that a merger took place and may name the firm of independent auditors that was merged with it. If the new firm decides not to express an opinion on the prior period financial statements, the guidance for the reissuance of reports in section 560 would apply.

Comparative Information (Ref: par. .49–.50)

.A70 Comparative information, which may be condensed financial statements or prior period summarized financial information, is not considered comparative financial statements because it is not a complete set of financial statements. For example, entities such as state and local governmental units frequently present total-all-funds information for the prior periods rather than information by individual funds because of space limitations or to avoid cumbersome or confusing formats. Also, not-for-profit organizations frequently present certain summarized financial information for the prior periods in total rather than by net asset class. Accordingly, the auditor need not opine on comparative information in accordance with this section.

³⁰ See section 560, *Subsequent Events and Subsequently Discovered Facts*.

.A71 Paragraph .49 requires the auditor to clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking in the auditor's report when comparative information is presented but not covered by the auditor's opinion on the financial statements of the current period. The requirements and guidance in section 930, *Interim Financial Information*, may be adapted to report on condensed financial statements or prior period summarized financial information that is derived from audited financial statements and is presented comparatively with the complete set of financial statements of the current period.^{31, 32} The exhibit to this section provides examples of auditor's reports when comparative summarized financial information for the prior period is presented.³³

.A72 If an entity requests the auditor to express an opinion on all periods presented, and comparative information is presented for one or more prior periods, in most cases, this will necessitate including additional columns or separate detail by fund or net asset class, or the auditor may need to modify the auditor's opinion, as required by section 705.

Written Representations (Ref: par. .55)

.A73 In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to reaffirm that the written representations it previously made with respect to the prior period remain appropriate.

Opinion on Prior Period Financial Statements Different From Previous Opinion (Ref: par. .56)

.A74 When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if, during the course of the audit of the current period, the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.³⁴

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: par. .58)

.A75 The predecessor auditor may be unable or unwilling to reissue the auditor's report on the prior period financial statements that have been restated. In this situation, provided that the auditor has audited the adjustments to the prior period financial statements, the auditor may include an other-matter paragraph³⁵ in the auditor's report indicating that the predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the auditor is engaged to audit the adjustments and obtains sufficient appropriate audit evidence to be satisfied about the appropriateness of

³¹ Paragraph .33 of section 930, *Interim Financial Information*.

³² See the AICPA Audit and Accounting Guides *State and Local Governments* and *Not-for-Profit Entities* for further guidance on reporting on summarized comparative financial information.

³³ Illustration 5, "An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year is Presented," of the exhibit "Illustrations of Auditor's Reports on Financial Statements."

³⁴ See section 560.

³⁵ See section 706.

the restatement, the auditor's report may also include the following within the other-matter paragraph:

As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the Company other than with respect to the adjustments, and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements as a whole.

Prior Period Financial Statements Not Audited (Ref: par. .59–.60)

.A76 The following is an example of an other-matter paragraph when a review was performed on the prior period financial statements:

Other Matter

The 20X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 20X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in accordance with accounting principles generally accepted in the United States of America. A review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements as a whole.

.A77 The following is an example of an other-matter paragraph when a compilation was performed on the prior period financial statements:

Other Matter

We (other accountants) performed a compilation engagement with respect to the 20X1 financial statements and our (their) report thereon, dated March 1, 20X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

.A78 If the prior period financial statements were not audited, reviewed, or compiled, the following is an example of an other-matter paragraph:

Other Matter

The accompanying balance sheet of X Company as of December 31, 20X1, and the related statements of income and cash flows for the year then ended were not audited, reviewed, or compiled by us, and, accordingly, we do not express an opinion or any other form of assurance on them.

Information Presented in the Financial Statements (Ref: par. .61)

.A79 In some circumstances, the entity may be required by law, regulation, or standards, or may voluntarily choose, to include in the basic financial statements information that is not required by the applicable financial reporting framework. The auditor's opinion covers information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented.

.A80 If the information included in the basic financial statements is not required by the applicable financial reporting framework and is not necessary for fair presentation but is clearly differentiated, then such information may be identified as "unaudited" or as "not covered by the auditor's report."

.A81

Exhibit—Illustrations of Auditor's Reports on Financial Statements (Ref: par. .A24, .A32, .A65, and .A71)

Illustration 1—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Including Communication of Key Audit Matters

Illustration 3—An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 4—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Illustration 5—An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year Is Presented

Illustration 6—An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Unaudited Financial Statements for the Prior Year Is Presented

Illustration 7—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board

Illustration 8—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Non-registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board

Illustration 1 — An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about

² In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (refer to illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Including Communication of Key Audit Matters

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements³

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the

³ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report]

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on

the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁴

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (refer to illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁴ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 3—An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements⁵

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be

⁵ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁶
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about

⁶ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 4—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The financial statements are audited in accordance with auditing standards generally accepted in the United States of America and International Standards on Auditing (ISAs).⁷
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*, and ISA 210, *Agreeing the Terms of Audit Engagements*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise relevant ethical requirements in the United States of America and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

⁷ Paragraph 50 of International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, allows the auditor to use the layout or wording of the national auditing standards (in this case, GAAS), provided that (1) there are no conflicts between the requirements in GAAS and the ISAs that would lead to a different conclusion with respect to the opinion, and (2) the layout or wording addresses, and is not inconsistent with, certain of the required minimum reporting elements in ISA 700 (Revised).

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements⁸***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of ABC Company, and have fulfilled our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits, which include relevant ethical requirements in the United States of America and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management and Those Charged With Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework]; to disclose, as applicable, matters related to going concern; and to use the going concern basis of accounting unless management either intends to liquidate ABC Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing ABC Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance

⁸ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

with GAAS and ISAs will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and ISAs, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁹
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the ABC Company to express an opinion on the financial statements. We are responsible for the direction, supervision, and performance of the group audit of ABC Company. We remain solely responsible for our audit opinion.¹⁰

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

⁹ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

¹⁰ This has been included to comply with paragraph 50(k) of ISA 700 (Revised).

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 5—An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year Is Presented

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Prior year summarized comparative financial information derived from audited financial statements is presented.
- Management is responsible for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹¹

Opinion

We have audited the financial statements of XYZ Not-for-Profit Organization, which comprise the statement of financial position as of September 30, 20X1, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Not-for-Profit Organization as of September 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

¹¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Not-for-Profit Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed.¹²

¹² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for a reasonable period of time.

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

Report on Summarized Comparative Information

We have previously audited XYZ Not-for-Profit Organization's 20X0 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 15, 20X0. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 20X0, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 6—An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Unaudited Financial Statements for the Prior Year Is Presented

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Prior year summarized comparative financial information derived from unaudited financial statements is presented.
- Management is responsible for the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹³

Opinion

We have audited the financial statements of XYZ Not-for-Profit Organization, which comprise the statement of financial position as of September 30, 20X1, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Not-for-Profit Organization as of September 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

¹³ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Not-for-Profit Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed.¹⁴

¹⁴ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for a reasonable period of time.

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

Report on Summarized Comparative Information

The summarized comparative information presented herein as of and for the year ended September 30, 20X0, derived from those unaudited financial statements, has not been audited, reviewed, or compiled, and, accordingly, we express no opinion on it.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 7—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) of an entity whose audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended. The audit is not a group audit.
- The firm is registered with the PCAOB and for purposes of this engagement is required by regulation to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity's internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Report of Independent Registered Public Accounting Firm

*[To the Shareholders and the Board of Directors of X Company]*¹⁵

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the Company) as of December 31, 20X2 and 20X1, the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, and the related notes *[and schedules]* (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of *[at]* December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

¹⁵ See paragraph .07 of PCAOB Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, in *PCAOB Standards and Related Rules*. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance sec. 300.04), states that

AS 3101 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, if a company is not organized as a corporation, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for a benefit plan; (2) the directors (or equivalent) and equity owners for a broker or dealer; and (3) the trustees and unit holders or other investors for an investment company organized as a trust. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether to include additional addressees in the auditor's report.

All AS sections can be found in *PCAOB Standards and Related Rules*.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.¹⁶

Critical Audit Matters (if Applicable)

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee¹⁷ and that: (1) relate to accounts or disclosures that are material to the financial statements and (2)

¹⁶ As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the "Basis for Opinion" section in those circumstances. A similar paragraph may voluntarily be included in the auditor's report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

¹⁷ AS 1301, *Communications with Audit Committees*, defines "audit committee" as

A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[Include critical audit matters]

[Signature]

We have served as the Company's auditor since [year].¹⁸

[City and State or Country]

[Date]

¹⁸ As discussed in Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The sample auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

Illustration 8—An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) of an entity whose audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended.
- The firm is not registered with the PCAOB and for purposes of this engagement is not required to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity's internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Report of Independent Public Accounting Firm

*[To the Shareholders and the Board of Directors of X Company]*¹⁹

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company (the Company) as of December 31, 20X2 and 20X1, the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, and the related notes *[and schedules]* (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of *[at]* December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial

¹⁹ See paragraph .07 of PCAOB Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, in *PCAOB Standards and Related Rules*. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance sec. 300.04), states that

AS 3101 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, if a company is not organized as a corporation, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for a benefit plan, (2) the directors (or equivalent) and equity owners for a broker or dealer, and (3) the trustees and unit holders or other investors for an investment company organized as a trust. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether to include additional addressees in the auditor's report.

statements based on our audits. We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.²⁰

Critical Audit Matters (if applicable)

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee²¹ and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the

²⁰ As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the "Basis for Opinion" section in those circumstances. A similar paragraph may voluntarily be included in the auditor's report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

²¹ AS 1301, *Communications with Audit Committees*, defines "audit committee" as

A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[Include critical audit matters]

[Signature]

We have served as the Company's auditor since *[year]*.²²

[City and State or Country]

[Date]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. Revised, January 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

²² As discussed in Staff Guidance *Changes To The Auditor's Report Effective For Audits of Fiscal Years Ending On or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The example auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

AU-C Section 9700***Forming an Opinion and Reporting on Financial Statements: Auditing Interpretations of Section 700*****1. Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting**

.01 Question — An entity prepares its financial statements using the liquidation basis of accounting in accordance with FASB *Accounting Standards Codification* (ASC) 205, *Presentation of Financial Statements*, because the entity is either in liquidation or liquidation is imminent. Is the auditor permitted to issue an unmodified opinion on such financial statements?

.02 Interpretation — Yes. A liquidation basis of accounting is considered generally accepted accounting principles (GAAP) for entities in liquidation or for which liquidation is imminent. Therefore, the auditor is permitted to issue an unmodified opinion on such financial statements, provided that the liquidation basis of accounting has been properly applied and that adequate disclosures are made in the financial statements in accordance with FASB ASC 205-30.

.03 Typically, the financial statements of entities using the liquidation basis of accounting are presented along with financial statements of a period prior to adoption of a liquidation basis that were prepared on the going concern basis in accordance with GAAP. Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, requires the auditor to include an emphasis-of-matter paragraph when a matter that is appropriately presented or disclosed in the financial statements is of such importance, in the auditor's professional judgment, that it is fundamental to users' understanding of the financial statements. If the auditor determines an emphasis-of-matter paragraph is appropriate, the emphasis-of-matter paragraph would state that the entity has changed the basis of accounting used to determine the amounts at which assets and liabilities are carried from the going concern basis to a liquidation basis.

.04 Two examples of auditor's reports with such an emphasis-of-matter paragraph follow.

Example 1**Report on the Audit of Single-Year Financial Statements in Year of Adoption of Liquidation Basis****Independent Auditor's Report**

[Appropriate Addressee]

Opinion

We have audited the financial statements of XYZ Company, which comprise the statement of net assets in liquidation as of December 31, 20X2, the related statement of changes in net assets in liquidation for the period from April 26,

20X2 to December 31, 20X2, and the statements of income, changes in stockholders' equity, and cash flows for the period from January 1, 20X2 to April 25, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets in liquidation of XYZ Company as of December 31, 20X2, the changes in its net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the results of its operations and its cash flows for the period from January 1, 20X2 to April 25, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the stockholders of XYZ Company approved a plan of liquidation on April 25, 20X2, and the Company determined liquidation is imminent. As a result, the Company changed its basis of accounting on April 25, 20X2 from the going concern basis to a liquidation basis. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such

procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control.¹ Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

[Signature of the auditor's firm]

[City and state where report is issued]

[Date of the auditor's report]

Example 2

Report on the Audit of Comparative Financial Statements in Year of Adoption of Liquidation Basis

Independent Auditor's Report

[Appropriate Addressee]

Opinion

We have audited the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X1, the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, the statements of income, changes in stockholders' equity, and cash flows for the period from January 1, 20X2 to April 25, 20X2, the statement of net assets in liquidation as of December 31, 20X2, the related statement of changes in net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Company as of December 31, 20X1, the results of its operations and its cash flows for the year then ended and for the period from January 1, 20X2 to April 25, 20X2, its net assets in liquidation as of December 31, 20X2, and the changes in its net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under

¹ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control. Accordingly, no such opinion is expressed."

those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the stockholders of XYZ Company approved a plan of liquidation on April 25, 20X2, and the Company determined liquidation is imminent. As a result, the Company changed its basis of accounting on April 25, 20X2 from the going concern basis to a liquidation basis. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control.² Accordingly, no such opinion is expressed.

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

[Signature of the auditor's firm]

[City and state where report is issued]

[Date of the auditor's report]

.05 The auditor may, in subsequent years, continue to include an emphasis-of-matter paragraph in the auditor's report to emphasize that the financial statements are presented on a liquidation basis of accounting.

[Issue Date: December 1984; Revised: June 1993; Revised: February 1997; Revised: October 2000; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012; Revised: May 2014; Revised: September 2014; Revised: March 2020.]

2. Sustainability Financial Statements Under Federal Financial Accounting Standards — Auditor Reporting

.06 Question — The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards (SFFAS) No. 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. SFFAS No. 36, as amended, requires that the statement of long-term fiscal projections be presented in the consolidated financial report of the U.S. government as a basic financial statement starting in fiscal year 2015. The focus of this standard is on forward-looking information intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statement of long-term fiscal projections presents the actuarial present value of the U.S. government's estimated future income to be received and future expenditures to be paid. The statement of long-term fiscal projections includes information drawn from the current statement of social insurance (SFFAS No. 17, *Accounting for Social Insurance*, as amended, a basic statement since fiscal year 2006) and statement of changes in social insurance amounts (SFFAS No. 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*, a basic statement since fiscal year 2011). Collectively, the statement of long-term fiscal projections, the statement of social insurance, and the statement of changes in social insurance amounts are referred to herein as sustainability financial statements. May an auditor report on these basic financial statements in accordance with auditing standards generally accepted in the United States of America (GAAS)? If so, how would an auditor report on these statements?

.07 Interpretation — Yes, consistent with Statement of Position 04-1, *Auditing the Statement of Social Insurance* (AUD sec. 35), an auditor may report on the basic financial statements, which include the statements of social insurance, changes in social insurance amounts, and long-term fiscal projections, in accordance with GAAS. Section 700, *Forming an Opinion and Reporting*

on *Financial Statements*, provides requirements and guidance on forming an opinion on the basic financial statements. An illustration of an auditor's report containing an unmodified opinion on the U.S. government-wide financial statements follows³ (footnotes are provided for necessary adjustments when reporting on component financial statements containing sustainability financial statements):

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements

Opinions on the Financial Statements

We have audited the financial statements of *the U.S. government*,⁴ which comprise the consolidated financial statements and the sustainability financial statements. The consolidated financial statements comprise the *consolidated balance sheets as of September 30, 20XX and 20YY, and the related consolidated statements of net cost, of operations and changes in net position, reconciliations of net operating cost and budget deficit, and changes in cash balance from budget and other activities*⁵ for the years then ended, and the related notes to the consolidated financial statements.

The sustainability financial statements comprise the statements of social insurance as of *[dates — five years presented]*, the statements of changes in social insurance amounts for the periods *[dates — two periods presented]*, and the *statements of long-term fiscal projections as of September 30, 20XX and 20YY*, and the related notes to the sustainability financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, *the financial position of the U.S. government as of September 30, 20XX and 20YY, and its net cost, operations, and changes in net position; reconciliations of net operating cost and budget deficit, and changes in cash balance from budget and other activities*⁶ for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Also, in our opinion, the sustainability financial statements referred to above present fairly, in all material respects, the *U.S. government's social insurance information as of [dates — five years presented]*, its changes in social insurance amounts for the periods *[dates — two periods presented]*, and the *long-term fiscal projections as of September 30, 20XX and 20YY*, in accordance with accounting principles generally accepted in the United States of America.

³ The sustainability financial statements do not articulate with the consolidated financial statements. For that reason, the opinion on the sustainability financial statements ordinarily will not affect the opinion on the consolidated financial statements. For example, the opinion on the sustainability financial statements may be modified, whereas the opinion on the consolidated financial statements may be unmodified.

⁴ Italicized text would be applicable only to reports on the consolidated financial statements of the U.S. government. Where appropriate, alternative text applicable to reports on component entity financial statements are provided in other footnotes.

⁵ For reports on component entity financial statements, the financial statements would be tailored to the financial statements presented, for example "...the balance sheets as of September 30, 20XX and 20YY and the related statements of net cost, (and) changes in net position, (and custodial activity), and combined statements of budgetary resources..."

⁶ For reports on component entity financial statements, this language would be tailored to the financial statements presented, for example "... the financial position of [name of entity] as of September 30, 20XX and 20YY, and its net cost, changes in net position, (and) and budgetary resources (, and custodial activity)...."

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States [include *Office of Management and Budget (OMB) Bulletin No. and title, if applicable*]. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the U.S. government, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives under GAAS and *Government Auditing Standards* are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* [include *OMB Bulletin, if applicable*] will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the U.S. Government's internal control. Accordingly, no such opinion is expressed.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about U.S. Government's ability to continue as a going concern for a reasonable period of time.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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

Emphasis of Matter

As discussed in Note X to the financial statements, the sustainability financial statements are based on management's assumptions. These sustainability financial statements present the actuarial present value of the U.S. government's estimated future income to be received and future expenditures to be paid using a projection period sufficient to illustrate long-term sustainability. The sustainability financial statements are intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statements of social insurance and changes in social insurance amounts are based on income and benefit formulas in current law and assume that scheduled benefits will continue after any related trust funds are exhausted. *The statements of long-term fiscal projections are based on the continuation of current policy.* The sustainability financial statements are not forecasts or predictions. The sustainability financial statements are not intended to imply that current policy or law is sustainable. In preparing the sustainability financial statements, management considers and selects assumptions and data that it believes provide a reasonable basis to illustrate whether current policy or law is sustainable. Assumptions underlying such sustainability information do not consider changes in policy or all potential future events that could affect future income, future expenditures, and sustainability, for example, implementation of policy changes to avoid trust fund exhaustion or *unsustainable debt levels*. Because of the large number of factors that affect the sustainability financial statements and the fact that future events and circumstances cannot be estimated with certainty, even if current policy is continued, there will be differences between the estimates in the sustainability financial statements and the actual results, and those differences may be material. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information in the Management's Discussion and Analysis and Required Supplementary Information (RSI) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Management is responsible for the other information [included in the annual report]. The other information comprises the [information included in the annual report] but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated [date of report] on our consideration of the U.S. government's internal control over financial reporting and our report dated [report date] on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the U.S. government's internal control over financial reporting and compliance.

[Signature of the auditor's firm]

[City and state where report is issued]

[Date of the auditor's report]

[Issue Date: October 2015; Revised: March 2020.]

3. Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

[.08–.13] [Withdrawn March 2020 due to the issuance of SAS No. 134, as amended.]

Introduction

On June 1, 2017, the PCAOB adopted AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.⁷ The SEC approved AS 3101 and related amendments on October 23, 2017. AS 3101 retains the pass or fail opinion of the existing PCAOB auditor's report but makes significant changes to the existing PCAOB auditor's report, including the following:

- Requiring communication of critical audit matters (CAMs). Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that

⁷ All PCAOB auditing standards can be found in *PCAOB Standards and Related Rules*.

- relates to accounts or disclosures that are material to the financial statements and
- involved especially challenging, subjective, or complex auditor judgment
- Requiring disclosure of auditor tenure. The year in which the auditor began serving consecutively as the company's auditor
- Other improvements to the auditor's report. Clarification of the auditor's role and responsibilities, such as a statement regarding the requirement for the auditor to be independent with respect to the company, and making the auditor's report easier to read

Among the other revisions, AS 3101 specifies the form of the report, including requirements related to the order of presentation and section titles. All the changes, except those relating to CAMs, are effective for audits of fiscal years ending on or after December 15, 2017.⁸

As noted in PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*,

There are situations in which an auditor may be required by law or regulation, or voluntarily agrees, to perform an audit engagement in accordance with PCAOB standards for a company whose audit is not subject to PCAOB oversight.¹¹² For example, SEC rules permit audits under PCAOB standards in connection with offerings under Regulation A and Regulation Crowdfunding. In these situations, certain elements of the auditor's report required under the final standard, such as the use of "registered public accounting firm" in the title or the statement regarding independence requirements, may not apply.

¹¹² Under the Sarbanes-Oxley Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the PCAOB oversees the audits of "issuers" and brokers and dealers reporting under Exchange Act Rule 17a-5. See Sarbanes-Oxley Act Section 101. An "issuer" under the Sarbanes-Oxley Act is an entity whose securities are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a Securities Act registration statement that has not yet become effective and that it has not withdrawn. See Sarbanes-Oxley Section 2(a).

GAAS currently address the appropriate form of report when an auditor issues a report referencing both GAAS and the standards of the PCAOB. Section 700, *Forming an Opinion and Reporting on Financial Statements*,⁹ states

When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002 (the Act), as amended, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form

⁸ PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, was issued June 1, 2017, and was approved by the SEC on October 23, 2017. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance, sec. 300.04) (updated as of December 28, 2017), was prepared by PCAOB staff to help firms when implementing changes to the auditor's report effective for audits of fiscal years ending on or after December 15, 2017.

⁹ Paragraph .46 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS.

Interpretation No. 4, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB" (par. .14–.21), provides guidance on how an auditor complies with section 700¹⁰ in the context of the revised reporting standards adopted by the PCAOB and approved by the SEC. Because of the phased approach of the effective dates of AS 3101, Interpretation No. 4 does not address the changes relating to CAMs.

Interpretation No. 5, "Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB" (par. .22–.26), provides guidance on how an auditor complies with section 700 in the context of the PCAOB reporting standards when the communication of CAMs is required.

Although Interpretation No. 4 and Interpretation No. 5 have been determined to be consistent with GAAS, the interpretations should not be construed to be interpretations of PCAOB standards. Moreover, Interpretation No. 4 and Interpretation No. 5 have not been approved or acted upon by the PCAOB.

4. Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB

.14 Question — Section 700¹¹ states, in part, that the auditor should use the form of report required by the standards of the PCAOB. Are there any elements of the auditor's report required by the standards of the PCAOB whose presentation may need to be revised in order to comply with the PCAOB reporting requirements?

.15 Interpretation — Yes. To appropriately apply the requirement in section 700¹² to follow the PCAOB form of the report, the auditor will need to evaluate the circumstances of the engagement and also may need to modify the report as described in the following paragraphs to avoid making an untrue statement.

.16 Question — Paragraph .06 of AS 3101 states that the auditor "must include the title, 'Report of Independent Registered Public Accounting Firm'" and the related description in the "Basis for Opinion" section of the report required by paragraph .09g of AS 3101. Is it appropriate for an auditor to revise the report by removing the references to "registered" if the firm is not registered with the PCAOB?

.17 Interpretation — Yes, removing the reference to "registered" from the title and from the "Basis for Opinion" section of the report is appropriate if the firm is not registered with the PCAOB. As noted in Staff Questions and Answers *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board*,¹³ dated June 30, 2004, a public accounting firm does not need to be registered with

¹⁰ See footnote 9.

¹¹ See footnote 9.

¹² See footnote 9.

¹³ PCAOB Staff Guidance, sec. 100.01.

the PCAOB to perform an audit of a nonissuer in accordance with PCAOB standards.

.18 Question — How should the auditor address the requirement in paragraph .09g of AS 3101 that notes that the auditor "is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB"?

.19 Interpretation — Generally, GAAS do not require the auditor to be independent under SEC and PCAOB standards unless required by law or regulation. Therefore, it would be appropriate in those circumstances for the auditor to revise the statement in the report regarding independence to reflect the circumstances of the engagement. For example, if the auditor is not required to be independent under U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB, this statement may be amended to read, "We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audit."¹⁴ Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, explains that relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.¹⁵ Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. Depending on the circumstances, for example, when independence and ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (such as the AICPA Code of Professional Conduct) or rule or applicable regulation or may refer to a term that appropriately describes those sources.

.20 In addition, the auditor may need to revise the reference to "the standards" of the PCAOB as described in section 700.¹⁶ As noted in section 700,¹⁷ reference to "the standards" of the PCAOB indicates that the auditor has complied not only with the PCAOB's auditing standards but also with the related professional practice standards of the PCAOB, including its independence rules, whereas a reference to "the auditing standards of the Public Company Accounting Oversight Board (United States)" is limited to compliance with the auditing standards of the PCAOB. The auditor of financial statements of an entity whose audits are not within the jurisdiction of the PCAOB may, nevertheless, be responsible for complying with the independence and other related professional practice standards of the PCAOB if, for example, the engagement is subject to regulatory oversight that requires compliance with those rules. Whether the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB or the auditing standards of the PCAOB depends on the circumstances of the engagement.

¹⁴ See illustration 8, "An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board," in the exhibit to section 700.

¹⁵ Paragraph .A15 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

¹⁶ Paragraph .A62 of section 700.

¹⁷ See footnote 10 and paragraph .A62.

.21 The exhibit to section 700¹⁸ contains examples of auditor's reports on comparative financial statements when the audits are conducted in accordance with both GAAS and either the standards of the PCAOB or the auditing standards of the PCAOB.

[Issue Date: March 2018; Revised: March 2020.]

5. Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB

.22 Question — When reporting on audits of nonissuer entities that are not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended, but conducted in accordance with the standards of the PCAOB and GAAS, is the auditor required to communicate critical audit matters (CAMs) in accordance with paragraphs .11–.17 of AS 3101?

.23 Interpretation — Section 700¹⁹ states that the auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS unless the audit was conducted in accordance with both sets of standards in their entirety. Section 700²⁰ also states that "...when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS."

.24 Accordingly, the auditor would follow the relevant requirements in the PCAOB standards regarding the determination and reporting of critical audit matters. This would not affect the requirement for the auditor to state in the auditor's report that the audit was also conducted in accordance with GAAS, as required by section 700.²¹

.25 Note that paragraph .05b of AS 3101 lists entities for which communication of CAMs is not required, including brokers and dealers, investment companies registered under the Investment Company Act of 1940, employee stock purchases, savings and similar plans, and emerging growth companies. Whether a nonissuer is such an entity is a matter for management to determine, and may involve consultation with management's legal counsel, based on the entity's circumstances.

.26 Accordingly, an auditor should apply all the requirements for CAMs set forth in AS 3101 unless it is determined by management that the entity is not subject to CAM reporting as described previously.

[Issue Date: October 2019; Revised: March 2020.]

¹⁸ See illustration 7, "An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board," and illustration 8.

¹⁹ Paragraph .44 of section 700.

²⁰ Paragraph .46 of section 700.

²¹ Paragraph .28 of section 700.

AU-C Section 701

Communicating Key Audit Matters in the Independent Auditor's Report

Source: SAS No. 134; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

NOTE

In July 2020, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 143, *Auditing Accounting Estimates and Related Disclosures*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

In October 2021, the ASB issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to communicate key audit matters in the auditor's report when the auditor is engaged to do so. It is intended to address both the auditor's judgment about what to communicate in the auditor's report and the form and content of such communication. This section does not require the communication of key audit matters. (Ref: par. .A1)

.02 The purpose of communicating key audit matters is to provide greater transparency about the audit that was performed. The communication of key audit matters in the auditor's report may also provide intended users of the financial statements (intended users) with a basis to further engage with management and those charged with governance about certain matters relating to

the entity, the audited financial statements, or the audit that was performed. (Ref: par. .A2–.A3)

.03 Communicating key audit matters in the auditor's report is done in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report does *not* constitute the following:

- a. A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
- b. A substitute for the auditor expressing a modified opinion when required to do so by the circumstances of a specific audit engagement in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*
- c. A substitute for reporting in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, if, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains
- d. A separate opinion on individual matters (Ref: par. .A4–.A6)

.04 This section applies to an audit of a complete set of general purpose financial statements when the auditor is engaged to communicate key audit matters. Section 705 prohibits the auditor from communicating key audit matters when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.¹

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objectives

.06 The objectives of the auditor are to determine key audit matters and communicate those matters by describing them in the auditor's report.

Definition

.07 For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

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

¹ Paragraph .30 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Requirements

Determining Key Audit Matters

.08 The auditor should determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor should take into account the following: (Ref: par. .A7–.A16)

- a. Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Ref: par. .A17–.A20)
- b. Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty (Ref: par. .A21–.A22)
- c. The effect on the audit of significant events or transactions that occurred during the period (Ref: par. .A23–.A24)

.09 The auditor should determine which of the matters determined in accordance with paragraph .08 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters. (Ref: par. .A7–.A9, .A25–.A30)

Communicating Key Audit Matters

.10 The auditor should describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters," unless the circumstances in paragraphs .13–.14 apply. The introductory language in this section of the auditor's report should state the following:

- a. Key audit matters are those matters that were communicated with those charged with governance and, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.
- b. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: par. .A31–.A33)

Key Audit Matters Not a Substitute for Expressing a Modified Opinion

.11 The auditor should not communicate a matter in the "Key Audit Matters" section of the auditor's report when the auditor would be required to modify the opinion in accordance with section 705 as a result of the matter. (Ref: par. .A4)

Descriptions of Individual Key Audit Matters

.12 The description of each key audit matter in the "Key Audit Matters" section of the auditor's report should include a reference to the related disclosures, if any, in the financial statements and should address the following: (Ref: par. .A34–.A41)

- a. Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter (Ref: par. .A42–.A44)
- b. How the matter was addressed in the audit (Ref: par. .A45–.A50)

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report

.13 The auditor should describe each key audit matter in the auditor's report unless either of the following applies:

- a. Law or regulation precludes disclosure about the matter. (Ref: par. .A51)
- b. In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This does not apply if information about the matter is available outside the entity. (Ref: par. .A52–.A55)

Interaction Between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report

.14 Matters giving rise to a qualified opinion in accordance with section 705, or when substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, are by their nature key audit matters. However, these matters should not be described in the "Key Audit Matters" section of the auditor's report, and the requirements in paragraphs .12–.13 do not apply. Rather, the auditor should do the following:

- a. Report on these matters in accordance with the applicable AU-C sections.
- b. Include a reference to the "Basis for Qualified Opinion" or "Going Concern" section in the "Key Audit Matters" section. (Ref: par. .A5)

Form and Content of the "Key Audit Matters" Section in Other Circumstances

.15 If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate or that the only key audit matters communicated are those matters addressed by paragraph .14, the auditor should include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters." (Ref: par. .A56–.A57)

Communication With Those Charged With Governance

.16 The auditor should communicate the following with those charged with governance:

- a. Those matters the auditor has determined to be the key audit matters, or
- b. If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report (Ref: par. .A58–.A61)

Documentation

.17 The auditor should include the following in the audit documentation:² (Ref: par. .A62)

- a. The matters that required significant auditor attention as determined in accordance with paragraph .08, and the rationale for the auditor's determination about whether or not each of the matters is a key audit matter in accordance with paragraph .09
- b. When applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report or that the only key audit matters to communicate are those matters addressed by paragraph .14
- c. When applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Paragraph .45 and related application material in section 700, *Forming an Opinion and Reporting on Financial Statements*, address reporting on audits conducted in accordance with the standards of the PCAOB and GAAS when the audit is not within the jurisdiction of the PCAOB.

.A2 Communicating key audit matters provides additional information to intended users to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

.A3 Section 320, *Materiality in Planning and Performing an Audit*, explains that the auditor may assume the following regarding reasonable users of the financial statements:³

- a. Users have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence.
- b. Users understand that the financial statements are prepared, presented, and audited to levels of materiality.
- c. Users recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events.
- d. Users make reasonable judgments based on the information in the financial statements.

Because the auditor's report accompanies the audited financial statements, the users of the auditor's report are considered to be the same as the intended users of the financial statements.

[Revised, April 2021, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

² Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

³ Paragraph .04 of section 320, *Materiality in Planning and Performing an Audit*.

Relationship Between Key Audit Matters, the Auditor's Opinion, and Other Elements of the Auditor's Report (Ref: par. .03, .11, .14)

.A4 Sections 700 and 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, establish requirements and provide guidance on forming an opinion on the financial statements.⁴ Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation. Section 705 addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.⁵

.A5 When the auditor expresses a qualified opinion in accordance with section 705, communicating key audit matters would still be relevant to enhancing intended users' understanding of the audit. In these circumstances, presenting the description of the matter giving rise to a qualified opinion in the "Basis for Qualified Opinion" section gives the matter the appropriate prominence in the auditor's report (see paragraph .14) and separates the communication of this matter from any other key audit matters described in the "Key Audit Matters" section. The exhibit in section 705 includes illustrative examples of how the introductory language in the "Key Audit Matters" section is affected when the auditor expresses a qualified opinion and other key audit matters are communicated in the auditor's report. Paragraph .A57 of this section illustrates how the "Key Audit Matters" section is presented when the auditor has determined that there are no other key audit matters to be communicated in the auditor's report beyond matters addressed in the "Basis for Qualified Opinion" or "Going Concern" sections of the auditor's report.

.A6 Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, establishes mechanisms for auditors of financial statements of all entities to include additional communication in the auditor's report through the use of emphasis-of-matter paragraphs and other-matter paragraphs when the auditor considers it necessary to do so. However, when this section applies, the use of an emphasis-of-matter or other-matter paragraph is not a substitute for including a matter in the "Key Audit Matters" section of the auditor's report if the matter meets the definition of a key audit matter. Section 706 provides further guidance on the relationship between key audit matters and emphasis-of-matter and other-matter paragraphs.⁶

Determining Key Audit Matters (Ref: par. .08–.09)

.A7 The auditor's decision-making process in determining key audit matters begins with selecting, from among the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit of the financial statements of the current period.

.A8 From the matters that required significant auditor attention, the auditor then determines those matters that, in the auditor's judgment, were of most significance in the audit of the financial statements of the current period

⁴ Paragraphs .12–.17 and .A5–.A20 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraphs .37–.42 and .A61–.A74 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

⁵ Paragraph .A7 of section 705.

⁶ Paragraphs .A1–.A2 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

and that, therefore, are the key audit matters. The auditor's determination of key audit matters is limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented (that is, even when the auditor's opinion refers to each period for which financial statements are presented).

.A9 This section does not require the auditor to update key audit matters included in the prior period's auditor's report. However, it may nevertheless be useful for the auditor to consider whether a matter that was a key audit matter in the audit of the financial statements of the prior period continues to be a key audit matter in the audit of the financial statements of the current period.

Matters That Required Significant Auditor Attention (Ref: par. .08)

.A10 The concept of significant auditor attention recognizes that an audit is risk based and focuses on identifying and assessing the risks of material misstatement of the financial statements, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. For a particular account balance, class of transactions or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof.

.A11 Accordingly, matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion on the financial statements may be particularly relevant in the auditor's determination of key audit matters.

.A12 Areas of significant auditor attention often relate to areas of complexity and significant management judgment in the financial statements and therefore often involve difficult or complex auditor judgments. In turn, this often affects the auditor's overall audit strategy, the allocation of resources, and the extent of audit effort in relation to such matters. These effects may include, for example, the extent of involvement of senior personnel on the audit engagement or the involvement of an auditor's expert or individuals with expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm to address these areas.

.A13 Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

- a. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.⁷ For example, there may be potential difficulties relating to the following:
 - i. *Related party transactions*. In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction.⁸

⁷ Paragraphs .12b and .A26 of section 260, *The Auditor's Communication With Those Charged With Governance*.

⁸ Paragraph .A46 of section 550, *Related Parties*.

- ii. *Limitations on the group audit.* For example, the group engagement team's access to information may be restricted.⁹
- b. Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters.¹⁰ For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.

Considerations in Determining Those Matters That Required Significant Auditor Attention (Ref: par. .08)

.A14 The auditor may develop a preliminary view at the planning stage about matters that are likely to be areas of significant auditor attention in the audit and therefore may be key audit matters. The auditor may communicate this with those charged with governance when discussing the planned scope and timing of the audit in accordance with section 260. However, the auditor's determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit.

.A15 Paragraph .08 includes specific required considerations in the auditor's determination of those matters that required significant auditor attention. These considerations focus on the nature of matters communicated with those charged with governance that are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users. The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit in accordance with paragraph .09. Because the considerations may be interrelated (for example, matters relating to the circumstances described in paragraphs .08b–c may also be identified as significant risks), the applicability of more than one of the considerations to a particular matter communicated with those charged with governance may increase the likelihood of the auditor identifying that matter as a key audit matter.

.A16 In addition to matters that relate to the specific required considerations in paragraph .08, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph .09. Such matters may include, for example, matters that are relevant to the audit that was performed but that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, particularly if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (for example, changes to a system affecting revenue recognition).

⁹ Paragraph .49d of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

¹⁰ Paragraph .20 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance With Section 315 (Ref: par. .08a)

.A17 Section 260 requires the auditor to communicate with those charged with governance about the significant risks identified by the auditor.¹¹ Section 260 explains that the auditor may also communicate with those charged with governance about areas of higher assessed risks of material misstatement.¹²

.A18 Section 315A defines a *significant risk* as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

.A19 However, this may not be the case for all significant risks. For example, section 240, *Consideration of Fraud in a Financial Statement Audit*, presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.¹³ In addition, section 240 indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.¹⁴ Depending on their nature, these risks may not require significant auditor attention and therefore would not be considered in the auditor's determination of key audit matters in accordance with paragraph .09.

.A20 Section 315A explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained.¹⁵ Revision to the auditor's risk assessment and reevaluation of the planned audit procedures with respect to a particular area of the financial statements may result in an area being determined to be one requiring significant auditor attention, particularly when the revision results in a higher assessed risk of material misstatement. For example, the auditor's risk assessment may have been based on an expectation that certain controls were operating effectively, but the audit evidence obtained may indicate that such controls were not operating effectively throughout the audit period, leading to a change in audit strategy and additional audit effort.

Significant Auditor Judgments Relating to Areas in the Financial Statements That Involved Significant Management Judgment, Including Accounting Estimates That Have Been Identified as Having High Estimation Uncertainty (Ref: par. .08b)

.A21 Section 260 requires the auditor to communicate with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.¹⁶ In particular, this may include accounting policies that have a significant effect on the financial statements (and significant changes to those policies), especially in circumstances in which an entity's accounting policies are not consistent with others in its industry.

.A22 In many cases, the auditor's communication with those charged with governance relates to accounting estimates and related disclosures. Among

¹¹ Paragraph .11 of section 260.

¹² Paragraph .A20 of section 260.

¹³ Paragraphs .26–.27 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

¹⁴ Paragraph .31 of section 240.

¹⁵ Paragraph .32 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

¹⁶ Paragraph .12a of section 260.

other things, estimates may be highly dependent on management judgment and are often the most complex areas of the financial statements, and the estimates may require the involvement of both a management's expert and an auditor's expert. Such estimates are often areas of significant auditor attention, and they may be identified as significant risks.

The Effect on the Audit of Significant Events or Transactions That Occurred During the Period (Ref: par. .08c)

.A23 Events or transactions that had a significant effect on the financial statements or the audit may be areas of significant auditor attention and may be identified as significant risks. For example, the auditor may have had extensive discussions with management and those charged with governance at various stages throughout the audit about the effect on the financial statements of significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.¹⁷ Management may have made difficult or complex judgments in relation to recognition, measurement, presentation, or disclosure of such transactions, which may have had a significant effect on the auditor's overall strategy.

.A24 Significant economic, accounting, regulatory, industry, or other developments that affected management's assumptions or judgments may also affect the auditor's overall approach to the audit and result in a matter requiring significant auditor attention.

Matters of Most Significance (Ref: par. .09)

.A25 The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. As such, the intent is for the auditor to identify matters specific to the audit and to make a judgment about their relative importance.

.A26 Matters that required significant auditor attention also may have resulted in significant interaction with those charged with governance. The nature and extent of communication about such matters with those charged with governance often provides an indication of which matters are of most significance in the audit. For example, the auditor may have had more in-depth, frequent, or robust interactions with those charged with governance on more difficult and complex matters, such as the application of significant accounting policies that were the subject of significant auditor or management judgment.

.A27 The importance of a matter to intended users' understanding of the financial statements as a whole and, in particular, the matter's materiality to the financial statements is relevant to determining whether the matter is a key audit matter.

.A28 Other considerations that may be relevant to determining the relative significance of a matter and whether such a matter is a key audit matter include the following:

- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry

¹⁷ Paragraphs .12a, .14, and .A32 of section 260, and the appendix, "Qualitative Aspects of Accounting Practices," of section 260.

- The nature and materiality, quantitative or qualitative, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any
- The nature and extent of audit effort needed to address the matter, including the following:
 - The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any
 - The nature of consultations outside the engagement team regarding the matter
- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, particularly as the auditor's judgments become more subjective
- The severity of any control deficiencies identified that are relevant to the matter
- Whether the matter involved a number of separate, but related, auditing considerations (For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation, or other contingencies and may have an effect on other accounting estimates.)

.A29 Determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial statements of the current period is a matter of professional judgment. The number of key audit matters to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. In general, the greater the number of matters initially determined to be key audit matters, the more the auditor may need to reconsider whether each of these matters meets the definition of a key audit matter. Lengthy lists of key audit matters may be contrary to the notion of such matters being those of most significance in the audit.

.A30 Paragraph .15 addresses the form and content of the "Key Audit Matters" section of the auditor's report when the auditor determines that there are no key audit matters to be communicated.

Communicating Key Audit Matters

Separate "Key Audit Matters" Section in the Auditor's Report (Ref: par. .10)

.A31 Placing the separate "Key Audit Matters" section in close proximity to the "Opinion" and "Basis for Opinion" sections may give prominence to such information.

.A32 The order of presentation of individual matters within the "Key Audit Matters" section is a matter of professional judgment. For example, such information may be organized in order of relative importance, may be based on the auditor's judgment, or may correspond to the manner in which matters are disclosed in the financial statements. The requirement in paragraph .10 to include subheadings is intended to further differentiate the matters.

.A33 When comparative financial information is presented, the introductory language of the "Key Audit Matters" section is tailored to draw attention to the fact that the key audit matters described relate to only the audit of the financial statements of the current period and may include reference to the specific period covered by those financial statements (for example, "for the year ended December 31, 20X1").

Descriptions of Individual Key Audit Matters (Ref: par. .12)

.A34 The adequacy of the description of a key audit matter is a matter of professional judgment. The description of a key audit matter is meant to provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. Limiting the use of highly technical auditing terms also helps enable intended users, who may not have a reasonable knowledge of auditing, to understand the basis for the auditor's focus on particular matters during the audit. The nature and extent of information provided by the auditor is intended to be balanced in the context of the responsibilities of the respective parties (that is, for the auditor to provide useful information in a concise and understandable form while not inappropriately being the provider of original information about the entity).

.A35 Original information is any information about the entity that has not otherwise been made publicly available by the entity (for example, the information has not been included in the financial statements or other information available at the date of the auditor's report and has not been addressed in other oral or written communications by management or those charged with governance). Such information is the responsibility of the entity's management and those charged with governance.

.A36 Although the auditor seeks to avoid providing original information about the entity, it may be necessary for the auditor to do so in the description of a key audit matter. Such information may be necessary to appropriately explain why the matter was considered to be one of most significance in the audit, and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation. When the auditor determines that it is necessary to include such information in the description of a key audit matter, management may elect to expand or supplement the entity's disclosures, rather than having the auditor provide original information in the auditor's report.

.A37 Management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor's report. Such new or enhanced disclosures, for example, may be included to provide more robust information about the sensitivity of key assumptions used in accounting estimates or the entity's rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework. Additional disclosures by management may also be helpful when the auditor considers it necessary to include additional information to explain why a matter was determined to be a key audit matter and how the matter was addressed in the audit.

.A38 Although the auditor's opinion on the financial statements does not extend to the other information addressed by section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, the auditor may consider this information, as well as other publicly available communications by the entity or other credible sources, in formulating the description of a

key audit matter. [Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

.A39 Audit documentation prepared during the audit can also be useful to the auditor in formulating the description of a key audit matter. For example, written communications, or the auditor's documentation of oral communications, with those charged with governance and other audit documentation provide a useful basis for the auditor's communication in the auditor's report. This is because audit documentation in accordance with section 230, *Audit Documentation*, is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions, and serves as a record of the nature, timing, and extent of the audit procedures performed, the results of those procedures, and the audit evidence obtained. Such documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matters and may also assist in applying the requirement in paragraph .17.

Reference to Where the Matter Is Disclosed in the Financial Statements
(Ref: par. .12)

.A40 Paragraph .12 requires the description of each key audit matter to address why the auditor considered the matter to be one of most significance in the audit and how the matter was addressed in the audit. Accordingly, the description of key audit matters is not a mere reiteration of what is disclosed in the financial statements. However, a reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements.

.A41 In addition to referring to related disclosures, the auditor may draw attention to key aspects of them. The extent of disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial statements of the current period may help the auditor pinpoint particular aspects of how the matter was addressed in the audit such that intended users can understand why the matter is a key audit matter, such as in the following examples:

- When an entity includes robust disclosure about accounting estimates, the auditor may draw attention to the disclosure of key assumptions, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates as part of addressing why the matter was one of most significance in the audit and how the matter was addressed in the audit.
- When the auditor concludes, in accordance with section 570, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans, the auditor may nevertheless determine that one or more matters relating to this conclusion arising from the auditor's work effort under section 570 are key audit matters. In such circumstances, the auditor's description of such key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial statements, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or noncompliance with loan agreements, and related mitigating factors.¹⁸

¹⁸ Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

Why the Auditor Considered the Matter to Be One of Most Significance in the Audit (Ref: par. .12a)

.A42 The description of a key audit matter in the auditor's report is intended to provide insight regarding why the matter was determined to be a key audit matter. Accordingly, the requirements in paragraphs .08–.09 and the application material in paragraphs .A10–.A28 related to determining key audit matters may also be helpful for the auditor in considering how such matters are to be communicated in the auditor's report. For example, explaining the factors that led the auditor to conclude that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users.

.A43 Relating a matter directly to the specific circumstances of the entity may also help minimize the potential that such descriptions become overly standardized and less useful over time. For example, certain matters may be determined to be key audit matters in a particular industry across a number of entities due to the circumstances of the industry or the underlying complexity in financial reporting. In describing why the auditor considered a matter to be one of most significance, it may be useful for the auditor to highlight aspects of the matter that are specific to the entity (for example, circumstances that affected the underlying judgments made in the financial statements of the current period) in order to make the description more relevant for intended users. This may also be important in describing a key audit matter that recurs over periods.

.A44 The description may also make reference to the principal considerations that led the auditor, in the circumstances of the audit, to determine the matter to be one of most significance. The following are examples of such considerations:

- Economic conditions that affected the auditor's ability to obtain audit evidence, for example, illiquid markets for certain financial instruments
- New or emerging accounting policies, for example, entity-specific or industry-specific matters on which the engagement team consulted
- Changes in the entity's strategy or business model that had a material effect on the financial statements

How the Matter Was Addressed in the Audit (Ref: par. .12b)

.A45 The amount of detail to be provided in the auditor's report to describe how a key audit matter was addressed in the audit is a matter of professional judgment. In accordance with paragraph .12b, the auditor may describe the following elements, or some combination thereof:

- Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement
- A brief overview of procedures performed
- An indication of the outcome of the auditor's procedures
- Key observations with respect to the matter

Law or regulation may prescribe a specific form or content for the description of a key audit matter or may specify the inclusion of one or more of these elements.

.A46 In order for intended users to understand the significance of a key audit matter in the context of the audit of the financial statements as a whole,

as well as the relationship between key audit matters and other elements of the auditor's report, including the auditor's opinion, care may be necessary so that language used in the description of a key audit matter does the following:

- Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements
- Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language
- Takes into account how the matter is addressed in the related disclosures in the financial statements, if any
- Does not contain or imply discrete opinions on separate elements of the financial statements

.A47 Describing aspects of the auditor's response or approach to a matter, particularly when the audit approach required significant tailoring to the facts and circumstances of the entity, may assist intended users in understanding unusual circumstances and significant auditor judgments required to address the risk of material misstatement. In addition, the audit approach in a particular period may have been influenced by entity-specific circumstances, economic conditions, or industry developments. It may also be useful for the auditor to make reference to the nature and extent of communications with those charged with governance about the matter.

.A48 For example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may wish to highlight that the auditor employed or engaged an auditor's expert. Such a reference to the use of an auditor's expert does not reduce the auditor's responsibility for the opinion on the financial statements and is therefore not inconsistent with paragraphs .14–.15 of section 620, *Using the Work of an Auditor's Specialist*.

.A49 There may be challenges in describing the auditor's procedures, particularly in complex, judgmental areas of the audit. In particular, it may be difficult to summarize the procedures performed in a succinct way that adequately communicates the nature and extent of the auditor's response to the assessed risk of material misstatement and the significant auditor judgments involved. Nonetheless, the auditor may consider it necessary to describe certain procedures that were performed to explain how a matter was addressed in the audit. Such description may typically be at a high level, rather than a detailed description of all procedures performed regarding the matter; that is, the auditor may describe just those procedures that are most relevant to the unique facts and circumstances of the entity and the current period audit.

.A50 As noted in paragraph .A45, the auditor may also provide an indication of the outcome of the auditor's response in the description of the key audit matter in the auditor's report. However, if this is done, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual key audit matter or that the description in any way may call into question the auditor's opinion on the financial statements as a whole.

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report (Ref: par. .13)

.A51 Law or regulation may preclude disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, disclosure about a matter related to a government contractor may be

precluded due to the nature of the matter and security clearance provisions that may apply to the auditor.

.A52 As indicated by paragraph .13*b*, it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report. This is because there is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgment not to communicate a key audit matter is appropriate only in cases in which the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating the matter.

.A53 The determination not to communicate a key audit matter takes into account the facts and circumstances related to the matter. Communication with management and those charged with governance helps the auditor understand management's views about the significance of the adverse consequences that may arise as a result of communicating a matter. In particular, communication with management and those charged with governance helps inform the auditor's judgment in determining whether to communicate the matter in the following ways:

- Assisting the auditor in understanding why the matter has not been disclosed by the entity (for example, if law, regulation, or certain financial reporting frameworks permit delayed disclosure or nondisclosure of the matter) and understanding management's views regarding the adverse consequences, if any, of disclosure. Management may draw attention to certain aspects in law or regulation or other authoritative sources that may be relevant to the consideration of adverse consequences (for example, such consequences may include harm to the entity's commercial negotiations or competitive position). However, management's views about the adverse consequences alone do not alleviate the need for the auditor to determine whether the adverse consequences would reasonably be expected to outweigh the public interest benefits of communication in accordance with paragraph .13*b*.
- Highlighting whether there have been any communications with applicable regulatory, enforcement, or supervisory authorities in relation to the matter and, in particular, whether such discussions would appear to support management's assertion about why public disclosure about the matter is not appropriate.
- Enabling the auditor, when appropriate, to encourage management and those charged with governance to disclose relevant information about the matter. In particular, this may be possible if the concerns of management and those charged with governance about communicating the matter are limited to specific aspects of the matter, such that certain information about the matter may be less sensitive and could be communicated.

The auditor also may consider it necessary to obtain a written representation from management explaining why disclosure of the matter is not appropriate, including management's view about the significance of the adverse consequences that may arise as a result of such communication.

.A54 It may also be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements. In addition, the auditor may be required by law or regulation to communicate with applicable regulatory, enforcement, or

supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. Such communication may also help inform the auditor's consideration of the adverse consequences that may arise from communicating about the matter.

.A55 The issues considered by the auditor regarding a decision to not communicate a matter are complex and involve significant auditor judgment. Accordingly, the auditor may consider it appropriate to obtain legal advice.

Form and Content of the "Key Audit Matters" Section in Other Circumstances (Ref: par. .15)

.A56 The requirement in paragraph .15 applies in three circumstances:

- In the rare circumstance that the auditor determines, in accordance with paragraph .09, that there are no key audit matters. This may be the case because there were no matters that required significant auditor attention.
- The auditor determines, in accordance with paragraph .13, that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be key audit matters.
- The only matters determined to be key audit matters are those communicated in accordance with paragraph .14.

.A57 The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

Key Audit Matters

[Except for the matter described in the Basis for Qualified Opinion section or Going Concern section,] We have determined that there are no [other] key audit matters to communicate in our report.

Communication With Those Charged With Governance (Ref: par. .16)

.A58 Section 260 requires the auditor to communicate with those charged with governance on a timely basis. The appropriate timing for communications with those charged with governance about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.

.A59 Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report and provides them with an opportunity to obtain further clarification when necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. Communication with those charged with governance recognizes their important role in overseeing the financial reporting process and provides them the opportunity to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance

to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

.A60 The communication with those charged with governance required by paragraph .16a also addresses the extremely rare circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report (see paragraphs .13 and .A53).

.A61 The requirement in paragraph .16b to communicate with those charged with governance when the auditor has determined that there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality control reviewer, when one has been appointed). These discussions may cause the auditor to reevaluate the auditor's determination that there are no key audit matters.

Documentation (Ref: par. .17)

.A62 Paragraph .08 of section 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgments. In the context of key audit matters, these professional judgments include the determination, from the matters communicated with those charged with governance, of the matters that required significant auditor attention and whether or not each of those matters is a key audit matter. The auditor's judgments in this regard are likely to be supported by the documentation of the auditor's communications with those charged with governance and the audit documentation relating to each individual matter (see paragraph .A39), as well as by certain other audit documentation of the significant matters arising during the audit (for example, a completion memorandum). However, this section does not require the auditor to document why other matters communicated with those charged with governance were not matters that required significant auditor attention.

AU-C Section 703

Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA

Source: SAS No. 136; SAS No. 138; SAS No. 140; SAS No. 141.

Effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021. Exhibit B provides transitional implementation reporting guidance upon initial implementation by the auditor of this section.

NOTE

In July 2020, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 143, *Auditing Accounting Estimates and Related Disclosures*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix D of section 540 until the effective date, when they will be applied to this section.

In October 2021, the ASB issued SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to form an opinion on the financial statements of employee benefit plans (EBPs) subject to the Employee Retirement Income Security Act of 1974 (ERISA), hereinafter referred to as ERISA plans. It also addresses the form and content of the auditor's report issued as a result of an audit of ERISA plan financial statements. This section applies to audits of single employer, multiple employer, and multiemployer plans subject to ERISA. This section should not be adapted for plans that are not subject to ERISA. (Ref: par. .A1)

.02 This section applies to an audit of a complete set of general purpose financial statements of EBPs subject to ERISA and is written in that context.

.03 The Department of Labor (DOL), IRS, and the Pension Benefit Guaranty Corporation (PBGC) jointly developed the Form 5500 series so EBPs could use the Form 5500 series forms to satisfy annual reporting requirements under Title I and Title IV of ERISA and the IRC. The Form 5500 series is part of ERISA's overall reporting and disclosure framework, which is intended to assure that EBPs are operated and managed in accordance with certain prescribed standards and that participants and beneficiaries, as well as regulators, are provided or have access to sufficient information to protect the rights and benefits of participants and beneficiaries under EBPs. The Form 5500 series includes Form 5500, *Annual Return / Report for Employee Benefit Plan*, and related schedules (hereinafter referred to as *Form 5500*). (Ref: par. A2–A5)

.04 ERISA requires that certain supplemental schedules accompany the ERISA plan financial statements (hereinafter referred to as *ERISA-required supplemental schedules*), if applicable. Paragraphs .127–.135 address the auditor's responsibilities relating to reporting on the ERISA-required supplemental schedules, and paragraphs .22–.24 address the auditor's responsibilities relating to prohibited transactions.

.05 The requirements in this section are specific to ERISA plan audit engagements and are intended to be performed as part of the audit of ERISA plan financial statements in accordance with generally accepted auditing standards (GAAS); however, this section does not contain all the requirements necessary to form an opinion and report on ERISA plan financial statements.

.06 When performing an audit of ERISA plan financial statements, all AU-C sections apply, except for the following sections or portions thereof, which are not applicable to an audit of ERISA plan financial statements because those requirements and related application material are specifically covered in this section:

- a. Section 700, *Forming an Opinion and Reporting on Financial Statements*
- b. Paragraph .09 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*

In addition, this section contains incremental requirements to section 210A, *Terms of Engagement*; section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*; section 260, *The Auditor's Communication With Those Charged With Governance*; and section 580, *Written Representations*.

.07 This section also addresses the auditor's responsibilities for forming an opinion on ERISA plan financial statements, including the form and content of the report when management elects to have an audit performed pursuant to ERISA Section 103(a)(3)(C) (hereinafter referred to as an *ERISA Section 103(a)(3)(C) audit*).

.08 When management elects an ERISA Section 103(a)(3)(C) audit, as discussed in paragraph .07, the audit need not extend to any statements or information related to assets held for investment of the plan (hereinafter referred to as *investment information*) by a bank or similar institution or an insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with the Code of Federal Regulations (CFR), *Labor*, Title 29, Section 2520.103-5 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA (hereinafter referred to as a *qualified*

institution). Paragraphs .29–.35 contain required procedures when an ERISA Section 103(a)(3)(C) audit is performed. (Ref: par. .A6–.A10)

.09 Reference to *ERISA plan financial statements* in this section means a complete set of general purpose financial statements¹ for an EBP subject to ERISA. The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements. (Ref: par. .A11–.A12)

.10 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, and section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, address how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion) or includes an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report. (Ref: par. .A13)

.11 This section does not require the communication of key audit matters. Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, addresses the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so.

.12 Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, addresses special considerations when financial statements are prepared in accordance with a special purpose framework.² Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement. (Ref: par. .A14–.A15)

Effective Date

.13 This section is effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021. Exhibit B, "Implementation Guidance for ERISA Section 103(a)(3)(C) Audits," provides transitional implementation reporting guidance upon initial implementation by the auditor of this section. [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objectives

.14 The objectives of the auditor are to do the following:

- a. Accept an ERISA plan audit engagement when the basis upon which it is to be performed has been agreed upon through establishing whether the preconditions for the audit are present (Ref: par. .A5)
- b. Appropriately plan and perform the audit of ERISA plan financial statements, including procedures required by this section on the certified investment information when management elects an ERISA Section 103(a)(3)(C) audit

¹ See the AU-C Glossary for a definition of *general purpose financial statements*.

² See section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, for a definition of *special purpose framework*.

- c. Form an opinion on the ERISA plan financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements³
- d. Express clearly the opinion on the ERISA plan financial statements through a written report
- e. Perform procedures and report on the presentation of the supplementary information in accordance with this section
- f. Appropriately communicate to management and those charged with governance reportable findings that the auditor has identified during the audit of the ERISA plan financial statements

Requirements

Engagement Acceptance

.15 In addition to the preconditions for an audit in section 210A, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility for the following: (Ref: par. .A16)

- a. Maintaining a current plan instrument, including all plan amendments (Ref: par. .A22)
- b. Administering the plan and determining that the plan's transactions that are presented and disclosed in the ERISA plan financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants to determine the benefits due or which may become due to such participants (Ref: par. .A60)
- c. When management elects to have an ERISA Section 103(a)(3)(C) audit, determining whether
 - i. an ERISA Section 103(a)(3)(C) audit is permissible under the circumstances,
 - ii. the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8,
 - iii. the certification meets the requirements in 29 CFR 2520.103-5, and
 - iv. the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework

.16 When management elects to have an ERISA Section 103(a)(3)(C) audit, the auditor should inquire of management about how management determined that the entity preparing and certifying the investment information is a qualified institution, as discussed in paragraphs .08 and .A6.

.17 The auditor should also obtain the agreement of management or those charged with governance to provide to the auditor, prior to the dating of the auditor's report, a draft of Form 5500 that is substantially complete (hereinafter referred to as the *draft Form 5500*). (Ref: par. .A17)

³ See the AU-C Glossary for a definition of *comparative financial statements*.

Audit Risk Assessment and Response in an Audit of ERISA Plan Financial Statements

.18 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, addresses the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, including the entity's internal control. The plan instrument is essential to understanding the plan and identifying and performing audit procedures that are responsive to assessed risks. (Ref: par. .A18–.A21)

.19 The auditor should obtain and read the most current plan instrument for the audit period, including effective amendments (hereinafter referred to as the *plan instrument*), as part of obtaining an understanding of the entity sufficient to perform risk assessment procedures. (Ref: par. .A22–.A24)

.20 When designing and performing audit procedures, the auditor should consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures. (Ref: par. .A25–.A28)

Plan Tax Status

.21 As part of the auditor's responsibilities in accordance with section 250 relating to the plan's tax status, the auditor should consider whether management has performed the relevant IRC compliance tests, including but not limited to, discrimination testing, and has corrected or intends to correct failures, as applicable. (Ref: par. .A29–.A32)

Prohibited Transactions

.22 The auditor should evaluate whether prohibited transactions identified by management or as part of the audit have been appropriately reported in the applicable ERISA-required supplemental schedules (see paragraph .A5). (Ref: par. .A33–.A35)

.23 If the auditor becomes aware that the plan has entered into a prohibited transaction with a party in interest, and the prohibited transaction has not been properly reported in the applicable ERISA-required supplemental schedule, the auditor should discuss the matter with management. If management does not revise the ERISA-required supplemental schedule, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the ERISA-required supplemental schedule is not revised, the auditor should modify the auditor's opinion on the ERISA-required supplemental schedule, when the effect of the transaction is material based on the financial statements as a whole. When the effect of the prohibited transaction is not material to the financial statements, then the auditor should include additional discussion in the other-matter paragraph in the auditor's report on the ERISA-required supplemental schedules describing the prohibited transaction. (Ref: par. .A36)

.24 If a material prohibited party-in-interest transaction that is not disclosed in the ERISA-required supplemental schedule is also considered a related party transaction and that transaction is not properly disclosed in the notes to the ERISA plan financial statements, the auditor should modify the auditor's opinion on the financial statements in accordance with section 705 due to a departure from the applicable financial reporting framework.

Evaluation and Documentation

.25 When the audit work performed results in the identification of items that are not in accordance with the criteria specified (for example, not in accordance with the plan instrument), the auditor should evaluate whether the matters are reportable findings. Reportable findings are matters that are one or more of the following:

- a. An identified instance of noncompliance or suspected noncompliance with laws or regulations in accordance with section 250
- b. A finding arising from the audit that is, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process in accordance with section 260
- c. An indication of deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*

.26 The auditor should prepare audit documentation in accordance with section 230, *Audit Documentation*. If the auditor has determined that it is not necessary to test any relevant plan provisions as described in paragraph .20, the auditor should document the considerations in reaching such conclusion. (Ref: par. .A37)

Communication With Management or Those Charged With Governance

.27 Based on the evaluation required by paragraph .25, the auditor should communicate in writing to those charged with governance, on a timely basis, reportable findings from the audit procedures performed relating to the matters included in paragraph .20. Such communication should be included with the required communication with those charged with governance in accordance with sections 250, 260, or 265, as appropriate, either in a separate section or placed in such communications as the auditor deems appropriate. The written communication should include the following:

- a. A description of the reportable finding
- b. Sufficient information to enable those charged with governance and management to understand the context of the communication
- c. An explanation of the potential effects of the reportable findings on the financial statements or to the plan

(Ref: par. .A38–.A45)

.28 The auditor should not issue a written communication stating that no reportable findings were identified during the audit. (Ref: par. .A46)

Procedures for an ERISA Section 103(a)(3)(C) Audit

.29 When management elects to have an ERISA Section 103(a)(3)(C) audit as discussed in paragraph .08, the auditor should evaluate management's assessment of whether the entity issuing the certification is a qualified institution under DOL rules and regulations. (Ref: par. .A47–.A48)

.30 If, as a result of the procedures performed in paragraph .29, the auditor has concerns about whether the entity preparing and certifying the investment

information is a qualified institution, the auditor should discuss his or her concerns with management. If management does not provide sufficient information that supports its determination that the entity preparing and certifying the investment information is a qualified institution, then the auditor should discuss his or her concerns with those charged with governance and determine the implications for the audit. (Ref: par. .A49)

.31 The auditor should identify which investment information is certified.

.32 The auditor should perform the following procedures on the certified investment information: (Ref: par. .A50)

- a. Obtain from management and read the certification as it relates to investment information prepared and certified by a qualified institution (Ref: par. .A6–.A7 and .A50–.A52)
- b. Compare the certified investment information with the related information presented and disclosed in the ERISA plan financial statements and ERISA-required supplemental schedules (Ref: par. .A53)
- c. Read the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of the applicable financial reporting framework

.33 If, as part of the procedures performed in paragraphs .31–.32, the auditor becomes aware that the certified investment information in the financial statements and related disclosures is incomplete, inaccurate, or otherwise unsatisfactory, the auditor should discuss the matter with management and perform additional procedures to determine the appropriate course of action. (Ref: par. .A54–.A57)

.34 The auditor should perform audit procedures on the financial statement information, including the disclosures, not covered by the certification as well as noninvestment-related information based on the assessed risk of material misstatement. Plans may hold investments in which only a portion are covered by a certification by a qualified institution. In that case, the auditor should perform audit procedures on the investment information that has not been certified. (Ref: par. .A58)

.35 For all audits of ERISA plan financial statements, including an ERISA Section 103(a)(3)(C) audit, the auditor should perform the procedures necessary to become satisfied that received and disbursed amounts (for example, employer or employee contributions and benefit payments) reported by the trustee or custodian were determined in accordance with the plan provisions (also see paragraph .17).

Written Representations

.36 In addition to the requirements in section 580, the auditor should request the following written representations from management in an audit of ERISA plan financial statements: (Ref: par. .A59)

- a. That management has provided the auditor with the most current plan instrument for the audit period, including all plan amendments
- b. Acknowledgement of its responsibility for administering the plan and determining that the plan's transactions that are presented and disclosed in the ERISA plan financial statements are in conformity with the plan's provisions, including maintaining

sufficient records with respect to each of the participants to determine the benefits due or which may become due to such participants (Ref: par. .A60)

- c. When management elects to have an ERISA Section 103(a)(3)(C) audit, acknowledgement that management's election of the ERISA Section 103(a)(3)(C) audit does not affect its responsibility for the financial statements and for determining whether
 - i. an ERISA Section 103(a)(3)(C) audit is permissible under the circumstances,
 - ii. the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8,
 - iii. the certification meets the requirements in 29 CFR 2520.103-5, and
 - iv. the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework

Forming an Opinion on the ERISA Plan Financial Statements

.37 The auditor should form an opinion on whether the ERISA plan financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (Ref: par. .A61)

.38 In order to form that opinion, the auditor should conclude whether the auditor has obtained reasonable assurance⁴ about whether the ERISA plan financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion should take into account the following:

- a. The auditor's conclusion, in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, about whether sufficient appropriate audit evidence has been obtained⁵
- b. The auditor's conclusion, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*, about whether uncorrected misstatements are material, individually or in the aggregate⁶
- c. The evaluations required by paragraphs .39–.42 of this section

.39 The auditor should evaluate whether the ERISA plan financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation should include consideration of the qualitative aspects of the plan's accounting practices, including indicators of possible bias in management's judgments. (Ref: par. .A62–.A64)

.40 In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

⁴ Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, defines the term *reasonable assurance*.

⁵ Paragraph .28 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

⁶ Paragraph .11 of section 450, *Evaluation of Misstatements Identified During the Audit*.

- a. the ERISA plan financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the plan and whether they have been presented in an understandable manner. (Ref: par. .A65)
- b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
- c. the accounting estimates made by management are reasonable.
- d. the information presented in the ERISA plan financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented; (Ref: par. .A66)
- e. the ERISA plan financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the ERISA plan financial statements. (Ref: par. .A67)
- f. the terminology used in the ERISA plan financial statements, including the title of each financial statement, is appropriate.

.41 The auditor's evaluation about whether the ERISA plan financial statements achieve fair presentation should also include consideration of the following: (Ref: par. .A68–.A70)

- a. The overall presentation, structure, and content of the ERISA plan financial statements
- b. Whether the ERISA plan financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A71)

.42 The auditor should evaluate whether the ERISA plan financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A72–.A75)

Form of Opinion

Auditor's Opinion on ERISA Plan Financial Statements

.43 The auditor should express an unmodified opinion⁷ when the auditor concludes that the ERISA plan financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.44 The auditor should modify the opinion in the auditor's report, in accordance with section 705, in the following circumstances:

- a. The auditor concludes that, based on the audit evidence obtained, the ERISA plan financial statements as a whole are materially misstated.
- b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the ERISA plan financial statements as a whole are free from material misstatement.

⁷ See the AU-C Glossary for a definition of *unmodified opinion*.

Auditor's Opinion on ERISA Plan Financial Statements When Performing an ERISA Section 103(a)(3)(C) Audit

.45 When management elects an ERISA Section 103(a)(3)(C) audit, the auditor should follow the requirements in paragraphs .98–.126 of this section. (Ref: par. .A13)

Fair Presentation

.46 If the auditor concludes that the ERISA plan financial statements do not achieve fair presentation, the auditor should discuss the matter with management and, depending on how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705. (Ref: par. .A76–.A77)

Considerations Relating to Form 5500 Filing**Reading the Draft Form 5500**

.47 The auditor should make appropriate arrangements with management to obtain the draft Form 5500. The auditor should obtain and read the draft Form 5500 prior to dating the auditor's report. (Ref: par. .A78)

.48 The auditor should read the draft Form 5500 in order to identify material inconsistencies, if any, with the audited ERISA plan financial statements. (Ref: par. .A79–.A80)

.49 The auditor should communicate with those charged with governance the auditor's responsibility with respect to Form 5500, procedures performed relating to Form 5500, and the results of those procedures.

Material Inconsistencies With the Draft Form 5500

.50 If, on reading the draft Form 5500, the auditor identifies a material inconsistency, the auditor should determine whether the audited ERISA plan financial statements or the draft Form 5500 needs to be revised.

.51 *Material Inconsistencies With the Draft Form 5500 Identified Prior to the Date of the Auditor's Report That Require Revision of the Audited ERISA Plan Financial Statements.* When the auditor identifies a material inconsistency between the draft Form 5500 and the ERISA plan financial statements that requires revision of the audited ERISA plan financial statements prior to the date of the auditor's report, and management refuses to make the revision, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the revisions are not made, the auditor should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705.

.52 *Material Inconsistencies With the Draft Form 5500 Identified After the Date of the Auditor's Report But Prior to the Report Release Date That Require Revision of the Audited ERISA Plan Financial Statements.* When the auditor identifies a material inconsistency between the draft Form 5500 and the ERISA plan financial statements after the date of the auditor's report but prior to the report release date that requires revision of the audited ERISA plan financial statements, the auditor should apply the relevant requirements in section 560, *Subsequent Events and Subsequently Discovered Facts*.

.53 *Material Inconsistencies With the Draft Form 5500 Identified Prior to the Report Release Date That Require Revision of the Draft Form 5500.* When the

auditor identifies a material inconsistency prior to the report release date that requires revision of the information in the draft Form 5500, and management refuses to make the revision, the auditor should communicate this matter to those charged with governance and (Ref: par. .A81)

- a. include in the auditor's report an other-matter paragraph describing the material inconsistency, in accordance with section 706,
- b. withhold the auditor's report, or
- c. when withdrawal is possible under applicable law or regulation, withdraw from the engagement.

.54 *Material Inconsistencies Identified Subsequent to the Report Release Date.* When revision of the audited ERISA plan financial statements is necessary as a result of a material inconsistency with the information in Form 5500 and the auditor's report on the ERISA plan financial statements has already been released, the auditor should apply the relevant requirements in section 560.

.55 When revision of Form 5500 is necessary after the report release date and management agrees to make the revision, the auditor should carry out the procedures necessary under the circumstances. (Ref: par. .A82)

.56 When revision of Form 5500 is necessary after the report release date but management refuses to make the revision, the auditor should notify those charged with governance of the auditor's concerns regarding Form 5500 and take any further appropriate action. (Ref: par. .A83)

Material Misstatement of Fact

.57 If, on reading the draft Form 5500 for the purpose of identifying material inconsistencies between Form 5500 and the ERISA plan financial statements, the auditor becomes aware of an apparent material misstatement of fact in the draft Form 5500, the auditor should discuss the matter with management. (Ref: par. .A84)

.58 When, following such discussions as described in paragraph .57, the auditor still considers that there is an apparent material misstatement of fact, the auditor should request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor should consider the advice received by the entity in determining whether such matter is a material misstatement of fact.

.59 When the auditor concludes that there is a material misstatement of fact that management refuses to correct, the auditor should notify those charged with governance of the auditor's concerns regarding the information in the draft Form 5500 and take any further appropriate action. (Ref: par. .A85)

Auditor's Report on ERISA Plan Financial Statements (Other Than for an ERISA Section 103(a)(3)(C) Audit)⁸

.60 The auditor's report should be in writing. (Ref: par. .A86–.A87)

Title

.61 The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A88)

⁸ For ERISA Section 103(a)(3)(C) audits, paragraphs .98–.126 apply instead of paragraphs .60–.82.

Addressee

.62 The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A89–.A90)

Auditor's Opinion

.63 The first section of the auditor's report should include the auditor's opinion and should have the heading "Opinion."

.64 The "Opinion" section of the auditor's report should also do the following: (Ref: par. .A91–.A93)

- a. Identify the plan whose financial statements have been audited
- b. State that the financial statements have been audited, and the plan is an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA),
- c. Identify the title of each statement that the financial statements comprise
- d. Refer to the notes
- e. Specify the dates of or periods covered by each financial statement that the financial statements comprise

.65 When expressing an unmodified opinion on the ERISA plan financial statements, the auditor's opinion should state that, in the auditor's opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [*the applicable financial reporting framework*]. (Ref: par. .A94–.A97)

.66 The auditor's opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A98)

Basis for Opinion

.67 The auditor's report should include a section, directly following the "Opinion" section, with the heading "Basis for Opinion" that does the following: (Ref: par. .A99)

- a. States that the audit was conducted in accordance with generally accepted auditing standards and identifies the United States of America as the country of origin of those standards (Ref: par. .A100–.A101)
- b. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS
- c. Includes a statement that the auditor is required to be independent of the plan and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref: par. .A102–.A103)
- d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion

Going Concern

.68 When applicable, the auditor should report in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

Key Audit Matters

.69 When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701. (Ref: par. .A104)

Responsibilities of Management for the Financial Statements

.70 The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements."

.71 This section of the auditor's report should describe management's responsibility for the following:

- a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. (Ref: par. .A105–.A106)
- b. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern [*for the time period set by the applicable financial reporting framework, as applicable.*]
- c. Maintaining a current plan instrument, including all plan amendments
- d. Administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants

.72 The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A107)

Auditor's Responsibilities for the Audit of the Financial Statements

.73 The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

.74 This section of the auditor's report should do the following: (Ref: par. .A108)

- a. State that the objectives of the auditor are to
 - i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and (Ref: par. .A109)
 - ii. issue an auditor's report that includes the auditor's opinion
- b. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. (Ref: par. .A110)
- c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as

fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control

- d. State that misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.⁹ (Ref: par. .A111)

[As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.75 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

- a. Exercise professional judgment and maintain professional skepticism throughout the audit.
- b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed.

In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed."

- d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time.

.76 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that the auditor identified during the audit.

ERISA-Required Supplemental Schedules

.77 As discussed in paragraph .127, when auditing ERISA plan financial statements, the auditor is required to report on whether the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to

⁹ Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit*.

the financial statements as a whole, in accordance with section 725 and paragraphs .129–.130 of this section, as applicable.

Other Reporting Responsibilities

.78 If the auditor addresses other reporting responsibilities in the auditor's report on the ERISA plan financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A112–.A113)

.79 If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements in paragraphs .61–.77 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A114)

Signature of the Auditor

.80 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A115–.A116)

Auditor's Address

.81 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A117–.A118)

Date of the Auditor's Report

.82 The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the ERISA plan financial statements, including evidence of the following: (Ref: par. .A119)

- a. All the statements and disclosures that the ERISA plan financial statements comprise have been prepared.
- b. Management has asserted that it has taken responsibility for those ERISA plan financial statements. (Ref: par. .A120–.A121)
- c. The procedures relating to the draft Form 5500 have been performed.

Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards

.83 Paragraph .67 requires that the auditor's report state that the audit was conducted in accordance with GAAS and identify the United States of America as the country of origin of those standards. However, an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards (for example, International Standards on Auditing [ISAs], or *Government Auditing Standards*). The auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS, unless the audit was conducted in accordance with both sets of standards in their entirety.

.84 When the auditor's report refers to both GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards as well as its origin.

Comparative Financial Statements

.85 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the auditor's report should refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: par. .A122–.A124)

.86 When expressing an opinion on all periods presented, a continuing auditor should update the report on the financial statements of one or more prior periods presented on a comparative basis with those of the current period. The auditor's report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit. (Ref: par. .A125–.A126)

Audit Procedures

.87 The auditor should perform the procedures required by paragraphs .88–.90 if comparative financial statements are presented for the prior periods.

.88 The auditor should determine whether the comparative financial statements have been presented in accordance with the relevant requirements, if any, of the applicable financial reporting framework.

.89 The auditor should evaluate the following:

- a. Whether the comparative financial statements agree with the amounts and other disclosures presented in the prior period or, when appropriate, has been restated for the correction of a material misstatement or adjusted for the retrospective application of an accounting principle
- b. Whether the accounting policies reflected in the comparative financial statements are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed¹⁰

.90 If the auditor becomes aware of a possible material misstatement in the comparative financial statements while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor audited the prior period's financial statements and becomes aware of a material misstatement in those financial statements, the auditor should also follow the relevant requirements of section 560. If the prior period financial statements are restated, the auditor should determine that the comparative financial statements agree with the restated financial statements.

.91 As required by section 580, the auditor should request written representations for all periods referred to in the auditor's opinion. The auditor also should obtain a specific written representation regarding any restatement made to correct a material misstatement in a prior period that affects the comparative financial statements. (Ref: par. .A127)

.92 When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial

¹⁰ See section 708, *Consistency of Financial Statements*.

statements differs from the opinion the auditor previously expressed, the auditor should disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706:

- a. The date of the auditor's previous report
- b. The type of opinion previously expressed
- c. The substantive reasons for the different opinion
- d. That the auditor's opinion on the amended financial statements is different from the auditor's previous opinion (Ref: par. .A128)

Prior Period Financial Statements Audited by a Predecessor Auditor

.93 If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued,¹¹ in addition to expressing an opinion on the current period's financial statements, the auditor should state the following in an other-matter paragraph:¹²

- a. That the financial statements of the prior period were audited by a predecessor auditor
- b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore
- c. The nature of an emphasis-of-matter paragraph, other-matter paragraph, or a going concern section included in the predecessor auditor's report, if any
- d. The date of that report

.94 If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor should follow the communication requirements in section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.¹³ If the prior period financial statements are restated, and the predecessor auditor agrees to issue a new auditor's report on the restated financial statements of the prior period, the auditor should express an opinion only on the current period. (Ref: par. .A129)

Prior Period Financial Statements Not Audited

.95 When current period financial statements are audited and presented in comparative form with financial statements for the prior period for which a compilation or review was performed, and the report on the prior period is not reissued, the auditor should include an other-matter paragraph¹⁴ in the current period auditor's report that includes the following with respect to the prior period: (Ref: par. .A130)

- a. The service performed in the prior period
- b. The date of the report on that service
- c. A description of any material modifications noted in that report

¹¹ Paragraphs .19–.20 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

¹² See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

¹³ Paragraphs .12–.13 of section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

¹⁴ See footnote 12.

- d. For a review engagement, a statement that the service was substantially less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements as a whole (Ref: par. .A131)
- e. For a compilation engagement, a statement that no opinion or other form of assurance is expressed on the financial statements (Ref: par. .A132)

.96 If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (Ref: par. .A133)

Information Presented in the Financial Statements

.97 Information that is not required by the applicable financial reporting framework but is nevertheless presented as part of the basic financial statements should be covered by the auditor's opinion if it cannot be clearly differentiated. (Ref: par. .A134–.A136)

Auditor's Report for an ERISA Section 103(a)(3)(C) Audit

.98 The auditor's report should be in writing. (Ref: par. .A86–.A87)

.99 The auditor should apply the provisions in paragraphs .83–.97, when applicable. (Ref: par. .A137)

Title

.100 The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A88)

Addressee

.101 The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A89–.A90)

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

.102 The first section of the auditor's report should include a description of the scope and nature of the ERISA Section 103(a)(3)(C) audit and should have the heading "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit."

.103 The "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section of the auditor's report should also do the following:

- a. Identify the plan whose financial statements have been audited
- b. State that the auditor performed an audit of the financial statements of an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit) (Ref: par. .A138)
- c. Identify the title of each statement that the financial statements comprise
- d. Refer to the notes
- e. Specify the dates of or periods covered by each financial statement that the financial statements comprise

- f. State that management, having determined it is permissible in the circumstances, has elected to have the audit of the plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (Ref: par. .A139)
- g. State that as permitted by ERISA Section 103(a)(3)(C), the audit need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution) (Ref: par. .A140)
- h. State that management has obtained a certification [*or certifications*] from a qualified institution as of [*date or dates*], and for the [*period or year ended date*], stating that the certified investment information, as described in [*insert note reference*] to the financial statements is complete and accurate

Auditor's Opinion

.104 The auditor's report should include the "Opinion" section, directly following the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section, with the heading "Opinion."

.105 When the auditor has not identified any material misstatements of the financial statements and no scope limitations exist, the auditor's report should include a statement that, in the auditor's opinion, based on the audit and on the procedures performed as described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section

- a. the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
- b. the information in the accompanying financial statements related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C). (Ref: par. .A140)

.106 The auditor's opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A98)

Basis for Opinion

.107 The auditor's report should include a section, directly following the "Opinion" section, with the heading "Basis for Opinion" that does the following: (Ref: par. .A99)

- a. States that the audit was conducted in accordance with generally accepted auditing standards (GAAS) and identifies the United

States of America as the country of origin of those standards (Ref: par. .A100–.A101)

- b. Refers to the section of the auditor's report that describes the auditor's responsibilities for GAAS
- c. Includes a statement that the auditor is required to be independent of the plan and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref: par. .A102–.A103)
- d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the ERISA Section 103(a)(3)(C) audit opinion.

Going Concern

.108 When applicable, the auditor should report in accordance with section 570.

Key Audit Matters

.109 When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701. (Ref: par. .A104)

Responsibilities of Management for the Financial Statements

.110 The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements."

.111 This section of the auditor's report should describe management's responsibility for the following:

- a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. (Ref: par. .A105–.A106)
- b. The election of the ERISA Section 103(a)(3)(C) audit and that the election does not affect management's responsibility for the financial statements.
- c. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern [*for the time period set by the applicable financial reporting framework, as applicable.*]
- d. Maintaining a current plan instrument, including all plan amendments
- e. Administering the plan and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

.112 The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A107)

Auditor's Responsibilities for the Audit of the Financial Statements

.113 The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

.114 This section of the auditor's report should do the following: (Ref: par. .A108)

- a. State that except as described in the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section of the report, the objectives of the auditor are to
 - i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error and (Ref: par. .A109)
 - ii. issue an auditor's report that includes the auditor's opinion.
- b. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. (Ref: par. .A110)
- c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- d. State that misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.¹⁵ (Ref: par. .A111)

[As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.115 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

- a. Exercise professional judgment and maintain professional skepticism throughout the audit
- b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed.

In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following "but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, no such opinion is expressed."

¹⁵ See footnote 9.

- d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time.

.116 The auditor's report should state that the audit did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of the applicable financial reporting framework.

.117 The auditor's report should state that, accordingly, the objective of the ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.118 The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal-control-related matters that the auditor identified during the audit.

Modifications to the Opinion

.119 Section 705 addresses the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with this SAS, the auditor concludes that a modification to the auditor's opinion on the ERISA plan financial statements is necessary. In the case of an ERISA Section 103(a)(3)(C) audit, the auditor should apply the requirements in section 705, adapted as necessary in the circumstances of the engagement, including the following: (Ref: par. .A141–.A142)

- a. When the auditor expresses a qualified opinion due to a material misstatement of the financial statements, the auditor should amend the "Opinion" section as required by paragraph .105, to state that, in the auditor's opinion, except for the effects of the matters described in the "Basis for Qualified Opinion" section, based on the audit and on the procedures performed as described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section
 - i. the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
 - ii. the information in the accompanying financial statements related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C). (Ref: par. .A140)

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase *except for the possible effects of the matter(s)...* for the modified opinion.

- b. When the auditor expresses an adverse opinion, the requirements in paragraph .105 do not apply, and the auditor should state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matters described in the "Basis for Adverse Opinion" section, the financial statements are not presented fairly in accordance with the applicable financial reporting framework.
- c. When the auditor expresses a qualified or an adverse opinion, the auditor should amend the description in the "Basis for Opinion" section to state whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified ERISA Section 103(a)(3)(C) audit opinion.
- d. When the auditor disclaims an opinion, the auditor should amend the statement required by paragraph .103b, which indicates that the auditor performed an audit of the financial statements, to state that the auditor was engaged to perform an audit of the financial statements. The auditor should also amend the description of the auditor's responsibility for the audit of the financial statements and the description of the scope of the audit to state only the following: "Our responsibility is to conduct an audit of the plan's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matters described in the "Basis for Disclaimer of Opinion" section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements."
- e. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the requirements in paragraph .105 do not apply, and the auditor should state in the "Disclaimer of Opinion" section that
 - i. because of the significance of the matters described in the "Basis for Disclaimer of Opinion" section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and
 - ii. accordingly, the auditor does not express an opinion on the financial statements.¹⁶

ERISA-Required Supplemental Schedules

.120 The auditor's report should include an other-matter paragraph with the heading "Other Matter — Supplemental Schedules Required by ERISA."

.121 The auditor should report on ERISA-required supplemental schedules in accordance with paragraph .132 of this section.

Other Reporting Responsibilities

.122 If the auditor addresses other reporting responsibilities in the auditor's report on the ERISA plan financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities

¹⁶ Paragraph .20 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A143–.A144)

.123 If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements in paragraphs .102–.121 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A145)

Signature of the Auditor

.124 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A115–.A116)

Auditor's Address

.125 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A117–.A118)

Date of the Auditor's Report

.126 The auditor's report should be dated no earlier than the date on which the auditor has obtained an appropriate certification and has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the ERISA plan financial statements, including evidence of the following: (Ref: par. .A119)

- a. All the statements and disclosures that the ERISA plan financial statements comprise have been prepared.
- b. Management has asserted that they have taken responsibility for those ERISA plan financial statements. (Ref: par. .A120–.A121)
- c. The procedures relating to the draft Form 5500 have been performed.

Reporting on Supplemental Schedules

.127 As discussed in paragraph .04, ERISA requires that certain supplemental schedules accompany the ERISA plan financial statements (referred to as *ERISA-required supplemental schedules*), if applicable. In addition, ERISA plan financial statements may have accompanying supplementary information that is not required by ERISA. Except as discussed in paragraph .132, when auditing ERISA plan financial statements, the auditor should report on whether the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, in accordance with section 725 and paragraphs .129–.130 of this section. Section 725 addresses the performance requirements as well as the form and content of the report on supplementary information in relation to the financial statements as a whole. Section 725 requires the auditor to report on the supplementary information in either (a) a separate section in the auditor's report on the financial statements with the heading "Supplementary Information" or other appropriate heading or (b) in a separate report on the supplementary information. Paragraphs .22–.24 address additional considerations related to reporting on the ERISA-required supplemental schedules when prohibited transactions with a party in interest exist. (Ref: par. .A146–.A147) [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.128 When the auditor is also engaged to report on supplementary information accompanying the ERISA plan financial statements that is not required by ERISA, and that is not required by the applicable financial reporting framework, section 725 applies. (Ref: par. .A148)

ERISA-Required Supplemental Schedules

.129 *Reporting on ERISA-Required Supplemental Schedules When Performing an Audit of ERISA Plan Financial Statements Not Subject to ERISA Section 103(a)(3)(C).*¹⁷ When reporting on the ERISA-required supplemental schedules in accordance with section 725, the reporting elements discussed in paragraph .09 of section 725 should be replaced with the following (see paragraph .132 when performing an ERISA Section 103(a)(3)(C) audit):

- a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole
- b. The title of the supplemental schedules and the periods covered
- c. A statement that the supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA
- d. A statement that such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements
- e. A statement that the information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America
- f. A statement that in forming the auditor's opinion on the supplemental schedules, the auditor evaluated whether the supplemental schedules, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA
- g. When the auditor's report on the audited ERISA plan financial statements contains an unmodified opinion and the auditor has concluded that the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the information in the accompanying schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. (Ref: par. .A149–.A152)
- h. When the auditor's report on the audited ERISA plan financial statements contains a qualified opinion and the qualification has

¹⁷ For ERISA Section 103(a)(3)(C) audits, paragraphs .131–.132 apply instead of paragraphs .129–.130.

an effect on the ERISA-required supplemental schedules, a statement that, in the auditor's opinion, except for the effects or possible effects on the supplemental schedules of (refer to the paragraph in the auditor's report explaining the qualification), the information in the accompanying supplemental schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA

.130 When the auditor's report on the audited ERISA plan financial statements contains an adverse opinion or a disclaimer of opinion, the auditor is precluded from expressing an opinion on the ERISA-required supplemental schedules. When permitted by law or regulation, the auditor may withdraw from the engagement to report on the ERISA-required supplemental schedules. If the auditor does not withdraw, the reporting elements in paragraph .11 of section 725 should be replaced with the following:

- a. If the auditor's report on the audited ERISA plan financial statements contains an adverse opinion, a statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole, or if the auditor's report contains a disclaimer of opinion, a statement that the auditor was engaged for the purpose of forming an opinion on the financial statements as a whole
- b. A statement that the supplemental schedules are presented for the purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the DOL's Rules and Regulations for Reporting and Disclosure under ERISA.
- c. A statement that because of the significance of the matter described in the auditor's report (refer to the "Basis for Adverse Opinion" or "Basis for Disclaimer of Opinion" sections, as applicable), it is inappropriate to, and the auditor does not, express an opinion on the supplemental schedules

.131 *Reporting on ERISA-Required Supplemental Schedules When Reporting Under an ERISA Section 103(a)(3)(C) Audit.* In addition to the procedures performed during the audit of the ERISA plan financial statements (including the procedures required by paragraph .32), in order to report on the ERISA-required supplemental schedules when reporting under an ERISA Section 103(a)(3)(C) audit, the auditor should perform the following procedures using the same materiality level used in the audit of the financial statements:

- a. Determine whether the form and content of the ERISA-required supplemental schedules, other than the information that agreed to or is derived from the certified investment information, is presented in conformity with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA
- b. Compare and reconcile the information included in the ERISA-required supplemental schedules, other than that agreed to or derived from the certified investment information, to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves
- c. Obtain written representations from management
 - i. that it acknowledges its responsibility for the presentation of the ERISA-required supplemental schedules in

accordance with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA and

- ii. that it believes the ERISA-required supplemental schedules, including their form and content, are presented in conformity with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA

.132 When management elects to have an ERISA Section 103(a)(3)(C) audit, the auditor should include an other-matter paragraph in the ERISA Section 103(a)(3)(C) audit report that contains the following elements:

- a. The title of the supplemental schedules and the periods covered.
- b. A statement that the supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- c. A statement that such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements.
- d. A statement that the information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.
- e. A statement that, for information included in the supplemental schedules that agreed to or is derived from the certified investment information, the auditor compared such information to the related certified investment information.
- f. A statement that, in forming the auditor's opinion on the supplemental schedules, the auditor evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- g. A statement whether, in the auditor's opinion
 - i. the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
 - ii. the information in the supplemental schedules related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

- h. If the auditor issues a qualified ERISA Section 103(a)(3)(C) opinion on the ERISA plan financial statements and the qualification has an effect on the ERISA-required supplemental schedules, a statement that, in the auditor's opinion, except for the effects of [describe the matters by referring to the section in the auditor's report explaining the qualification] on the supplemental schedules of [identify the schedules]
 - i. the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
 - ii. the information in the supplemental schedules related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase *except for the possible effects of the matter(s)...* for the modified opinion.

- i. If the auditor's report on the ERISA plan financial statements subject to ERISA Section 103(a)(3)(C) contains an adverse opinion or a disclaimer of opinion, the auditor is precluded from expressing an opinion on the supplemental schedules. When permitted by law or regulation, the auditor may withdraw from the engagement to report on the ERISA-required supplemental schedules. If the auditor does not withdraw, the auditor should do the following:
 - i. Include a statement that the supplemental schedules are presented for the purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA
 - ii. Include a statement that such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements
 - iii. Include a statement that because of the significance of the matter described in [refer to the *Basis for Adverse Opinion* or *Basis for Disclaimer of Opinion* sections, as applicable], it is inappropriate to and the auditor does not express an opinion on the supplemental schedules.

.133 Errors, Omissions, or Inconsistencies in ERISA-Required Supplemental Schedules (Ref: par. A149–A152). When the auditor concludes, on the basis of the procedures performed, that the information in the ERISA-required supplemental schedules is materially inconsistent with the certified investment information, the auditor should discuss the matters with management and propose appropriate revision of the ERISA-required supplemental schedules. If management does not revise the ERISA-required supplemental schedules,

the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the ERISA-required supplemental schedules are not revised, the auditor should modify the auditor's opinion regarding the ERISA-required supplemental schedules and describe the inconsistency in the auditor's report.

.134 When the auditor concludes, on the basis of the procedures performed, that the information in the ERISA-required supplemental schedules is materially misstated in relation to the financial statements, the auditor should discuss the matters with management and propose appropriate revision of the ERISA-required supplemental schedules. If management does not revise the ERISA-required supplemental schedules, the auditor should discuss the matter with those charged with governance (unless all those charged with governance are involved in managing the plan). If the ERISA-required supplemental schedules are not revised, the auditor should modify the auditor's opinion regarding the ERISA-required supplemental schedules and describe the misstatement in the auditor's report. (Ref: par. .A149)

.135 If a material prohibited party-in-interest¹⁸ transaction that is not disclosed in the ERISA-required supplemental schedule is also considered a related party transaction and if that transaction is not properly disclosed in the notes to the ERISA plan financial statements, the requirements in paragraph .24 apply.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.12)

.A1 The AICPA Audit and Accounting Guide *Employee Benefit Plans* provides interpretive guidance to apply this section, including example audit procedures for performing an audit of ERISA plan financial statements. Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to consider applicable interpretive publications in planning and performing the audit.¹⁹

.A2 ERISA provides for federal government oversight of management's operating and reporting practices for EBPs. In addition to establishing reporting requirements for covered plans, ERISA establishes minimum standards for participation, vesting, and funding for defined benefit and defined contribution plans sponsored by private entities. It also establishes standards of fiduciary conduct and imposes specific restrictions and responsibilities on fiduciaries.

.A3 The plan administrator is identified in the plan document as having responsibility for managing the day-to-day administration and decisions for the plan. This section uses the term management to include the plan administrator as described in the DOL's Rules and Regulations for Reporting and Disclosure under ERISA as well as other members of management.

.A4 Under ERISA, the DOL and IRS have the authority to issue regulations governing the administration of EBPs, including reporting and disclosure requirements to be included in an annual filing with the DOL. The DOL does not establish the financial reporting framework, for example, the DOL

¹⁸ *Party in interest* is defined in Section 3(14) of ERISA.

¹⁹ Paragraph .27 of section 200.

does not set generally accepted accounting principles for ERISA plan financial statements. The selection of an acceptable financial reporting framework is the responsibility of management. The PBGC guarantees participants in most private-sector defined benefit pension plans certain minimum pension benefits if the plan terminates without sufficient money to pay all benefits, and it administers terminated plans in certain circumstances. The IRS, DOL, and PBGC have consolidated their reporting and disclosure requirements into Form 5500 to minimize the filing burden for plan management.

.A5 ERISA contains a requirement for annual audits of EBP financial statements by an independent qualified public accountant. Generally, plans with 100 or more participants (as defined in the Form 5500 instructions) are subject to the audit requirement. ERISA and DOL regulations require additional information to be disclosed in the financial statements or presented in supplemental schedules. ERISA also contains a requirement for the auditor to report on whether certain supplemental schedules, as identified in ERISA Section 103, are presented fairly, in all material respects, in relation to the financial statements as a whole.

.A6 A qualified institution is an organization as defined in accordance with 29 CFR 2520.103-5 and 29 CFR 2520.103-8 as a bank or similar institution that holds plan assets, or an insurance carrier which provides benefits under the plan or holds plan assets, that is regulated, supervised, and subject to periodic examination by a state or federal agency that prepares and certifies the investment information. The DOL's Rules and Regulations for Reporting and Disclosure under ERISA are outlined in 29 CFR 2520.103-1. Investment companies and broker-dealers are not considered qualified institutions as it relates to providing a certification.

.A7 An ERISA Section 103(a)(3)(C) audit may be elected by management only when a qualified institution certifies both the accuracy and completeness of the investment information submitted to the plan administrator. Certifications that address only accuracy or only completeness, but not both, do not comply with the DOL's regulation and, therefore, are not adequate to allow plan management to elect an ERISA Section 103(a)(3)(C) audit.

.A8 When performing an ERISA Section 103(a)(3)(C) audit, although the audit need not extend to investment information as discussed in paragraph .08, areas such as participant data; contributions; benefit payments; participant account balances, including related earnings and other allocations to such account balances; or other information would be subject to audit procedures, regardless of whether such information is included in the certified statement or information.

.A9 An ERISA Section 103(a)(3)(C) audit may relate to the audit of the plan's investment in an entity, as permitted by 29 CFR 2520.103-12 (a 103-12 investment entity), provided the 103-12 investment entity properly filed its report with the DOL. Accordingly, the guidance in this section is applicable whether an ERISA Section 103(a)(3)(C) audit is being performed pursuant to 29 CFR 2520.103-8 or 29 CFR 2520.103-12. However, the wording in the auditor's report may need to be revised to adapt to the circumstances of the engagement.

.A10 Sometimes, the plan's recordkeeper certifies the investment information on behalf of the plan's qualified institution as "agent for." In this situation, such certification generally would be acceptable when there is a contractual arrangement between a qualified institution and the recordkeeper such that the recordkeeper is able to provide the certification on the qualified institution's behalf.

.A11 ERISA requires certain comparative financial statements to be presented.

.A12 Paragraph .32 describes the auditor's responsibilities with respect to the disclosures in the financial statements covered by the certification.

.A13 As discussed in paragraph .A47, an ERISA Section 103(a)(3)(C) audit is unique to EBPs and is not considered a scope limitation as discussed in section 705. For an ERISA Section 103(a)(3)(C) audit, paragraph .119 requires the auditor to apply the requirements in section 705, adapted as necessary in the circumstances of the engagement, and provides further guidance on how section 705 should be adapted.

.A14 Section 800 also addresses the auditor's responsibilities when the auditor is reporting on financial statements prepared in accordance with a special purpose framework and is required by law or regulation to use a specific layout, form, or wording of the auditor's report. When reporting on financial statements prepared in accordance with a general purpose framework, and law or regulation requires a specific layout, form, or wording of the auditor's report, the auditor may adapt and apply the requirements in section 800.

.A15 Other AU-C sections that also contain reporting requirements include, but are not limited to, the following:

- Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*
- Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- Section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Section 730, *Required Supplementary Information*

Engagement Acceptance (Ref: par. .15)

.A16 The concept of an independent audit requires that the auditor not assume management's responsibility for the preparation and fair presentation of the financial statements. When the auditor assists in drafting the financial statements, in whole or in part, based on information provided by management during the performance of the audit, such assistance is considered a nonattest service under the "Nonattest Services" interpretation (ET sec 1.295) under the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. Before performing nonattest services, the auditor is required to establish and document in writing the auditor's understanding with the client regarding the objectives of the engagement, services to be performed, client's acceptance of its responsibilities, auditor's responsibilities, and any limitations of the engagement.

.A17 A draft of Form 5500 that is substantially complete includes the forms and schedules that could have a material effect, involving both qualitative and quantitative considerations, on the information in the financial statements and ERISA-required supplemental schedules.

Audit Risk Assessment and Response in an Audit of ERISA Plan Financial Statements (Ref: par. .18–.20)

.A18 Section 300, *Planning an Audit*, requires the auditor to establish an overall audit strategy that sets the scope, timing, and direction of the audit and

that guides the development of the audit plan.²⁰ The audit plan should include a description of the nature and extent of planned risk assessment procedures as determined under section 315A; the nature, timing, and extent of planned further audit procedures at the relevant assertion level as determined under section 330; and other planned audit procedures that are required to be carried out so that the engagement complies with GAAS.²¹

.A19 Obtaining an understanding of the plan and its environment, including its internal control, is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The auditor's understanding of the plan establishes a frame of reference for planning the audit and exercising professional judgment throughout the audit when the auditor does the following:

- Assesses the risks of material misstatement of the financial statements, including the related disclosures
- Determines materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*
- Considers the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures
- Identifies areas for which special audit consideration may be necessary
- Develops expectations for use when performing analytical procedures
- Responds to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence
- Evaluates the sufficiency and appropriateness of audit evidence obtained²²

.A20 Section 315A requires the auditor to perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and relevant assertion levels.²³ The consideration of risks of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence.

.A21 Section 330 requires the auditor to design and perform further audit procedures whose nature, timing, and extent are based on, and are responsive to, the assessed risks of material misstatement at the relevant assertion level.²⁴ Further audit procedures consist of tests of the operating effectiveness of controls and substantive procedures. Additionally, section 330 requires the auditor to evaluate whether the overall presentation of the financial statements, including the related disclosures, is in accordance with the applicable financial reporting framework.²⁵

²⁰ Paragraph .07 of section 300, *Planning an Audit*.

²¹ Paragraph .09 of section 300.

²² Paragraph .A1 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

²³ Paragraph .05 of section 315A.

²⁴ Paragraph .06 of section 330.

²⁵ Paragraph .26 of section 330.

.A22 ERISA Section 402 requires that EBPs be established and maintained pursuant to a written plan instrument. The IRC requires that the provisions in the plan document satisfy the requirements of the IRC; therefore, the plan provisions are required to be followed. The plan instrument for defined benefit pension plans and defined contribution pension plans is generally referred to as a plan document. Multiple documents for such plans, as well as health and welfare plans, may comprise the plan instrument. Among other requirements, for a plan to be qualified, the plan instrument must be in writing and communicated to employees. The terms of the plan instrument generally deal with matters such as eligibility of participants, entitlement to benefits, funding, plan amendments, operation and administration of plan provisions, identification of the plan's fiduciary, allocation of responsibilities among those who serve in a capacity as a fiduciary, and delegation of fiduciary duties in connection with the administration of the plan.

.A23 Management is responsible for determining that the plan's transactions that are presented and disclosed in the ERISA plan financial statements are in accordance with the plan instrument. Although some of the provisions of the plan instrument may not relate directly to accounts that are presented as financial statement account balances, they could affect matters such as disclosures, the tax qualified status of the plan, or the benefits that will be paid to participants when they become eligible for a distribution. For example, participant account balances are an accumulation of transactions and represent the amount that the participant is entitled to receive as a benefit payment. Overstated or understated participant account balances may result in errors in allocations or benefits paid to participants.

.A24 Participant data plays an important role in determining many of the account balances in the financial statements. The types of participant data that are tested in an ERISA plan audit will vary from plan to plan, depending upon the bases on which contributions, participant elections, participant allocations, and benefits are determined. In general, the data tested may include demographic data, such as birth date, marital status, date of hire, date of termination, and other demographic data that determines eligibility and vesting; payroll data, such as hours worked, earnings, and contributions to the plan; benefit data for participants receiving benefits; and participant elections for salary deferral percentage and investment elections. The procedures for testing payroll and participant data may be coordinated with those for plan contributions.

.A25 Many of the financial statement amounts in ERISA plan financial statements are determined from provisions specified in the plan instrument. For example, conditions relating to participation and eligibility provisions need to be met for employees to participate in the plan and receive contributions. Participation and eligibility provisions may be tested as part of the auditor's testing of contributions and individual participant accounts.

.A26 Other typical plan provisions include types of contributions and distributions, timing of the contributions, contribution limitations, investment of contributions, forms of distributions, benefit commencement dates, vesting and forfeitures, service requirements and credits, participant loans, transfers, and administration of plan.

.A27 Because of the nature of ERISA plan engagements, it would be rare for the auditor, based upon the assessed risks of material misstatement at the relevant assertion level, not to test any relevant plan provisions.

.A28 Appendix A to this section provides some examples of plan provisions often included in a plan instrument by audit area.

Plan Tax Status (Ref: par. .21)

.A29 When plans are granted special tax status for the contributions and earnings on plan investments to be exempt from taxation (tax-exempt status), such plans are required to be designed and operated in accordance with IRC requirements in order to maintain their tax-exempt status. Accordingly, the plan's tax status is fundamental to the plan.

.A30 To determine if a plan is operating within the specific guidelines established by the plan instrument in accordance with the IRC, management is responsible for conducting certain nondiscrimination and other compliance tests, which are required to be performed at least annually, unless otherwise provided by the IRC.

.A31 The auditor's consideration of whether the plan has performed and passed, corrected, or intends to correct failures of relevant IRC compliance tests may include inquiry and inspection.

.A32 The AICPA Audit and Accounting Guide *Employee Benefit Plans* discusses the tax status of EBPs, including nondiscrimination and other operating tests for plan qualification.

Prohibited Transactions (Ref: par. .22–.24)

.A33 A party in interest is defined in Section 3(14) of ERISA. The AICPA Audit and Accounting Guide *Employee Benefit Plans* contains common examples of parties that may be related parties, parties in interest, or both.

.A34 Certain plan transactions with parties in interest are prohibited under Sections 406 and 407 of ERISA (referred to as *prohibited transactions*) and are required, without regard to their materiality, to be disclosed to the DOL in the plan's Form 5500 if they occur.

.A35 Evaluating whether identified prohibited transactions have been appropriately reported in the ERISA-required supplemental schedule is often performed in conjunction with reading the draft Form 5500 and performing procedures on the ERISA-required supplemental schedule as discussed in paragraphs .127–.135.

.A36 ERISA requires that all transactions with parties in interest (excluding any transactions exempted from prohibited transaction rules) be disclosed in the ERISA-required supplemental schedule without regard to their materiality. For example, information on all delinquent participant contributions are required to be reported on Schedule H of Form 5500. Large plans with delinquent participant contributions are required to attach a Schedule of Delinquent Participant Contributions. All other prohibited transactions are reported on the Schedule of Nonexempt Transactions.

Evaluation and Documentation (Ref: par. .25)

.A37 Paragraph .27 of this section requires the auditor to communicate to those charged with governance the reportable findings from the audit procedures performed relating to the plan provisions. Section 230²⁶ requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand

- a. the nature, timing, and extent of the audit procedures performed to comply with GAAS and applicable legal and regulatory requirements;

²⁶ Paragraph .08 of section 230, *Audit Documentation*.

- b. the results of the audit procedures performed and the audit evidence obtained; and
- c. significant findings or issues arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Communication With Management or Those Charged With Governance (Ref: par. .27–.28)

.A38 The requirements of section 250 are designed to assist the auditor in identifying material misstatement of the financial statements due to noncompliance with laws and regulations. Section 250 requires the auditor to communicate with those charged with governance matters involving noncompliance with laws and regulations that come to the auditor's attention during the course of the audit, other than when the matters are clearly inconsequential, unless all those charged with governance are involved in management of the entity and aware of matters involving identified or suspected noncompliance already communicated by the auditor.²⁷

.A39 Section 260²⁸ requires the auditor to communicate with those charged with governance significant findings or issues from the audit. Such communication includes findings or issues arising from the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. For an ERISA plan, this may include operational errors that have been identified by the auditor as part of the audit when testing the plan provisions of the plan instrument.

.A40 It is important for the plan administrator, as part of his or her fiduciary responsibilities, to be informed about reportable findings identified during the audit so that the plan administrator can decide whether to participate in the IRS or DOL correction programs, if applicable. The auditor may want to discuss his or her reportable findings with the plan administrator prior to the written communication so that the plan administrator can take corrective action in a timely manner.

.A41 For the purposes of communications with those charged with governance, section 260 requires the auditor to determine the appropriate person or persons within the entity's governance structure with whom to communicate. When the appropriate person or persons with whom to communicate is not clearly identifiable, the auditor and the engaging party may need to discuss and agree on the relevant persons within the entity's governance structure with whom the auditor will communicate.

.A42 For an ERISA plan, the appropriate person or persons with whom to communicate may not be clearly identifiable from the engagement circumstances. Some plans have a formal board of trustees (or other formal governing body), and others do not. For a single-employer employee benefit plan, the individual charged with governance may include the individual with the level of authority and responsibility equivalent to an audit committee, such as the named fiduciary, which is often the plan sponsor or an officer thereof; the sponsor's board of directors or audit committee; or a committee overseeing the activities of the employee benefit plan, such as the employee benefit committee,

²⁷ Paragraph .21 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

²⁸ Paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*.

employee benefit administrative committee, employee benefit investment committee, plan administrator, or other responsible party.

.A43 Section 265 requires the auditor to communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit.²⁹ The auditor is required to communicate to management at an appropriate level of responsibility, on a timely basis, in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.³⁰

.A44 For an ERISA plan, instances identified by the auditor in which the plan is not operating in accordance with the plan's provisions may be indicative of a deficiency in internal control at the plan. If this is the case, the auditor is required to communicate such deficiency in accordance with section 265 when, in the auditor's professional judgment, the deficiency is of such importance to merit management's attention.

.A45 The communication of reportable findings relating to audit work performed that involved the testing of plan provisions may describe the plan provision relating to the reportable finding and may provide more details, or an explanation, about the reportable finding and its effect on the financial statements, if any. When explaining the potential effect of the reportable finding, the auditor need not quantify those effects.

.A46 Written communication indicating that no reportable findings were identified during the audit is precluded by paragraph .28 because such a communication has the potential to be misunderstood or misused.

Procedures for an ERISA Section 103(a)(3)(C) Audit (Ref: par. .29–.35)

.A47 The ERISA Section 103(a)(3)(C) audit is unique to EBPs and, as set forth in this standard, is not considered a scope limitation under section 705. The ability of management to make this election is dependent on the qualifications of the institution preparing and certifying the investment information. However, if the institution is not qualified, the auditor is precluded from performing the ERISA Section 103(a)(3)(C) audit.

.A48 The nature of procedures necessary to evaluate management's assessment may vary depending upon the auditor's knowledge of the plan and types of investments held. In some instances, inquiry of management may be sufficient.

.A49 Implications for the audit, as discussed in paragraph .30, may include withdrawing from the audit when withdrawal is possible under applicable law or regulation or considering a change in the terms of the audit engagement in accordance with section 210A because the auditor is precluded from performing an ERISA Section 103(a)(3)(C) audit.

.A50 When planning and performing the audit procedures for an ERISA Section 103(a)(3)(C) audit, the materiality considerations apply to the financial statements as a whole.

²⁹ Paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

³⁰ Paragraph .12 of section 265.

.A51 A qualified institution may certify all plan activity. However, as discussed in paragraph .A8, the ERISA Section 103(a)(3)(C) audit and corresponding required procedures in paragraph .32 extend only to investment information certified by a qualified institution.

.A52 The certification and results of the procedures performed by the auditor in paragraphs .32–.33 are considered part of audit evidence relating to the certified investment information when determining whether the form of opinion required by paragraphs .98–.126 is appropriate.

.A53 Comparing involves agreeing or reviewing reconciliations of the certified investment information with the amounts included in the ERISA plan financial statements and related investment disclosures as well as the investment information included in the ERISA-required supplemental schedules. To the extent that the investment information in the ERISA plan financial statements and related disclosures and ERISA-required supplemental schedules cannot be agreed to or derived from the certified information, appropriate audit procedures would need to be performed on such information.

.A54 Additional procedures typically include further inquiry, which might result in additional testing. The auditor may want to consider the implications such additional procedures may have on the nature, timing, and extent of other audit procedures, including consideration for revisions to the engagement letter and risk assessment. Depending upon how the matter is resolved, the additional procedures may result in a modification to the auditor's opinion in accordance with section 705.

.A55 If the auditor becomes aware that the certified investment information has not been appropriately measured, presented, or disclosed and, therefore, the financial statements may not be prepared in accordance with the applicable financial reporting framework, it is important for the auditor to communicate the matter to management. It is management's responsibility to prepare the financial statements and disclosures in conformity with the applicable financial reporting framework and with the DOL Rules and Regulations for Reporting and Disclosure under ERISA. Management may request that the trustee or custodian recertify or amend the certification to exclude investments that are not appropriately measured or to reflect the appropriate investment valuation.

.A56 If the trustee or custodian amends the certification to exclude such investments from the certification, management is responsible for valuing such investments as of the plan year-end, and the auditor would need to perform audit procedures on the investments excluded from the certification.

.A57 If the certified information is inaccurate, incomplete, or otherwise unsatisfactory and the certification is not amended, management is still responsible for determining whether the financial statements and disclosures related to such investment information are prepared in accordance with the applicable financial reporting framework and in conformity with the DOL Rules and Regulations for Reporting and Disclosure under ERISA and may need to engage the auditor to perform audit procedures on such information.

.A58 Performing an ERISA Section 103(a)(3)(C) audit of ERISA plan financial statements does not eliminate the requirement for the auditor to plan and perform the audit in accordance with GAAS.

Written Representations (Ref: par. .36)

.A59 The AICPA Audit and Accounting Guide *Employee Benefit Plans* provides interpretative guidance on representations that may be appropriate when

auditing ERISA plan financial statements. Section 725 requires specific written representations from management.³¹

A60 Administering the plan is covered by ERISA Sections 401–404, which establish responsibilities and imposes restrictions on plan fiduciaries. ERISA Section 209 (29 USC 1027 *Retention of Records*) requires the maintenance of records by employers relating to individual benefit reporting. ERISA Section 107 (29 USC 1059 *Recordkeeping and Reporting Requirements*) provides general record retention requirements for EBPs. ERISA requires that records be maintained in sufficient detail to permit the benefits to be properly calculated and paid when due.

Forming an Opinion on the ERISA Plan Financial Statements (Ref: par. .37)

A61 As described in section 200, a financial reporting framework is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

Qualitative Aspects of the Entity's Accounting Practices (Ref: par. .39)

A62 Management makes a number of judgments about the amounts and disclosures in the ERISA plan financial statements.

A63 Section 260 contains a discussion of the qualitative aspects of accounting practices.³² In considering the qualitative aspects of the plan's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

- a. The selective correction of misstatements brought to management's attention during the audit
- b. Possible management bias in the making of accounting estimates

A64 Section 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, addresses possible management bias in making accounting estimates. Indicators of possible management bias themselves do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

A65 *Accounting Policies Appropriately Disclosed in the ERISA Plan Financial Statements (Ref: par. 40a)*. In evaluating whether the ERISA plan financial statements appropriately disclose the significant accounting policies selected and applied, the auditor's consideration may include matters such as the following:

- Whether the financial statements include all disclosures related to the significant accounting policies that are required by the applicable financial reporting framework

³¹ Paragraph .07 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*.

³² See the appendix, "Qualitative Aspects of Accounting Practices," in section 260.

- Whether the information about the significant accounting policies that has been disclosed is relevant and therefore reflects how the recognition, measurement, and presentation criteria in the applicable financial reporting framework have been applied to classes of transactions, account balances, and disclosures in the financial statements in the particular circumstances of the plan's operations and its environment
- The clarity with which the significant accounting policies have been presented

.A66 *Information Presented in the Financial Statements Is Relevant, Reliable, Comparable, and Understandable (Ref: par. .40d).* Evaluating the understandability of the ERISA plan financial statements may include consideration of whether the information in the ERISA plan financial statements is presented in a manner that facilitates users' ability to identify necessary information. This may include whether the disclosures are appropriately labeled and cross-referenced.

Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the ERISA Plan Financial Statements (Ref: par. .40)

.A67 It is common for ERISA plan financial statements prepared in accordance with a general purpose framework to present a plan's net assets available for benefits and changes in net assets available for benefits. For defined benefit pension plans, the financial statements may also present accumulated plan benefits and changes in accumulated plan benefits. For defined benefit health and welfare plans, the financial statements may also present plan benefit obligations and changes in plan benefit obligations. Evaluating whether, in view of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on (a) the plan's net assets available for benefits, (b) changes in net assets available for benefits, (c) accumulated plan benefits and changes in accumulated plan benefits (for defined benefit pension plans), and (d) plan benefit obligations and changes in plan benefit obligations (for defined benefit health and welfare plans) may include consideration of such matters as the following:

- The extent to which the information in the ERISA plan financial statements is relevant and specific to the circumstances of the plan
- Whether the disclosures are adequate to assist the intended users in understanding the following:
 - The nature and extent of the plan's assets and liabilities arising from transactions or events that do not meet the criteria for recognition (or the criteria for derecognition) established by the applicable financial reporting framework
 - The methods used and the assumptions and judgments made, and changes to them, that affect amounts presented or otherwise disclosed, including relevant sensitivity analyses

Evaluating Whether the ERISA Plan Financial Statements Achieve Fair Presentation (Ref: par. .41)

.A68 Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. As noted in section 200, a *fair presentation financial reporting framework*³³ not only requires compliance with the requirements of the framework but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework.

.A69 The auditor's evaluation about whether the ERISA plan financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the plan, including changes thereto, based on the auditor's understanding of the plan and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements as a whole.³⁴ [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 138.]

.A70 Evaluating whether the ERISA plan financial statements achieve fair presentation may include, for example, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example, the following:

- The degree to which the amounts in the ERISA plan financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information, or results in misleading information
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted

.A71 The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the auditor would have no consistent standard for evaluating the presentation of the following in the financial statements:

- Net assets available for benefits
- Accumulated plan benefits (for defined benefit pension plans)
- Plan benefit obligations (for defined benefit health and welfare plans)
- Changes in net assets available for benefits
- Changes in accumulated plan benefits (for defined benefit pension plans)

³³ Paragraph .14 of section 200.

³⁴ See section 320.

- Changes in plan benefit obligations (for defined benefit health and welfare plans)

Description of the Applicable Financial Reporting Framework (Ref: par. .42)

.A72 As explained in section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.³⁵ That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

.A73 The description may indicate that the financial statements have been prepared in accordance with that framework. Such a statement is appropriate only when the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

.A74 Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

.A75 The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework. Such information may not be required by the applicable financial reporting framework but may be presented as part of the basic financial statements. As discussed in paragraph .97, such information is considered an integral part of the financial statements if it cannot be clearly differentiated and, accordingly, is covered by the auditor's opinion.

Form of Opinion***Fair Presentation (Ref: par. .46)***

.A76 In some instances, the ERISA plan financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. When this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in unusual circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements, which would be extremely rare.

.A77 The "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct states the following:

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole.

³⁵ Paragraphs .A2–.A3 of section 200.

If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Considerations Relating to Form 5500 Filing

Reading the Draft Form 5500 (Ref: par. .47–.49)

.A78 Paragraph .47 requires the auditor to obtain and read the draft Form 5500 prior to dating the auditor's report. Obtaining a draft Form 5500 prior to dating the auditor's report enables the auditor to resolve possible material inconsistencies and apparent material misstatements of facts with management on a timely basis. An agreement with management regarding when the Form 5500 will be filed may be helpful. A *misstatement of fact* is information contained in the Form 5500 unrelated to matters appearing in the audited ERISA plan financial statements that is incorrectly stated or presented. *Misstatements of fact* may be identified by the auditor upon reading the draft Form 5500 for the purpose of identifying material inconsistencies, as discussed in paragraph .57.

.A79 Information in the draft Form 5500 may be relevant to an independent audit or the continuing propriety of the auditor's report. Information contained in the Form 5500 that conflicts with information contained in the audited ERISA plan financial statements is considered an inconsistency. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the ERISA plan financial statements.

.A80 Certain differences may exist between the Form 5500 Schedule H, *Financial Information*, and the ERISA plan financial statements. DOL rules and regulations require the notes to the ERISA plan financial statements to include an explanation of differences, if any, between the information contained in the separate ERISA plan financial statements and the net assets, liabilities, income, expense, and changes in net assets as required to be reported on the Form 5500 Schedule H. There are some differences that are not considered inconsistencies with Form 5500, for example, differences resulting from accruals recorded in the ERISA plan financial statements that are not reported in Form 5500 when Form 5500 is on a cash basis or benefits payable required to be reported on Form 5500 but not recorded in the ERISA plan financial statements. In contrast, a difference in investment categories may be due to a misclassification that may require correction in either the ERISA plan financial statements or Form 5500.

.A81 *Material Inconsistencies With the Draft Form 5500 Identified Prior to the Report Release Date That Require Revision of the Draft Form 5500 (Ref: par. .53).* When management refuses to revise the information in the draft Form 5500, the auditor may base any decision on what further action to take on advice from the auditor's legal counsel.

.A82 *Material Inconsistencies Identified Subsequent to the Report Release Date (Ref: par. .54–.56).* When revision of the information in Form 5500 is necessary after the report release date and management agrees to make the revision, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued ERISA plan

financial statements, the auditor's report thereon, and Form 5500 are informed of the need for revision.

.A83 When revision of information in the Form 5500 is necessary after the report release date but management refuses to make the revision, appropriate further actions by the auditor may include obtaining legal advice.

Material Misstatement of Fact (Ref: par. .57–.59)

.A84 When discussing an apparent material misstatement of fact in the draft Form 5500 with management, the auditor may not be able to evaluate the validity of some disclosures included within the draft Form 5500 and management's responses to the auditor's inquiries and may conclude that valid differences of judgment or opinion exist.

.A85 When the auditor concludes that there is a material misstatement of fact that management refuses to correct, appropriate further actions by the auditor may include obtaining legal advice from the auditor's legal counsel, withholding the auditor's report if such report has not been released, or withdrawing from the engagement when withdrawal is possible under applicable law or regulation.

Auditor's Report on ERISA Plan Financial Statements (Other Than for an ERISA Section 103(a)(3)(C) Audit) (Ref: par. .60–.82)

.A86 A written report encompasses reports issued in hard copy format and those using an electronic medium.

.A87 Exhibit A, "Illustrations of Auditor's Reports on Financial Statements of Employee Benefit Plans Subject to ERISA," contains illustrations of auditor's reports on financial statements for ERISA plans. With the exception of the "Opinion"³⁶ and "Basis for Opinion" sections, this section does not establish requirements for ordering the elements of the auditor's report. However, this section requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with GAAS more recognizable, particularly in situations in which the elements of the auditor's report are presented in an order that differs from the illustrative auditor's reports in the exhibit to this section.

Title (Ref: par. .61 and .100)

.A88 Section 200 provides guidance on reporting when the auditor is not independent.³⁷

Addressee (Ref: par. .62 and .101)

.A89 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being audited or to those charged with governance. Occasionally, an auditor may be retained to audit the financial statements of an entity that is not a client; in such a case, the report may be addressed to the client and not to those charged with governance of the entity whose financial statements are being audited.

³⁶ For an ERISA Section 103(a)(3)(C) audit this relates to the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section, the "Opinion" section, and the "Basis for Opinion" section of the report.

³⁷ Paragraph .A18 of section 200.

.A90 For ERISA plans, the report may be addressed to the plan or trust whose ERISA plan financial statements are being audited, the plan administrator or board of trustees, or participants and beneficiaries.

Auditor's Opinion (Ref: par. .64)

.A91 The auditor's report states, for example, that the auditor has "audited the financial statements of ABC Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), which comprise the statements of net assets available for benefits as of December 31, 20X1 and 20X2, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements."

.A92 The identification of the title and the dates of, or periods covered by, each statement that the financial statements comprise may also be achieved by referencing the table of contents in a document bound with or accompanying the financial statements and auditor's report thereon.

.A93 When the auditor is aware that the audited financial statements will be included in a document that contains information in addition to the financial statements and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users identify the financial statements to which the auditor's report relates.

.A94 When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion because these suggest a conditional opinion or a weakening or modification of the opinion.

.A95 The auditor's opinion covers the complete set of ERISA plan financial statements, as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the ERISA plan financial statements include statements of net assets available for benefits and a statement of changes in net assets available for benefits; for defined benefit pension plans, a statement of accumulated plan benefits and a statement of changes in accumulated plan benefits; and for a defined benefit health and welfare plan, a statement of benefit obligations and statement of changes in benefit obligations, including related notes. In some circumstances, additional or different statements, schedules, or information also might be considered to be an integral part of the ERISA plan financial statements.

.A96 The reports in exhibit A include example wording that may be used to replace the [...] based on the applicable financial reporting framework.

.A97 The title of the financial statements identified in the "Opinion" section (see paragraph .64c) describes the information that is the subject of the auditor's opinion. For example, in the case of ERISA plan financial statements prepared in accordance with U.S. GAAP, these may include statements of net assets available for benefits (and of accumulated plan benefits) as of the end of the period and the statement of changes in net assets available for benefits (and of changes in accumulated plan benefits) for the period then ended. For defined benefit pension plans, the accumulated plan benefits and changes in accumulated plan benefits may be presented in the notes to the financial statements. The notes to the financial statements are an integral part of the financial statements, so the auditor's opinion covers these amounts regardless of whether they are presented in separate statements or in the notes to the financial statements. Therefore, the auditor is not required to make specific reference to the benefit information in the opinion paragraph of the auditor's

report when the benefit information is presented in the notes to the financial statements.

.A98 *Description of the applicable financial reporting framework and how it may affect the auditor's opinion (Ref: par. .66).* The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph .41. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles.

Basis for Opinion (Ref: par. .67 and .107)

.A99 The "Basis for Opinion" section provides important context about the auditor's opinion. Accordingly, this section requires the "Basis for Opinion" section to directly follow the "Opinion" section in the auditor's report.

.A100 The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards. For example, the auditor's report may refer to auditing standards generally accepted in the United States of America or U.S. GAAS.

.A101 In accordance with section 200, the auditor does not represent compliance with GAAS in the auditor's report unless the auditor has complied with the requirements of section 200 and all other AU-C sections relevant to the audit.³⁸

Relevant Ethical Requirements (Ref: par. .67c and .107c)

.A102 Section 200 explains that ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.³⁹ When the AICPA Code of Professional Conduct applies, the auditor's other ethical responsibilities relate to the principles of professional conduct (ET sec. 0.300, *Principles of Professional Conduct*). ERISA Section 103(a)(3)(A) requires that the accountant retained by an employee benefit plan be "independent" for purposes of examining plan financial information and rendering an opinion on the financial statements schedules required to be contained in the annual report. The DOL has issued guidelines (29 CFR 2509.75-9) for determining when an auditor is independent for purposes of auditing and rendering an opinion on the annual report.

.A103 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable, the rule or applicable regulation, or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources.

Key Audit Matters (Ref: par. .69 and .109)

.A104 Section 210A requires the audit engagement letter or other suitable form of written agreement to include reference to the expected form and content of any reports to be issued by the auditor.⁴⁰

³⁸ Paragraph .22 of section 200.

³⁹ Paragraph .A15 of section 200.

⁴⁰ Paragraph .10 of section 210A, *Terms of Engagement*.

Responsibilities of Management for the Financial Statements
(Ref: par. .70–.72 and .110–.112)

.A105 Section 200 explains the premise relating to the responsibilities of management and, when appropriate, those charged with governance on which an audit in accordance with GAAS is conducted.⁴¹ Management and, when appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both of these responsibilities because it helps explain to users the premise on which an audit is conducted. Section 260 uses the term *those charged with governance* to describe the persons or organizations with responsibility for overseeing the plan, and provides a discussion about the diversity of governance structures among entities.

.A106 Management has additional responsibilities when arranging for an audit of ERISA plan financial statements due to the regulatory nature of such plans.

.A107 In some instances, a document containing the auditor's report may include a separate statement by management or those charged with governance regarding their responsibility for the preparation of the financial statements. Any elaboration in the auditor's report about the responsibilities of management or those charged with governance regarding the preparation of the financial statements, or reference to a separate statement by management or those charged with governance about such responsibilities if one is included in a document containing the auditor's report, may lead users to erroneously believe that the auditor is providing assurances about representations made by management or those charged with governance about their responsibility for financial reporting, internal control, and other matters that might be discussed in the management report.

Auditor's Responsibilities for the Audit of the Financial Statements
(Ref: par. .73–.76 and .113–.118)

.A108 The description of the auditor's responsibilities as required by paragraphs .73–.76 or .113–.118 of this section may be tailored to reflect the specific nature of the plan.

.A109 *Objectives of the Auditor* (Ref: par. .74 and .114). The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion.⁴² These objectives are in contrast to management's responsibilities for the preparation and fair presentation of the financial statements.

⁴¹ Paragraphs .05 and .A2 of section 200.

⁴² For an ERISA Section 103(a)(3)(C) audit, the auditor's report explains that, except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of the auditor's report, the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatements, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion.

.A110 Because the auditor's opinion is based on obtaining reasonable assurance, the auditor's report does not constitute a guarantee. Because of the inherent limitation of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS.⁴³

.A111 When the applicable financial reporting framework defines materiality differently from the definition in section 320, the auditor's report may need to reflect the definition or description of materiality from the applicable financial reporting framework.

Other Reporting Responsibilities (Ref: par. .78–.79)

.A112 In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under GAAS to report on the financial statements. The form and content of the "Other Reporting Responsibilities" section of the auditor's report described in paragraph .78 will vary depending on the nature of the auditor's other reporting responsibilities.

.A113 In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

.A114 These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor's report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

Signature of the Auditor (Ref: par. .80 and .124)

.A115 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm.

.A116 The DOL's Rules and Regulations for Reporting and Disclosure under ERISA contain requirements for how the accountant's report is to be signed for filing with the DOL.

Auditor's Address (Ref: par. .81 and .125)

.A117 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

.A118 In accordance with 29 CFR 2520.103-1(b)(5)(i)(C) of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA, the auditor's report is required to indicate the city and state where it is issued.

Date of the Auditor's Report (Ref: par. .82 and .126)

.A119 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review

⁴³ Paragraph .A56 of section 200 and paragraph .10d of section 210A.

of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.⁴⁴ When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.⁴⁵

.A120 The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in section 560.

.A121 Because the auditor's opinion is provided on the ERISA plan financial statements, and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements and disclosures that the financial statements comprise have been prepared, and management has accepted responsibility for them.

Comparative Financial Statements (Ref: par. .85)

.A122 The level of information included for the prior periods in comparative financial statements is comparable with that of the financial statements of the current period.

.A123 Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, use the ERISA Section 103(a)(3)(C) audit report, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor's opinion on one or more financial statements of another period presented.

.A124 ERISA requires a statement of assets and liabilities of the plan to be displayed in comparative form. This may be achieved by presenting the statement of net assets available for benefits in comparative form.

Updating the Report (Ref: par. .86)

.A125 An updated report on prior period financial statements is distinguished from a reissuance of a previous report.⁴⁶ When issuing an updated report, the information considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor's report on the current period financial statements.

Other Considerations Relating to Comparative Financial Statements (Ref: par. .86)

.A126 If one firm of independent auditors merges with another firm, and the new firm becomes the auditor of a former client of one of the two former firms, the new firm may accept responsibility and express an opinion on the financial statements for the prior periods, as well as on those for the current

⁴⁴ See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

⁴⁵ Paragraph .21 of section 220A.

⁴⁶ See section 560.

period. In such circumstances, paragraphs .85–.96 of this section apply. The new firm may indicate in the auditor's report or as part of the signature that a merger took place and may name the firm of independent auditors that was merged with it. If the new firm decides not to express an opinion on the prior period financial statements, the guidance for the reissuance of reports in section 560 would apply.

Written Representations (Ref: par. .91)

.A127 In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to reaffirm that the written representations it previously made with respect to the prior period remain appropriate.

Opinion on Prior Period Financial Statements Different From Previous Opinion (Ref: par. .92)

.A128 When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if, during the course of the audit of the current period, the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.⁴⁷

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: par. .94)

.A129 The predecessor auditor may be unable or unwilling to reissue the auditor's report on the prior period financial statements that have been restated. In this situation, provided that the auditor has audited the adjustments to the prior period financial statements, the auditor may include an other-matter paragraph⁴⁸ in the auditor's report indicating that the predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the auditor is engaged to audit the adjustments and obtains sufficient appropriate audit evidence to be satisfied about the appropriateness of the restatement, the auditor's report may also include the following paragraph within the other-matter paragraph:

As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the Plan other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements as a whole.

Prior Period Financial Statements Not Audited (Ref: par. .95–.96)

.A130 When the auditor is auditing a plan that previously was not subject to audit, section 510 applies.

.A131 The following is an example of an other-matter paragraph when a review was performed on the prior period financial statements:

⁴⁷ See footnote 46.

⁴⁸ See section 706.

Other Matter

The 20X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 20X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in accordance with accounting principles generally accepted in the United States of America. A review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements as a whole.

.A132 The following is an example of an other-matter paragraph when a compilation was performed on the prior period financial statements:

Other Matter

We (other accountants) performed a compilation engagement with respect to the 20X1 financial statements and our (their) report thereon, dated March 1, 20X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

.A133 If the prior period financial statements were not audited, reviewed, or compiled, the following is an example of an other-matter paragraph:

Other Matter

The accompanying statement of net assets available for benefits of XYZ Plan as of December 31, 20X1, and the related statement of changes in net assets available for benefits for the year then ended were not audited, reviewed, or compiled by us and, accordingly, we do not express an opinion or any other form of assurance on them.

Information Presented in the Financial Statements (Ref: par. .97)

.A134 In some circumstances, the plan may be required by law, regulation, or standards, or may voluntarily choose, to include in the basic financial statements information that is not required by the applicable financial reporting framework. The auditor's opinion covers information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented.

.A135 ERISA requires certain items to be disclosed in the notes to the financial statements that may not also be required to be disclosed by the applicable financial reporting framework. Appendix A of the AICPA Audit and Accounting Guide *Employee Benefit Plans* contains a list of the disclosure items required by ERISA.

.A136 If the information included in the basic financial statements is not required by the applicable financial reporting framework and is not necessary for fair presentation but is clearly differentiated, then such information may be identified as *unaudited* or as *not covered by the auditor's report*.

Auditor's Report for an ERISA Section 103(a)(3)(C) Audit (Ref: par. .98–.126)

.A137 ERISA requires certain comparative financial statements to be presented; therefore, paragraphs .85–.96 apply even when performing an ERISA Section 103(a)(3)(C) audit.

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit (Ref: par. .103)

.A138 The auditor's report states, for example, that the auditor has "performed audits of the financial statements of ABC 401(k) Plan, an employee

benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X1 and 20X2, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements."

.A139 Management may also elect to have an ERISA Section 103(a)(3)(C) audit when management has elected to file its audited financial statements in accordance with 29 CFR 2520.103-12 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA. In such circumstances, the report wording may need to be changed to reflect the circumstances of the engagement.

.A140 In accordance with ERISA, insurance entities may provide benefits under the plan or hold plan assets. Accordingly, the wording in the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section in paragraph .103g and the opinion in paragraph .104b may need to be revised.

Modifications to the Opinion (Ref: par. .119)

.A141 As discussed in paragraphs .A13 and .A47, an ERISA Section 103(a)(3)(C) audit is unique to EBPs and is not considered a scope limitation as discussed in section 705.

.A142 When performing an ERISA Section 103(a)(3)(C) audit, the auditor may encounter situations in which the financial statements are materially misstated or a limitation on the scope of the audit exists. For example, if the plan has not maintained sufficient accounting records and supporting documents and the auditor is unable to apply certain auditing procedures, the auditor may need to disclaim an opinion on the ERISA plan financial statements and ERISA-required supplemental schedules.

Other Reporting Responsibilities (Ref: par. .122-.123)

.A143 In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under GAAS to report on the financial statements. The form and content of the "Other Reporting Responsibilities" section of the auditor's report described in paragraph .123 will vary depending on the nature of the auditor's other reporting responsibilities.

.A144 In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

.A145 These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor's report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

Reporting on Supplemental Schedules (Ref: par. .127-.135)

.A146 According to 29 CFR 2520.103-10, the administrator of a plan filing an annual report pursuant to ERISA Section 2520.103-1(a)(2) should, as provided in the instructions to Form 5500, include as part of the annual report certain separate financial schedules.

.A147 Such schedules are required to be attached to the Form 5500 filing.⁴⁹ These schedules are covered by the auditor's report on whether such ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole, in accordance with section 725. Form 5500 is updated annually and, therefore, Form 5500 contains the most current information about the required schedules.

.A148 The requirements in paragraphs .129–.135 apply only to the ERISA-required supplemental schedules, as applicable. When supplementary information that is not required by ERISA accompanies the financial statements, the auditor may also be engaged to report on whether the supplementary information not required by ERISA is fairly stated, in all material respects, in relation to the financial statements as a whole. In such circumstances, the auditor is required to follow the requirements in section 725 in its entirety, and the requirements in paragraphs .129–.135 of this section do not apply. This may result in the inclusion of a separate section (as required by paragraph .129) or an other-matter paragraph (as required by paragraph .132) in the auditor's report, as applicable, relating to the ERISA-required supplemental schedules and a separate section relating to the other supplementary information accompanying the ERISA plan financial statements presented in accordance with section 725. [As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Errors, Omissions, or Inconsistencies in ERISA-Required Supplemental Schedules

.A149 When the auditor concludes, on the basis of the procedures performed, that the ERISA-required supplemental schedules are materially misstated in relation to the financial statements as a whole, section 725 requires the auditor to discuss the matters with management and propose appropriate revision of the ERISA-required supplemental schedules. If management does not revise the ERISA-required supplemental schedules, the auditor is required to modify the auditor's opinion on the ERISA-required supplemental schedules and describe the misstatement in the auditor's report. If a separate report is being issued on the ERISA-required supplemental schedules, the auditor is required to withhold the auditor's report on the supplemental schedules.⁵⁰

.A150 During the audit, the auditor may become aware of a departure from DOL requirements relating to the ERISA-required supplemental schedules that is not also a departure from the applicable financial reporting framework. In such circumstances, the auditor may consider including an additional discussion in the ERISA-required supplemental schedules section of the auditor's report (or for an ERISA Section 103(a)(3)(C) audit, the other-matter paragraph relating to the ERISA-required supplemental schedules) that describes the error, omission, or inconsistency. When the departure relates to a prohibited transaction with a party in interest, see paragraphs .22–.24.

.A151 When the auditor concludes that the supplemental schedules do not contain all required information or contain information that is inaccurate or inconsistent with the ERISA plan financial statements and the omission or inconsistency is not considered a material misstatement, the auditor may decide to include a discussion in the ERISA-required supplemental schedules section of the auditor's report (or for an ERISA Section 103(a)(3)(C) audit, the

⁴⁹ Appendix A of the AICPA Audit and Accounting Guide *Employee Benefit Plans* provides a listing of the required ERISA schedules.

⁵⁰ Paragraph .13 of section 725.

other-matter paragraph relating to the ERISA-required supplemental schedules) that describes the omission or inconsistency of the information.

.A152 Departures from the DOL requirements relating to the ERISA-required supplemental schedules includes omitted required information, information that is inaccurate or inconsistent with the ERISA plan financial statements, or an omitted ERISA-required supplemental schedule.

.A153

Appendix A — Examples of Plan Provisions by Audit Area (Not All-Inclusive)

Paragraph .20 of this section requires the auditor to consider relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures when designing and performing audit procedures. The relevant plan provisions will vary for each type of plan and the circumstances of each engagement. When designing audit procedures, the testing of relevant plan provisions may be coordinated among the various audit areas to which they relate.

The following are some examples of plan provisions often included in a plan instrument by audit area (this list is not all-inclusive).

- *Individual Participant Accounts*
 - Participation and eligibility requirements
 - Types of contributions and distributions
 - Timing of contributions
 - Contribution limitations
 - Investment of contributions
 - Allocations to participant accounts
 - Forms of distributions
 - Benefit commencement dates
 - Vesting and forfeitures
 - Service requirements and credits
 - Participant loans
 - Transfers
 - Administration of the plan
- *Contributions and Contributions Receivable*
 - Participation and eligibility requirements
 - Types of contributions
 - Timing of contributions
 - Contribution limitations
 - Investment of contributions
 - Use of forfeitures
 - Service requirements and credits
 - Allocations to participant accounts
- *Distributions and Related Obligations*
 - Eligibility requirements (distributable events)
 - Types of distributions
 - Forms of distribution
 - Benefit commencement dates
 - Determination of benefits

- Vesting
 - Service requirements and credits
 - Allocations to participant accounts
- *Claims* (in a health and welfare plan)
 - Eligibility requirements
 - Types of claims
 - Claims coverage
 - Determination of claims
- *Loans to Participants*
 - Eligibility requirements
 - Loan terms
 - Allocations to participant accounts
- *Investments and Investment Income*
 - Investment of contributions
 - Administrative provisions
 - Direction of investments
 - Allocations to participant accounts
- *Expenses*
 - Administrative provisions
 - Allocations to participant accounts

.A154

Exhibit A — Illustrations of Auditor's Reports on Financial Statements of Employee Benefit Plans Subject to ERISA

Illustration 1 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA

Illustration 2 — An Auditor's Report on Financial Statements for a Defined Benefit Pension Plan Subject to ERISA

Illustration 3 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects the ERISA Section 103(a)(3)(C) Audit

Illustration 4 — An Auditor's Report Containing a Qualified Opinion on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When the Auditor Has Performed an ERISA Section 103(a)(3)(C) Audit

Illustration 5 — An Auditor's Report Containing an Adverse Opinion on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When the Auditor Has Performed an ERISA Section 103(a)(3)(C) Audit

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion, Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence Because the Plan Has Not Maintained Sufficient Accounting Records, on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When the Auditor Has Performed an ERISA Section 103(a)(3)(C) Audit

Illustration 1 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA

Circumstances include the following:

- Audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion on the ERISA plan financial statements is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as a separate section in accordance with paragraphs .129–.130. The auditor has concluded that the information in the ERISA-required supplemental schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Independent Auditor's Report

[Appropriate Addressee]

Opinion

We have audited the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), which comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets available for benefits of ABC 401(k) Plan as of December 31, 20X2 and 20X1, and the changes in its net assets available for benefits for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion

on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

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

Supplemental Schedules Required by ERISA

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules of [*identify title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion, the information in the accompanying schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 2 — An Auditor's Report on Financial Statements for a Defined Benefit Pension Plan Subject to ERISA

Circumstances include the following:

- Audit of a complete set of general purpose financial statements for a defined benefit pension plan subject to ERISA (comparative statements of net assets available for benefits and accumulated plan benefits [end-of-year benefit information date] and a single-year statement of changes in net assets available for benefits and changes in accumulated plan benefits).
- The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements (paragraph .A91 provides guidance when the accumulated plan benefit information is presented in the notes to the financial statements).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion on the ERISA plan financial statements is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as a separate section in accordance with paragraphs .129–.130. The auditor has concluded that the information in the ERISA-required supplemental schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Independent Auditor's Report

[Appropriate Addressee]

Opinion

We have audited the financial statements of XYZ Pension Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), which comprise the statements of net assets available for benefits and of accumulated plan benefits as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets available for benefits and accumulated plan benefits of XYZ Pension Plan as of December 31, 20X2 and 20X1, and the changes in its net assets available for benefits and changes in its accumulated plan benefits for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Pension Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and

perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Pension Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Pension Plan's ability to continue as a going concern for a reasonable period of time.

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

Supplemental Schedules Required by ERISA

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules of *[identify title of supplemental schedules and periods covered]* are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion, the information in the accompanying schedules is fairly stated, in all material respects, in relation to the financial statements as a whole, and the form and content are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 3 — An Auditor's Report on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by Code of Federal Regulations (CFR), *Labor*, Title 29, Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.¹
- The auditor performed an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- There are no limitations on the scope of the audit, and the auditor has not identified any material misstatements of the ERISA plan financial statements.
- The auditor has concluded that the ERISA Section 103(a)(3)(C) report is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. The auditor has concluded that the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, is presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. The information in the supplemental schedules related to assets held by and certified to by a qualified institution agreed to or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

¹ Although not as common, an ERISA Section 103(a)(3)(C) audit may relate to the audit of a 103-12 entity as permitted by 29 CFR 2520.103-12. Accordingly, the wording in this illustrative report may need to be revised to fit the circumstances of the engagement.

Independent Auditor's Report

[Appropriate Addressee]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.²

Opinion

In our opinion, based on our audits and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the accompanying financial statements related to assets held by³ and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities,

² If the note to the financial statements does not identify the names of the qualified certifying institutions and periods covered, then such information may be included in the auditor's report.

³ This sentence may need to be modified when the certification is provided by an insurance entity, which provides benefits under the plan or holds plan assets.

in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by

management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [*identify the title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

- the information in the supplemental schedules related to assets held by⁴ and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁴ See footnote 3.

Illustration 4 — An Auditor's Report Containing a Qualified Opinion on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.⁵
- The auditor performed an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements have inadequate disclosures. The auditor has concluded that (a) it is not practicable to present the required information, and (b) the effects are such that an adverse opinion is not appropriate. Accordingly, the auditor's report contains a qualified ERISA Section 103(a)(3)(C) audit opinion. [Note: For this example, the form of modified opinion is appropriate in the circumstances; however, generally, the DOL will reject Form 5500 filings that contain modified opinions.]
- There are no limitations on the scope of the audit.
- The auditor has concluded that a qualified ERISA Section 103(a)(3)(C) report is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. The auditor has concluded that the qualification has an effect on the supplemental schedules because it is information also required by DOL Rules and Regulations for Reporting and Disclosure under ERISA. The auditor has included a discussion

⁵ See footnote 1.

in the other-matter paragraph that describes the matter as discussed in paragraph .A151 of this section.

Independent Auditor's Report

[Appropriate Addressee]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.⁶

Qualified Opinion

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion section of our report, based on our audits and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the accompanying financial statements related to assets held by⁷ and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Basis for Qualified Opinion

ABC 401(k) Plan's financial statements do not disclose [describe the nature of the omitted information that is not practicable to present in the auditor's

⁶ See footnote 2.

⁷ See footnote 3.

report]. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of *[identify title of supplemental schedules and periods covered]* are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Schedule *[identify supplemental schedule]* that accompanies ABC 401(k) Plan's financial statements does not disclose *[describe the nature of the omitted information]*. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion, except for the effects of *[describe the nature of the omitted information]* as described in the Basis for Qualified Opinion section, on Schedule *[identify the schedule]*

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- the information in the supplemental schedules related to assets held by⁸ and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁸ See footnote 3.

Illustration 5 — An Auditor's Report Containing an Adverse Opinion on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by 29 CFR 2520.103-8 of the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under ERISA.⁹
- The auditor performed an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements are materially misstated. The material misstatement is deemed to be pervasive to the financial statements. Accordingly, the auditor's report contains an adverse opinion. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so. [Note: For this example, the form of modified opinion is appropriate in the circumstances; however, generally, the DOL will reject Form 5500 filings that contain modified opinions.]
- There are no limitations on the scope of the audit.
- The auditor has concluded that an adverse ERISA Section 103(a)(3)(C) report is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor is precluded from communicating key audit matters when issuing an adverse opinion.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. Because the auditor has issued an adverse ERISA Section 103(a)(3)(C) audit opinion, the auditor is precluded from issuing an opinion on the supplemental schedules.

⁹ See footnote 1.

Independent Auditor's Report

[Appropriate Addressee]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.¹⁰

Adverse Opinion

In our opinion, because of the significance of the matter described in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly the net assets available for benefits of ABC 401(k) Plan as of December 31, 20X2 and 20X1, and the changes in net assets available for benefits for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Adverse Opinion

As described in Note X, ABC 401(k) Plan *[describe the material misstatement of the financial statements]*. Under accounting principles generally accepted in the United States of America *[describe how the matter should have been accounted for in accordance with accounting principles generally accepted in the United States of America]*. The effects on the financial statements have not been determined.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse ERISA Section 103(a)(3)(C) audit opinion.

¹⁰ See footnote 2.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — ERISA-Required Supplemental Schedules

The supplemental schedules of [*identify title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Because of the significance of the matter described in the Basis for Adverse Opinion section of our report, it is inappropriate to and we do not express an opinion on the supplemental schedules referred to above.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion, Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence Because the Plan Has Not Maintained Sufficient Accounting Records, on Financial Statements of a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit, as permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.¹¹
- The auditor was engaged to perform an ERISA Section 103(a)(3)(C) audit of a complete set of general purpose financial statements for a 401(k) plan subject to ERISA (comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits).
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- There are no known material misstatements to the financial statements.
- The auditor was unable to obtain sufficient appropriate audit evidence for certain participant account balances that merged into the plan in 20XX. This is a limitation on the scope of the audit in accordance with section 705. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's report contains a disclaimer of opinion. [Note: For this example, the form of modified opinion is appropriate in the circumstances; however, generally, the DOL will reject Form 5500 filings that contain modified opinions.]
- The auditor has concluded that a disclaimer of opinion relating to the ERISA Section 103(a)(3)(C) audit is appropriate based on the audit evidence obtained.
- The auditor is precluded from communicating key audit matters when issuing a disclaimer of opinion.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.
- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph in accordance with paragraph .132. Because the auditor has disclaimed an opinion on the ERISA plan financial statements, the auditor is precluded from issuing an opinion on the supplemental schedules.

¹¹ See footnote 1.

Independent Auditor's Report

[Appropriate Addressee]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We were engaged to perform audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.¹²

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of ABC 401(k) Plan. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

Basis for Disclaimer of Opinion

ABC 401(k) Plan does not have sufficient accounting records and supporting documents relating to certain participant account balances that merged into ABC 401(k) Plan in 20XX. Accordingly, we were unable to apply auditing procedures sufficient to determine the extent to which the accompanying financial statements may have been affected by these conditions.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise

¹² See footnote 2.

substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of ABC 401(k) Plan's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC 401(k) Plan, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits.

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of *[identify the title of supplemental schedules and periods covered]* are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section, it is inappropriate to and we do not express an opinion on the supplemental schedules referred to above.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Revised, January 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138. As amended, effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.A155

Exhibit B — Implementation Guidance for ERISA Section 103(a)(3)(C) Audits

ERISA requires a statement of assets and liabilities of the plan to be displayed in comparative form. Typically, a plan will present comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits (see paragraph .A95 for typical plan financial statements by type of plan). Accordingly, when this SAS is adopted, the auditor may be asked to perform an ERISA Section 103(a)(3)(C) audit for the current year when the auditor disclaimed an opinion on the financial statements in the prior year.

Paragraphs .A123–.A125 explain that because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, use the ERISA Section 103(a)(3)(C) audit report, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor's opinion on one or more financial statements of another period presented. Further, when issuing an updated report, the information considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor's report on the current period financial statements.

The following illustration contains example reports for when the auditor has adopted this SAS for the first time and is performing an ERISA Section 103(a)(3)(C) audit for the current year and updating their audit from the prior year.

Illustration B-1 — Auditor's Reports on Financial Statements for a Defined Contribution Retirement Plan Subject to ERISA When Management Elects an ERISA Section 103(a)(3)(C) Audit in the Current Year (2020) and the Auditor Disclaimed an Opinion on the Financial Statements in the Prior Year (2019)

Circumstances include the following:

- Management elected an ERISA Section 103(a)(3)(C) audit for the 2020 plan financial statements, as permitted by Code of Federal Regulations (CFR), *Labor*, Title 29, Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.¹
- The audit is for a complete set of general purpose financial statements for a 401(k) plan subject to ERISA that is presenting comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.
- The auditor performed an ERISA Section 103(a)(3)(C) audit as of and for the year ended December 31, 2020.
- The auditor disclaimed an opinion on the prior year financial statements (for the year ended December 31, 2019).
- The auditor is issuing two separate reports.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- There are no limitations on the scope of the audit for the current year, and the auditor has not identified any material misstatements of the ERISA plan financial statements in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.
- The auditor has concluded that the ERISA Section 103(a)(3)(C) report is appropriate as of and for the year ended December 31, 2020 based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

¹ Although not as common, an ERISA Section 103(a)(3)(C) audit may relate to the audit of a 103-12 entity as permitted by 29 CFR 2520.103-12. Accordingly, the wording in this illustrative report may need to be revised to fit the circumstances of the engagement.

- The report on the ERISA-required supplemental schedules is presented as an other-matter paragraph for the year ended December 31, 2020.

Independent Auditor's Report

[Appropriate Addressee]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed an audit of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statement of net assets available for benefits as of December 31, 2020, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audit of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audit need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained a certification from a qualified institution as of and for the year ended December 31, 2020, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.²

Opinion

In our opinion, based on our audit and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the financial statements related to assets held by³ and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

² If the note to the financial statements does not identify the names of the qualified certifying institutions and periods covered, then such information may be included in the auditor's report.

³ This sentence may need to be modified when the certification is provided by an insurance entity, which provides benefits under the plan or holds plan assets.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, administering the plan, and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA Section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the

circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audit did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

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

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of *[identify the title of supplemental schedules and periods covered]* are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented,

in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

- the information in the supplemental schedules related to assets held by⁴ and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Independent Auditor's Report

[Appropriate Addressee]

We were engaged to audit the accompanying statement of net assets available for benefits of ABC 401(k) Plan, as of December 31, 2019, and the related notes to the financial statement.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of a financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the 2019 financial statement based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in Note X, which was certified by ABC Bank, the trustee of the Plan, except for comparing such information with the related information included in the financial statement. We have been informed by the plan administrator that the trustee (or custodian) holds the Plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian) as of December 31, 2019 that the information provided to the plan administrator by the trustee (or custodian) is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 2019 financial statement. Accordingly, we do not express an opinion on the 2019 financial statement.

⁴ See footnote 3.

Report on Form and Content in Compliance With DOL Rules and Regulations for 2019 Financial Statement

The form and content of the information included in the 2019 financial statement, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Revised, June 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

AU-C Section 705

Modifications to the Opinion in the Independent Auditor's Report

(Supersedes SAS No. 122 section 705.)

Source: SAS No. 134; SAS No. 137; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to issue an appropriate report in circumstances in which, in forming an opinion in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This section also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion. In all cases, the reporting requirements in section 700 or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, apply; those requirements are not repeated in this section unless they are explicitly addressed or amended by the requirements of this section.

Types of Modified Opinions

.02 This section establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends on the following:

- a. The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated
- b. The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements (Ref: par. .A1)

.03 Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, and section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, address additional communications in the auditor's report that are not modifications to the auditor's opinion.

Effective Date

.04 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objective

.05 The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary in the following circumstances:

- a. The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated.
- b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Definitions

.06 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Modified opinion. A qualified opinion, an adverse opinion, or a disclaimer of opinion on the financial statements.

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

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent or could represent a substantial proportion of the financial statements; or
- regarding disclosures, are fundamental to users' understanding of the financial statements.

Requirements

Circumstances in Which a Modification to the Auditor's Opinion Is Required

.07 The auditor should modify the opinion in the auditor's report when

- a. the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated or (Ref: par. A2–A8)
- b. the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: par. A9–A13)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

.08 The auditor should express a qualified opinion in the following circumstances:

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

Adverse Opinion

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

Disclaimer of Opinion

.10 The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. (Ref. par. .A14–.A15)

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement

.11 If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

.12 If management refuses to remove the limitation referred to in paragraph .11, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,¹ and, if appropriate, determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

.13 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should determine the implications as follows:

- a. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor should qualify the opinion.
- b. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would

¹ Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

be inadequate to communicate the severity of the situation, the auditor should

- i. disclaim an opinion on the financial statements or
- ii. withdraw from the audit, when practicable. (Ref: par. .A16–.A17)

.14 If the auditor decides to withdraw from the audit in accordance with paragraph .13bii, before doing so, the auditor should communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: par. .A17)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

.15 When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report should not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts, or items of a financial statement (piecemeal opinion). To include such an unmodified opinion in the same report² in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: par. .A18–.A19)

Auditor Is Not Independent But Is Required by Law or Regulation to Report on the Financial Statements

.16 When the auditor is not independent but is required by law or regulation to report on the financial statements, the auditor should disclaim an opinion and should specifically state that the auditor is not independent. The auditor is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the auditor chooses to provide the reasons for the lack of independence, the auditor should include all the reasons therefor. (Ref: par. .A20)

Form and Content of the Auditor's Report When the Opinion Is Modified

Auditor's Opinion

.17 When the auditor modifies the audit opinion, the auditor should use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the "Opinion" section. (Ref: par. .A21–.A23)

Qualified Opinion

.18 When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor should state that, in the auditor's opinion, except for the effects of the matters described in the "Basis for Qualified Opinion" section of the auditor's report, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [*the applicable financial reporting framework*]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should

² Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

use the corresponding phrase "except for the possible effects of the matters..." for the modified opinion. (Ref: par. .A24–.A25)

Adverse Opinion

.19 When the auditor expresses an adverse opinion, the auditor should state that, in the auditor's opinion, because of the significance of the matters described in the "Basis for Adverse Opinion" section of the auditor's report, the accompanying financial statements do not present fairly [...] in accordance with [*the applicable financial reporting framework*].

Disclaimer of Opinion

.20 When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should do the following:

- a. State that the auditor does not express an opinion on the accompanying financial statements.
- b. State that, because of the significance of the matters described in the "Basis for Disclaimer of Opinion" section of the auditor's report, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.
- c. Amend the statement required by paragraph .25b of section 700, or paragraph .64b of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Basis for Opinion

.21 When the auditor modifies the opinion on the financial statements, the auditor should, in addition to including the specific elements required by section 700 or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, do the following: (Ref: par. .A26)

- a. Amend the heading "Basis for Opinion" required by paragraph .28 of section 700 or paragraphs .67 or .107 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate.
- b. Within this section of the auditor's report, include a description of the matter giving rise to the modification.

.22 If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the "Basis for Opinion" section a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should state that in the "Basis for Opinion" section. (Ref: par. .A27–.A28)

.23 If there is a material misstatement of the financial statements that relates to qualitative disclosures, the auditor should include an explanation of how the disclosures are misstated in the "Basis for Opinion" section.

.24 If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should do the following:

- a. Discuss the omission of such information with those charged with governance.
- b. Describe in the "Basis for Opinion" section the nature of the omitted information.
- c. Include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: par. .A29–.A30)

.25 If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include the reasons for that inability in the "Basis for Opinion" section. (Ref. par. .A31)

.26 When the auditor expresses a qualified or an adverse opinion, the auditor should amend the statement required by paragraph .28d of section 700 or paragraphs .67 or .107 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion, to include the word "qualified" or "adverse," as appropriate.

.27 When the auditor disclaims an opinion on the financial statements, the auditor's report should not include the elements required by paragraphs .28b and .28d of section 700 or paragraphs .67b and .67d or .107b and .107d of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. Those elements are

- a. a reference to the section of the auditor's report where the auditor's responsibilities are described and
- b. a statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

.28 Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should describe the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof, in the "Basis for Opinion" section. (Ref: par. .A32–.A33)

Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements

.29 When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor should amend the description of the auditor's responsibilities required by paragraphs .35–.37 of section 700 or paragraphs .74–.76 or .115–.119 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, to include only the following: (Ref: par. .A34)

- a. A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report

- b. A statement that, however, because of the matters described in the "Basis for Disclaimer of Opinion" section of the auditor's report, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements
- c. A statement that the auditor is required to be independent and to meet other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit, required by paragraph .28c of section 700 or paragraph .67c or .107c of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable

Considerations When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements

.30 When the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, the auditor's report should not include a "Key Audit Matters" section in accordance with section 701.³ (Ref: par. .A35–.A36) Also, when the auditor disclaims an opinion on the financial statements, the auditor's report should not include an "Other Information" section in accordance with section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Communication With Those Charged With Governance

.31 When the auditor expects to modify the opinion in the auditor's report, the auditor should communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification. (Ref: par. .A37)

Application and Other Explanatory Material

Types of Modified Opinions (Ref: par. .02)

.A1 The following table illustrates how the auditor's professional judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed:

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

³ Paragraphs .10–.12 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

Circumstances in Which a Modification to the Auditor's Opinion Is Required

Nature of Material Misstatements (Ref: par. .07a)

.A2 Sections 700 and 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, require the auditor, in order to form an opinion on the financial statements, to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.⁴ This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*.

.A3 Section 450 defines a *misstatement* as a difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to the following:

- The appropriateness of the selected accounting policies
- The application of the selected accounting policies
- The appropriateness of the financial statement presentation, or the appropriateness or adequacy of disclosures in the financial statements

Appropriateness of the Selected Accounting Policies

.A4 Regarding the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise, for example, when

- the selected accounting policies are not consistent with the applicable financial reporting framework,
- the financial statements do not correctly describe an accounting policy relating to a significant item therein, or
- the financial statements do not represent or disclose the underlying transactions and events in a manner that achieves fair presentation.

.A5 Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. When the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements. If a change in accounting policy does not meet the conditions described in section 708, *Consistency of Financial Statements*, then a material misstatement of the financial statements may arise.

Application of the Selected Accounting Policies

.A6 Regarding the application of the selected accounting policies, material misstatements of the financial statements may arise

⁴ Paragraph .13 of section 700, *Forming an Opinion and Reporting on Financial Statements* and paragraph .38 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

- when management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application).
- due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness of the Financial Statement Presentation or Appropriateness or Adequacy of Disclosures in the Financial Statements

.A7 Regarding the appropriateness of the financial statement presentation or the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when the following occur:

- The financial statements do not include all the disclosures required by the applicable financial reporting framework.
- The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework.
- The financial statements do not provide the additional disclosures necessary to achieve fair presentation beyond disclosures specifically required by the applicable financial reporting framework.
- Information required to be presented in accordance with the applicable financial reporting framework is omitted either because a required statement (for example, a statement of cash flows) has not been included or because the information has not otherwise been disclosed in the financial statements.

Paragraph .A23 of section 450 provides further examples of material misstatements that may arise in qualitative disclosures.

.A8 Adequate disclosures relate to the presentation of the financial statements and the related notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .07b)

.A9 The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from the following:

- Circumstances beyond the control of the entity
- Circumstances relating to the nature or timing of the auditor's work
- Limitations imposed by management

.A10 An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements in paragraphs .08b and .10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of risks of material misstatement due to fraud and consideration of engagement continuance.

.A11 Examples of circumstances beyond the control of the entity include the following:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

.A12 Examples of circumstances relating to the nature or timing of the auditor's work include the following:

- The entity is required to use the equity method of accounting for an investee, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories, and the auditor is unable to obtain sufficient appropriate audit evidence through other appropriate procedures, such as performing a rollback of inventory.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

.A13 Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include the following:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Determining the Type of Modification to the Auditor's Opinion

Effect of Uncertainties (Ref: par. .10)

.A14 Absence of the existence of information related to the outcome of an uncertainty does not necessarily lead to a conclusion that the audit evidence supporting management's assertion is not sufficient. Rather, the auditor's professional judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient appropriate audit evidence supports management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unmodified opinion ordinarily is appropriate.

.A15 In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on whether the financial statements as a whole are fairly presented in accordance with the applicable financial reporting framework due to the interaction and possible cumulative effects of the uncertainties.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement (Ref: par. .13)

.A16 The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an

opinion, and explain the scope limitation in the "Basis for Disclaimer of Opinion" section.

.A17 In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor who is appointed or elected to audit the financial statements of governmental entities. It may also be the case in circumstances in which the auditor is appointed to audit the financial statements covering a specific period or is appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period. In such circumstances, the auditor may consider it necessary to include an other-matter paragraph in the auditor's report.⁵

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: par. .15)

.A18 The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- In an initial audit, the expression of an unmodified opinion regarding the financial position and a disclaimer of opinion regarding the results of operations and cash flows, when relevant. In this case, the auditor has not disclaimed an opinion on the financial statements as a whole.
- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.

Considerations Specific to Audits of Governmental Entities

.A19 Because the auditor of a state or local governmental entity expresses an opinion or disclaims an opinion for each opinion unit,⁶ an auditor's report in these circumstances may include an unmodified opinion with respect to one or more opinion units and a modified opinion for one or more other opinion units.

Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements (Ref: par. .16)

Considerations Specific to Governmental Entities

.A20 The nature of a government auditor's lack of independence may have a limited effect because the impairment may result from the government auditor's association with only a component of the overall governmental entity. A government auditor may determine that the lack of independence affects only one or more, but not all, of the governmental entity's opinion units, and in such circumstances, the auditor may disclaim an opinion on the affected opinion units while expressing unmodified, qualified, or adverse opinions on other opinion units. The more significant the affected opinion units are to the overall governmental entity, the more likely that it will be appropriate for the auditor to disclaim an opinion on the financial statements of the overall governmental entity.

⁵ Paragraphs .10–.11 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

⁶ Paragraph .A6 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

Form and Content of the Auditor's Report When the Opinion Is Modified

Illustrative Auditor's Reports (Ref: par. .17)

.A21 Illustrations 1 and 3 in the exhibit to this section contain auditor's reports with qualified and adverse opinions, respectively, because the financial statements are materially misstated.

.A22 Illustration 4 in the exhibit contains an auditor's report with a qualified opinion because the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 6 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability to obtain sufficient appropriate audit evidence are both material and pervasive. The exhibits to other AU-C sections that include reporting requirements also include illustrations of auditor's reports with modified opinions.

Auditor's Opinion (Ref: par. .17)

.A23 Amending the heading required by paragraph .17 makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

Qualified Opinion (Ref: par. .18)

.A24 When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the "Opinion" section because these are not sufficiently clear or forceful. Because accompanying notes are part of the financial statements, wording such as "fairly presented, in all material respects, when read in conjunction with note 1" is likely to be misunderstood and would also not be appropriate.

.A25 When the auditor expresses a qualified opinion due to a scope limitation, paragraph .18 requires that the auditor state in the opinion paragraph that the qualification pertains to the possible effects of the matter on the financial statements and not to the scope limitation itself. Wording such as "In our opinion, except for the above-mentioned limitation on the scope of our audit..." bases the exception on the restriction itself rather than on the possible effects on the financial statements and, therefore, is unacceptable.

Basis for Opinion (Ref: par. .21, .22, .24, .28)

.A26 Consistency in the auditor's report helps promote users' understanding and helps users identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and the description of the reasons for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

.A27 An example of the financial effects of misstatements that the auditor may describe within the "Basis for Opinion" section in the auditor's report is the quantification of the effects on income before taxes, income taxes, net income, and equity if inventory is overstated. If such disclosures are made in a note to the financial statements, the "Basis for Opinion" section may refer to the note.

.A28 In considering the adequacy of disclosure, and in other aspects of the audit, the auditor uses information received in confidence from management. Without such confidence, the auditor would find it difficult to obtain information necessary to form an opinion on the financial statements. The "Confidential Client Information Rule" (ET sec. 1.700.001) of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client. Accordingly, the auditor may not make available, without management's consent, information that is not required to be disclosed in the financial statements to comply with the applicable financial reporting framework.

.A29 *Practicable*, as used in the context of paragraphs .22 and .24c, means that the information is reasonably obtainable from management's accounts and records and that providing the information in the report does not require the auditor to assume the position of a preparer of financial information. For example, the auditor would not be expected to prepare a basic financial statement and include it in the auditor's report when management omits such information.

.A30 Disclosing the omitted information within the "Basis for Opinion" section would not be practicable if

- the information has not been prepared by management or the information is otherwise not readily available to the auditor or,
- in the auditor's judgment, the information would be unduly voluminous in relation to the auditor's report.

.A31 When the auditor modifies the opinion due to an inability to obtain sufficient appropriate audit evidence, it is not appropriate for the scope of the audit to be explained in a note to the financial statements because the description of the audit scope is the responsibility of the auditor and not that of management.

.A32 An adverse opinion or a disclaimer of opinion relating to a specific matter described within the "Basis for Opinion" section does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

.A33 The auditor may consider whether there is a need to describe in an emphasis-of-matter or other-matter paragraph⁷ any other matters of which the auditor is aware that would not require a modification of the auditor's opinion.

Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements (Ref: par. .29)

.A34 When the auditor disclaims an opinion on the financial statements, the following statements are better positioned within the "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report, as illustrated in illustrations 5–6 of the exhibit to this section:

⁷ See section 706.

- The statement required by paragraph .28a of section 700 or paragraph .67a or .107a of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, amended to state that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America
- The statement required by paragraph .28c of section 700 or paragraph .67c or .107c of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, about independence and other ethical responsibilities

Considerations When the Auditor Issues an Adverse Opinion or Disclaims an Opinion on the Financial Statements (Ref: par. .30)

.A35 Describing the reasons for the modification of the opinion within the "Basis for Opinion" section of the auditor's report provides information to users that is useful in understanding why the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements. Furthermore, describing these reasons may guard against inappropriate reliance on the financial statements. However, providing further details about the audit may overshadow the reasons for the modification of the opinion and may potentially be confusing to users.

.A36 When the auditor expresses an adverse opinion, the communication of any key audit matters other than the matters giving rise to the modified opinion may overshadow the fact that the financial statements as a whole are materially misstated. When the auditor disclaims an opinion, the communication of any key audit matters other than the matters giving rise to the disclaimer of opinion may suggest that the financial statements are more credible in relation to those matters than would be appropriate in the circumstances and would be inconsistent with the disclaimer of opinion on the financial statements as a whole. Similarly, it would not be appropriate for the auditor to make any statements about the auditor's consideration of the consistency of other information in an annual report with the financial statements. Accordingly, paragraph .30 of this section prohibits the inclusion of a "Key Audit Matters" section in the auditor's report when the auditor issues an adverse opinion or disclaims an opinion on the financial statements and also prohibits the inclusion of an "Other Information" section in the auditor's report when the auditor disclaims an opinion on the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Communication With Those Charged With Governance (Ref: par. .31)

.A37 Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables the following:

- The auditor to give notice to those charged with governance of the intended modification and the reasons (or circumstances) for the modification
- The auditor to seek the concurrence of those charged with governance regarding the facts of the matters giving rise to the expected

modification, or to confirm matters of disagreement with management as such

- Those charged with governance to have an opportunity, when appropriate, to provide the auditor with further information and explanations regarding the matters giving rise to the expected modification

.A38

Exhibit — Illustrations of Auditor's Reports With Modifications to the Opinion

Illustration 1 — An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements

Illustration 2 — An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure

Illustration 3 — An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Illustration 4 — An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence

Illustration 5 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements

Illustration 7 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year

Illustration 8 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows

Illustration 1 — An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Qualified Opinion

ABC Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX and \$XXX would have been required as of December 31, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by \$XXX and \$XXX, and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, and \$XXX, \$XXX, and \$XXX, as of and for the years ended December 31, 20X1 and 20X0, respectively.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the

circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 2 — An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements have inadequate disclosures. The auditor has concluded that (a) it is not practicable to present the required information and (b) the effects are such that an adverse opinion is not appropriate. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor has been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements³

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

ABC Company's financial statements do not disclose [describe the nature of the omitted information that is not practicable to present in the auditor's report]. In

³ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

[Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report]

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and

perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁴ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 3 — An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The financial statements are materially misstated due to the nonconsolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. Accordingly, the auditor's report contains an adverse opinion. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor is precluded from communicating key audit matters when issuing an adverse opinion.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements⁵

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated

⁵ The subtitle "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

financial statements do not present fairly the financial position of ABC Company and its subsidiaries as of December 31, 20X1, or the results of their operations or their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Adverse Opinion

As described in Note X, ABC Company has not consolidated the financial statements of subsidiary XYZ Company that it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁶
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁶ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 4 — An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements⁷

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

⁷ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Qualified Opinion

ABC Company's investment in XYZ Company, a foreign affiliate acquired during the year and accounted for under the equity method, is carried at \$XXX on the balance sheet at December 31, 20X1, and ABC Company's share of XYZ Company's net income of \$XXX is included in ABC Company's net income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company's investment in XYZ Company as of December 31, 20X1, and ABC Company's share of XYZ Company's net income for the year then ended because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁸
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁸ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 5 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment accounted for under the proportionate consolidation approach. The investment represents over 90 percent of the Company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's report contains a disclaimer of opinion.
- The auditor concluded that it was unnecessary to include in the auditor's report specific amounts for the Company's proportional share of the assets, liabilities, income, and expenses of the joint venture investment because the investment represents over 90 percent of the Company's net assets, and that fact is disclosed in the auditor's report.
- The auditor is precluded from including an Other Information section in the auditor's report when disclaiming an opinion on the financial statements.
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements⁹

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

⁹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

Basis for Disclaimer of Opinion

ABC Company's investment in XYZ Company, a joint venture, is carried at \$XXX on the Company's balance sheet, which represents over 90 percent of the Company's net assets as of December 31, 20X1. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary relating to the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the statements of changes in stockholders' equity and cash flows.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable at year-end because at that time the auditor had not been engaged. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's opinion contains a disclaimer of opinion.
- The auditor is precluded from including an Other Information section in the auditor's report when disclaiming an opinion on the financial statements.
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹⁰

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

¹⁰ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Disclaimer of Opinion

We were not engaged as auditors of ABC Company until after December 31, 20X1, and, therefore, did not observe the counting of physical inventories at the beginning or end of the year. We were unable to satisfy ourselves by other auditing procedures concerning the inventory held at December 31, 20X1, which is stated in the balance sheet at \$XXX. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous misstatements in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the misstatements. We were unable to confirm or verify by alternative means accounts receivable included in the balance sheet at a total amount of \$XXX at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statements of income, changes in stockholders' equity, and cash flows.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matters described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 7 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- Certain lease obligations have been excluded from the financial statements in the current year. The effect of the exclusion is material but not pervasive. The auditor expressed an unmodified opinion in the prior year and is expressing a modified opinion (qualified opinion) in the current year.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹¹

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the effects on the accompanying 20X1 financial statements of not capitalizing certain lease obligations as described in the Basis for Qualified Opinion section of our report, the financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion on the 20X1 Financial Statements

ABC Company has excluded, from property and debt in the accompanying 20X1 balance sheet, certain lease obligations that were entered into in 20X1 that, in

¹¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

our opinion, should be capitalized in accordance with accounting principles generally accepted in the United States of America. If these lease obligations were capitalized, property would be increased by \$XXX, long-term debt by \$XXX, and retained earnings by \$XXX as of December 31, 20X1, and net income and earnings per share would be increased (decreased) by \$XXX and \$XXX, respectively, for the year then ended.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion on the 20X1 financial statements and for our opinion on the 20X0 financial statements.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on

the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.¹²

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

¹² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 8 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor was unable to observe the physical inventory as of December 31, 20X0, because at that time the auditor had not been engaged. Accordingly, the auditor was unable to obtain sufficient appropriate audit evidence regarding the net income and cash flows for the year ended December 31, 20X1. The effects of the inability to obtain sufficient appropriate audit evidence are deemed material and pervasive.
- In accordance with paragraph .A26 of section 700, the opinion does not separately refer to the statement of changes in stockholders' equity because changes in stockholders' equity accounts are considered part of the presentation of financial position, results of operations, and cash flows.
- The auditor expressed an unmodified opinion on the December 31, 20X2 and 20X1, balance sheets and a disclaimer of opinion on the 20X1 statements of income, changes in stockholders' equity, and cash flows.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹³

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements

¹³ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying balance sheets of ABC Company as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2, present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Disclaimer of Opinion on 20X1 Operations and Cash Flows

We do not express an opinion on the accompanying results of operations and cash flows for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the balance sheets as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2.

Basis for Disclaimer of Opinion on 20X1 Operations and Cash Flows

We did not observe the taking of the physical inventory as of December 31, 20X0, because that date was prior to our engagement as auditors for ABC Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of December 31, 20X0, enter into the determination of net income and cash flows for the year ended December 31, 20X1.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one

resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.¹⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138.]

¹⁴ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

AU-C Section 706

Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report

(Supersedes SAS No. 122 section 706.)

Source: SAS No. 134; SAS No. 137; SAS No. 140; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

Introduction

Scope of This Section

.01 This section addresses additional communications in the auditor's report when the auditor considers it necessary to

- a. draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements (emphasis-of-matter paragraph); or
- b. draw users' attention to any matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report (other-matter paragraph).

.02 The communication of key audit matters is not required by section 700, *Forming an Opinion and Reporting on Financial Statements*, section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, or section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. However, when the auditor is engaged to communicate key audit matters, this section addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this section. (Ref: par. .A1)

.03 Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, and section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, addresses communication in the auditor's report relating to going concern and other information, respectively. (Ref. par. .A2) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

.04 Exhibit B, "List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs," and exhibit C, "List of AU-C Sections Containing Requirements for Other-Matter Paragraphs," of this section identify AU-C sections containing specific requirements for the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report. When an emphasis-of-matter or other-matter paragraph is required, the requirements in this section regarding the form of such paragraphs apply. (Ref: par. .A3)

Effective Date

.05 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objective

.06 The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to the following:

- a. A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements
- b. As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report

Definitions

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

Emphasis-of-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Other-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report.

Requirements

Emphasis-of-Matter Paragraphs in the Auditor's Report

.08 If the auditor considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor's report, provided that the following apply: (Ref: par. .A4–.A5)

- a. The auditor would not be required to modify the opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, as a result of the matter.
- b. When section 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. .A1)

.09 When the auditor includes an emphasis-of-matter paragraph in the auditor's report, the auditor should do the following:

- a. Include the paragraph within a separate section of the auditor's report with an appropriate heading. When key audit matters are communicated in the auditor's report, the heading should include the term "Emphasis of Matter." (Ref: par. .A6)
- b. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph should refer only to information presented or disclosed in the financial statements.
- c. Indicate that the auditor's opinion is not modified with respect to the matter emphasized. (Ref: par. .A7–.A8, .A14–.A15)

Other-Matter Paragraphs in the Auditor's Report

.10 If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, the auditor should include an other-matter paragraph in the auditor's report, provided that, when section 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. .A9–.A12)

.11 When the auditor includes an other-matter paragraph in the auditor's report, the auditor should include the paragraph within a separate section with the heading "Other Matter" or other appropriate heading. (Ref: par. .A13–.A15)

Communication With Those Charged With Governance

.12 If the auditor expects to include an emphasis-of-matter or other-matter paragraph in the auditor's report, the auditor should communicate with those charged with governance regarding this expectation and the wording of the paragraph. (Ref: par. .A16)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.04)

The Relationship Between Emphasis-of-Matter Paragraphs and Key Audit Matters in the Auditor's Report (Ref: par. .02–.04, .08b)

.A1 *Key audit matters* are defined in section 701 as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance, which include significant findings from the audit of the financial statements of the current period.¹ Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit and may also assist them in understanding the entity

¹ Paragraph .14 of section 260, *The Auditor's Communication With Those Charged With Governance*.

and areas of significant management judgment in the audited financial statements. When section 701 applies, the use of emphasis-of-matter paragraphs is not a substitute for a description of individual key audit matters.

.A2 If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor is required to include a separate section in the auditor's report under the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern."² If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with this section, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.³

.A3 The AU-C sections identified in exhibits B and C require the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report relating to certain matters. The nature of these matters is such that they are brought to the attention of users of the auditor's report in all instances rather than at the discretion of the auditor. The explanatory language provided by such required paragraphs achieves the same objective as an emphasis-of-matter or other-matter paragraph that is included based on the professional judgment of the auditor (that is, to provide additional communication to the users of the auditor's report). Therefore, the auditor follows the requirements in this section regarding the form of these required paragraphs.

Emphasis-of-Matter Paragraphs in the Auditor's Report

Circumstances in Which an Emphasis-of-Matter Paragraph May Be Necessary (Ref: par. .08)

.A4 In addition to the required emphasis-of-matter paragraphs listed in exhibit B, the following are examples of circumstances in which the auditor may consider it necessary to include an emphasis-of-matter paragraph:

- An uncertainty relating to the future outcome of unusually important litigation or regulatory action
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report⁴
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position or results of operations
- Significant transactions with related parties

.A5 Paragraph .08 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a

² Paragraph .24 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

³ Paragraphs .A54–.A56 of section 570.

⁴ Paragraph .07 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure.

Including an Emphasis-of-Matter Paragraph in the Auditor's Report
(Ref: par. .09)

.A6 The term "Emphasis of Matter" is required to be included in the heading when key audit matters are communicated to clearly differentiate the matter in the emphasis-of-matter paragraph from those included in the Key Audit Matters section of the auditor's report. The auditor may add further context to the heading "Emphasis of Matter" (for example, "Emphasis of Matter — Subsequent Event") to further describe the nature of the matter addressed by the emphasis-of-matter paragraph.

.A7 The inclusion of an emphasis-of-matter paragraph in the auditor's report does not affect the auditor's opinion. An emphasis-of-matter paragraph is not a substitute for the following:

- A modified opinion in accordance with section 705 when required by the circumstances of a specific audit engagement
- Disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
- Reporting in accordance with section 570 when, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, in which case the auditor is required to include a separate section in the auditor's report (see paragraph .A2)

.A8 Paragraphs .A14–.A15 provide further guidance on the placement of emphasis-of-matter paragraphs in particular circumstances.

Other-Matter Paragraphs in the Auditor's Report
(Ref: par. .10–.11)

Circumstances in Which an Other-Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

.A9 When the auditor is unable to withdraw from an engagement, even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,⁵ the auditor may consider it necessary to include an other-matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.

Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report

.A10 Law, regulation, or generally accepted practice may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. When the "Other Matter" section includes more than one matter that, in the auditor's judgment, is relevant to users' understanding of

⁵ See paragraph .13 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, for a discussion of this circumstance.

the audit, the auditor's responsibilities, or the auditor's report, it may be helpful to use different subheadings for each matter.

.A11 An other-matter paragraph does not address circumstances in which the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under GAAS (see the section "Other Reporting Responsibilities" in section 700) or when the auditor has been asked to perform and report on additional specified procedures or to express an opinion on specific matters.

Reporting on More Than One Set of Financial Statements

.A12 An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board) and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an other-matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Including an Other-Matter Paragraph in the Auditor's Report

.A13 The content of an other-matter paragraph clearly reflects that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the auditor is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to confidentiality of information). An other-matter paragraph also does not include information that is required to be provided by management.

Placement of Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Auditor's Report (Ref: par. .09, .11)

.A14 This section does not specify the placement of an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report. Rather, the placement depends on the nature of the information to be communicated and the auditor's judgment about the relative significance of such information to intended users compared to other elements required to be reported in accordance with section 700. The following are examples of considerations related to the placement of emphasis-of-matter and other-matter paragraphs:

- *Emphasis-of-Matter Paragraphs.* When a "Key Audit Matters" section is presented in the auditor's report, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter," such as "Emphasis of Matter — Subsequent Event," to differentiate the emphasis-of-matter paragraph from the individual matters described in the "Key Audit Matters" section.
- *Other-Matter Paragraphs.*
 - When a "Key Audit Matters" section is presented in the auditor's report and an other-matter paragraph is also

considered necessary, the auditor may add further context to the heading "Other Matter," such as "Other Matter — Scope of the Audit," to differentiate the other-matter paragraph from the individual matters described in the "Key Audit Matters" section.

- When an other-matter paragraph is included to draw users' attention to a matter relating to other reporting responsibilities addressed in the auditor's report, the paragraph may be included in the section "Report on Other Legal and Regulatory Requirements."
- When it is relevant to all the auditor's responsibilities or to users' understanding of the auditor's report, the other-matter paragraph may be included as a separate section following the sections "Report on the Audit of the Financial Statements" and "Report on Other Legal and Regulatory Requirements."

.A15 Illustration 2 in exhibit A shows the interaction between the "Key Audit Matters" section, an emphasis-of-matter paragraph, and an other-matter paragraph when all are presented in the auditor's report.

Communication With Those Charged With Governance (Ref. par. .12)

.A16 The auditor's communication with those charged with governance required by paragraph .12 enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report and provides them with an opportunity to obtain further clarification from the auditor when necessary. As discussed in paragraph .A50 of section 260, *The Auditor's Communication With Those Charged With Governance*, certain matters may be important to communicate prior to the issuance of the auditor's report. When the inclusion of an other-matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

.A17

Exhibit A — Illustrations of Auditor's Reports With Emphasis-of-Matter or Other-Matter Paragraphs

Illustration 1 — An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Illustration 2 — An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Illustration 3 — An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Illustration 4 — An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Illustration 1 — An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes an emphasis-of-matter paragraph.¹
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the

¹ Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

² The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, ABC Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.³

³ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.¹
- The prior period financial statements were audited by a predecessor auditor.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

¹ Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

² The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter³

As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in ABC Company's production facilities. Our opinion is not modified with respect to this matter.

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report]

Other Matter

The financial statements of ABC Company for the year ended December 31, 20X0, were audited by another auditor, who expressed an unmodified opinion on those statements on March 31, 20X1.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and

³ As noted in paragraph .A14, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph.

therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁴ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 3 — An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor's report on the prior period financial statements expressed an adverse opinion due to identified departures from accounting principles generally accepted in the United States of America that resulted in the financial statements being materially misstated. The entity has elected to change its method of accounting for the matters that gave rise to the adverse opinion in the prior period and has restated the prior period financial statements. Therefore, the auditor has expressed an unmodified opinion on the comparative financial statements.
- The auditor's report includes an other-matter paragraph indicating that the updated report on the financial statements of the prior period contains an opinion different from the opinion previously expressed, as required by section 700. Although the entity changed its method of accounting for the matters that gave rise to the adverse opinion in the prior period and corrected the material misstatement in the 20X0 financial statements, the principal objective of the communication in the other-matter paragraph is to draw users' attention to the change in the auditor's opinion on the prior period financial statements. The other-matter paragraph refers to the change in accounting principle and the related disclosure in the financial statements. Therefore, the other-matter paragraph also meets the objective of communicating the change in accounting principle as required by section 708, *Consistency of Financial Statements*, and a separate emphasis-of-matter paragraph is not considered necessary.¹
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

¹ Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report

- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other Matter

In our report dated March 1, 20X1, we expressed an opinion that the 20X0 financial statements did not fairly present the financial position, results of operations, and cash flows of ABC Company in accordance with accounting principles generally accepted in the United States of America because of two departures from such principles: (1) ABC Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) ABC Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these items and restated its 20X0 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the restated 20X0 financial statements, as presented herein, is different from that expressed in our previous report.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise

² The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.³
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

³ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 4 — An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes a qualified opinion and also includes an emphasis-of-matter paragraph.¹
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Qualified Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

¹ Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

² The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Qualified Opinion

ABC Company has stated inventories at cost in the accompanying balance sheet. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX would have been required as of December 31, 20X1. Accordingly, cost of sales would have been increased by \$XXX and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, as of and for the year ended December 31, 20X1, respectively.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Emphasis of Matter — Litigation

As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit *[briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements]*. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and

perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.³
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

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

³ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

.A18

Exhibit B — List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs (Ref: par. .04)

This exhibit identifies paragraphs in other AU-C sections that require the auditor to include an emphasis-of-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16c of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .08–.09 and .11–.13 of section 708, *Consistency of Financial Statements*
- Paragraphs .19 and .21 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

.A19

Exhibit C — List of AU-C Sections Containing Requirements for Other-Matter Paragraphs (Ref: par. .04)

This exhibit identifies paragraphs in other AU-C sections that require the auditor to include an other-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16c of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .55–.56 and .58–.59 of section 700, *Forming an Opinion and Reporting on Financial Statements*
- Paragraphs .53, .92–.93, .95–.96, .121, and .133 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*
- Paragraph .20 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
- Paragraph .13 of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
- Paragraph .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*

[Revised, June 2020, to reflect conforming changes necessary due to the issuance of SAS No. 138. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 708

Consistency of Financial Statements

Source: SAS No. 122; SAS No. 136.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's evaluation of the consistency of the financial statements between periods, including changes to previously issued financial statements and the effect of that evaluation on the auditor's report on the financial statements.

Effective Date

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

Objectives

.03 The objectives of the auditor are to

- a. evaluate the consistency of the financial statements for the periods presented and
- b. communicate appropriately in the auditor's report when the comparability of financial statements between periods has been materially affected by a change in accounting principle or by adjustments to correct a material misstatement in previously issued financial statements.

Definition

.04 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

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

Requirements

Evaluating Consistency

.05 The auditor should evaluate whether the comparability of the financial statements between periods has been materially affected by a change in accounting principle or by adjustments to correct a material misstatement in previously issued financial statements. (Ref: par. .A1)

.06 The periods included in the auditor's evaluation of consistency depend on the periods covered by the auditor's opinion on the financial statements. When the auditor's opinion covers only the current period, the auditor should

evaluate whether the current-period financial statements are consistent with those of the preceding period, regardless of whether financial statements for the preceding period are presented. When the auditor's opinion covers two or more periods, the auditor should evaluate consistency between such periods and the consistency of the earliest period covered by the auditor's opinion with the period prior thereto, if such prior period is presented with the financial statements being reported upon. The auditor also should evaluate whether the financial statements for the periods being reported upon are consistent with previously issued financial statements for the relevant periods. (Ref: par. .A2–.A3)

Change in Accounting Principle

.07 The auditor should evaluate a change in accounting principle to determine whether (Ref: par. .A4–.A6)

- a. the newly adopted accounting principle is in accordance with the applicable financial reporting framework,
- b. the method of accounting for the effect of the change is in accordance with the applicable financial reporting framework,
- c. the disclosures related to the accounting change are appropriate and adequate, and
- d. the entity has justified that the alternative accounting principle is preferable.

.08 If the auditor concludes that the criteria in paragraph .07 have been met, and the change in accounting principle has a material effect on the financial statements, the auditor should include an emphasis-of-matter paragraph¹ in the auditor's report that describes the change in accounting principle and provides a reference to the entity's disclosure. If the criteria in paragraph .07 are not met, the auditor should evaluate whether the accounting change results in a material misstatement and whether the auditor should modify the opinion accordingly.² (Ref: par. .A7–.A9)

.09 The auditor should include an emphasis-of-matter paragraph relating to a change in accounting principle in reports on financial statements in the period of the change, and in subsequent periods, until the new accounting principle is applied in all periods presented. If the change in accounting principle is accounted for by retrospective application to the financial statements of all prior periods presented, the emphasis-of-matter paragraph is needed only in the period of such change.

.10 The auditor should evaluate and report on a change in accounting estimate that is inseparable from the effect of a related change in accounting principle like other changes in accounting principle, as required by paragraphs .08–.09. (Ref: par. .A10)

.11 When a change in the reporting entity results in financial statements that, in effect, are those of a different reporting entity, the auditor should include an emphasis-of-matter paragraph in the auditor's report that describes the change in the reporting entity and provides a reference to the entity's disclosure, unless the change in reporting entity results from a transaction or event. The requirements in paragraph .09 also apply. (Ref: par. .A11)

¹ Paragraphs .06–.07 of section 706A, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

² See section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.12 If an entity's financial statements contain an investment accounted for by the equity method, the auditor's evaluation of consistency should include consideration of the investee. If the investee makes a change in accounting principle that is material to the investing entity's financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor's report to describe the change in accounting principle. The requirements in paragraph .09 also apply.

Correction of a Material Misstatement in Previously Issued Financial Statements

.13 The auditor should include an emphasis-of-matter paragraph in the auditor's report when there are adjustments to correct a material misstatement in previously issued financial statements. The auditor should include this type of emphasis-of-matter paragraph in the auditor's report when the related financial statements are restated to correct the prior material misstatement. The paragraph need not be repeated in subsequent periods. (Ref: par. .A12–.A13)

.14 The emphasis-of-matter paragraph should include

- a. a statement that the previously issued financial statements have been restated for the correction of a material misstatement in the respective period and
- b. a reference to the entity's disclosure of the correction of the material misstatement. (Ref: par. .A14)

.15 If the financial statement disclosures relating to the restatement to correct a material misstatement in previously issued financial statements are not adequate, the auditor should address the inadequacy of disclosure as described in section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Change in Classification

.16 The auditor should evaluate a material change in financial statement classification and the related disclosure to determine whether such a change is also either a change in accounting principle or an adjustment to correct a material misstatement in previously issued financial statements. If so, the requirements of paragraphs .07–.15 apply. (Ref: par. .A15–.A16)

Application and Other Explanatory Material

Evaluating Consistency (Ref: par. .05–.06)

.A1 Unless the auditor's report explicitly states otherwise, the auditor's report implies that the auditor is satisfied that the comparability of financial statements between periods has not been materially affected by a change in accounting principle or by adjustments to correct a material misstatement in previously issued financial statements. There may be no effect on comparability between or among periods because either (a) no change in an accounting principle has occurred, or (b) there has been a change in an accounting principle or in the method of application, but the effect of the change on the comparability of the financial statements is not material. When no material effect on comparability results from a change in accounting principle or an adjustment to previously issued financial statements, the auditor need not refer to consistency in the auditor's report.

.A2 The periods covered in the auditor's evaluation of consistency depend on the periods covered by the auditor's opinion on the financial statements. If an entity presents comparative financial statements and has a change in auditors in the current year, the auditor evaluates consistency between the year covered by the auditor's opinion and the immediately preceding year in accordance with the requirements in paragraph .06.

.A3 When an entity accounts for a change in accounting principle by applying the principle to one or more prior periods that were included in previously issued financial statements, as if that principle had always been used (commonly referred to as *retrospective application*), the financial statements presented generally will be consistent. However, the previous periods' financial statements presented with the current period's financial statements will reflect the change in accounting principle and, therefore, will appear different from those previous periods' financial statements on which the auditor previously reported. The evaluation required by paragraph .06 encompasses previously issued financial statements for the relevant periods.

Change in Accounting Principle (Ref: par. .07)

.A4 A change in accounting principle is a change from one accounting principle in accordance with the applicable financial reporting framework to another accounting principle in accordance with the applicable financial reporting framework when (1) two or more accounting principles apply or (2) the accounting principle formerly used is no longer in accordance with the applicable financial reporting framework. A change in the method of applying an accounting principle also is considered a change in accounting principle.

.A5 The applicable financial reporting framework usually sets forth the method of accounting for the effects of a change in accounting principle and the related disclosures.

.A6 The issuance of an accounting pronouncement that requires use of a new accounting principle, interprets an existing principle, expresses a preference for an accounting principle, or rejects a specific principle is sufficient justification for a change in accounting principle, as long as the change in accounting principle is made in accordance with the applicable financial reporting framework.

Reporting on Changes in Accounting Principles (Ref: par. .08-.11)

.A7 The following is an example of an emphasis-of-matter paragraph for a change in accounting principle resulting from the adoption of a new accounting pronouncement:

Emphasis of Matter

As discussed in Note X to the financial statements, in [insert year(s) of financial statements that reflect the accounting method change], the entity adopted new accounting guidance [insert description of new accounting guidance]. Our opinion is not modified with respect to this matter.

.A8 The following is an example of an emphasis-of-matter paragraph when the entity has made a voluntary change in accounting principle (that is, other than a change due to the adoption of a new accounting pronouncement).

Emphasis of Matter

As discussed in Note X to the financial statements, the entity has elected to change its method of accounting for [describe accounting method change] in

[insert year(s) of financial statements that reflect the accounting method change].
Our opinion is not modified with respect to this matter.

.A9 If a change in accounting principle does not have a material effect on the financial statements in the current year but the change is expected to have a material effect in later years, the auditor is not required to recognize the change in the auditor's report in the current year. The applicable financial reporting framework may include a requirement for the entity to disclose such situations in the notes to the financial statements. Section 700, *Forming an Opinion and Reporting on Financial Statements*, section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, and section 705 require the auditor to evaluate the appropriateness and adequacy of disclosures in connection with forming an opinion and reporting on the financial statements.³ [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

.A10 Paragraph .10 requires the auditor to evaluate and report on a change in accounting estimate that is inseparable from the effect of a related change in accounting principle like other changes in accounting principle. It is sometimes difficult to differentiate between a change in an accounting estimate and a change in an accounting principle because the change in accounting estimate may be inseparable from the effect of a related change in accounting principle. For example, when a change is made to the method of depreciation of an asset to reflect a change in the estimated future benefit of the asset or the pattern of consumption for those benefits, such change in accounting may be inseparable from a change in estimate.

Change in Reporting Entity

.A11 A change in reporting entity that results from a transaction or event, such as the creation, cessation, or complete or partial purchase or disposition of a subsidiary or other business unit, does not require recognition in the auditor's report. Examples of a change in the reporting entity that is not a result of a transaction or event include

- a. presenting consolidated or combined financial statements in place of financial statements of individual entities.
- b. changing specific subsidiaries that make up the group of entities for which consolidated financial statements are presented.
- c. changing the entities included in combined financial statements.

Correction of a Material Misstatement in Previously Issued Financial Statements (Ref: par. .13–.14)

.A12 A change from an accounting principle that is not in accordance with the applicable financial reporting framework to one that is in accordance with the applicable financial reporting framework is a correction of a misstatement.

.A13 Section 560, *Subsequent Events and Subsequently Discovered Facts*, addresses the auditor's responsibilities when adjustments have been made to correct a material misstatement in previously issued financial statements.

³ Paragraph .15 of section 700, *Forming an Opinion and Reporting on Financial Statements*, paragraph .40 of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and paragraphs .07 and .A7 of section 705. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Reporting on a Correction of a Material Misstatement in Previously Issued Financial Statements

.A14 The following is an example of an emphasis-of-matter paragraph when there has been a correction of a material misstatement in previously issued financial statements:

Emphasis of Matter

As discussed in Note X to the financial statements, the 20X2 financial statements have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

Change in Classification (Ref: par. .16)

.A15 Changes in classification in previously issued financial statements do not require recognition in the auditor's report unless the change represents the correction of a material misstatement or a change in accounting principle. For example, certain reclassifications in previously issued financial statements, such as reclassifications of debt from long-term to short-term or reclassifications of cash flows from the operating activities category to the financing activities category, might occur because those items were classified incorrectly in the previously issued financial statements. In such situations, the reclassification also is the correction of a misstatement.

.A16 In some cases, changes in classification in previously issued financial statements may result from changes in the entity's business or operating structure. The auditor may need to obtain a further understanding of the underlying rationale for such reclassifications to determine whether the requirements of paragraph .16 apply.

AU-C Section 720

The Auditor's Responsibilities Relating to Other Information Included in Annual Reports

Source: SAS No. 137; SAS No. 141.

Effective for audits of financial statements for periods ending on or after December 15, 2021.

NOTE

In October 2021, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to other information, whether financial or nonfinancial information (other than financial statements and the auditor's report thereon), included in an entity's annual report. An entity's annual report may be a single document or a combination of documents that serve the same purpose.

.02 This section also may be applied, and adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention. (Ref: par. .A1–.A3)

.03 This section is written in the context of an audit of financial statements by an independent auditor. Accordingly, the objectives of the auditor in this section are to be understood in the context of the overall objectives of the auditor as stated in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.¹ The requirements in the standards are designed to enable the auditor to achieve the objectives specified in the standards, and thereby the overall

¹ Paragraph .12 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

objectives of the auditor. The auditor's opinion on the financial statements does not cover the other information, nor does this section require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.

.04 This section requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit may indicate that a material misstatement of the financial statements or that a material misstatement of the other information exists, either of which may undermine the credibility of the financial statements and the auditor's report thereon.

.05 Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail about amounts or other items in the financial statements and other amounts or other items about which the auditor has obtained knowledge in the audit. Other information may include nonfinancial information.

.06 The auditor's responsibilities relating to other information, other than applicable reporting requirements, apply regardless of whether the other information is obtained by the auditor prior to or after the date of the auditor's report.

.07 The auditor's responsibilities under this section do not constitute an assurance engagement on other information or impose an obligation on the auditor to obtain assurance about the other information.

.08 Law or regulation may impose additional obligations on the auditor in relation to other information that are beyond the scope of this section.

.09 This section does not apply to supplemental information addressed by section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, or required supplementary information addressed by section 730, *Required Supplementary Information*. (Ref: par. .A2)

Effective Date

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2021. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 141.]

Objectives

.11 The objectives of the auditor, having read the other information, are as follows:

- a. To consider whether a material inconsistency exists between the other information and the financial statements
- b. To remain alert for indications that
 - i. a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit or
 - ii. a material misstatement of fact exists or the other information is otherwise misleading
- c. To respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated
- d. To report in accordance with this section

Definitions

.12 For purposes of the auditing standards, the following terms have the meanings attributed:

Annual report. A document, or combination of documents, typically prepared on an annual basis by management or those charged with governance in accordance with law, regulation, or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains, accompanies, or incorporates by reference the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. Annual reports include annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public. (Ref: par. .A4–.A10)

Misstatement of the other information. A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading. (Ref: par. .A11–.A12)

Other information. Financial or nonfinancial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. (Ref: par. .A13)

Requirements

Obtaining the Other Information

.13 The auditor should do the following: (Ref: par. .A14–.A24)

- a. Through discussion with management, determine and obtain management's written acknowledgment regarding which document or documents comprise the annual report and the entity's planned manner and timing of the issuance of such documents.
- b. Make appropriate arrangements with management to obtain in a timely manner and, if possible, prior to the date of the auditor's report, the final version of the document or documents comprising the annual report.
- c. When some or all the documents determined in (a) will not be available until after the date of the auditor's report on the financial statements, request management to provide a written representation that the final version of the documents will be provided to the auditor when available, and prior to the document's issuance by the entity, such that the auditor can complete the procedures required by this section. (Ref: par. .A23–.A24)

.14 If the auditor becomes aware that the entity did not provide the auditor with the final version of documents determined in accordance with paragraph .13a to be part of the annual report prior to the issuance of those documents to third parties, the auditor should take appropriate action. (Ref: par. .A25)

Communication With Those Charged With Governance

.15 The auditor should communicate with those charged with governance the auditor's responsibility with respect to other information, the procedures performed related to the other information, and the results.

Reading and Considering the Other Information

.16 The auditor should read the other information and consider whether a material inconsistency exists between the other information and the financial statements. As the basis for this consideration, to evaluate their consistency, the auditor should compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements) with such amounts or other items in the financial statements. (Ref: par. .A26–.A32)

.17 While reading the other information in accordance with paragraph .16, the auditor should remain alert for indications that (Ref: par. .A33–.A42)

- a. a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit.
- b. a material misstatement of fact exists or the other information is otherwise misleading.

.18 The auditor is not responsible for searching for omitted information or for the completeness of the other information.

Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated

.19 If the auditor identifies that a material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated), the auditor should discuss the matter with management and, if necessary, perform other procedures to conclude the following: (Ref: par. .A43–.A47)

- a. Whether a material misstatement of the other information exists
- b. Whether a material misstatement of the financial statements exists
- c. Whether the auditor's understanding of the entity and its environment needs to be updated

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists

.20 If the auditor concludes that a material misstatement of the other information exists, the auditor should request management to correct the other information and

- a. if management agrees to make the correction, determine that the correction has been made.
- b. if management refuses to make the correction, communicate the matter to those charged with governance and request that the correction be made.

.21 If the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance, the auditor should (Ref: par. .A48)

- a. consider the implications for the auditor's report and communicate to those charged with governance about how the auditor plans to address the material misstatement in the auditor's report (see paragraph .24cii); (Ref: par. .A49)
- b. withhold the auditor's report; or (Ref: par. .A51)
- c. withdraw from the engagement, when withdrawal is possible under applicable law or regulation. (Ref: par. .A50–.A51)

.22 If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor should do the following:

- a. If the other information is corrected, perform the procedures necessary in the circumstances. (Ref: par. .A52)
- b. If the other information is not corrected after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations to seek to have the uncorrected material misstatement appropriately brought to the attention of anyone in receipt of the financial statements and the auditor's report. (Ref: par. .A53–.A54)

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated

.23 If, as a result of performing the procedures in paragraphs .16–.18, the auditor concludes that a material misstatement in the financial statements exists or the auditor's understanding of the entity and its environment needs to be updated, the auditor should respond appropriately in accordance with other relevant AU-C sections. (Ref: par. .A55)

Reporting

.24 At the date of the auditor's report, when the auditor has obtained all the other information, the composition of which was determined through discussion with management and for which the auditor obtained management's written acknowledgment (pursuant to paragraph .13a), the auditor should include a separate section in the auditor's report on the financial statements with the heading "Other Information" or other appropriate heading. The "Other Information" section in the auditor's report on the financial statements should include the following: (Ref: par. .A56)

- a. A statement that management is responsible for the other information
- b. An identification of other information and a statement that the other information does not include the financial statements and the auditor's report thereon
- c. A statement that the auditor's opinion on the financial statements does not cover the other information and that the auditor does not express an opinion or any form of assurance thereon
- d. A statement that, in connection with the audit of the financial statements, the auditor is responsible to read the other information and consider whether a material inconsistency exists

between the other information and the financial statements or the other information otherwise appears to be materially misstated

- e. A statement that, if, based on the work performed, the auditor concludes that an uncorrected material misstatement of the other information exists, the auditor is required to describe it in the auditor's report
- f. If the auditor has concluded that an uncorrected material misstatement of the other information exists, a statement that the auditor has concluded that an uncorrected material misstatement of the other information exists and a description of it in the auditor's report

.25 When the auditor expresses a qualified or adverse opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, the auditor should consider the implications of the matter giving rise to the modification of opinion for the statement required in paragraph .24f of this section. (Ref: par. .A57–.A61)

Documentation

.26 In addressing the requirements in section 230, *Audit Documentation*,² as those requirements apply to this section, the auditor should include the following in the audit documentation:

- a. The procedures performed under this section
- b. The final version of the other information on which the auditor has performed the work required under this section

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02 and .09)

.A1 In instances in which the auditor applies this section to other documents to which the auditor, at management's request, devotes attention, the requirements of this section are applicable, adapted as necessary in the circumstances.

.A2 Other AU-C sections provide requirements and guidance with respect to information in certain documents other than annual reports. For example, section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*; section 945, *Auditor Involvement With Exempt Offering Documents*; and Statement on Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (sec. 703).³

.A3 This section also addresses other information for which a designated accounting standard setter⁴ has issued standards or guidance regarding the

² Paragraphs .08–.11 of section 230, *Audit Documentation*.

³ Statement on Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (sec. 703), is effective for audits of financial statements for periods ending on or after December 15, 2021.

⁴ Designated accounting standards setter is defined in paragraph .04 of section 730, *Required Supplementary Information*.

format to be used and content to be included when such information is voluntarily presented in an annual report — for example, GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*.

Definitions

Annual Report (Ref: par. .12)

.A4 Law, regulation, or custom may define the content of an annual report and the name by which it is to be referred.

.A5 An annual report is typically prepared on an annual basis. However, when the financial statements being audited are prepared for a period less than or more than a year, an annual report may also be prepared that covers the same period as the financial statements.

.A6 In some cases, an entity's annual report may be a single document and referred to by the title "Annual Report" or by some other title. In other cases, law, regulation, or custom may require the entity to report to owners (or similar stakeholders) information on the entity's operations and the entity's financial results and financial position as set out in the financial statements (that is, an annual report) by way of a single document or by way of two or more separate documents that, in combination, serve the same purpose.

.A7 An annual report may be made available to users in printed form, or electronically, including on the entity's website. A document (or combination of documents) may meet the definition of an *annual report*, irrespective of the manner in which it is made available to users.

.A8 An annual report is different in nature, purpose, and content from other reports, such as a report prepared to meet the information needs of a specific stakeholder group or a report prepared to comply with a specific regulatory reporting objective (even when such a report is required to be publicly available). Examples of reports that, when issued as stand-alone documents, are not typically part of the combination of documents that comprise an annual report (subject to law, regulation, or custom), and, therefore, are not other information within the scope of this section, include the following:

- IRS Form 990, *Return of Organization Exempt From Income Tax*
- IRS Form 5500, *Annual Return/Report of Employee Benefit Plan*
- Annual statement filed with National Association of Insurance Commissioners
- Separate industry or regulatory reports (for example, capital adequacy reports), such as those prepared in the banking, insurance, and pension industries
- Corporate social responsibility reports
- Sustainability reports
- Diversity and equal opportunity reports
- Product responsibility reports
- Labor practices and working conditions reports
- Human rights reports

.A9 Though a document may be referred to as an *annual report*, such document may not meet the definition of an *annual report* for purposes of this section.

Considerations Specific to Governmental Entities

.A10 The term *annual reports of governments* is intended to include comprehensive annual financial reports or other annual financial reports that include the government's financial statements and the auditor's report thereon.

Misstatement of the Other Information (Ref: par. .12)

.A11 A misstatement of the other information may be

- an inconsistency;
- a misstatement of fact; or
- information that is otherwise misleading, including because it omits or obscures information necessary for a user to appropriately understand a matter disclosed in the other information.

An inconsistency exists when other information conflicts with information contained in the financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements. A misstatement of fact exists when other information that is unrelated to matters appearing in the financial statements is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the annual report. Information that is otherwise misleading, including because it omits or obscures information necessary for a user to appropriately understand a matter disclosed in the other information, could result in a material misstatement of the other information.

.A12 The concept of materiality may be discussed in a framework applicable to the other information and, if so, such a framework may provide a frame of reference for the auditor in making judgments about materiality under this section. In many cases, however, there may be no applicable framework that includes a discussion of the concept of materiality as it applies to the other information. In such circumstances, the following characteristics provide the auditor with a frame of reference in determining if a misstatement of the other information is material:

- Materiality is considered in the context of the common information needs of users as a group. The users of the other information are expected to be the same as the users of the financial statements because such users may be expected to read the other information to provide context to the financial statements.
- Judgments about materiality take into account the specific circumstances of the misstatement, considering whether users would be influenced by the effect of the uncorrected misstatement. Not all misstatements will influence the economic decisions of users.
- Judgments about materiality involve both qualitative and quantitative considerations. Accordingly, such judgments may take into account the nature or magnitude of the items that the other information addresses in the context of the entity's annual report.

Other Information (Ref: par. .12)

.A13 The following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive:

- Management report, management commentary, or operating and financial review or similar reports by those charged with governance (for example, a directors' report)
- Chairman's statement
- Corporate governance statement
- Management's internal control and risk assessment reports
- Financial summaries or highlights
- Employment data
- Planned capital expenditures
- Financial ratios
- Names of officers and directors
- Selected quarterly data

Obtaining the Other Information (Ref: par. .13–.14)

.A14 Determining the document or documents that comprise the annual report is often clear based on law, regulation, or custom. In many cases, management or those charged with governance may have customarily issued a package of documents that, together, comprise the annual report or may have committed to do so. In some cases, it may not be clear which documents comprise the annual report. In such cases, the timing and purpose of the documents (and for whom they are intended) are matters that may be relevant to the auditor's determination of which documents are the annual report.

.A15 In accordance with paragraph .13a, management's written acknowledgment may be included in the engagement letter, an amendment to the engagement letter, a representation letter, or some other written communication.

.A16 Management, or those charged with governance, is responsible for preparing the annual report. The auditor may communicate the following to management or those charged with governance:

- The auditor's expectations in relation to obtaining the final version of the annual report (including a combination of documents that, together, comprise the annual report) in a timely manner prior to the date of the auditor's report such that the auditor can complete the procedures required by this section before the date of the auditor's report, or if that is not possible, as soon as practicable and, in any case, prior to the entity's issuance of such information
- The possible implications when the other information is obtained after the date of the auditor's report

.A17 The communications referred to in paragraph .A16 may be particularly appropriate in the following instances:

- In an initial audit engagement
- When there has been a change in management or those charged with governance
- When other information is expected to be obtained after the date of the auditor's report

.A18 When those charged with governance are to approve the other information prior to its issuance by the entity, the final version of such other information is the version that has been approved by those charged with governance for issuance.

.A19 In some cases, the entity's annual report may be a single document to be released, in accordance with law or regulation or the entity's reporting practice, shortly after the entity's financial reporting period such that it is available to the auditor prior to the date of the auditor's report. In other cases, such a document may not be required to be released until a later time, or at a time of the entity's choosing. There may also be circumstances in which the entity's annual report is a combination of documents, each subject to different requirements or reporting practices by the entity with respect to the timing of their release.

.A20 Obtaining the other information in a timely manner prior to the date of the auditor's report enables any revisions that are found to be necessary to the financial statements, the auditor's report, or the other information prior to their issuance. The audit engagement letter⁵ may make reference to an agreement with management to make available to the auditor the other information in a timely manner, and, if possible, prior to the date of the auditor's report.

.A21 When other information is made available to users only via the entity's website, the version of the other information obtained from the entity, rather than directly from the entity's website, is the relevant document on which the auditor would perform procedures in accordance with this section. The auditor has no responsibility in accordance with this section to search for other information, including other information that may be on the entity's website, nor to perform any procedures to confirm that other information is appropriately displayed on the entity's website or otherwise has been appropriately transmitted or displayed electronically.

.A22 The auditor is not precluded from dating or issuing the auditor's report if the auditor has not obtained some or all of the other information.

.A23 When the other information is obtained after the date of the auditor's report, the auditor is not required to update the procedures performed in accordance with section 560, *Subsequent Events and Subsequently Discovered Facts*.⁶

.A24 Section 580, *Written Representations*, establishes requirements and provides guidance on the use of written representations. The written representation regarding other information that will be available only after the date of the auditor's report is intended to support the auditor's ability to complete the procedures required by this section with respect to such information. In addition, the auditor may find it useful to request other written representations, such as the following:

- That management has informed the auditor of all the documents that it expects to issue that may be other information
- That the financial statements and any other information obtained by the auditor prior to the date of the auditor's report are consistent with one another, and the other information does not contain any material misstatements

⁵ Paragraph .A23 of section 210A, *Terms of Engagement*.

⁶ Paragraphs .09–.11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

- With regard to other information that has not been obtained by the auditor prior to the date of the auditor's report, that management intends to prepare and issue such other information and the expected timing of such issuance

.A25 In accordance with paragraph .14, appropriate actions that the auditor may take include the following:

- Obtaining those documents from management and performing the procedures required by this section as soon as practical
- Communicating the matter to those charged with governance, if applicable
- Considering the need to obtain legal advice

Reading and Considering the Other Information (Ref: par. .16–.17)

.A26 Section 200⁷ requires the auditor to plan and perform the audit with professional skepticism. Maintaining professional skepticism when reading and considering the other information includes, for example, recognizing that management may be overly optimistic about the success of its plans.

.A27 In accordance with section 220A, *Quality Control for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*,⁸ the engagement partner is required to take responsibility for the direction, supervision, and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements. In the context of this section, factors that may be considered when determining the appropriate engagement team members to address the requirements of paragraphs .16–.17 of this section include the following:

- The relative experience of engagement team members
- Whether the engagement team members have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge
- The degree of judgment involved in addressing the requirements of paragraphs .16–.17 of this section, for example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component

.A28 Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements. Examples of such amounts or other items may include the following:

- Tables, charts, or graphs containing extracts of the financial statements

⁷ Paragraph .17 of section 200.

⁸ Paragraph .17a of section 220A, *Quality Control for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*.

- A disclosure providing greater detail about a balance or account shown in the financial statements, such as "Revenue for 20X1 was XXX million from product X and YYY million from product Y"
- Descriptions of the financial results, such as "Total research and development expense was XXX in 20X1"

.A29 In evaluating the consistency of selected amounts or other items in the other information with the financial statements, the auditor is not required to compare all amounts or other items in the other information that are intended to be the same as, to summarize, or to provide greater detail about the amounts or other items in the financial statements, with such amounts or other items in the financial statements.

.A30 Selecting the amounts or other items to compare is a matter of professional judgment. Factors relevant to this judgment include the following:

- The significance of the amount or other item in the context in which it is presented, which may affect the importance that users would attach to the amount or other item (for example, a key ratio or amount)
- If quantitative, the relative size of the amount compared with accounts or items in the financial statements or the other information to which they relate
- The sensitivity of the particular amount or other item in the other information, for example, share-based payments for senior management

.A31 Determining the nature and extent of procedures to address the requirement in paragraph .16 is a matter of professional judgment, recognizing that the auditor's responsibilities under this section do not constitute an assurance engagement on the other information or impose an obligation to obtain assurance about the other information. Examples of such procedures include the following:

- For information that is intended to be the same as information in the financial statements, comparing the information to the financial statements
- For information intended to convey the same meaning as disclosures in the financial statements, comparing the words used and considering the significance of differences in wording used and whether such differences imply different meanings
- Obtaining a reconciliation between an amount within the other information and the financial statements from management
- Comparing items in the reconciliation to the financial statements and the other information
- Checking whether the calculations within the reconciliation are arithmetically accurate

.A32 Evaluating the consistency of selected amounts or other items in the other information with the financial statements includes, when relevant given the nature of the other information, the manner of their presentation compared to the financial statements.

.A33 Other information may include amounts or items that are related to the auditor's knowledge obtained in the audit (other than those in paragraph .16). Examples of such amounts or items may include the following:

- A disclosure of the units produced or a table summarizing such production by geographical region
- A statement that "the company introduced product X and product Y during the year"
- A summary of the locations of the entity's major operations, such as "the entity's major center of operation is in country X, and there are also operations in countries Y and Z"

.A34 The auditor's knowledge obtained in the audit includes the auditor's understanding of the entity and its environment, including the entity's internal control, obtained in accordance with section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.⁹ Section 315A sets out the auditor's required understanding, which includes such matters as obtaining an understanding of the following:

- a. The relevant industry, regulatory, and other external factors
- b. The nature of the entity
- c. The entity's selection and application of accounting policies
- d. The entity's objectives and strategies
- e. The measurement and review of the entity's financial performance
- f. The entity's internal control

.A35 The auditor's knowledge obtained in the audit may also include matters that are prospective in nature. Such matters may include, for example, business prospects and future cash flows that the auditor considered when evaluating the assumptions used by management in performing impairment tests on intangible assets such as goodwill, or when evaluating management's evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

.A36 In the case of a group audit, though the group auditor is required to read the entirety of the other information if, in accordance with section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,¹⁰ the group auditor decides to make reference to a component auditor in the auditor's report on the group financial statements, the group auditor's knowledge does not extend beyond that obtained by the group auditor during the audit of the group financial statements.

.A37 While remaining alert for indications that a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit, the auditor may focus on those matters in the other information that are of sufficient importance that a misstatement of the other information in relation to those matters could be material.

.A38 In relation to many matters in the other information, the auditor's recollection of the audit evidence obtained and conclusions reached during the audit may be sufficient to enable the auditor to consider whether a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit. For example, the auditor may be able to consider whether

⁹ Paragraphs .12–.13 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

¹⁰ Paragraph .24 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*

a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit in light of the auditor's recollection of discussions held with management or those charged with governance or findings from procedures carried out during the audit, such as the reading of board minutes, without the need to take further action.

.A39 The manner in which an auditor resolves a concern regarding whether other information is materially inconsistent with the auditor's knowledge obtained in the audit, is a matter of professional judgment. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team or relevant component auditors is appropriate as a basis for the auditor's consideration of whether a material misstatement exists. Whether, and if so, the extent to which, the auditor refers to relevant audit documentation or makes inquiries of relevant members of the engagement team or relevant component auditors is a matter of professional judgment.

.A40 It may not be necessary for the auditor to refer to relevant audit documentation or to make inquiries of relevant members of the engagement team or relevant component auditors about any matter included in the other information. This may be the case, for example, when the group auditor decides to make reference to a component auditor in the auditor's report in accordance with section 600,¹¹ and the group auditor has obtained sufficient knowledge in connection with the group audit about matters in the other information relating to the significant component with respect to which the component auditor has performed an audit of the financial statements.

.A41 Other information may include discussion of matters that are not related to the financial statements and may also extend beyond the auditor's knowledge obtained in the audit. For example, the other information may include statements about the entity's greenhouse gas emissions.

.A42 Remaining alert for indications that a material misstatement of fact exists or the other information is otherwise misleading could potentially result in the auditor identifying such matters as the following:

- Information that omits or obscures information necessary for a user to appropriately understand a matter disclosed in the other information
- Differences between the other information and the general knowledge, apart from the knowledge obtained in the audit, of the engagement team member reading the other information that leads the auditor to believe that the other information appears to be materially misstated
- An internal inconsistency in the other information that leads the auditor to believe that the other information appears to be materially misstated

Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated (Ref: par. .19)

.A43 The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may

¹¹ Paragraph .24 of section 600.

include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management's explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

.A44 Conversely, the discussion with management may provide further information that supports the auditor's conclusion that a material misstatement of the other information exists.

.A45 It may be more difficult for the auditor to challenge management on matters of judgment than on those of a more factual nature. However, there may be circumstances in which the auditor concludes that the other information contains a statement that is not consistent with the financial statements or the auditor's knowledge obtained in the audit. These circumstances may raise doubt about the other information, the financial statements, or the auditor's knowledge obtained in the audit.

.A46 Because there is a wide range of possible material misstatements of the other information, the nature and extent of other procedures the auditor may perform to conclude whether a material misstatement of the other information exists are matters of the auditor's professional judgment in the circumstances.

.A47 When a matter is unrelated to the financial statements or the auditor's knowledge obtained in the audit, the auditor may not be able to fully assess management's responses to the auditor's inquiries. Nevertheless, based on management's further information or explanations, or following changes made by management to the other information, the auditor may be satisfied that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated. When the auditor is unable to conclude that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated, the auditor may request management to consult with a qualified third party (for example, management's expert or legal counsel). In certain cases, after considering the responses from management's consultation, the auditor may not be able to conclude whether a material misstatement of the other information exists. Actions the auditor may then take include one or more of the following:

- Obtaining advice from the auditor's legal counsel
- Considering the implications for the auditor's report, for example, whether to describe the circumstances when there is a limitation imposed by management
- Withdrawing from the audit, when withdrawal is possible under applicable law or regulation

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists

Responding When the Auditor Concludes That a Material Misstatement Exists in Other Information Obtained Prior to the Date of the Auditor's Report (Ref: par. .21)

.A48 The actions the auditor takes if the other information is not corrected after communicating with those charged with governance are a matter of the

auditor's professional judgment. The auditor may consider whether the rationale given by management and those charged with governance for not making the correction raises doubt about the integrity or honesty of management or those charged with governance, such as when the auditor suspects an intention to mislead. The auditor may also consider it appropriate to seek legal advice. In some cases, the auditor may be required by law, regulation, or other professional standards to communicate the matter to a regulator or relevant professional body.

Reporting Implications (Ref: par. .21a)

.A49 In rare circumstances, a disclaimer of opinion on the financial statements may be appropriate when the refusal to correct the material misstatement of the other information casts such doubt on the integrity of management and those charged with governance that it calls into question the reliability of audit evidence in general.

Withdrawal From the Engagement (Ref: par. .21c)

.A50 Withdrawal from the engagement, when withdrawal is possible under applicable law or regulation, may be appropriate when the circumstances surrounding the refusal to correct the material misstatement of the other information cast such doubt on the integrity of management and those charged with governance that it calls into question the reliability of representations obtained from them during the audit.

Considerations Specific to Governmental Entities (Ref: par. .21b–c)

.A51 In audits of governmental entities, withdrawal from the engagement or withholding the auditor's report may not be possible under law or regulation. In such cases, the auditor may issue a report or written communication to those charged with governance and the appropriate statutory body, if applicable, giving details of the material misstatement.

Responding When the Auditor Concludes That a Material Misstatement Exists in Other Information Obtained After the Date of the Auditor's Report (Ref: par. .22)

.A52 If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, and such a material misstatement has been corrected, the auditor's procedures necessary in the circumstances include determining that the correction has been made (in accordance with paragraph .20a) and may include reviewing the steps taken by management to communicate with those in receipt of the other information, if previously issued, to inform them of the revision.

.A53 If those charged with governance do not agree to revise the other information, taking appropriate action to seek to have the uncorrected misstatement appropriately brought to the attention of anyone in receipt of the financial statements and the auditor's report requires the exercise of professional judgment and may be affected by relevant law or regulation in the jurisdiction. Accordingly, the auditor may consider it appropriate to seek legal advice about the auditor's legal rights and obligations.

.A54 When a material misstatement of the other information remains uncorrected, appropriate actions that the auditor may take to seek to have the uncorrected material misstatement appropriately brought to the attention of anyone in receipt of the financial statements and the auditor's report, when permitted by law or regulation, include, for example, the following:

- Providing a new or amended auditor's report to management, including a modified section in accordance with paragraph .25, and requesting management to provide this new or amended auditor's report to anyone in receipt of the financial statements and the auditor's report. In doing so, the auditor may need to consider the effect, if any, on the date of the new or amended auditor's report, in view of the requirements of GAAS or applicable law or regulation. The auditor may also review the steps taken by management to provide the new or amended auditor's report to such users.
- Bringing the material misstatement of the other information to the attention of known users of the financial statements and the auditor's report.
- Communicating with a regulator or relevant professional body about the uncorrected material misstatement.
- Considering the implications for engagement continuance (see also paragraph .A51).

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated (Ref: par. .23)

.A55 In reading the other information, the auditor may become aware of new information that has implications for the following:

- The auditor's understanding of the entity and its environment, which may indicate the need to revise the auditor's risk assessment¹²
- The auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements¹³
- The auditor's responsibilities relating to subsequent events¹⁴

Reporting (Ref: par. .24–.25)

.A56 Illustrative examples of the "Other Information" section in the auditor's report are included in the exhibit.

Reporting Implications When the Auditor's Opinion on the Financial Statements Is Qualified or Adverse (Ref: par. .25)

.A57 A qualified or adverse auditor's opinion on the financial statements may not have an impact on the statement required by paragraph .24f if the matter with respect to the auditor's opinion has been modified is not included or otherwise addressed in the other information, and the matter does not affect any part of the other information. For example, a qualified opinion on the financial statements because of nondisclosure of directors' remuneration as required by the applicable financial reporting framework may have no implications for the reporting required under this section. In other circumstances, there may be implications for such reporting as described in paragraphs .A58–.A61.

¹² Paragraphs .11, .31, and .A1 of section 315A.

¹³ Section 450, *Evaluation of Misstatements Identified During the Audit*.

¹⁴ Paragraphs .10 and .14 of section 560.

Qualified Opinion Due to a Material Misstatement in the Financial Statements

.A58 In circumstances in which the auditor's opinion is qualified, consideration may be given to whether the other information is also materially misstated for the same matter as, or a matter related to, the matter giving rise to the qualified opinion on the financial statements.

Qualified Opinion Due to Limitation of Scope

.A59 When there is a limitation of scope with respect to a material item in the financial statements, the auditor will not have obtained sufficient appropriate audit evidence about that matter. In these circumstances, the auditor may be unable to conclude whether the amounts or other items in the other information related to this matter result in a material misstatement of the other information. Accordingly, the auditor may need to modify the statement required by paragraph .24f to refer to the auditor's inability to consider management's description of the matter in the other information with respect to which the auditor's opinion on the financial statements has been qualified, as explained in the Basis for Qualified Opinion paragraph. The auditor is, nevertheless, required to report any other uncorrected material misstatements of the other information that have been identified.

Adverse Opinion

.A60 An adverse opinion on the financial statements relating to a specific matter or matters described in the Basis for Adverse Opinion paragraph does not justify the omission of reporting of material misstatements of the other information that the auditor has identified in the auditor's report in accordance with paragraph .24f. When an adverse opinion has been expressed on the financial statements, the auditor may need to appropriately modify the statement required by paragraph .24f, for example, to indicate that amounts or items in the other information are materially misstated for the same matter as, or a related matter to, the matter giving rise to the adverse opinion on the financial statements.

Disclaimer of Opinion

.A61 When the auditor disclaims an opinion on the financial statements, providing further details about the audit, including a section to address other information, may overshadow the disclaimer of opinion on the financial statements as a whole. Accordingly, in those circumstances, as required by section 705,¹⁵ the auditor's report does not include a section addressing the reporting requirements under this section.

¹⁵ Paragraph .30 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

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Exhibit — Illustrations of Other Information Sections to Be Included in Auditor's Reports Relating to Other Information Included in the Annual Report

Illustration 1 — The auditor has not identified an uncorrected material misstatement of the other information.

Illustration 2 — The auditor has concluded that an uncorrected material misstatement of the other information exists.

Illustration 1: The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information

Other Information [Included in the Annual Report]

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*information included in the annual report*]¹ but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

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

¹ A more specific description of the other information, such as "the management report and chairman's statement," may be used to identify the other information.

Illustration 2: The Auditor Has Concluded That an Uncorrected Material Misstatement of the Other Information Exists***Other Information [Included in the Annual Report]***

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*information included in the annual report*]² but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report. As described below, we have concluded that such an uncorrected material misstatement of the other information exists.

[Description of material misstatement of the other information]

² See footnote 1.

AU-C Section 725

Supplementary Information in Relation to the Financial Statements as a Whole

(With SAS No. 118 supersedes SAS No. 29.)

Source: SAS No. 119; SAS No. 122; SAS No. 125; SAS No. 136; SAS No. 137; SAS No. 140.

See section 9725 for interpretations of this section.

Effective for audits of financial statements for periods beginning on or after December 15, 2010, unless otherwise indicated. Early application is permitted.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. The information covered by this section is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. This section also may be applied, with the report wording adapted as necessary, when an auditor has been engaged to report on whether required supplementary information¹ is fairly stated, in all material respects, in relation to the financial statements as a whole. When the auditor is performing an audit of an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, applies. Accordingly, the requirements in paragraph .09 of this section are replaced by the requirements in section 703, for such audits only. (Ref: par. .A1–.A6) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 136.]

Effective Date

.02 This section is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

Objective

.03 The objective of the auditor, when engaged to report on supplementary information in relation to the financial statements as a whole, is to

¹ Required supplementary information is defined in paragraph .04 of section 730, *Required Supplementary Information*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

- a. evaluate the presentation of the supplementary information in relation to the financial statements as a whole and
- b. report on whether the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Definition

.04 For purposes of generally accepted auditing standards, the following term has the meaning attributed as follows:

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the audited financial statements or separate from the financial statements. (Ref: par. .A7–.A8)

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Requirements

Procedures to Determine Whether Supplementary Information Is Fairly Stated, in All Material Respects, in Relation to the Financial Statements as a Whole (Ref: par. .A9–.A15)

.05 In order to opine on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should determine that all of the following conditions are met:

- a. The supplementary information was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements.
- b. The supplementary information relates to the same period as the financial statements.
- c. The auditor issued an audit report on the financial statements that contained neither an adverse opinion nor a disclaimer of opinion. (Paragraph .11 addresses reporting while not opining on supplementary information when the report on the financial statements contains an adverse opinion or a disclaimer of opinion.)
- d. The supplementary information will accompany the entity's audited financial statements, or such audited financial statements will be made readily available by the entity. (Ref: par. .A9)

[Revised, April 2012 and January 2013, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.06 The auditor should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation of the supplementary information in accordance with the applicable criteria.

- b. to provide the auditor with the written representations described in paragraph .07g.
- c. to include the auditor's report on the supplementary information in any document that contains the supplementary information and that indicates that the auditor has reported on such supplementary information.
- d. to present the supplementary information with the audited financial statements or, if the supplementary information will not be presented with the audited financial statements, to make the audited financial statements readily available to the intended users of the supplementary information no later than the date of issuance by the entity of the supplementary information and the auditor's report thereon. (Ref: par. .A9)

.07 In addition to the procedures performed during the audit of the financial statements, in order to opine on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, the auditor should perform the following procedures using the same materiality level used in the audit of the financial statements:

- a. Inquire of management about the purpose of the supplementary information and the criteria used by management to prepare the supplementary information, such as an applicable financial reporting framework, criteria established by a regulator, a contractual agreement, or other requirements
- b. Determine whether the form and content of the supplementary information complies with the applicable criteria
- c. Obtain an understanding about the methods of preparing the supplementary information and determine whether the methods of preparing the supplementary information have changed from those used in the prior period and, if the methods have changed, the reasons for such changes
- d. Compare and reconcile the supplementary information to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves
- e. Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information
- f. Evaluate the appropriateness and completeness of the supplementary information, considering the results of the procedures performed and other knowledge obtained during the audit of the financial statements (Ref: par. .A13)
- g. Obtain written representations from management
 - i. that it acknowledges its responsibility for the presentation of the supplementary information in accordance with the applicable criteria;
 - ii. that it believes the supplementary information, including its form and content, is fairly presented in accordance with the applicable criteria;
 - iii. that the methods of measurement or presentation have not changed from those used in the prior period or, if the methods of measurement or presentation have changed, the reasons for such changes;

- iv. about any significant assumptions or interpretations underlying the measurement or presentation of the supplementary information; and
- v. that when the supplementary information is not presented with the audited financial statements, management will make the audited financial statements readily available to the intended users of the supplementary information no later than the date of issuance by the entity of the supplementary information and the auditor's report thereon. (Ref: par. .A9)

.08 The auditor has no responsibility for the consideration of subsequent events with respect to the supplementary information. However, if information comes to the auditor's attention

- a. prior to the release of the auditor's report on the financial statements regarding subsequent events that affect the financial statements, or
- b. subsequent to the release of the auditor's report on the financial statements regarding facts that, had they been known to the auditor at the date of the auditor's report, may have caused the auditor to revise the auditor's report,

the auditor should apply the relevant requirements in section 560, *Subsequent Events and Subsequently Discovered Facts*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Reporting

.09 When the entity presents the supplementary information with the financial statements, the auditor should report on the supplementary information in either (a) a separate section in the auditor's report on the financial statements with the heading "Supplementary Information," or other appropriate heading, or (b) in a separate report on the supplementary information.^[2] The supplementary information section in the auditor's report on the financial statements or separate report should include the following elements:

- a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole
- b. A statement that the supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements
- c. A statement that the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements
- d. A statement that the supplementary information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and

^[2] [Footnote deleted by the issuance of SAS No. 140, April 2020.]

other additional procedures, in accordance with auditing standards generally accepted in the United States of America

- e. If the auditor issues an unmodified opinion on the financial statements and the auditor has concluded that the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole
- f. If the auditor issues a qualified opinion on the financial statements and the qualification has an effect on the supplementary information, a statement that, in the auditor's opinion, except for the effects on the supplementary information of (refer to the paragraph in the auditor's report explaining the qualification), such information is fairly stated, in all material respects, in relation to the financial statements as a whole

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.10 When the audited financial statements are not presented with the supplementary information, the auditor should report on the supplementary information in a separate report. When reporting separately on the supplementary information, the report should include, in addition to the elements in paragraph .09, a reference to the report on the financial statements, the date of that report, the nature of the opinion expressed on the financial statements, and any report modifications. (Ref: par. A16)

.11 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion and the auditor has been engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to such financial statements as a whole, the auditor is precluded from expressing an opinion on the supplementary information. When permitted by law or regulation, the auditor may withdraw from the engagement to report on the supplementary information. If the auditor does not withdraw, the auditor's report on the supplementary information should state that because of the significance of the matter disclosed in the auditor's report, it is inappropriate to, and the auditor does not, express an opinion on the supplementary information.

.12 The date of the auditor's report on the supplementary information in relation to the financial statements as a whole should not be earlier than the date on which the auditor completed the procedures required in paragraph .07.

.13 If the auditor concludes, on the basis of the procedures performed, that the supplementary information is materially misstated in relation to the financial statements as a whole, the auditor should discuss the matter with management and propose appropriate revision of the supplementary information. If management does not revise the supplementary information, the auditor should either

- a. modify the auditor's opinion on the supplementary information and describe the misstatement in the auditor's report or
- b. if a separate report is being issued on the supplementary information, withhold the auditor's report on the supplementary information.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibility for information that a designated accounting standard setter³ requires to accompany an entity's basic financial statements is addressed in section 730, *Required Supplementary Information*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A2 The auditor's responsibility relating to other information whether financial or nonfinancial information (other than the financial statements and the auditor's report thereon), included in an entity's annual report, excluding required supplementary information, is addressed in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

.A3 The supplementary information need not be presented with the audited financial statements in order for the auditor to express an opinion on whether such supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. However, in accordance with paragraph .10, if the supplementary information is not presented with the audited financial statements, the auditor's report on the supplementary information is required to make reference to the auditor's report on the financial statements.

.A4 The auditor may be engaged to audit a specified element, account, or item of a financial statement for the purpose of a separate presentation, in accordance with section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. In such an engagement, the auditor's procedures are designed to provide the auditor with reasonable assurance that the supplementary information is not misstated by an amount that would be material to the information itself. An engagement to examine the supplementary information or an assertion related to the supplementary information also may be performed in accordance with AT-C section 205, *Examination Engagements*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A5 Although an auditor has no obligation to apply auditing procedures to supplementary information presented outside the basic financial statements, the auditor may choose to modify or redirect certain of the procedures to be applied in the audit of the basic financial statements so that the auditor may express an opinion on the supplementary information in relation to the financial statements as a whole.

.A6 Management may include nonaccounting information and accounting information that is not directly related to the basic financial statements in a document containing the basic financial statements. Ordinarily, such information would not have been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, the auditor would be

³ *Designated accounting standards setter* is defined in paragraph .04 of section 730. [Footnote renumbered and revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

unable to opine on the information in relation to the financial statements as a whole. In some circumstances, however, such information may have been obtained or derived from accounting records that have been tested by the auditor (for example, number of units produced related to royalties under a license agreement or number of employees related to a given payroll period). Accordingly, the auditor may be in a position to express an opinion on such information in relation to the financial statements as a whole.

Definition (Ref: par. .04)

.A7 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity.

.A8 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements.

Procedures to Determine Whether Supplementary Information Is Fairly Stated, in All Material Respects, in Relation to the Financial Statements as a Whole (Ref: par. .05–.08)

The Meaning of Readily Available (Ref: par. .05e, .06d, and .07f)

.A9 Audited financial statements are deemed to be readily available if a third party user can obtain the audited financial statements without any further action by the entity. For example, financial statements on an entity's website may be considered readily available, but being available upon request is not considered readily available.

Procedures Performed on Supplementary Information (Ref: par. .07)

.A10 When engaged to report on supplementary information in relation to the financial statements as a whole, the auditor need not apply procedures as extensive as would be necessary to express an opinion on the information on a stand-alone basis.

.A11 With respect to the supplementary information, the auditor is not required to obtain a separate understanding of the entity's internal control or to assess fraud risk.

.A12 The auditor may consider materiality in determining which information to compare and reconcile to the underlying accounting and other records used in preparing the financial statements or to the financial statements themselves.

.A13 In evaluating the appropriateness and completeness of the supplementary information as required by paragraph 07f, the auditor may consider testing accounting or other records through observation or examination of source documents or other procedures ordinarily performed in an audit of the financial statements.

.A14 The auditor may consider whether it is appropriate to address the supplementary information in procedures that the auditor performs in auditing the financial statements, including, but not limited to, the following:

- a. Obtaining an updated representation letter, in accordance with section 580, *Written Representations*⁴
- b. Performing subsequent events procedures, in accordance with section 560
- c. Sending a letter of audit inquiry to the client's lawyer specifically regarding the information contained in the supplementary information, in accordance with section 501, *Audit Evidence—Specific Considerations for Selected Items*⁵

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Considerations Specific to Audits of Governmental Entities

.A15 For most state and local governments, the auditor's report on the financial statements includes multiple opinions to address individual reporting units or aggregation of reporting units of the governmental entity. Accordingly, materiality is considered by the auditor for each opinion unit. However, in the context of this section, the auditor's opinion on the supplementary information is in relation to the financial statements as a whole. Accordingly, in this situation, materiality is considered at a level that represents the entire governmental entity.

Reporting (Ref: par. .09–.13)

.A16 When reporting on supplementary information in a separate report, the auditor may consider including an alert that restricts the use of the separate report solely to the appropriate specified parties, in accordance with section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, to avoid potential misinterpretation or misunderstanding of the supplementary information that is not presented with the financial statements. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

⁴ Paragraph .A24 of section 580, *Written Representations*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

⁵ Paragraphs .18–.24 of section 501, *Audit Evidence—Specific Considerations for Selected Items*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A17

Exhibit—Illustrative Reporting Examples When the Auditor Is Reporting on Supplementary Information in Relation to the Financial Statements as a Whole

Illustration 1 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Illustration 2 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Illustration 3 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Disclaiming an Opinion on the Financial Statements

Illustration 4 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Illustration 5 — A Separate Report When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Illustration 6 — A Separate Report When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Illustration 7 — A Separate Report When the Auditor Is Disclaiming an Opinion on the Financial Statements

Illustration 8 — A Separate Report When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Illustration 1 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 2 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The *[identify accompanying supplementary information]* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the effect on the supplementary information of *[describe reason for qualification of the auditor's opinion on the financial statements and reference the other-matter paragraph]*, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 3 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Disclaiming an Opinion on the Financial Statements

We were engaged for the purpose of forming an opinion on the basic financial statements as a whole. The [*identify accompanying supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Because of the significance of the matter described above [*the auditor may describe the basis for the disclaimer of opinion*], it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Illustration 4 — Supplementary Information Section in the Auditor's Report on the Financial Statements When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The [*identify accompanying supplementary information*] is presented for the purposes of additional analysis and is not a required part of the financial statements. Because of the significance of the matter described above [*the auditor may describe the basis for the adverse opinion*], it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Illustration 5—A Separate Report When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated *[date of the auditor's report on the financial statements]* which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The *[identify supplementary information]* is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 6—A Separate Report When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated *[date of the auditor's report on the financial statements, the nature of the opinion expressed on the financial statements, and a description of the report modifications]*. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The *[identify supplementary information]* is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the effect on the accompanying information of the qualified opinion on the financial statements as described above, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Illustration 7—A Separate Report When the Auditor Is Disclaiming an Opinion on the Financial Statements

We were engaged to audit the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated *[date of the auditor's report on the financial statements]*. However, the scope of our audit of the financial statements was not sufficient to enable us to express an opinion because *[describe reasons]* and accordingly we did not express an opinion on such financial statements. The *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Because of the significance of the matter discussed above, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

Illustration 8—A Separate Report When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated *[date of the auditor's report on the financial statements]* which stated that the financial statements are not presented fairly in accordance with *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America [GAAP])]* because *[describe reasons]*. The *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Because of the significance of the matter discussed above, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 9725***Supplementary Information in Relation to the Financial Statements as a Whole: Auditing Interpretations of Section 725*****1. Dating the Auditor's Report on Supplementary Information**

.01 Question—In accordance with section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, the auditor's report on supplementary information should not be dated earlier than the date on which the auditor completed the procedures required by section 725.¹ When the auditor completes those procedures subsequent to the date of the auditor's report on the audited financial statements, the auditor is not required to obtain additional evidence with respect to the audited financial statements. When reporting on the supplementary information (either in a separate report or in a separate section within the auditor's report on the financial statements) after the date of the auditor's report on the financial statements, how may an auditor make it clear that no additional procedures were performed on the audited financial statements subsequent to the date of the auditor's report on those financial statements?

.02 Interpretation—Although not required, an auditor may

- a. when issuing a separate report on the supplementary information, include in such report a statement that the auditor has not performed any auditing procedures with respect to the audited financial statements subsequent to the date of the auditor's report on those audited financial statements (see paragraph .03 of this interpretation), or
- b. when reissuing a report on the audited financial statements to include a separate section to report on the supplementary information, include two report dates to indicate that the date of reporting on the supplementary information is as of the later date (see paragraph .04 of this interpretation).

.03 The following illustrative separate report on supplementary information includes additional language intended to make it clear that no procedures were performed subsequent to the date of the auditor's report on the audited financial statements.

Independent Auditor's Report on [Identify Supplementary Information]

[Appropriate Addressee]

We have audited the financial statements of XYZ Entity as of and for the year ended June 30, 20X1, and have issued our report thereon dated [date of the

¹ Paragraph .12 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*.

auditor's report on the financial statements, for example, "September 15, 20X1"] which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. We have not performed any procedures with respect to the audited financial statements subsequent to [date of the auditor's report on the financial statements, for example, "September 15, 20X1"].

The [identify supplementary information] is presented for the purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

[Auditor's signature]

[Auditor's city and state]

December 1, 20X1 [Date of the auditor's report on the supplementary information—not to be earlier than the date on which the auditor completed the procedures required by section 725]²

.04 The following illustrative report on the audited financial statements includes a separate section to report on supplementary information subsequent to the date of the report on the audited financial statements. For this illustration, March 31, 20X2, is the original date of the report on the audited financial statements.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities,

² Paragraph .07 of section 725.

in accordance with relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing these financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.³
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about

³ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Report on *[Identify Supplementary Information]*

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The *[identify accompanying supplementary information]* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

[Auditor's signature]

[Auditor's city and state]

March 31, 20X2, except for our report on the supplementary information for which the date is June 1, 20X2 [Date of the auditor's report on the audited financial statements, with a later date used for the paragraph labeled "Report on *[identify supplementary information]*," which is as of a date not earlier than the date on which the auditor completed the procedures required by paragraph .07 of section 725.

[Issue Date: July 2011; Revised: October 2011.]

AU-C Section 730

Required Supplementary Information

(Supersedes SAS No. 52 section 558.)

Source: SAS No. 120; SAS No. 122; SAS No. 137; SAS No. 140.

Effective for audits of financial statements for periods beginning on or after December 15, 2010, unless otherwise indicated. Early application is permitted.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility with respect to information that a designated accounting standards setter requires to accompany an entity's basic financial statements (hereinafter referred to as *required supplementary information*). In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the basic financial statements does not cover required supplementary information. (Ref: par. .A1) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Effective Date

.02 This section is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

Objective

.03 The objectives of the auditor when a designated accounting standards setter requires information to accompany an entity's basic financial statements are to perform specified procedures in order to

- a. describe, in the auditor's report, whether required supplementary information is presented and
- b. communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standards setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated accounting standards setter.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

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

Basic financial statements. Financial statements presented in accordance with an applicable financial reporting framework as established by a designated accounting standards setter, excluding required supplementary information.

Designated accounting standards setter. A body designated by the Council of the AICPA to promulgate GAAP pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

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

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

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Procedures

.05 The auditor should apply the following procedures to required supplementary information:

- a. Inquire of management about the methods of preparing the information, including (i) whether it has been measured and presented in accordance with prescribed guidelines, (ii) whether methods of measurement or presentation have been changed from those used in the prior period and the reasons for any such changes, and (iii) whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information
- b. Compare the information for consistency with (i) management's responses to the foregoing inquiries, (ii) the basic financial statements, and (iii) other knowledge obtained during the audit of the basic financial statements

- c. Obtain written representations from management (i) that it acknowledges its responsibility for the required supplementary information; (ii) about whether the required supplementary information is measured and presented in accordance with prescribed guidelines; (iii) about whether the methods of measurement or presentation have changed from those used in the prior period and, if so, the reasons for such changes; and (iv) about any significant assumptions or interpretations underlying the measurement or presentation of the required supplementary information¹

.06 If the auditor is unable to complete the procedures in paragraph .05, the auditor should consider whether management contributed to the auditor's inability to complete the procedures. If the auditor concludes that the inability to complete the procedures was due to significant difficulties encountered in dealing with management, the auditor should inform those charged with governance.²

Reporting

.07 The auditor should include a separate section in the auditor's report on the financial statements with the heading "Required Supplementary Information," or other appropriate heading.^[3] The required supplementary information section in the auditor's report on the financial statements should include language to explain the following circumstances, as applicable:

- a. The required supplementary information is included, and the auditor has applied the procedures in paragraph .05 of this section.
- b. The required supplementary information is omitted.
- c. Some required supplementary information is missing and some is presented in accordance with the prescribed guidelines.
- d. The auditor has identified material departures from the prescribed guidelines.
- e. The auditor is unable to complete the procedures in paragraph .05 of this section.
- f. The auditor has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.08 If the entity has presented all or some of the required supplementary information, the required supplementary information section in the auditor's report on the financial statements referred to in paragraph .07 should include the following elements: (Ref: par. .A2)

¹ See section 580, *Written Representations*, for additional requirements and guidance with respect to obtaining written representations from management as part of an audit of financial statements performed in accordance with generally accepted auditing standards. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

² See paragraph .12 of section 260, *The Auditor's Communication With Those Charged With Governance*, for additional guidance when the auditor encounters significant difficulties in dealing with management during the audit. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

^[3] [Footnote deleted by the issuance of SAS No. 140, April 2020.]

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information is the responsibility of management and, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. If the auditor is able to complete the procedures in paragraph .05,
 - i. a statement that the auditor has applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to the auditor's inquiries, the basic financial statements, and other knowledge the auditor obtained during the audit of the basic financial statements
 - ii. a statement that the auditor does not express an opinion or provide any assurance on the information because the limited procedures do not provide the auditor with sufficient evidence to express an opinion or provide any assurance
- d. If the auditor is unable to complete the procedures in paragraph .05,
 - i. a statement that the auditor was unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States because *[state the reasons]*
 - ii. a statement that the auditor does not express an opinion or provide any assurance on the information
- e. If some of the required supplementary information is omitted,
 - i. a statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
 - ii. a statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
 - iii. a statement that the auditor's opinion on the basic financial statements is not affected by the missing information
- f. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that although the auditor's opinion on the basic financial statements is not affected, material departures from

prescribed guidelines exist [*describe the material departures from the applicable financial reporting framework*]

- g. If the auditor has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that although the auditor's opinion on the basic financial statements is not affected, the results of the limited procedures have raised doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by [*identify designated accounting standards setter*]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.09 If all of the required supplementary information is omitted, the required supplementary information section in the auditor's report on the financial statements should include the following elements:

- a. A statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the auditor's opinion on the basic financial statements is not affected by the missing information

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The auditor's responsibility relating to other information whether financial or nonfinancial information (other than the financial statements and the auditor's report thereon), included in an entity's annual report, excluding required supplementary information, is addressed in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Reporting (Ref: par. .07–.09)

.A2 Because the required supplementary information accompanies the basic financial statements, the auditor's report on the financial statements

includes a discussion of the responsibility taken by the auditor on that information. However, because the required supplementary information is not part of the basic financial statements, the auditor's opinion on the fairness of presentation of such financial statements in accordance with the applicable financial reporting framework is not affected by the presentation by the entity of the required supplementary information or the failure to present some or all of such required supplementary information. Furthermore, if the required supplementary information is omitted by the entity, the auditor does not have a responsibility to present that information.

.A3

Exhibit — Examples of Required Supplementary Information Sections in the Auditor's Report on the Financial Statements

Illustration 1 — The Required Supplementary Information Is Included, the Auditor Has Applied the Specified Procedures, and No Material Departures From Prescribed Guidelines Have Been Identified

Illustration 2 — All Required Supplementary Information Omitted

Illustration 3 — Some Required Supplementary Information Is Omitted and Some Is Presented in Accordance With the Prescribed Guidelines

Illustration 4 — Material Departures From Prescribed Guidelines Identified

Illustration 5 — Specified Procedures Not Completed

Illustration 6 — Unresolved Doubts About Whether the Required Supplementary Information Is in Accordance With Prescribed Guidelines

Illustration 1 — The Required Supplementary Information Is Included, the Auditor Has Applied the Specified Procedures, and No Material Departures From Prescribed Guidelines Have Been Identified

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that the *[identify the required supplementary information]* on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Illustration 2 — All Required Supplementary Information Omitted

Management has omitted [*describe the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*] who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Illustration 3 — Some Required Supplementary Information Is Omitted and Some Is Presented in Accordance With the Prescribed Guidelines

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that *[identify the included supplementary information]* be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with evidence sufficient to express an opinion or provide any assurance.

Management has omitted *[describe the missing required supplementary information]* that *[identify the applicable financial reporting framework]* require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Illustration 4 — Material Departures From Prescribed Guidelines Identified

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that the *[identify the supplementary information]* on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. Although our opinion on the basic financial statements is not affected, the following material departures from the prescribed guidelines exist *[identify the required supplementary information and describe the material departures from the prescribed guidelines]*. We do not express an opinion or provide any assurance on the information.

Illustration 5 — Specified Procedures Not Completed

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that the *[identify the supplementary information]* on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We were unable to apply certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America because *[state the reasons]*. We do not express an opinion or provide any assurance on the information.

Illustration 6 — Unresolved Doubts About Whether the Required Supplementary Information Is in Accordance With Prescribed Guidelines

[Identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)] require that the *[identify the supplementary information]* on page XX be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by *[identify designated accounting standards setter]* who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. Although our opinion on the basic financial statements is not affected, the results of the limited procedures have raised doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standards setter]*. *[The auditor may consider including in the report the reason(s) he or she was unable to resolve his or her doubts.]*

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Sections 800–899

SPECIAL CONSIDERATIONS

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AU-C Section 800

Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks

Source: SAS No. 122; SAS No. 125; SAS No. 127; SAS No. 132; SAS No. 139.

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

Introduction

Scope of This Section

.01 AU-C sections 200–700 apply to an audit of financial statements. This section addresses special considerations in the application of those AU-C sections to an audit of financial statements prepared in accordance with a special purpose framework, which is a cash, a tax, a regulatory, a contractual, or an other basis of accounting. This section does not purport to address all special considerations that may be relevant in the circumstances. (Ref: par. .A1–.A5) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.02 This section is written in the context of a complete set of financial statements prepared in accordance with a special purpose framework. Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

.03 Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, applies to audits of special purpose financial statements, as discussed in paragraph .14 of this section. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.04 Section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*, addresses the auditor's responsibility and the form and content of the report when the auditor is requested to report on the entity's compliance with aspects of contractual agreements or regulatory requirements in connection with the audit of financial statements.

Effective Date

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

Objective

.06 The objective of the auditor, when applying generally accepted auditing standards (GAAS) in an audit of financial statements prepared in accordance with a special purpose framework, is to address appropriately the special considerations that are relevant to

- a. the acceptance of the engagement,
- b. the planning and performance of that engagement, and
- c. forming an opinion and reporting on the financial statements.

Definitions

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

Special purpose financial statements. Financial statements prepared in accordance with a special purpose framework.

Special purpose framework. A financial reporting framework other than generally accepted accounting principles (GAAP) that is one of the following bases of accounting: (Ref: par. .A6)

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.08 Reference to *financial statements* in this section means "a complete set of special purpose financial statements."¹ The requirements of the applicable

¹ Paragraphs .14 and .A9 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.09 Reference to *GAAP* in GAAS means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA (Council) pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Requirements

Considerations When Accepting the Engagement

Acceptability of the Financial Reporting Framework (Ref: par. .A7–.A10)

.10 Section 210A, *Terms of Engagement*, requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.² In an audit of special purpose financial statements, the auditor should obtain an understanding of

- a. the purpose for which the financial statements are prepared,
- b. the intended users, and
- c. the steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

Preconditions for an Audit (Ref: par. .A11)

.11 Section 210A requires the auditor to establish whether the preconditions for an audit are present, including determining whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable.³ In an audit of special purpose financial statements, the auditor should obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements, including

- a. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effects of which need not be quantified.
- b. informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.
- c. a description of any significant interpretations of the contract on which the special purpose financial statements are based, in the

² Paragraph .06a of section 210A, *Terms of Engagement*.

³ Paragraph .06 of section 210A.

case of special purpose financial statements prepared in accordance with a contractual basis of accounting.

- d. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose financial statements to achieve fair presentation. (Ref: par. .A12)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Considerations When Planning and Performing the Audit (Ref: par. .A13–.A17)

.12 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to comply with all AU-C sections relevant to the audit.⁴ In planning and performing an audit of special purpose financial statements, the auditor should adapt and apply all AU-C sections relevant to the audit as necessary in the circumstances of the engagement.

.13 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity's selection and application of accounting policies.⁵ In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would have produced a material difference in the information presented in the financial statements.

Auditor's Responsibilities Regarding the Entity's Ability to Continue as a Going Concern

.14 Irrespective of whether the going concern basis of accounting is relevant to the preparation of the special purpose financial statements, the requirements of section 570 apply regarding the auditor's responsibilities to perform the following tasks: (Ref: par. .A18)

- a. Based on the audit evidence obtained, conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.
- b. When such substantial doubt exists, evaluate the adequacy of the financial statement disclosures.⁶

[Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

⁴ Paragraph .20 of section 200.

⁵ Paragraph .12c of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

⁶ Paragraphs .20–.22 and .A46 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139]

Forming an Opinion and Reporting Considerations

.15 When forming an opinion and reporting on special purpose financial statements, the auditor should apply the requirements in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. When, in forming an opinion, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary, the auditor should apply the requirements in section 705, *Modifications to the Opinion in the Independent Auditor's Report*. (Ref: par. .A19–.A22) [Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Description of the Applicable Financial Reporting Framework (Ref: par. .A23–.A24)

.16 Section 700 requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.⁷ In an audit of special purpose financial statements, the auditor should evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.17 In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should also evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Fair Presentation (Ref: par. .A25–.A29)

.18 Section 700 requires the auditor to evaluate whether the financial statements achieve fair presentation.⁸ In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether

- a. the financial statements include informative disclosures similar to those required by GAAP, and
- b. additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

[Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

⁷ Paragraph .15 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139].

⁸ Paragraph .16 or section 700. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

Auditor's Report

.19 Section 700 addresses the form and content of the auditor's report, including the specific ordering for certain elements. In the case of an auditor's report on special purpose financial statements

- a. the auditor's report should describe the purpose for which the financial statements are prepared or refer to a note in the special purpose financial statements that contains that information, when the financial statements are prepared in accordance with
 - i. a regulatory or contractual basis of accounting or
 - ii. an other basis of accounting, and the auditor is required to restrict use of the auditor's report pursuant to paragraph .06a–b of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. (Ref: par. .A30)
- b. if management has a choice of financial reporting frameworks in the preparation of the special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Alerting Readers in an Emphasis-of-Matter Paragraph That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework (Ref: par. .A31)

.20 Except for the circumstances described in paragraph .22, the auditor's report on special purpose financial statements should include an *emphasis-of-matter* paragraph,⁹ under an appropriate heading, that includes the following:

- a. A statement that the financial statements are prepared in accordance with a special purpose framework
- b. A reference to the note to the financial statements that describes that framework
- c. A statement that the special purpose framework is a basis of accounting other than GAAP.
- d. When a description of the purpose for which the financial statements are prepared or a reference to a note in the special purpose financial statements that contains that information is required pursuant to paragraph .19a, a statement that, as a result, the financial statements may not be suitable for another purpose.¹⁰

[Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

⁹ Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

¹⁰ Paragraph .06 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Restricting the Use of the Auditor's Report in an Other-Matter Paragraph (Ref: par. .A32–.A33)

.21 Except for the circumstances described in paragraph .22, the auditor's report on special purpose financial statements should include an *other-matter* paragraph,¹¹ under an appropriate heading, that restricts¹² the use of the auditor's report when the special purpose financial statements are prepared in accordance with

- a. a contractual basis of accounting,
- b. a regulatory basis of accounting, or
- c. an other basis of accounting when required pursuant to paragraph .06a–b of section 905.

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Regulatory Basis Financial Statements Intended for General Use (Ref: par. .A34)

.22 If the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and the special purpose financial statements together with the auditor's report are intended for general use, the auditor should not include the *emphasis-of-matter* or *other-matter* paragraphs required by paragraphs .20–.21. Instead, the auditor should express an opinion about whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP. The auditor should also, in a separate paragraph, express an opinion about whether the financial statements are prepared in accordance with the special purpose framework. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Auditor's Report Prescribed by Law or Regulation (Ref: par. .A35–.A38)

.23 If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, the auditor's report should refer to GAAS only if the auditor's report includes, at a minimum, each of the following elements:

- a. A title that clearly indicates that it is the report of an independent auditor
- b. An addressee
- c. An opinion section that
 - i. identifies the special purpose financial statements that have been audited and

¹¹ Paragraph .07 of section 706. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

¹² See paragraphs .06a–b and .07 of section 905. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

- ii. contains an expression of opinion on the special purpose financial statements and a reference to the special purpose framework used to prepare the financial statements and, if applicable, an opinion on whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP when required by paragraph .22
- d. A description of the purpose for which the financial statements are prepared when required by paragraph .19a
- e. A statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit
- f. When applicable, a section that addresses the reporting requirements in paragraphs .24–.27 of section 570
- g. A description of management's responsibilities for the preparation and fair presentation of the special purpose financial statements that addresses, and is consistent with, the requirements in paragraphs .31–.33 of section 700
- h. A reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when required by paragraph .19b
- i. If applicable, a reference to the law or regulation and a description of the auditor's responsibilities for an audit of financial statements that addresses, and is consistent with, the requirements in paragraphs .35–.37 of section 700
- j. When applicable, a section that addresses the reporting requirements in paragraph .24 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- k. An emphasis-of-matter paragraph that
 - i. when required by paragraph .20
 - (1) indicates that the financial statements are prepared in accordance with a special purpose framework
 - (2) refers to the note to the financial statements that describes that framework
 - (3) states that the special purpose framework is a basis of accounting other than GAAP, and
 - ii. when required by paragraph .20d
 - (1) describes the purpose for which the financial statements are prepared or refers to a note in the special purpose financial statements that contains that information, and
 - (2) states that, as a result, the financial statements may not be suitable for another purpose¹³
- l. An *other-matter* paragraph that restricts the use of the auditor's report when required by paragraph .21
- m. The signature of the auditor's firm

¹³ Paragraph .06 of section 905.

- n. The city and state where the auditor's report is issued
- o. The date of the auditor's report

[Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.24 If the prescribed specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make, the auditor should reword the prescribed form of report or attach an appropriately worded separate report. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Application and Other Explanatory Material

Introduction

Scope of This Section (Ref: par. .01)

.A1 Special purpose financial statements may be prepared for use by regulatory bodies, the parties to a contract or agreement, or other specified parties. For example, a loan agreement may require the borrower to prepare consolidated financial statements for the lender presented on a contractual basis of accounting, which is not in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) or International Financial Reporting Standards promulgated by the International Accounting Standards Board.

.A2 There may be circumstances in which a regulatory or contractual basis of accounting is based on a general purpose framework, such as U.S. GAAP, established by an authorized or recognized standard-setting organization or by law or regulation, but does not comply with all the requirements of that framework.¹⁴ An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of U.S. GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial statements are materially misstated due to a departure from that framework, section 705 applies. [As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A3 When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply that the special purpose framework includes all requirements of, or is the same as, the financial reporting framework on which the special purpose framework is based. In the example of the contract in paragraph .A2, the description of the applicable financial reporting framework would refer to the financial reporting provisions of the contract, rather than make reference to U.S. GAAP. The requirements in paragraphs .20–.22 are designed to avoid misunderstandings about compliance with the general purpose framework. [As amended, effective for audits of financial statements

¹⁴ The term *general purpose framework* is defined in paragraph .10 of section 700. [Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A4 Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of GAAS. The requirement in paragraph .20 is designed to avoid misunderstandings about the framework used to prepare the financial statements. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A5 Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*, addresses circumstances in which an auditor practicing in the United States is engaged to report on financial statements that have been prepared in accordance with a financial reporting framework generally accepted in another country not adopted by a body designated by the Council of the AICPA (Council) to promulgate generally accepted accounting principles (GAAP) when such audited financial statements are intended for use outside the United States. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Definitions

Special Purpose Financial Statements and Special Purpose Frameworks **(Ref: par. .07)**

.A6 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on a framework promulgated by an authorized or recognized standard-setting organization (for example, FASB or GASB), but does not include all of the requirements of that framework. Such frameworks are regulatory bases of accounting, as described in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Considerations When Accepting the Engagement

Acceptability of the Financial Reporting Framework (Ref: par. .10)

.A7 In the case of special purpose financial statements, the financial information needs of the intended users are a factor in determining the acceptability

of the financial reporting framework applied in the preparation of the financial statements. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A8 The applicable financial reporting framework may encompass the financial reporting standards established by an organization that is authorized or recognized to promulgate standards for special purpose financial statements. In that case, those standards will be presumed acceptable for that purpose if the organization follows an established and transparent process involving deliberation and consideration of the views of relevant stakeholders. In some circumstances, law or regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such an entity. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A9 The acceptability of the financial reporting framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by acceptable financial reporting frameworks. Section 210A discusses the attributes of acceptable financial reporting frameworks, which provide management with an appropriate basis for preparing the financial statements and the auditor with suitable criteria for auditing the financial statements.¹⁵ In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment. For example, for purposes of establishing the value of net assets of an entity at the date of its sale, the seller and purchaser may have agreed that conservative estimates of allowances for uncollectible accounts receivable are appropriate for their needs, even though such financial information may be biased when compared with financial information prepared in accordance with a general purpose framework. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A10 In the case of financial statements prepared in accordance with a contractual basis of accounting, the parties to the contract or agreement may need to agree on the significant interpretations of the contract on which the special purpose financial statements are based. If agreement cannot be reached, the auditor may determine that the framework is not acceptable. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Preconditions for an Audit (Ref: par. .11)

.A11 Section 210A also requires the agreed-upon terms of the audit engagement to include references to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.¹⁶ The auditor may discuss with management and, when appropriate, those charged with governance how an auditor's report on financial statements prepared in accordance with a special purpose framework differs from an auditor's report on financial statements prepared in accordance with a general purpose framework.

¹⁵ Paragraphs .A2–.A3 of section 210A, *Terms of Engagement*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

¹⁶ Paragraph .10f of section 210A.

Discussing the expected form and content of the auditor's report may assist management in understanding its responsibilities related to the audit engagement. [Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Achieving Fair Presentation (Ref: par. .11d)

.A12 In accordance with section 700, the auditor's evaluation about whether the financial statements achieve fair presentation in accordance with the applicable financial reporting framework requires consideration of the following:¹⁷

- a. The overall presentation, structure and content of the financial statements
- b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Also see paragraphs .A25–.A29 of this section. [Paragraph renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Considerations When Planning and Performing the Audit (Ref: par. .12–.13)

.A13 Section 200 requires the auditor to comply with (a) relevant ethical requirements relating to financial statement audit engagements and (b) all AU-C sections relevant to the audit. It also requires the auditor to comply with each requirement of an AU-C section unless, in the circumstances of the audit, the entire AU-C section is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement in an AU-C section by performing alternative audit procedures to achieve the intent of that requirement.¹⁸ [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A14 An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist.¹⁹ In an audit of special purpose financial statements, some of the requirements within the relevant AU-C sections may need to be adapted by the auditor. For example, in section 320, *Materiality in Planning and Performing an Audit*, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group.²⁰ In an audit of special purpose financial statements, those judgments may be

¹⁷ Paragraph .14 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

¹⁸ Paragraphs .16, .20, and .24–.26 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 139, March 2020.]

¹⁹ Paragraph .20 of section 200. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 139, March 2020.]

²⁰ Paragraph .02 of section 320, *Materiality in Planning and Performing an Audit*. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 139, March 2020.]

based on a consideration of the financial information needs of the intended users. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A15 [Paragraph renumbered and deleted by the issuance of SAS No. 139, March 2020.]^[21]

.A16 In the case of special purpose financial statements, such as those prepared in accordance with a contractual basis of accounting, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with section 320 for purposes of planning and performing the audit of the special purpose financial statements. With respect to interpretations of the contract on which the special purpose financial statements are based, the auditor may determine that an interpretation is significant based on qualitative considerations. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A17 Communication with those charged with governance in accordance with GAAS is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility; for example, when the financial information is prepared solely for management's use. In such cases, the requirements of section 260, *The Auditor's Communication With Those Charged With Governance*, may not be relevant to the audit of the special purpose financial statements, except when the auditor is also responsible for the audit of the entity's general purpose financial statements or, for example, has agreed to communicate with those charged with governance of the entity relevant matters identified during the audit of the special purpose financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Auditor's Responsibilities Regarding the Entity's Ability to Continue as a Going Concern (Ref: par. .14)

Relevance of Going Concern Basis of Accounting to a Special Purpose Framework

.A18 Special purpose financial statements may or may not be prepared in accordance with an applicable financial reporting framework for which the going concern basis of accounting is relevant. The going concern basis of accounting is relevant to a special purpose framework if the special purpose framework requires management, in specified circumstances, to use a basis of accounting other than the going concern basis of accounting. For example, the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities requires management to assess whether the going concern basis of accounting is appropriate, and if not, to use the liquidation basis of accounting. In contrast, the

^[21] [Footnote renumbered and deleted by the issuance of SAS No. 139, March 2020.]

cash or tax bases of accounting do not specify any alternative basis of accounting to be considered and, thus, do not require management to assess whether the going concern basis of accounting is appropriate. Therefore, the going concern basis of accounting is not relevant to special purpose financial statements prepared using those bases of accounting. Depending on the applicable financial reporting framework used in the preparation of the special purpose financial statements, the description in the auditor's report of management's responsibilities relating to going concern may need to be adapted as necessary.²² The description in the auditor's report of the auditor's responsibilities may also need to be adapted as necessary depending on how section 570 applies in the circumstances of the engagement.²³ [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A19 Appendix A, "Overview of Reporting Requirements," provides an overview of the reporting requirements depending on the special purpose framework. The exhibit, "Illustrations of Auditor's Reports on Special Purpose Financial Statements," contains illustrations of auditor's reports on special purpose financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Application of Section 700 or Section 703 When Reporting on Special Purpose Financial Statements

.A20 Paragraph .15 of this section requires the auditor to apply the requirements in section 700 or section 703 when forming an opinion and reporting on special purpose financial statements. In doing so, the auditor is also required to apply the reporting requirements in other AU-C sections and may find the special considerations addressed in paragraphs .A18 and .A21–.A22 of this section helpful. [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Key Audit Matters

.A21 For audits of special purpose financial statements, section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies only when the auditor is engaged to communicate key audit matters. [Paragraph added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Other Information

.A22 Section 720 addresses the auditor's responsibilities relating to other information in an entity's annual report. In the context of this section, an annual report is a document or combination of documents, the purpose of which is to provide owners (or similar stakeholders) with information on matters presented in the special purpose financial statements. The term similar stakeholders includes specific users whose financial information needs are met by the special purpose framework used to prepare the special purpose financial statements. When the auditor determines that the entity has issued or plans to issue an annual report, the requirements in section 720 apply to the audit of the special purpose financial statements. [Paragraph added, effective for audits of

²² Paragraph .32b of section 700.

²³ Paragraph .36e of section 700.

financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Forming an Opinion and Reporting Considerations (Ref: par. .14)

Description of the Applicable Financial Reporting Framework (Ref: par. .16–.17)

.A23 Terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows*, or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP. Accordingly, the auditor is required by paragraph .16 to evaluate whether the financial statements are suitably titled. For example, cash basis financial statements might be titled as a statement of assets and liabilities arising from cash transactions or as a statement of revenue collected and expenses paid; a financial statement prepared on a regulatory basis of accounting might be titled as a statement of income — regulatory basis. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A24 The description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently under the special purpose framework than they would be under U.S. GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described. The differences need not be quantified. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Fair Presentation (Ref: par. .18)

.A25 Financial statements that achieve a fair presentation include all informative disclosures that are appropriate for the applicable financial reporting framework, including matters that affect their use, understanding, and interpretation. Also refer to paragraph .A12. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A26 When the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, informative disclosures similar to those required by GAAP are necessary to achieve fair presentation. For example, financial statements prepared on a tax basis or on a modified cash basis of accounting usually reflect depreciation, long-term debt, and owners' equity. Thus, the informative disclosures for depreciation, long-term debt, and owners' equity in such financial statements would be comparable to those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A27 Disclosures in special purpose financial statements may substitute qualitative information for some of the quantitative information required by GAAP or may provide information that communicates the substance of those requirements. For example, disclosing estimated percentages of revenues, rather than amounts that GAAP presentations would require, may sufficiently convey the significance of sales or leasing to related parties or major customers. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A28 The auditor is also required by paragraph .18*b* to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the special purpose financial statements to achieve fair presentation. For example, these disclosures may include matters about related party transactions, restrictions on assets and owners' equity, subsequent events, and significant uncertainties. In such circumstances, the special purpose financial statements would include the same disclosure required by GAAP or disclosure that communicates the substance of those requirements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A29 Appendix B, "Fair Presentation and Adequate Disclosures," provides additional guidance on evaluating the adequacy of disclosures in financial statements prepared in accordance with a special purpose framework, including matters related to the presentation of financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Auditor's Report (Ref: par. .18*b*)

.A30 When the special purpose financial statements are prepared in accordance with a regulatory or contractual basis of accounting or an other basis of accounting that requires an alert that restricts the use of the auditor's report pursuant to paragraph .06*a–b* of section 905, the auditor is required by paragraph .19*a* to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the special purpose financial statements are used for purposes other than those for which they were intended. The note to the financial statements may also describe any significant interpretations of the contract on which the financial statements are based. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Alerting Readers in an Emphasis-of-Matter Paragraph That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework (Ref: par. .20)

.A31 Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .20 requires the auditor to include an *emphasis-of-matter* paragraph in the auditor's report that alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Restricting the Use of the Auditor's Report in an Other-Matter Paragraph
(Ref: par. .21)

.A32 Special purpose financial statements prepared in accordance with a contractual or regulatory basis of accounting are suitable only for a limited number of users who can be presumed to have an adequate understanding of such bases of accounting. For example, special purpose financial statements prepared in accordance with a contractual basis of accounting are developed for and directed only to the parties to the contract or agreement. Accordingly, the alert that restricts the use of the auditor's report is required due to the nature of the report and the potential for the report to be taken out of the context in which the auditor's report was intended to be used. Section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, addresses adding other parties as specified parties. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A33 In the case of special purpose financial statements prepared in accordance with a cash or tax basis of accounting, the auditor may consider it necessary in the circumstances of the engagement to include an alert that restricts the use of the auditor's report. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

Regulatory Basis Financial Statements Intended for General Use
(Ref: par. .22)

.A34 Special purpose financial statements prepared in accordance with a regulatory basis of accounting may be intended for general use. Such special purpose financial statements are intended for general use when the financial statements together with the auditor's report are intended for use by parties other than those within the entity and the regulatory agencies to whose jurisdiction the entity is subject or when the financial statements together with the auditor's report are distributed by the entity to parties other than the regulatory agencies to whose jurisdiction the entity is subject, either voluntarily or upon specific request. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

Auditor's Report Prescribed by Law or Regulation (Ref: par. .23–.24)

.A35 The auditor may be required to comply with legal or regulatory requirements in addition to GAAS. When this is the case, the auditor may be required to use a layout, form, or wording in the auditor's report that differs from that described in this section, such as when printed forms or schedules designed or adopted by the bodies with which they are to be filed prescribe the wording of the auditor's report. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A36 When the differences between the legal or regulatory requirements and GAAS relate only to the layout, form, and wording of the auditor's report and, at a minimum, each of the elements identified in paragraph .23 are included in the auditor's report, the auditor's report may refer to GAAS. Accordingly, in such circumstances the auditor is considered to have complied with the requirements of GAAS, even when the layout, form, and wording used in the auditor's report are specified by legal or regulatory reporting requirements. Section 210A addresses circumstances in which law or regulation prescribes the layout, form, or wording of the auditor's report in terms that are significantly different from the requirements of GAAS.²⁴

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A37 Some report forms can be made acceptable by inserting additional wording to include the elements identified in paragraph .23. Other report forms can be made acceptable only by complete revision because the prescribed language of the report calls for statements by the auditor that are not consistent with the auditor's function or responsibility; for example, a report form that requests the auditor to certify the financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

.A38 This guidance can be applied to other circumstances, for example, reports on financial statements prepared in accordance with a general purpose framework for which a specific layout, form, or wording of the auditor's report is required. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 139, March 2020.]

²⁴ Paragraph .18 of section 210A. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Footnote subsequently renumbered by the issuance of SAS No. 132, February 2017. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

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Appendix A — Overview of Reporting Requirements

The following table provides an overview of the reporting requirements depending on the special purpose framework:

	<i>Cash Basis</i>	<i>Tax Basis</i>	<i>Regulatory Basis</i>	<i>Regulatory Basis (General Use)</i>	<i>Contractual Basis</i>	<i>Other Basis</i>
<i>Opinion(s)</i>	Single opinion on special purpose framework	Single opinion on special purpose framework	Single opinion on special purpose framework	Dual opinion on special purpose framework and generally accepted accounting principles ¹	Single opinion on special purpose framework	Single opinion on special purpose framework
<i>Description of purpose for which special purpose financial statements are prepared²</i>	No	No	Yes	Yes	Yes	As required by paragraph .19a(ii)
<i>Emphasis-of-matter paragraph alerting readers regarding the preparation in accordance with a special purpose framework³</i>	Yes	Yes	Yes	No	Yes	Yes
<i>Other-matter paragraph including an alert restricting the use of the auditor's report⁴</i>	No	No	Yes	No	Yes	As required by paragraph .21c ⁵
<i>Exhibit A Illustrations</i>	1	2	3	4	5	

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. As amended, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127. Paragraph

¹ Paragraph .22. [Footnote renumbered by the issuance of SAS No. 127, January 2013. Subsequently renumbered by issuance of SAS No. 139, March 2020.]

² Paragraph .19a(ii). [Footnote renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

³ Paragraphs .20 and .22. [Footnote renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

⁴ Paragraphs .21–.22. [Footnote renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

⁵ Paragraph .06a–b of section 905. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

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Appendix B — Fair Presentation and Adequate Disclosures (Ref: par. .A25–.A28)

When special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with generally accepted accounting principles (GAAP), paragraph .18 requires the auditor to evaluate whether, the financial statements include informative disclosures similar to those required by GAAP. The auditor is also required to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation. This appendix provides guidance, in addition to paragraphs .A25–.A28, on evaluating the adequacy of disclosures in financial statements prepared in accordance with a special purpose framework, including matters related to the presentation of financial statements.

If special purpose financial statements contain items for which GAAP would require disclosure, the financial statements may either provide the relevant disclosure that would be required for those items in a GAAP presentation or provide information that communicates the substance of that disclosure. Likewise, if GAAP sets forth requirements that apply to the presentation of financial statements, special purpose financial statements may either comply with those requirements or provide information that communicates the substance of those requirements, without modifying the format of the special purpose financial statements. This may result in substituting qualitative information for some of the quantitative information required for GAAP presentations, as in the following examples:

- Disclosure of the repayment terms of significant long-term borrowings may sufficiently communicate information about future principal reduction without providing the summary of principal reduction during each of the next five years.
- Information about the effects of accounting changes, discontinued operations, and extraordinary items, if applicable, could be disclosed in a note to the financial statements without following the GAAP presentation requirements in the statement of results of operations, using those terms, or disclosing net-of-tax effects.¹
- Instead of showing expenses by their functional classifications in certain industries, a statement of activities could present expenses according to their natural classifications, and a note to the statement could use estimated percentages to communicate information about expenses incurred by the major program and supporting services.
- Instead of showing the amounts of, and changes in, classes of net assets without donor-imposed restrictions and with donor-imposed restrictions in certain industries, a statement of assets and liabilities could report total net assets, a related statement of activities could report changes in those totals, and a note to the

¹ FASB Accounting Standards Update (ASU) No. 2015-01 eliminated the concept of extraordinary items. However, GASB generally accepted accounting principles still retain this concept. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

financial statements could provide information, using estimated or actual amounts or percentages, about the restrictions on those amounts and on any deferred restricted amounts, describe the major restrictions, and provide information about significant changes in restricted amounts.²

For special purpose financial statements, GAAP disclosure requirements that are not relevant to the measurement of the item need not be considered, as illustrated by the following:

- Fair value disclosures for debt and equity securities would not be relevant when the basis of presentation does not adjust the cost of such securities to their fair value.
- For a sponsor of a defined benefit plan, disclosures related to actuarial calculations for contributions to defined benefit plans would not be relevant in financial statements prepared in accordance with the cash or tax basis of accounting.
- Disclosures related to the use of estimates would not be relevant in a presentation that has no estimates.

Special purpose financial statements may not include a statement of cash flows. If a presentation of cash receipts and disbursements is presented in a format similar to a statement of cash flows or if the entity chooses to present such a statement, the statement would either conform to the requirements for a GAAP presentation or communicate their substance. As an example, the statement of cash flows might disclose noncash acquisitions through captions on its face.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

² FASB ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. [Footnote added, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

.A41

Exhibit — Illustrations of Auditor's Reports on Special Purpose Financial Statements (Ref: par. .A18)

Illustration 1 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Illustration 2 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 3 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Not Intended for General Use)

Illustration 4 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Intended for General Use)

Illustration 5 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Contractual Basis of Accounting

Illustration 1 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with the cash basis of accounting (that is, a special purpose framework).
- Management has a choice of financial reporting frameworks.¹

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of Financial Statements²

Opinion

We have audited the financial statements of ABC Partnership, which comprise the statement of assets and liabilities arising from cash transactions as of December 31, 20X1, and the related statement of revenue collected and expenses paid for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the assets and liabilities arising from cash transactions of ABC Partnership as of December 31, 20X1, and its revenue collected and expenses paid during the year then ended in accordance with the cash basis of accounting described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Partnership, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting³

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the cash basis of accounting described

¹ If management does not have a choice of financial reporting frameworks, the auditor is not required by paragraph .19b to make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

² The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

³ Another appropriate heading may be used.

in Note X, and for determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed.⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Partnership's ability to continue as a going concern for a reasonable period of time.

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

⁴ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed."

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of a partnership in accordance with the basis of accounting the partnership uses for income tax purposes (that is, a special purpose framework).
- Based on the partnership agreement, management does not have a choice of financial reporting frameworks.¹

Independent Auditor's Report

[Appropriate Addressee]

*Report on the Audit of the Financial Statements*²

Opinion

We have audited the financial statements of ABC Partnership, which comprise the statements of assets, liabilities, and capital—income tax basis as of December 31, 20X1, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the assets, liabilities, and capital of ABC Partnership as of December 31, 20X1, and its revenue and expenses and changes in partners' capital accounts for the year then ended in accordance with the basis of accounting ABC Partnership uses for income tax purposes described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Partnership, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting³

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the basis of accounting ABC Partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

¹ If management has a choice of financial reporting frameworks, paragraph .18b requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

² The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

³ Another appropriate heading may be used.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the basis of accounting ABC Partnership uses for income tax purposes and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed.⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Partnership's ability to continue as a going concern for a reasonable period of time.

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

⁴ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed."

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 3 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Not Intended for General Use)

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a regulatory basis of accounting prescribed by state statutes applicable to the government entity (that is, a special purpose framework).
- The financial statements together with the auditor's report are not intended for general use.
- Based on the regulatory requirements, management does not have a choice of financial reporting frameworks.¹

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinion

We have audited the financial statements of ABC Government Authority, which comprise the statement of net position—regulatory basis as of December 31, 20X1, and the related statements of revenues, expenses, and changes in net position — regulatory basis; and statement of cash flows — regulatory basis for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20XX, and the regulatory basis changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Government Authority and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting³

We draw attention to Note X of the financial statements, which describes the basis of accounting. As described in Note X to the financial statements, the financial statements are prepared by ABC Government Authority on the basis

¹ If management has a choice of financial reporting frameworks, paragraph .18b requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

² The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

³ Another appropriate heading may be used.

of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of Any State Statutes. As a result, the financial statements may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements⁴

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Government Authority's internal control. Accordingly, no such opinion is expressed.⁵
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about

⁴ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may need to be included in this section of the report, adapted as necessary, depending on whether the going concern basis of accounting is relevant. See paragraph .A18 of this section.

⁵ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Government Authority's internal control. Accordingly, no such opinion is expressed."

ABC Government Authority's ability to continue as a going concern for a reasonable period of time.

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

Restriction on Use⁶

Our report is intended solely for the information and use of ABC Government Authority and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁶ Another appropriate heading may be used.

Illustration 4 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Regulatory Basis of Accounting (the Financial Statements Together With the Auditor's Report Are Intended for General Use)

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a regulatory basis of accounting prescribed by state statutes applicable to the government entity (that is, a special purpose framework).
- The regulatory basis financial statements together with the auditor's report are intended for general use.
- Based on the regulatory requirements, management does not have a choice of financial reporting frameworks.¹
- The variances between the regulatory basis of accounting and accounting principles generally accepted in the United States of America (U.S. GAAP) are not reasonably determinable and are presumed to be material.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinions

We have audited the financial statements of ABC Government Authority, which comprise the statement of net position—regulatory basis as of December 31, 20X1, and the related statements of revenues, expenses, and changes in net position—regulatory basis and cash flows—regulatory basis for the year then ended, and the related notes to the financial statements.

Unmodified Opinion on Regulatory Basis of Accounting

In our opinion, the accompanying financial statements present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20X1, and the regulatory basis revenues, expenses, and changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles section of our report, the financial statements do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of ABC Government Authority as of December 31, 20X1, or the changes in net position and cash flows thereof for the year then ended.

¹ If management has a choice of financial reporting frameworks, paragraph .18b requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

² The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Government Authority, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note X of the financial statements, the financial statements are prepared by ABC Government Authority on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of Any State Statutes. The effects on the financial statements of the variances between the regulatory basis of accounting described in Note X and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material and pervasive.

***Responsibilities of Management for the Financial Statements*³**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

³ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may need to be included in this section of the report, adapted as necessary, depending on whether the going concern basis of accounting is relevant. See paragraph .A18 of this section.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Government Authority's internal control. Accordingly, no such opinion is expressed.⁴
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Government Authority's ability to continue as a going concern for a reasonable period of time.

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

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[Auditor's city and state]

[Date of the auditor's report]

⁴ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Partnership's internal control. Accordingly, no such opinion is expressed."

Illustration 5 — An Auditor's Report on a Complete Set of Financial Statements Prepared in Accordance With a Contractual Basis of Accounting

Circumstances include the following:

- The financial statements have been prepared by management of the entity in accordance with a contractual basis of accounting (that is, a special purpose framework) to comply with the provisions of that contract.
- Based on the provisions of the contract, management does not have a choice of financial reporting frameworks.¹

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

Opinion

We have audited the financial statements of ABC Company, which comprise the assets and liabilities — contractual basis as of December 31, 20X1, and the revenues and expenses — contractual basis, changes in equity — contractual basis, and cash flows — contractual basis for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the assets and liabilities of ABC Company as of December 31, 20X1, and revenues, expenses, changes in equity, and cash flows for the year then ended in accordance with the financial reporting provisions of Section Z of the contract between ABC Company and DEF Company dated January 1, 20X1 (the contract).

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting³

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared by ABC Company on the basis of the financial reporting provisions of Section Z of the contract, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the contract referred to above. As a result, the financial statements may not

¹ If management has a choice of financial reporting frameworks, paragraph .18b requires that the explanation of management's responsibility for the financial statements also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

² The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

³ Another appropriate heading may be used.

be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements⁴

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the financial reporting provisions of Section Z of the contract. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁵
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

⁴ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may need to be included in this section of the report, adapted as necessary, depending on whether the going concern basis of accounting is relevant. See paragraph .A18 of this section.

⁵ In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

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

Restriction on Use⁶

Our report is intended solely for the information and use of ABC Company and DEF Company and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for audits of financial statements prepared in accordance with a special purpose framework for periods ending on or after December 15, 2021, by SAS No. 139.]

⁶ Another appropriate heading may be used.

AU-C Section 805

Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement

Source: SAS No. 122; SAS No. 139.

See section 9805 for interpretations of this section.

Effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2012, unless otherwise indicated.

NOTE

In October 2021, the Auditing Standards board issued Statement on Auditing Standards No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 AU-C sections 200–700 apply to an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information. This section addresses special considerations in the application of those AU-C sections to an audit of a single financial statement or of a specific element, account, or item of a financial statement. The single financial statement or the specific element, account, or item of a financial statement may be prepared in accordance with a general or special purpose framework. If prepared in accordance with a special purpose framework, section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, also applies to the audit. (Ref: par. .A1–.A4)

.02 This section does not apply to the report of a component auditor issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see section 600, *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]*).

.03 This section does not override the requirements of the other AU-C sections nor does it purport to address all special considerations that may be relevant in the circumstances of the engagement.

Effective Date

.04 This section is effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2012.

Objective

.05 The objective of the auditor, when applying generally accepted auditing standards (GAAS) in an audit of a single financial statement or of a specific element, account, or item of a financial statement, is to address appropriately the special considerations that are relevant to

- a. the acceptance of the engagement;
- b. the planning and performance of that engagement; and
- c. forming an opinion and reporting on the single financial statement or the specific element, account, or item of a financial statement.

Definitions

.06 For purposes of this section, reference to

- a. an *element of a financial statement* or an *element* means an *element, account, or item of a financial statement*. (Ref: par. A5)
- b. a *single financial statement* or a *specific element of a financial statement* includes the related disclosures. (Ref: par. A2)

[As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.07 Reference to *generally accepted accounting principles* (GAAP) in GAAS means GAAP promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 203 1.320.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Considerations When Accepting the Engagement

Application of GAAS (Ref: par. A6–A8)

.08 Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to comply with all AU-C sections relevant to the audit.¹ In the case of an audit of a single financial statement or a specific element of a financial statement, this requirement applies irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements.

¹ Paragraph .20 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

.09 If the auditor is not also engaged to audit the entity's complete set of financial statements, the auditor should determine whether the audit of a single financial statement or a specific element of those financial statements in accordance with GAAS is practicable. The auditor should also determine whether the auditor will be able to perform procedures on interrelated items, as required by paragraph .13.

Acceptability of the Financial Reporting Framework (Ref: par. .A9–.A13)

.10 Section 210A, *Terms of Engagement*, requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.² In the case of an audit of a single financial statement or a specific element of a financial statement, the auditor should obtain an understanding of

- a. the purpose for which the single financial statement or specific element of a financial statement is prepared,
- b. the intended users, and
- c. the steps taken by management to determine that the application of the financial reporting framework is acceptable in the circumstances.

.11 The auditor's determination required by paragraph .10 should include consideration of whether the application of the financial reporting framework will result in a presentation that provides adequate disclosures to enable the intended users to understand the information conveyed in the financial statement or the specific element and the effect of material transactions and events on the information conveyed in the financial statement or the specific element.

Considerations When Planning and Performing the Audit

.12 Section 200 states that GAAS is written in the context of an audit of financial statements; it is to be adapted as necessary in the circumstances when applied to audits of other historical financial information.³ In planning and performing the audit of a single financial statement or a specific element of a financial statement, the auditor should adapt all AU-C sections relevant to the audit as necessary in the circumstances of the engagement. (Ref: par. .A14–.A17)

.13 In the case of an audit of a single financial statement or a specific element of a financial statement, the auditor should perform procedures on interrelated items as necessary to meet the objective of the audit. In the case of an audit of a specific element of a financial statement (Ref: par. .A18)

- a. the auditor should, if the specific element is, or is based upon, the entity's stockholders' equity or the equivalent, perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion about financial position, excluding matters related to classification or disclosure that are not relevant to the audit of the specific element.
- b. the auditor should, if the specific element is, or is based upon, the entity's net income or the equivalent, perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion about financial position and results

² Paragraph .06a of section 210A, *Terms of Engagement*.

³ Paragraph .02 of section 200.

of operations, excluding matters related to classification or disclosure that are not relevant to the audit of the specific element.

Materiality (Ref: par. .A19)

.14 Section 320, *Materiality in Planning and Performing an Audit*, requires the auditor to determine, when establishing the overall audit strategy, materiality for the financial statements as a whole.⁴ In the case of an audit of a single financial statement, the auditor should determine materiality for the single financial statement being reported on rather than for the complete set of financial statements. In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements.

Forming an Opinion and Reporting Considerations

.15 When forming an opinion and reporting on a single financial statement or a specific element of a financial statement, the auditor should apply the requirements in section 700, *Forming an Opinion and Reporting on Financial Statements*, or section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and when applicable, section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, adapted as necessary in the circumstances of the engagement. (Ref: par. .A20–.A22) [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Reporting on the Entity's Complete Set of Financial Statements and a Single Financial Statement or a Specific Element of Those Financial Statements

.16 If, in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor undertakes an engagement to audit a single financial statement or a specific element of a financial statement, the auditor should

- a. issue a separate auditor's report and express a separate opinion for each engagement.
- b. indicate in the report on a specific element of a financial statement the date of the auditor's report on the complete set of financial statements and the nature of opinion expressed on those financial statements under an appropriate heading.

.17 Except as required by paragraph .21, an audited single financial statement or an audited specific element of a financial statement may be published together with the entity's audited complete set of financial statements, provided that the presentation of the single financial statement or the specific element is sufficiently differentiated from the complete set of financial statements. The auditor should also differentiate the report on the single financial statement or the specific element of a financial statement from the report on the complete set of financial statements.

.18 If the auditor concludes that the presentation of the audited single financial statement or the audited specific element does not differentiate it sufficiently from the complete set of financial statements, as described in paragraph

⁴ Paragraph .10 of section 320, *Materiality in Planning and Performing an Audit*.

.17, the auditor should ask management to remedy the situation. The auditor should not release the auditor's report containing the opinion on the single financial statement or the specific element of a financial statement until satisfied with the differentiation.

Considering the Implications of Certain Matters Included in the Auditor's Report on the Entity's Complete Set of Financial Statements

.19 If the auditor's report on an entity's complete set of financial statements includes a modified opinion, an emphasis-of-matter or other-matter paragraph, a going concern section, a communication of key audit matters, or a statement describing an uncorrected material misstatement of other information, the auditor should consider the implications, if any, that these matters have for the audit of the single financial statement or for the specific element of a financial statement and for the auditor's report thereon. (Ref: par. .A23–.A26) [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Modifications to the Opinion in the Independent Auditor's Report

.20 In the case of an audit of a specific element of a financial statement, if the auditor's modified opinion on the entity's complete set of financial statements as a whole is relevant to the audit of the specific element, the auditor should (Ref: par. .A27–.A29)

- a. express an adverse opinion on the specific element when the modification of the auditor's opinion on the complete set of financial statements as a whole arises from a material misstatement in such financial statements.
- b. disclaim an opinion on the specific element when the modification of the auditor's opinion on the complete set of financial statements as a whole arises from an inability to obtain sufficient appropriate audit evidence.

Adverse Opinion or Disclaimer of Opinion in the Auditor's Report on the Entity's Complete Set of Financial Statements

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

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

[As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of

or for periods ending on or after December 15, 2021. Early application is not permitted.]

.22 A single financial statement is deemed to constitute a major portion of a complete set of financial statements. Therefore, the auditor should not express an unmodified opinion on a single financial statement of a complete set of financial statements if the auditor has expressed an adverse opinion or disclaimed an opinion on the complete set of financial statements as a whole, even if the auditor's report on the single financial statement is neither published together with nor otherwise accompanies the auditor's report containing the adverse opinion or disclaimer of opinion. (Ref: par. .A30)

.23 If the auditor's report on an entity's complete set of financial statements includes an emphasis-of-matter paragraph or an other-matter paragraph that is relevant to the audit of the single financial statement or the specific element, the auditor should include a similar emphasis-of-matter paragraph or an other-matter paragraph in the auditor's report on the single financial statement or the specific element, in accordance with section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. (Ref: par. .A29)

Reporting on an Incomplete Presentation but One That Is Otherwise in Accordance With Generally Accepted Accounting Principles (Ref: par. .A31–.A32)

.24 When the auditor reports on an incomplete presentation but one that is otherwise in accordance with GAAP, the auditor should include an emphasis-of-matter paragraph⁵ in the auditor's report that

- a. states the purpose for which the presentation is prepared and refers to a note in the financial statements that describes the basis of presentation and
- b. indicates that the presentation is not intended to be a complete presentation of the entity's assets, liabilities, revenues, or expenses.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01 and .06b)

.A1 Section 200 defines the term *historical financial information* as information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past. [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A2 Section 200 defines the term *financial statements* as a structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set

⁵ Paragraphs .06–.07 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.⁶ [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A3 Paragraph .A9 of section 200 provides guidance on what constitutes a complete set of financial statements and also provides the following examples of single financial statements, each of which would include related disclosures:

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

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A4 An attest engagement other than an audit of historical financial information is performed in accordance with Statements on Standards for Attestation Engagements. For example, AT-C section 215, *Agreed-Upon Procedures Engagements*, applies when reporting on the results of applying agreed-upon procedures to one or more specific elements of a financial statement, and AT-C section 210, *Review Engagements*, provides guidance when reporting on a review of one or more specific elements of a financial statement. Paragraph .A8 describes circumstances in which an engagement performed in accordance with the attestation standards may be more practicable than an audit performed in accordance with this section. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Definitions

Element of a Financial Statement (Ref: par. .06)

.A5 The appendix, "Examples of Specific Elements, Accounts, or Items of a Financial Statement," lists examples of an element of a financial statement. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Considerations When Accepting the Engagement

Application of GAAS (Ref: par. .08–.09)

.A6 Section 200 requires the auditor to comply with (a) relevant ethical requirements relating to financial statement audit engagements and (b) all

⁶ Paragraph .14 of section 200.

AU-C sections relevant to the audit. It also requires the auditor to comply with each requirement of an AU-C section, unless, in the circumstances of the audit, the entire AU-C section is not relevant or the requirement is not relevant because it is conditional and the condition does not exist. In rare circumstances, the auditor may judge it necessary to depart from a relevant presumptively mandatory requirement in an AU-C section by performing alternative audit procedures to achieve the intent of that requirement.⁷ [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Complying With Relevant Requirements

.A7 Compliance with the requirements of AU-C sections relevant to the audit of a single financial statement or a specific element of a financial statement may not be practicable when the auditor is not also engaged to audit the entity's complete set of financial statements. In such cases, the auditor often does not have the same understanding of the entity and its environment, including its internal control, as an auditor who also audits the entity's complete set of financial statements. The auditor also does not have the audit evidence about the general quality of the accounting records or other accounting information that would be acquired in an audit of the entity's complete set of financial statements. Accordingly, the auditor may need further evidence to corroborate audit evidence acquired from the accounting records. Also see paragraph .A18. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A8 In the case of an audit of a specific element of a financial statement, certain AU-C sections require audit work that may be disproportionate to the specific element being audited. For example, although the requirements of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, may be relevant in the circumstances of an audit of a schedule of accounts receivable (see paragraph .A14), complying with those requirements may not be practicable because of the audit effort required. If the auditor concludes that an audit of a single financial statement or a specific element of a financial statement in accordance with GAAS may not be practicable, the auditor may discuss with management whether another type of engagement might be more practicable, such as an engagement performed in accordance with the Statements on Standards for Attestation Engagements, as described in paragraph .A4. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Acceptability of the Financial Reporting Framework (Ref: par. .10–.11)

.A9 In the case of an audit of a single financial statement or a specific element of a financial statement, the financial information needs of the intended users are relevant in determining the acceptability of the financial reporting framework applied in the preparation of the single financial statement or the specific element. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A10 A single financial statement or a specific element of a financial statement may be prepared in accordance with relevant requirements of a financial reporting framework established by an authorized or recognized standards-setting organization for the preparation of a complete set of financial statements (for example, accounting principles generally accepted in the United

⁷ Paragraphs .16, .20, and .24–.26 of section 200.

States of America [U.S. GAAP] or International Financial Reporting Standards promulgated by the International Accounting Standards Board). If this is the case, determination of the acceptability of the applicable framework may involve considering whether that framework includes all the requirements of the framework that are relevant to the presentation of a single financial statement or a specific element of a financial statement that provides adequate disclosures. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A11 The determination of the acceptability of the applicable framework may also include consideration of the following:

- Whether the applicable financial reporting framework is explicitly or implicitly restricted to the preparation of a complete set of financial statements.
- Whether the single financial statement or the specific element of a financial statement will
 - comply fully with each of those requirements of the framework relevant to the particular financial statement or the particular element and the presentation of the financial statement or the specific element of a financial statement, including the related disclosures. For example, when reporting on a schedule of long-term debt prepared in accordance with U.S. GAAP relevant to that schedule, the schedule of long-term debt, including the related notes, would be comparable to such information in financial statements prepared in accordance with U.S. GAAP.
 - provide, if necessary to achieve fair presentation, disclosures beyond those specifically required by the framework or, in extremely rare circumstances, depart from a requirement of the framework.⁸ A single financial statement or a specific element of a financial statement, including the related notes, that achieves a fair presentation includes all informative disclosures that are appropriate for the applicable financial reporting framework, including matters that affect their use, understanding, and interpretation.

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A12 The auditor may be requested to audit an incomplete presentation but one that is otherwise in accordance with GAAP. For example, an entity wishing to sell a division or product line may present certain assets and liabilities, revenues, and expenses relating to the division or product line being sold. Incomplete presentations may also be required by a regulatory agency or a contract or an agreement. For example, a regulatory agency may require a schedule of gross income and certain expenses of an entity's real estate operation in which income and expenses are measured in accordance with GAAP, but *expenses* are defined to exclude certain items, such as interest, depreciation, and income taxes. Also, an acquisition agreement may specify a schedule

⁸ See paragraph .14 of section 200 for a definition of financial reporting framework.

of gross assets and liabilities of the entity measured in accordance with GAAP but limited to the assets to be sold and liabilities to be transferred pursuant to the agreement. These types of presentations are generally regarded as single financial statements, even though certain items may be excluded only to the extent necessary to meet the purpose for which they were prepared. The requirement in paragraph .24 is designed to avoid misunderstandings about the purpose for which the presentation is prepared. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A13 As indicated in paragraph .A12, incomplete presentations may be required by a regulatory agency or a contract or an agreement. Paragraphs .A2–.A3 of section 800 provide guidance on the acceptability of the financial reporting framework when the regulatory or contractual basis of accounting is based on a general purpose framework, such as GAAP. The auditor may determine that it is more appropriate for the description of the applicable financial reporting framework to refer to the regulatory or contractual basis of accounting, rather than make reference to GAAP. As indicated in paragraph .01, if the presentation is prepared in accordance with a special purpose framework, section 800 also applies to the audit. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Considerations When Planning and Performing the Audit (Ref: par. .12–.13)

.A14 An AU-C section is relevant to the audit when the AU-C section is in effect and the circumstances addressed by the AU-C section exist.⁹ Even when only a specific element of a financial statement is the subject of the audit, AU-C sections such as section 240, *Consideration of Fraud in a Financial Statement Audit*, section 550, *Related Parties*, and section 570 are, in principle, relevant. This is because the specific element could be misstated as a result of fraud, the effect of related party transactions, or the incorrect application of the going concern assumption under the applicable financial reporting framework. [Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A15 Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to determine the appropriate person or persons within the entity's governance structure with whom to communicate. Section 260 notes that, in some cases, all of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognize this circumstance. When a complete set of financial statements is also prepared by the entity, the person or persons responsible for oversight of the preparation of the single financial statement or the element may not be the same as those responsible for the oversight of the preparation of the complete set of financial statements. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

⁹ Paragraph .20 of section 200.

.A16 Furthermore, GAAS is written in the context of an audit of financial statements; it is to be adapted as necessary in the circumstances when applied to the audit of a single financial statement or a specific element of a financial statement.¹⁰ For example, written representations from management about the complete set of financial statements would be replaced by written representations about the presentation of the single financial statement or the specific element, in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A17 Matters included in the auditor's report on the complete set of financial statements may have implications for the audit of a single financial statement or of an element of a financial statement (see paragraph .19). When planning and performing an audit of a single financial statement or a specific element of a financial statement in conjunction with the audit of the entity's complete set of financial statements, the auditor may use audit evidence obtained as part of the audit of the entity's complete set of financial statements in the audit of the single financial statement or the specific element. GAAS, however, requires the auditor to plan and perform the audit of the single financial statement or specific element to obtain sufficient appropriate audit evidence on which to base the opinion on the single financial statement or the specific element. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A18 The individual financial statements that make up a complete set of financial statements, and many of the specific elements of those financial statements, including their related disclosures, are interrelated. For example, sales and receivables, inventory and payables, and buildings and equipment and depreciation each are interrelated. Accordingly, when auditing a single financial statement or a specific element of a financial statement, the auditor may not be able to consider the single financial statement or the specific element in isolation. Consequently, paragraph .13 requires the auditor to perform procedures on interrelated items as necessary to meet the objective of the audit. In the case of an audit of a specific element that is, or is based upon, the entity's stockholders' equity or net income (or the equivalents thereto), paragraph .13 requires the auditor to perform procedures necessary to obtain sufficient appropriate audit evidence about financial position, or financial position and results of operations, respectively, because of the interrelationship between the specific element and the balance sheet accounts and the income statement accounts. However, matters related to classification or disclosure may not be relevant to the audit of the specific element; therefore, audit procedures on such matters may not be necessary in an audit of a specific element. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Materiality (Ref: par. .14)

.A19 The materiality determined for a single financial statement or a specific element of a financial statement differs from the materiality determined for the entity's complete set of financial statements; this will affect the nature, timing, and extent of the audit procedures and the evaluation of uncorrected misstatements. In the case of an audit of a single financial statement, paragraph .14 requires the auditor to determine materiality for the single financial

¹⁰ Paragraph .02 of section 200.

statement being reported on rather than for the complete set of financial statements. In the case of an audit of one or more specific elements of a financial statement, the auditor's opinion is on each of the specific elements; therefore, paragraph .14 requires the auditor to determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements. Consequently, an audit of one or more specific elements of a financial statement is usually more extensive than if the same information was being considered in conjunction with an audit of the complete set of financial statements. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Forming an Opinion and Reporting Considerations (Ref: par. .15)

.A20 Sections 700 and 703 require the auditor, in forming an opinion, to evaluate whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.¹¹ In the case of an audit of a single financial statement or a specific element of a financial statement, it is important, in view of the requirements of the applicable financial reporting framework, that the disclosures enable the intended users to understand

- the information conveyed in the financial statement or the specific element and
- the effect of material transactions and events on the information conveyed in the financial statement or the specific element.

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Going Concern

.A21 The applicable financial reporting framework may not specifically address whether management is required to make a going concern assessment for a single financial statement or a specific element, account, or item of a financial statement. Therefore, the description in the auditor's report of management's responsibilities relating to going concern¹² may not be relevant or may need to be adapted as necessary. The description in the auditor's report of the auditor's responsibilities¹³ relating to going concern may also need to be adapted as necessary depending on whether section 570 is determined to be relevant to the audit in accordance with paragraph .12. In making that determination, the auditor may consider whether the auditor's responsibilities relating to going concern are likely to be relevant to users for the intended purpose of the single financial statement or specific element, account, or item of a financial

¹¹ Paragraph .15 of section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .37 of section 703. [As amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

¹² Paragraph .32b of section 700. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

¹³ Paragraph .36e of section 700. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

statement presented. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A22 The exhibit, "Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statements," contains illustrations of auditor's reports. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Considering the Implications of Certain Matters Included in the Auditor's Report on the Entity's Complete Set of Financial Statements (Ref: par. .19-.23)

.A23 Considering whether a matter included in the auditor's report on the complete set of financial statements is relevant in the context of an engagement to report on a single financial statement or a specific element of a financial statement involves professional judgment. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A24 Factors that may be relevant in considering those implications include the following:

- The nature of the matters described in the auditor's report on the complete set of financial statements and the extent to which they relate to what is included in the single financial statement or a specific element of a financial statement
- The pervasiveness of the matters described in the auditor's report on the complete set of financial statements
- The nature and extent of the differences between the applicable financial reporting frameworks
- The extent of the difference between the periods covered by the complete set of the financial statements compared with the periods or dates of the single financial statement or element of a financial statement
- The time elapsed since the date of the auditor's report on the complete set of the financial statements

[Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A25 When applicable, key audit matters communicated in the auditor's report on a complete set of financial statements may have implications for an audit of a single financial statement or specific element of a financial statement. The information included in the "Key Audit Matters" section about how the matter was addressed in the audit of a complete set of financial statements may be useful to the auditor's determination of how to address the matter when it is relevant to an audit of a single financial statement or specific element of a financial statement. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A26 If the auditor is engaged to communicate key audit matters in the auditor's report on a single financial statement or a specific element of a financial statement, section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, applies in its entirety. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Modifications to the Opinion in the Independent Auditor's Report
(Ref: par. .20 and .23)

.A27 In the case of an audit of a specific element of a financial statement, if the opinion in the auditor's report on an entity's complete set of financial statements is modified and the modification is relevant to the audit of the specific element, the modification is material and pervasive with respect to the specific element. Modifications related to an interrelated item of the specific element may also be relevant to the audit of the specific element. Conversely, modifications related solely to classification or disclosure may not be relevant to the audit of the specific element. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A28 For example, when there is a qualification of the auditor's opinion in relation to accounts receivable in the auditor's report on the complete set of financial statements and the single financial statement includes accounts receivable or the specific element of a financial statement relates to accounts receivable, there likely would be implications for the audit. On the other hand, if the qualification of the auditor's opinion on the complete set of financial statements relates to classification of long-term debt, then it is less likely that there would be implications for an audit of the single financial statement that is the income statement, or if the specific element of the financial statement relates to accounts receivable. [Paragraph added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

.A29 Even when certain matters included in the auditor's report on the entity's complete set of financial statements do not have implications for the audit of, or for the auditor's report on, the single financial statement or the specific element of a financial statement, the auditor may deem it appropriate to refer to the matter in an other-matter paragraph in an auditor's report on the single financial statement or on the specific element of a financial statement (see section 706). For example, the auditor may consider it appropriate to refer in the auditor's report on the single financial statement or the specific element of a financial statement to a going concern section included in the auditor's report on the complete set of financial statements. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Adverse Opinion or Disclaimer of Opinion in the Auditor's Report on the Entity's Complete Set of Financial Statements (Ref: par. .22)

.A30 In the auditor's report on an entity's complete set of financial statements, the expression of a disclaimer of opinion regarding the results of operations and cash flows, when relevant, and an unmodified opinion regarding the financial position are permitted because the disclaimer of opinion is being issued on the results of operations and cash flows only and not on the financial

statements as a whole.¹⁴ [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Reporting on an Incomplete Presentation but One That Is Otherwise in Accordance With GAAP (Ref: par. .24)

.A31 As described in paragraph .A12, the auditor may be requested to audit an incomplete presentation but one that is otherwise in accordance with GAAP. When the auditor reports on an incomplete presentation but one that is otherwise in accordance with GAAP, paragraph .24 requires the auditor to include an emphasis-of-matter paragraph in the auditor's report, which alerts users as to the purpose of the presentation and that the presentation is incomplete. The exhibit illustrates such a paragraph. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A32 If the presentation is prepared in accordance with a regulatory or contractual basis of accounting, the requirement in paragraph .24 does not apply. In such circumstances, refer to section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. See also paragraph .A13 of this section. [Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

¹⁴ Paragraph .A17 of section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*, and paragraph .A17 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

.A33

Appendix — Examples of Specific Elements, Accounts, or Items of a Financial Statement (Ref: par. .A5)

The following are examples of specific elements, accounts, or items of a financial statement:

- Accounts receivable; allowance for doubtful accounts receivable; inventory; the liability for accrued benefits of a private benefit plan; the recorded value of identified intangible assets; or the liability for incurred but not reported claims in an insurance portfolio, including related notes
- A schedule of externally managed assets and income of a private benefit plan, including related notes
- A schedule of disbursements regarding a lease property, including related notes
- A schedule of profit participation or employee bonuses, including related notes

.A34

Exhibit — Illustrations of Auditor's Reports on a Single Financial Statement and a Specific Element of a Financial Statement (Ref: par. .A22 and .A31)

Illustration 1 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a General Purpose Framework

Illustration 2 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a Special Purpose Framework

Illustration 3 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a General Purpose Framework

Illustration 4 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a Special Purpose Framework

Illustration 5 — An Auditor's Report on an Incomplete Presentation but One That Is Otherwise in Accordance With Generally Accepted Accounting Principles

Illustration 1 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a General Purpose Framework

Circumstances include the following:

- Audit of a balance sheet (that is, a single financial statement).
- The balance sheet has been prepared by management of the entity in accordance with accounting principles generally accepted in the United States of America.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statement¹

Opinion

We have audited the balance sheet of ABC Company as of December 31, 20X1, and the related notes (the financial statement).²

In our opinion, the accompanying financial statement presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statement section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statement³

Management is responsible for the preparation and fair presentation of the financial statement in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statement

Our objectives are to obtain reasonable assurance about whether the financial statement as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² The auditor may refer to the financial statement as the *balance sheet*.

³ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statement.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statement, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statement.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.⁴

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁴ This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Illustration 2 — An Auditor's Report on a Single Financial Statement Prepared in Accordance With a Special Purpose Framework

Circumstances include the following:

- Audit of a statement of cash receipts and disbursements (that is, a single financial statement).
- The financial statement has been prepared by management of the entity in accordance with the cash basis of accounting (a special purpose framework) to respond to a request for cash flow information received from a creditor.¹
- Management has a choice of financial reporting frameworks.²

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statement³

Opinion

We have audited the statement of cash receipts and disbursements of ABC Company for the year ended December 31, 20X1, and the related notes (the financial statement).⁴

In our opinion, the accompanying financial statement presents fairly, in all material respects, the cash receipts and disbursements of ABC Company for the year ended December 31, 20X1, in accordance with the cash basis of accounting described in Note X.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statement section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting⁵

We draw attention to Note X to the financial statement, which describes the basis of accounting. The financial statement is prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

¹ Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

² Paragraph .19b of section 800.

³ The subtitle "Report on the Financial Statement" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

⁴ The auditor may refer to the financial statements as the *statement of cash receipts and disbursements*.

⁵ Another appropriate heading may be used.

Responsibilities of Management for the Financial Statement⁶

Management is responsible for the preparation and fair presentation of the financial statement in accordance with the cash basis of accounting described in Note X, and for determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Financial Statement

Our objectives are to obtain reasonable assurance about whether the financial statement as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of certain internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statement.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statement, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statement.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.⁷

⁶ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

⁷ This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 3 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a General Purpose Framework

Circumstances include the following:

- Audit of a schedule of accounts receivable (that is, a specific element, account, or item of a financial statement).
- The schedule of accounts receivable has been prepared by management of the entity in accordance with accounting principles generally accepted in the United States of America.
- The audit of the schedule of accounts receivable was performed in conjunction with an engagement to audit the entity's complete set of financial statements. The opinion on those financial statements was not modified, and the report did not include an emphasis-of-matter paragraph or other-matter paragraph.¹
- Management determined that the going concern assessment in accounting principles generally accepted in the United States of America does not apply to the preparation of the schedule of accounts receivable. Although a going concern assessment was made in the preparation of the entity's complete set of financial statements from which the financial information being reported on has been derived, the going concern assessment period is significantly different because the schedule of accounts receivable is anticipated to be issued several months after the full set of financial statements were issued. The auditor agrees with management's determination regarding the applicability of the going concern assessment to the preparation of the schedule of accounts receivable.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Schedule²

Opinion

We have audited the schedule of accounts receivable of ABC Company as of December 31, 20X1, and the related notes (the schedule).³

In our opinion, the accompanying schedule presents fairly, in all material respects, the accounts receivable of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

¹ If the auditor undertakes an engagement to audit a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, paragraph .16b requires the auditor to indicate in the report on the specific element of a financial statement the date of the auditor's report on the complete set of financial statements and the nature of opinion expressed on those financial statements under an appropriate heading. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

² The subtitle "Report on the Audit of the Schedule" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

³ The auditor may refer to the schedule as the *schedule of accounts receivable*. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Schedule section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Schedule⁴

Management is responsible for the preparation and fair presentation of the schedule in accordance with accounting principles generally accepted in the United States of America and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

Our objectives are to obtain reasonable assurance about whether the schedule as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the schedule.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the schedule.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the schedule.

⁴ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.⁵

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

Other Matter

We have audited, in accordance with GAAS, the financial statements of ABC Company as of and for the year ended December 31, 20X1, and our report thereon, dated March 15, 20X2, expressed an unmodified opinion on those financial statements.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁵ This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

Illustration 4 — An Auditor's Report on a Specific Element, Account, or Item of a Financial Statement Prepared in Accordance With a Special Purpose Framework

Circumstances include the following:

- Audit of a schedule of royalties applicable to engine production (that is, a specific element, account, or item of a financial statement).
- The financial information has been prepared by management of the entity in accordance with a contractual basis of accounting (that is, a special purpose framework) to comply with the provisions of that contract.¹
- Based on the provisions of the contract, management does not have a choice of financial reporting frameworks.²
- The audit of the schedule was not performed in conjunction with an engagement to audit the entity's complete set of financial statements.³

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Schedule⁴

Opinion

We have audited the schedule of royalties applicable to engine production of the Q Division of ABC Company for the year ended December 31, 20X1, and the related notes (the schedule).⁵

In our opinion, the accompanying schedule presents fairly, in all material respects, the royalties applicable to engine production of the Q Division of ABC Company for the year ended December 31, 20X1, in accordance with the financial reporting provisions of Section Z of the license agreement between ABC Company and XYZ Corporation dated January 1, 20X1 (the contract).

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Schedule section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

¹ Section 800 contains requirements and guidance on the form and content of financial statements prepared in accordance with a special purpose framework.

² Paragraph .19b of section 800.

³ If the auditor undertakes an engagement to audit a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements, paragraph .16 requires the auditor to indicate in the report on the specific element of a financial statement the date of the auditor's report on the complete set of financial statements and the nature of opinion expressed on those financial statements under an appropriate heading.

⁴ The subtitle "Report on the Schedule" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

⁵ The auditor may refer to the schedule as the *schedule of royalties*.

Emphasis of Matter — Basis of Accounting⁶

We draw attention to Note X to the schedule, which describes the basis of accounting. The schedule was prepared by ABC Company on the basis of the financial reporting provisions of Section Z of the contract, which is a basis of accounting other than accounting principles generally accepted in the United States of America. As a result, the schedule may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Schedule⁷

Management is responsible for the preparation and fair presentation of the schedule in accordance with the financial reporting provisions of Section Z of the contract, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

Our objectives are to obtain reasonable assurance about whether the schedule as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the schedule.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the schedule.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the schedule.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about

⁶ Another appropriate heading may be used.

⁷ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

ABC Company's ability to continue as a going concern for a reasonable period of time.⁸

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

Other-Matter Paragraph — Restriction on Use⁹

Our report is intended solely for the information and use of ABC Company and XYZ Corporation and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

⁸ This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

⁹ Another appropriate heading may be used. [Footnote renumbered by the issuance of SAS No. 139, March 2020.]

Illustration 5 — An Auditor's Report on an Incomplete Presentation but One That Is Otherwise in Accordance With Generally Accepted Accounting Principles

Circumstances include the following:

- Audit of the historical summaries of gross income and direct operating expenses (that is, a single financial statement).
- The historical summaries have been prepared by management of the entity in accordance with accounting principles generally accepted in the United States of America but are an incomplete presentation of revenues and expenses.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Historical Summaries¹

Opinion

We have audited the Historical Summaries of Gross Income and Direct Operating Expenses of ABC Apartments for each of the three years in the period ended December 31, 20X1, and the related notes (the historical summaries).²

In our opinion, the accompanying historical summaries present fairly, in all material respects, the gross income and direct operating expenses described in Note X of ABC Apartments for each of the three years in the period ended December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Historical Summaries section of our report. We are required to be independent of ABC Apartments and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter — Basis of Accounting

We draw attention to Note X to the historical summaries, which describes that the accompanying historical summaries were prepared for the purpose of complying with the rules and regulations of Regulator DEF (for inclusion in the filing of Form Z of ABC Company) and are not intended to be a complete presentation of the Company's revenues and expenses. As a result, the financial statements may not be suitable for another purpose. Our opinion is not modified with respect to this matter.

¹ The subtitle "Report on the Audit of the Historical Summaries" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² The auditor may refer to the historical summaries as the *financial statement*.

Responsibilities of Management for the Historical Summaries³

Management is responsible for the preparation and fair presentation of the historical summaries in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the historical summaries that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Historical Summaries

Our objectives are to obtain reasonable assurance about whether the historical summaries as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the historical summaries.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the historical summaries, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the historical summaries.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the historical summaries.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.⁴

³ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may not be relevant or may need to be included in this section of the report, adapted as necessary. See paragraph .A21 of this section. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

⁴ This bullet is included only when the auditor determines that section 570 is relevant to the audit of the single financial statement or specific element, account, or item of a financial statement. See paragraph .A21. [Footnote added by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Paragraph renumbered and amended by SAS No. 139, effective for audits of single financial statements and specific elements, accounts, or items of a financial statement as of or for periods ending on or after December 15, 2021. Early application is not permitted.]

AU-C Section 9805

Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement: Auditing Interpretations of Section 805

1. Auditor of Governmental Cost-Sharing Multiple-Employer Pension Plan

.01 Question — Management of a governmental cost-sharing multiple-employer pension plan (cost-sharing plan or plan) has calculated and prepared a schedule of employer allocations and a schedule of pension amounts, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. If the plan auditor is engaged to perform an audit on schedules such as those illustrated in exhibit 1, "Schedule of Employer Allocations," and either exhibit 2(a), "Schedule of Pension Amounts by Employer," or exhibit 2(b), "Schedule of Collective Pension Amounts," of this interpretation, what type of audit report may be issued?

.02 Interpretation — Because the amounts contained in the previously mentioned schedules are considered elements or items of the cost-sharing plan or participating employer's financial statements, the elements included in these schedules may be audited under section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. An illustrative auditor's report on the schedule of employer allocations and schedule of pension amounts by employer prepared pursuant to section 805 follows.

Independent Auditor's Report

[Appropriate Addressee]

Opinions^{1, 2}

We have audited the schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the total for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense (specified column totals) included in the accompanying schedule of pension amounts by employer of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.

In our opinion, the accompanying schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the total of all participating entities for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Schedules section of our report. We are required to be independent

¹ If the plan prepares a schedule of pension amounts by employer and specific liabilities of individual employers, as defined in paragraph 56 of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27*, exist and are not displayed in the schedule, the "Opinions" section would be changed as follows:

We have audited the schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the columns titled net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and pension expense excluding specific liabilities of individual employers (specified column totals) included in the accompanying schedule of collective pension amounts of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.

In our opinion, the accompanying schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense excluding specific liabilities of individual employers for the total of all participating entities for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

² If the plan prepares a schedule of collective pension amounts as illustrated in exhibit 2(b), "Schedule of Collective Pension Amounts," of this interpretation instead of the schedule of pension amounts by employer as illustrated in exhibit 2(a), "Schedule of Pension Amounts by Employer," of this interpretation, the "Opinions" section would be changed as follows:

We have audited the schedule of employer allocations of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes. We have also audited the columns titled net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and pension expense (specified column totals) included in the accompanying schedule of collective pension amounts of ABC Pension Plan as of and for the year ended June 30, 20X5, and the related notes.

In our opinion, the accompanying schedules referred to above present fairly, in all material respects, the employer allocations and net pension liability, total deferred outflows of resources excluding employer specific amounts, total deferred inflows of resources excluding employer specific amounts, and total pension expense for ABC Pension Plan as of and for the year ended June 30, 20X5, in accordance with accounting principles generally accepted in the United States of America.

Additionally, if specific liabilities of individual employers, as defined in paragraph 56 of GASB Statement No. 68, exist but are excluded from the schedule, the paragraphs in this section would refer to pension expense excluding that attributable to specific liabilities of individual employers rather than pension expense.

of ABC Pension Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Schedules

Management is responsible for the preparation and fair presentation of these schedules in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedules that are free from material misstatement, whether due to fraud or error.³

Auditor's Responsibilities for the Audit of the Schedules

Our objectives are to obtain reasonable assurance about whether the schedules are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the schedules.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the schedules, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the schedules.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Pension Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the schedules.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Pension Plan's ability to continue as a going concern for a reasonable period of time.

³ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700, *Forming an Opinion and Reporting on Financial Statements*, may need to be included in this section of the report, or as stated in paragraph .A21 of section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, may not be relevant or may need to be adapted as necessary. See paragraph .A21 of section 805.

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

Other Matter

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of ABC Pension Plan as of and for the year ended June 30, 20X5, and our report thereon, dated October 15, 20X5, expressed an unmodified opinion on those financial statements.

Restriction on Use

Our report is intended solely for the information and use of ABC Pension Plan management, *[identify the body or individuals charged with governance of ABC Pension Plan]*, ABC Pension Plan employers and their auditors and is not intended to be and should not be used by anyone other than these specified parties.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

.03 Question — In planning and performing an audit of the schedules illustrated in exhibits 1 and 2(a) or exhibit 2(b) of this interpretation, may the plan auditor use the same materiality as used for the audit of the plan's basic financial statements?

.04 Interpretation — No. Section 805 states, in part:⁴

In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements.

Accordingly, the plan auditor should determine materiality separately for the schedule of employer allocations as well as each of the elements upon which the auditor opines from the schedule of pension amounts (that is, the column totals for net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense).

⁴ Paragraph .14 of section 805.

.05

Exhibit 1 — Schedule of Employer Allocations

EXAMPLE COST-SHARING PENSION PLAN Schedule of Employer Allocations As of and for the year ended 6/30/20X5

<i>Employer</i>	<i>20X5 Actual Employer Contributions</i>	<i>Employer Allocation Percentage</i>
Employer 1	\$2,143,842	36.376
Employer 2	268,425	4.554
Employer 3	322,142	5.466
Employer 4	483,255	8.199
Employer 5	633,125	10.742
Employer 6	144,288	2.448
Employer 7	95,365	1.618
Employer 8	94,238	1.599
Employer 9	795,365	13.495
Employer 10	267,468	4.538
Employer 11	403,527	6.847
Employer 12	165,886	2.815
Employer 13	68,454	1.161
Employer 14	6,240	0.106
Employer 15	2,144	0.036
Total	\$5,893,764	100.000

Exhibit 2(a) — Schedule of Pension Amounts by Employer

EXAMPLE COST-SHARING PENSION PLAN Schedule of Pension Amounts by Employer As of and for the year ended 6/30/20X5

Entity	Deferred Outflows of Resources					Deferred Inflows of Resources					Pension Expense			
	Net Pension Liability	Differences Between Expected and Actual Experience	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments	Changes of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions			Differences Between Expected and Actual Experience	Changes of Assumptions	Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions			Net Amortization of Deferred Amounts From Changes in Proportion and Differences Between Contributions and Proportionate Share of Pension Expense	Total Pension Expense
					Proportionate Share of Contributions	Total Deferred Outflows of Resources	Proportionate Share of Contributions			Proportionate Share of Contributions	Total Deferred Inflows of Resources	Proportionate Share of Pension Expense		
Employer 1	\$45,224,620	438,859	1,569,847	1,404,206	695,426	4,108,338	355,917	—	—	726,425	1,082,342	1,907,283	12,375	1,919,658
Employer 2	5,661,780	54,942	196,533	175,796	84,231	511,502	44,558	—	—	74,326	118,884	238,777	(1,783)	236,984
Employer 3	6,795,628	65,945	235,892	211,001	117,354	630,192	53,481	—	—	98,465	151,946	286,596	(8,088)	278,508
Employer 4	10,193,442	98,917	353,838	316,502	161,215	930,472	80,222	—	—	165,453	245,675	429,894	3,021	432,915
Employer 5	13,355,038	129,597	463,584	414,668	199,845	1,207,694	105,103	—	—	197,645	302,748	563,229	(9,900)	553,329
Employer 6	3,043,487	29,534	105,646	94,499	53,453	283,132	23,952	—	—	48,453	72,405	128,355	599	128,954
Employer 7	2,011,585	19,520	69,827	62,459	33,458	185,264	15,831	—	—	35,345	51,176	84,836	625	85,461
Employer 8	1,987,964	19,291	69,007	61,725	35,425	185,448	15,645	—	—	16,453	32,098	83,839	(5,712)	78,127
Employer 9	16,777,717	162,811	582,393	520,941	248,356	1,514,501	132,040	—	—	284,543	416,583	707,576	8,405	715,981
Employer 10	5,641,888	54,749	195,843	175,178	95,465	521,235	44,401	—	—	44,856	88,757	237,988	(1,188)	236,750
Employer 11	8,512,562	82,606	295,490	264,312	136,453	778,861	66,993	—	—	148,543	215,536	359,005	1,254	360,259
Employer 12	3,499,761	33,962	121,485	108,666	52,145	316,258	27,543	—	—	64,354	91,897	147,597	453	148,050
Employer 13	1,443,418	14,007	50,104	44,818	23,156	132,085	11,360	—	—	33,453	44,813	60,874	(205)	60,669
Employer 14	131,785	1,279	4,575	4,092	1,968	11,914	1,037	—	—	894	1,931	5,558	147	5,705
Employer 15	44,757	434	1,554	1,390	1,456	4,834	352	—	—	698	1,050	1,888	7	1,895
Total for All Entities	\$124,325,432	1,206,453	4,315,618	3,860,253	1,939,406	11,321,730	978,435	—	—	1,939,406	2,917,841	5,243,245	—	5,243,245

.07

Exhibit 2(b) — Schedule of Collective Pension Amounts

EXAMPLE COST-SHARING PENSION PLAN Schedule of Collective Pension Amounts As of and for the year ended 6/30/20X5

Deferred Outflows of Resources				Deferred Inflows of Resources				
Net Pension Liability	Net Difference Between Projected and Actual Investment Earnings on Pension Plan Investments			Total Deferred Outflows of Resources Excluding Employer Specific Amounts*		Differences Between Expected and Actual Assumptions of Employer Specific Amounts*		
	Differences Between Expected and Actual Experience	Investment Earnings	Changes of Assumptions	Employer Specific Amounts*	Differences Between Expected and Actual Experience	Changes of Assumptions	Employer Specific Amounts*	Pension Expense*
\$124,325,432	1,206,453	4,315,618	3,860,253	9,382,324	978,435	—	978,435	5,243,245

* Employer specific amounts that are excluded from this schedule are the changes in proportion and differences between employer contributions and proportionate share of contributions as well as the related amortization as defined in paragraphs 54–55 of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*.

[Issue Date: April 2014.]

2. Auditor of Governmental Agent Multiple-Employer Pension Plan

.08 Question — Management of a governmental agent multiple-employer pension plan (agent plan or plan) has calculated and prepared a schedule of changes in fiduciary net position by employer, as described in the AICPA's State and Local Governments Expert Panel white paper *Governmental Employer Participation in Agent Multiple-Employer Plans: Issues Related to Information for Employer Reporting*. If the plan auditor is engaged to perform an audit on a schedule such as that illustrated in exhibit 3, "Schedule of Changes in Fiduciary Net Position by Employer," of this interpretation, what type of audit report may be issued?

.09 Interpretation — Because the amounts contained in the previously mentioned schedule are considered specific elements, accounts, or items of the agent plan or participating employer's financial statements, the elements included in this schedule may be audited under section 805. An illustrative auditor's report on the schedule of changes in fiduciary net position by employer as a whole prepared pursuant to section 805 follows.

Independent Auditor's Report

[Appropriate Addressee]

Opinion⁵

We have audited the fiduciary net position as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, included in the accompanying Schedule of Changes in Fiduciary Net Position by Employer ("Schedule") of ABC Pension Plan, and the related notes.

In our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the fiduciary net position of ABC Pension Plan as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the

⁵ If the plan engages its auditor to opine on each employer column in the schedule of changes in fiduciary net position by employer as illustrated in exhibit 3, "Schedule of Changes in Fiduciary Net Position by Employer," of this interpretation, in addition to opining on the schedule as a whole, this section would be changed as follows:

We have audited the fiduciary net position as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, included in the accompanying Schedule of Changes in Fiduciary Net Position by Employer (Schedule) of ABC Pension Plan, and the related notes. We have also audited the fiduciary net position of each individual employer as of June 30, 20X5, and the changes in fiduciary net position of each individual employer for the year then ended, included in the accompanying Schedule, and the related notes.

In our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the fiduciary net position of ABC Pension Plan as of June 30, 20X5, and the changes in fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the accompanying Schedule referred to above presents fairly, in all material respects, the fiduciary net position of each individual employer as of June 30, 20X5, and the changes in fiduciary net position of each individual employer for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Additionally, the "Supplementary Information" section would be eliminated.

Audit of the Financial Statement section of our report. We are required to be independent of ABC Pension Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Schedule

Management is responsible for the preparation and fair presentation of the Schedule in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the Schedule that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the Schedule

Our objectives are to obtain reasonable assurance about whether the fiduciary net position and the changes in fiduciary net position included in the Schedule is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the Schedule.⁶

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the Schedule, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the Schedule.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Pension Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the Schedule.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Pension Plan's ability to continue as a going concern for a reasonable period of time.

⁶ The description of management's responsibilities relating to going concern required by paragraph .32b of section 700 may need to be included in this section of the report, or as stated in paragraph .A21 of section 805, may not be relevant or may need to be adapted as necessary. See paragraph .A21 of section 805.

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

Supplementary Information

Our audit of the financial statements of ABC Pension Plan was conducted for the purpose of forming an opinion on the financial statements as a whole. The individual employer information presented in each of the individual columns of the accompanying Schedule is presented for purposes of additional analysis and is not a required part of the financial statements. The individual employer information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Each column of individual employer information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the individual employer information presented in each individual column of the accompanying Schedule is stated fairly, in all material respects, in relation to the financial statements of ABC Pension Plan as a whole. We do not express an opinion on the fiduciary net position or changes in fiduciary net position of each individual employer.⁷

Other Matter

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of ABC Pension Plan as of and for the year ended June 30, 20X5, and our report thereon, dated October 15, 20X5, expressed an unmodified opinion on those financial statements.

Restriction on Use

Our report is intended solely for the information and use of ABC Pension Plan management, *[identify the body or individuals charged with governance of ABC Pension Plan]*, ABC Pension Plan participating employers and their auditors and is not intended to be and should not be used by anyone other than these specified parties.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

.10 Question — In planning and performing an audit of the schedule illustrated in exhibit 3 of this interpretation, may the plan auditor use the same materiality as used for the audit of the plan's basic financial statements?

.11 Interpretation — No. Section 805 states, in part:⁸

In the case of an audit of one or more specific elements of a financial statement, the auditor should determine materiality for each individual element reported on rather than the aggregate of all elements or the complete set of financial statements.

⁷ In accordance with section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, if the auditor's report on the audited financial statements contains an opinion other than unmodified, the auditor should refer to the guidance in section 725.

⁸ Paragraph .14 of section 805.

As a frame of reference, the plan auditor considers judgments about matters that are material to users of the financial statements based on a consideration of the common financial information needs of users as a group. In the report described in paragraph .09 of this interpretation, the auditor is opining on two elements: fiduciary net position and the changes in fiduciary net position. Accordingly, the plan auditor should determine materiality separately for the two elements (that is, fiduciary net position and the changes in fiduciary net position). If the plan auditor has been engaged to opine on each employer column in the schedule, the auditor should determine materiality separately for each employer column.

Exhibit 3 — Schedule of Changes in Fiduciary Net Position by Employer

EXAMPLE AGENT MULTIPLE-EMPLOYER PLAN Schedule of Changes in Fiduciary Net Position by Employer As of and for the year ended June 30, 20X5				
	Employer 1	Employer 2	Employer 3	Total
Additions:				
Contributions:				
Employer	86,252,000	34,500,000	51,751,000	172,503,000
Plan Member	32,662,000	13,065,000	19,597,000	65,324,000
Investment income:	80,965,000	20,347,000	37,112,000	138,424,000
Total additions	199,879,000	67,912,000	108,460,000	376,251,000
Deductions:				
Pension benefits, including refunds	384,635,000	184,352,000	228,356,000	797,343,000
Administrative expenses	4,716,000	1,886,000	2,829,000	9,431,000
Total deductions	389,351,000	186,238,000	231,185,000	806,774,000
Net increase (decrease)	(189,472,000)	(118,326,000)	(122,725,000)	(430,523,000)
Net position restricted for pension benefits:				
Beginning of year	5,843,645,000	1,468,538,000	2,678,595,000	9,990,778,000
End of year	\$5,654,173,000	1,350,212,000	2,555,870,000	9,560,255,000

[Issue Date: June 2014.]

AU-C Section 806

Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements

Source: SAS No. 122; SAS No. 125.

Effective for reports on compliance issued in connection with audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility when the auditor is requested to report on an entity's compliance with aspects of contractual agreements or regulatory requirements, insofar as they relate to accounting matters, in connection with an audit of financial statements (referred to hereinafter as a report on compliance). Such a report is commonly referred to as a by-product report. (Ref: par. .A1–.A2)

.02 Entities may be required by contractual agreements, such as certain bond indentures and loan agreements, or regulatory agencies to provide an auditor's report on compliance. For example, loan agreements may impose a variety of obligations on borrowers involving matters such as payments into sinking funds, payments of interest, maintenance of current ratios, and restrictions of dividend payments. Loan agreements may also require the borrower to provide annual financial statements that have been audited. In some instances, the lenders or their trustees may request the auditor to report that the borrower has complied with certain covenants of the agreement relating to accounting matters. The auditor may satisfy this request by issuing a report on compliance in accordance with the requirements of this section.

.03 As described in paragraph .01, this section addresses reporting on an entity's compliance with aspects of contractual agreements or regulatory requirements in connection with an audit of financial statements. When the auditor is engaged or required by law or regulation to perform a compliance audit in accordance with generally accepted auditing standards (GAAS), the standards for financial audits under *Government Auditing Standards*, and a governmental audit requirement that requires the auditor to express an opinion on compliance with applicable compliance requirements, section 935, *Compliance Audits*, applies.

.04 When the auditor is engaged to perform a separate attest engagement on an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants, AT-C section 315, *Compliance Attestation*, applies to an examination of an entity's compliance and to an agreed-upon procedures engagement related to an entity's compliance. When the auditor is engaged

to perform a separate attestation engagement related to an entity's internal control over compliance with requirements of specified laws, regulations, rules, contracts, or grants, AT-C section 205, *Examination Engagements*, applies to an examination of an entity's internal control over compliance and AT-C section 315 applies to agreed-upon procedures engagements related to an entity's internal control over compliance.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Effective Date

.05 This section is effective for reports on compliance issued in connection with audits of financial statements for periods ending on or after December 15, 2012.

Objective

.06 The objective of the auditor is to report appropriately on an entity's compliance with aspects of contractual agreements or regulatory requirements, in connection with the audit of financial statements, when the auditor is requested to report on such matters.

Requirements

Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements

.07 The auditor's report on compliance should include a statement that nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters, only when

- a. the auditor has not identified any instances of noncompliance,
- b. the auditor has expressed an unmodified or qualified opinion on the financial statements to which the applicable covenants of such contractual agreements or regulatory requirements relate, and
- c. the applicable covenants or regulatory requirements relate to accounting matters that have been subjected to the audit procedures applied in the audit of financial statements.

.08 When the auditor has identified one or more instances of noncompliance, the report on compliance should describe such noncompliance (see paragraphs .12*f* and .13*b*).

.09 When the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should issue a report on compliance only when instances of noncompliance are identified. Therefore, the requirement in paragraph .08 also applies in such circumstances. The auditor should modify the wording of the report on compliance, as appropriate to the circumstances. (Ref: par. .A3)

.10 Notwithstanding the requirements in paragraphs .07–.09, the auditor is not precluded from issuing a report on compliance if such report is required by another set of auditing standards (for example, *Government Auditing Standards*), and the auditor has been engaged to audit the financial statements in accordance with both GAAS and those other standards.

.11 The report on compliance should be in writing and should be provided either in a separate report (see paragraph .12) or in one or more paragraphs included in the auditor's report on the financial statements (see paragraph .13).

Separate Report on Compliance With Aspects of Contractual Agreements or Regulatory Requirements

.12 When the auditor reports on compliance in a separate report, the report should include the following:

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent auditor.
- b. An appropriate addressee.
- c. A paragraph that states that the financial statements were audited in accordance with generally accepted auditing standards and an identification of the United States of America as the country of origin of those standards (for example, auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards) and the date of the auditor's report on those financial statements.
- d. If the auditor expressed a modified opinion¹ on the financial statements, a statement describing the nature of the modification. (Ref: par. .A4)
- e. When no instances of noncompliance are identified by the auditor, a reference to the specific covenants or paragraphs of the contractual agreement or regulatory requirement and a statement that nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters (see paragraphs .07 and .10).
- f. When instances of noncompliance are identified by the auditor, a reference to the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters, and a description of the identified instances of noncompliance. (Ref: par. .A5)
- g. A statement that the report is being provided in connection with the audit of the financial statements.
- h. A statement that the audit was not directed primarily toward obtaining knowledge regarding compliance, and accordingly, had the auditor performed additional procedures, other matters may have come to the auditor's attention regarding noncompliance with the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters.
- i. A paragraph that includes a description and the source of significant interpretations, if any, made by the entity's management relating to the provisions of the relevant contractual agreement or regulatory requirement.

¹ See section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

- j. A paragraph that includes an appropriate alert in accordance with the section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.² (Ref: par. .A6–.A7)
- k. The manual or printed signature of the auditor's firm and the city and state where the auditor practices.
- l. The date of the report, which should be the same date as the auditor's report on the financial statements.³

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Report on Compliance With Aspects of Contractual Agreements or Regulatory Requirements Included in the Auditor's Report

.13 When a report on compliance is included in the auditor's report on the financial statements, the auditor's report should include an other-matter paragraph⁴ that includes a reference to the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters, and also should include the following:

- a. When no instances of noncompliance are identified by the auditor, a statement that nothing came to the auditor's attention that caused the auditor to believe that the entity failed to comply with specified aspects of the contractual agreements or regulatory requirements, insofar as they relate to accounting matters (see paragraphs .07 and .10).
- b. When instances of noncompliance are identified by the auditor, a description of the identified instances of noncompliance. (Ref: par. .A5)
- c. A statement that the communication is being provided in connection with the audit of the financial statements.
- d. A statement that the audit was not directed primarily toward obtaining knowledge regarding compliance, and accordingly, had the auditor performed additional procedures, other matters may have come to the auditor's attention regarding noncompliance with the specific covenants or paragraphs of the contractual agreement or regulatory requirement, insofar as they relate to accounting matters.
- e. A paragraph that includes a description and the source of significant interpretations, if any, made by the entity's management relating to the provisions of the relevant contractual agreement or regulatory requirement.
- f. A paragraph that includes an appropriate alert in accordance with section 905.⁵ (Ref: par. .A6–.A7)

² Paragraphs .06c, .07, and .11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

³ Paragraph .41 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

⁴ See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, for guidance on other-matter paragraphs.

⁵ See footnote 2.

[As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 The financial statements being audited and to which the applicable covenants of the contractual agreements or regulatory requirements relate may be either general purpose or special purpose financial statements.

Considerations Specific to Governmental Entities

.A2 For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units and, therefore, requires the presentation of financial statements for its activities in various reporting units. Consequently, a reporting unit or aggregation of reporting units of the governmental entity represents an opinion unit to the auditor. In the context of this section, the auditor is responsible for reporting on compliance for each opinion unit within a governmental entity, when requested.

Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements (Ref: par. .09)

.A3 The exhibit, "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements," provides an example of the wording of the report on compliance when the auditor has disclaimed an opinion on the financial statements.⁶

Separate Report on Compliance With Aspects of Contractual Agreements or Regulatory Requirements (Ref: par. .12d)

.A4 The auditor may include certain additional communications in the separate report on compliance when the auditor included such additional communications in the auditor's report on the financial statements⁷ that are not modifications to the auditor's opinion. For example, if the auditor included an emphasis-of-matter paragraph in the auditor's report on the financial statements because of an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time,⁸ the auditor may also include this in the separate report on compliance.

Reporting When Instances of Noncompliance Are Identified (Ref: par. .12f and .13b)

.A5 When instances of noncompliance are identified, and the entity has obtained a waiver for such noncompliance, the auditor may include a statement in

⁶ Illustration 4, "A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and the Auditor Has Disclaimed an Opinion on the Financial Statements," in the exhibit, "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements."

⁷ See section 706.

⁸ See section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.]

the report on compliance that a waiver has been obtained. The determination of whether to include such a statement is based on the procedures performed by the auditor to evaluate the waiver for the purposes of obtaining sufficient appropriate audit evidence in connection with the audit of the financial statements. All instances of noncompliance are required to be described in the report on compliance, in accordance with paragraph .08, including those for which a waiver has been obtained.

Restrictions on the Use of the Auditor's Report⁹ (Ref: par. .12j and .13f)

.A6 An alert, as discussed in paragraphs .12j and .13f, is necessary because, although compliance matters may be identified by the auditor during the course of the audit engagement, the identification of such matters is not the primary objective of the audit engagement. In addition, the basis, assumptions, or purpose of the provisions in contractual agreements or regulatory requirements to which the report on compliance relates are developed for, and directed only to, the parties to the contractual agreement or the regulatory agency responsible for the requirements. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

.A7 The alert that restricts the use of the report indicates that only the report on compliance with aspects of contractual agreements or regulatory requirements is restricted. Accordingly, the intended use of the auditor's report on the financial statements is not affected by this alert. [As amended, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125.]

⁹ See footnote 2.

.A8

Exhibit—Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements (Ref: par. .12–.13)

Illustration 1 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When No Instances of Noncompliance Are Identified

Illustration 2 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified

Illustration 3 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and a Waiver Has Been Obtained

Illustration 4 — A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and the Auditor Has Disclaimed an Opinion on the Financial Statements

Illustration 5 — A Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified

Illustration 1—A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When No Instances of Noncompliance Are Identified

Independent Auditor's Report

[Appropriate Addressee]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 16, 20X3.

In connection with our audit, nothing came to our attention that caused us to believe that XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Indenture dated July 21, 20X0, with ABC Bank, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Indenture, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

Illustration 2—A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified

Independent Auditor's Report

[Appropriate Addressee]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 5, 20X3.

In connection with our audit, we noted that XYZ Company failed to comply with the "Working Capital" provision of section XX of the Loan Agreement dated March 1, 20X2, with ABC Bank. Our audit was not directed primarily toward obtaining knowledge as to whether XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Loan Agreement, insofar as they relate to accounting matters. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Loan Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

Illustration 3—A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and a Waiver Has Been Obtained

Independent Auditor's Report

[Appropriate Addressee]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 5, 20X3.

In connection with our audit, we noted that XYZ Company failed to comply with the "Working Capital" provision of section XX of the Loan Agreement dated March 1, 20X2, with ABC Bank. The Company has received a waiver dated February 5, 20X3, from ABC Bank. Our audit was not directed primarily toward obtaining knowledge as to whether XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Loan Agreement, insofar as they relate to accounting matters. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Loan Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

Illustration 4—A Report on Compliance With Aspects of Contractual Agreements Provided in a Separate Report When Instances of Noncompliance Are Identified, and the Auditor Has Disclaimed an Opinion on the Financial Statements

Independent Auditor's Report

[Appropriate Addressee]

We were engaged to audit, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X2, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 5, 20X3. Our report disclaims an opinion on such financial statements because of *[describe the scope limitation or matter causing the disclaimer]*.

In connection with our engagement, we noted that XYZ Company failed to comply with the "Working Capital" provision of section XX of the Loan Agreement dated March 1, 20X2, with ABC Bank. Our engagement was not directed primarily toward obtaining knowledge as to whether XYZ Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Loan Agreement, insofar as they relate to accounting matters. Accordingly, had we been able to complete the audit, other matters may have come to our attention regarding noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Loan Agreement, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the board of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

Illustration 5—A Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements¹

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

Other Matter

In connection with our audit, nothing came to our attention that caused us to believe that ABC Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Indenture dated July 21, 20X0 with XYZ Bank, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such non-compliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Indenture, insofar as they relate to accounting matters.

Restricted Use Relating to the Other Matter

The communication related to compliance with the aforementioned Indenture described in the Other Matter paragraph is intended solely for the information and use of the boards of directors and management of ABC Company and XYZ

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Bank and is not intended to be and should not be used by anyone other than these specified parties.³

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Illustration added, effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012, by SAS No. 125. Revised, February 2020, to reflect conforming changes necessary due to the issuance of SAS No. 134, as amended.]

³ When the engagement is also performed in accordance with *Government Auditing Standards*, the alert may read as follows: "The purpose of the communication related to compliance with the aforementioned [compliance requirements] described in the Other Matter paragraph [or, *Report on Compliance*] is solely to describe the scope of our testing of compliance and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ABC Company's compliance. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide *Government Auditing Standards and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports.

AU-C Section 810

Engagements to Report on Summary Financial Statements

Source: SAS No. 122; SAS No. 137; SAS No. 139.

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities relating to an engagement to report separately on summary financial statements derived from financial statements audited in accordance with generally accepted auditing standards (GAAS) by the same auditor. In such an engagement, the auditor forms an opinion about whether the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria.

.02 This section does not apply to condensed financial statements or summarized financial information presented as comparative information.¹ Section 700, *Forming an Opinion and Reporting on Financial Statements*, addresses the auditor's responsibility for comparative information.² (Ref: par. .A1)

.03 Summary financial statements may be required by a designated accounting standards setter (for example, the Governmental Accounting Standards Board) to accompany the basic financial statements. This section does not apply in such circumstances. Section 730, *Required Supplementary Information*, addresses the auditor's responsibilities relating to information supplementary to the basic financial statements that is required by a designated accounting standards setter to accompany such financial statements.

Effective Date

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

Objectives

.05 The objectives of the auditor are

- a. to determine whether it is appropriate to accept the engagement to report on summary financial statements and,
- b. if engaged to report on summary financial statements, to
 - i. perform the procedures necessary as the basis for the auditor's opinion on the summary financial statements;

¹ Paragraph .11 of section 700, *Forming an Opinion and Reporting on Financial Statements*, defines the terms *condensed financial statements* and *comparative information*.

² Paragraphs .45–.52 of section 700. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131.]

- ii. form an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria, based on an evaluation of the conclusions drawn from the evidence obtained; and
- iii. express clearly that opinion through a written report that also describes the basis for that opinion.

Definitions

.06 For purposes of this section, the following terms have the meanings attributed as follows:

Applied criteria. The criteria applied by management in the preparation of the summary financial statements.

Summary financial statements. Historical financial information³ that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time. Summary financial statements are separately presented and are not presented as comparative information.

.07 In this section, the term *audited financial statements* refers to those financial statements⁴ audited by the auditor in accordance with GAAS and from which the summary financial statements are derived.

Requirements

Engagement Acceptance

.08 The auditor should not accept an engagement to report on summary financial statements in accordance with this section unless the auditor has been engaged to conduct an audit in accordance with GAAS of the financial statements from which the summary financial statements are derived. (Ref: par. .A2)

.09 Before accepting an engagement to report on summary financial statements, the auditor should

- a. determine whether the applied criteria are acceptable, including determining that the applied criteria (Ref: par. .A3–.A5)
 - i. are free from bias so that the summary financial statements are not misleading.
 - ii. permit reasonably consistent qualitative or quantitative measurements so that the information in the summary financial statements agrees with or can be recalculated

³ Paragraph .14 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, defines the term *historical financial information*.

⁴ Paragraph .14 of section 200 defines the term *financial statements*.

from the related information in the audited financial statements.

- iii. are sufficiently complete so that the summary financial statements contain the information necessary and are at an appropriate level of aggregation, so that they are not misleading in the circumstances.
 - iv. are relevant to the summary financial statements in view of their purpose.
- b. obtain the agreement of management, in writing, that it acknowledges and understands its responsibility
- i. for the preparation of the summary financial statements in accordance with the applied criteria.
 - ii. to clearly describe in the summary financial statements where the audited financial statements are available and to make the audited financial statements readily available to the intended users of the summary financial statements when the summary financial statements will not be accompanied by the audited financial statements. (Ref: par. .A6–.A7)
 - iii. to provide the auditor with written representations, as described in paragraph .12.
 - iv. to include the auditor's report on the summary financial statements in any document that contains the summary financial statements and indicates the auditor has reported on them.
- c. obtain the agreement of management, in writing, about the expected form and content of the report on the summary financial statements, including the agreement that there may be circumstances in which the report may differ from its expected form and content. (Ref: par. .A8)

.10 If the auditor concludes that the applied criteria are unacceptable or is unable to obtain the agreement of management in accordance with paragraph .09b–c, the auditor should not accept the engagement to report on the summary financial statements. [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Nature of Procedures

.11 The auditor should perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

- a. Evaluate whether the summary financial statements adequately disclose their summarized nature and identify the audited financial statements. (Ref: par. .A9)
- b. When the summary financial statements are not accompanied by the audited financial statements, evaluate
 - i. whether the summary financial statements clearly describe where the audited financial statements are available and

- ii. whether the audited financial statements are readily available to the intended users of the summary financial statements. (Ref: par. .A7)
- c. Evaluate whether the summary financial statements adequately disclose the applied criteria.
- d. Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be recalculated from the related information in the audited financial statements.
- e. Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.
- f. Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so that they are not misleading in the circumstances.

Written Representations

.12 The auditor should request management to provide written representations, in the form of a representation letter addressed to the auditor, for the following matters:

- a. Management has fulfilled its responsibility for the preparation of the summary financial statements in accordance with the applied criteria and believes the applied criteria are acceptable
- b. Management has made the audited financial statements readily available to the intended users of the summary financial statements, when the summary financial statements will not be accompanied by the audited financial statements
- c. If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements,
 - i. whether any information has come to management's attention that would cause management to believe that any of the previous representations on the audited financial statements need to be modified
 - ii. whether any events have occurred subsequent to the date of the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements

.13 The date of the written representations should be as of the date of the auditor's report on the summary financial statements. The written representations should be for all summary financial statements and period(s) referred to in the auditor's report on the summary financial statements.

.14 When the auditor has concluded that an unmodified opinion on the summary financial statements is appropriate, the auditor's opinion should state that the summary financial statements are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report (Ref: par. .A10)

.15 The auditor's report on summary financial statements should include the following elements:

- a. A title that clearly indicates that it is the report of an independent auditor (Ref: par. .A11)
- b. An addressee
- c. Identification of the summary financial statements on which the auditor is reporting, including the title of each statement included in the summary financial statements (Ref: par. .A12)
- d. Identification of the audited financial statements from which the summary financial statements have been derived
- e. Subject to paragraph .19, a clear expression of an opinion, as described in paragraphs .14 and .20
- f. A statement indicating that the summary financial statements do not contain all the disclosures required by the *[financial reporting framework applied in the preparation of the financial statements]* and that reading the summary financial statements and the auditor's report thereon is not a substitute for reading the audited financial statements and the auditor's report thereon
- g. If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, a statement that the summary financial statements and the audited financial statements do not reflect the effects of events, if any, that occurred subsequent to the date of the auditor's report on the audited financial statements (see paragraph .17) (Ref: par. .A13)
- h. Reference to the auditor's report on the audited financial statements, the date of that report, and, subject to paragraphs .19–.20, the fact that an unmodified opinion is expressed on the audited financial statements
- i. A description of management's responsibility for the summary financial statements, explaining that management is responsible for the preparation of the summary financial statements in accordance with the applied criteria
- j. A statement that the auditor is responsible for expressing an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on the procedures required by GAAS and an identification of the United States of America as the country of origin of those standards, including the following:
 - i. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the applied criteria.
 - ii. If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on

the audited financial statements, the auditor did not perform any audit procedures regarding the audited financial statements after the date of the report on those financial statements.

- k. The signature of the auditor's firm
- l. The city and state where the auditor's report is issued
- m. The date of the auditor's report

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.16 The auditor should date the auditor's report on the summary financial statements no earlier than

- a. the date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, including evidence that the summary financial statements have been prepared and that management and, when appropriate, those charged with governance, have asserted that they have taken responsibility for them; and
- b. the date of the auditor's report on the audited financial statements.

[Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.17 When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements, the auditor may become aware of *subsequently discovered facts* as defined in section 560, *Subsequent Events and Subsequently Discovered Facts*. In such cases, the auditor should not release the auditor's report on the summary financial statements until the auditor's consideration of subsequently discovered facts in relation to the audited financial statements, in accordance with section 560, has been completed. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Reference to the Auditor's Report on the Audited Financial Statements (Ref: par. .A14)

.18 If the auditor's report on the audited financial statements contains a qualified opinion, an emphasis-of-matter paragraph, an other-matter paragraph, a going concern section, or communication of key audit matters, and the auditor expresses an unmodified opinion (see paragraph .14) on the summary financial statements, in addition to the elements in paragraph .15, the auditor's report on the summary financial statements should

- a. state that the auditor's report on the audited financial statements contains a qualified opinion, an emphasis-of-matter paragraph, an other-matter paragraph, a going concern section, or communication of key audit matters and
- b. describe
 - i. the basis for the qualified opinion on the audited financial statements and the effect thereof, if any, on the summary financial statements, or
 - ii. the matter referred to in the emphasis-of-matter paragraph, other-matter paragraph, or going concern section in the auditor's report on the audited financial statements and the effect thereof, if any, on the summary financial statements.

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.19 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor should withdraw from the engagement to report on the summary financial statements, when withdrawal is possible under applicable law or regulation. If it is not possible for the auditor to withdraw from the engagement, the auditor's report on the summary financial statements should, in addition to the elements in paragraph .15

- a. state that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion.
- b. describe the basis for that adverse opinion or disclaimer of opinion.
- c. state that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express, and the auditor does not express, an opinion on the summary financial statements.

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Modified Opinion on the Summary Financial Statements

.20 If the summary financial statements are not consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor should express an adverse opinion on the summary financial statements. The auditor should state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section, the summary financial statements are not consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the applied criteria. (Ref: par. .A18) [Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Restriction on Use or Alerting Readers to the Basis of Accounting

.21 When use of the auditor's report on the audited financial statements is restricted or the auditor's report on the audited financial statements alerts readers that the audited financial statements are prepared in accordance with a special purpose framework, the auditor should include a similar restriction or alert in the auditor's report on the summary financial statements.

Comparatives

.22 If the audited financial statements contain comparative financial statements but the summary financial statements do not, the auditor should determine whether such omission is reasonable in the circumstances of the engagement. The auditor should determine the effect of an unreasonable omission on the auditor's report on the summary financial statements. (Ref: par. .A19–.A20)

.23 Unless the predecessor auditor's report on the prior period's summary financial statements is reissued with the summary financial statements, if the summary financial statements contain comparatives that were reported on

by another auditor, the auditor's report on the summary financial statements should state

- a. that the summary financial statements of the prior period were audited by a predecessor auditor.
- b. the type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore.
- c. the date of that report.

.24 If the summary financial statements contain comparatives that were not reported on by the auditor or another auditor, the auditor's report on the summary financial statements should state that the comparative summary financial statements were not reported on by the auditor and, accordingly, the auditor does not express an opinion on the comparative summary financial statements.

Unaudited Information Presented With Summary Financial Statements (Ref: par. .A21)

.25 The auditor should evaluate whether any unaudited information presented with the summary financial statements is clearly differentiated from the summary financial statements. If the auditor concludes that the entity's presentation of the unaudited information is not clearly differentiated from the summary financial statements, the auditor should ask management to change the presentation of the unaudited information. If management refuses to do so, the auditor should explain in the auditor's report on the summary financial statements that such information is not covered by that report and accordingly, the auditor does not express an opinion on the information.

Information in Documents Containing Summary Financial Statements (Ref: par. .A22)

.26 The auditor should read the information included in a document containing the summary financial statements and the auditor's report thereon and consider whether a material inconsistency exists between that information and the summary financial statements. [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.27 If, upon reading the other information, the auditor identifies that a material inconsistency appears to exist or becomes aware that the other information appears to be materially misstated, the auditor should discuss the matter with management and should consider appropriate further action in the circumstances. For an identified material inconsistency, the auditor should also determine whether the summary financial statements or the other information needs to be revised. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137.]

Auditor Association (Ref: par. .A23)

.28 If the auditor becomes aware that the entity plans to state that the auditor has reported on summary financial statements in a document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor should request management to include the auditor's report in the document. If management does not do so, the auditor should determine and carry out other appropriate actions designed to prevent

management from inappropriately associating the auditor with the summary financial statements in that document.

.29 The auditor may be engaged to report on the financial statements of an entity, while not engaged to report on the summary financial statements. If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and the fact that summary financial statements are derived from the financial statements audited by the auditor, the auditor should be satisfied that

- a.* the reference to the auditor is made in the context of the auditor's report on the audited financial statements, and
- b.* the statement does not give the impression that the auditor has reported on the summary financial statements.

If either *a* or *b* is not met, the auditor should request management to change the statement to meet both of the criteria in *a* and *b*, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the related auditor's report in the document. If management does not change the statement, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, the auditor should advise management that the auditor disagrees with the reference to the auditor, and the auditor should determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02)

.A1 Financial statements may present comparative information in the form of condensed financial statements or summarized financial information. For example, entities such as state and local governmental units may present prior period financial information in their government-wide financial statements only for the total reporting entity rather than disaggregated by governmental activities, business-type activities, total primary government, and discretely presented component units. Also, not-for-profit organizations frequently present certain information for the prior period in total rather than by net asset class. As described in paragraph .02, this section does not apply to reporting on financial statements containing such comparative information. Summary financial statements differ from comparative information. Summary financial statements may be presented in a document containing financial statements or in a separate document, whereas comparative information is presented within the financial statements.^[5] [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

Engagement Acceptance

.A2 The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities regarding the summary financial statements, in accordance with this section. Application of this section will

^[5] [Footnote deleted by the issuance of SAS No. 139, March 2020.]

not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor also has not audited the financial statements from which the summary financial statements are derived. (Ref: par. .08)

Criteria (Ref: par. .09a)

.A3 The preparation of summary financial statements requires management to determine the information that needs to be reflected in the summary financial statements so that they are consistent, in all material respects, with the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure, there is an increased risk that they may not contain the information necessary so that they are not misleading in the circumstances. This risk increases when established criteria for the preparation of summary financial statements do not exist.

.A4 Factors that may affect the auditor's determination of the acceptability of the applied criteria include the following:

- The nature of the entity
- The purpose of the summary financial statements
- The information needs of the intended users of the summary financial statements
- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances

.A5 The criteria for the preparation of summary financial statements may be established by an authorized or recognized standards-setting organization or by law or regulation. In many such cases, the auditor may presume that such criteria are acceptable. When established criteria for the preparation of summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry.

Availability of the Audited Financial Statements (Ref: par. .09b(ii) and .11b(ii))

.A6 Summary financial statements are presented in considerably less detail than the complete set of financial statements and do not contain all the disclosures required by the financial reporting framework applied in the preparation of the complete set of financial statements. In addition, reading the summary financial statements is not a substitute for reading the audited financial statements. Accordingly, before accepting an engagement to report on summary financial statements, the auditor is required by paragraph .09b(ii) to obtain management's agreement that it acknowledges and understands its responsibility to make the audited financial statements readily available to the intended users of the summary financial statements, when the summary financial statements will not be accompanied by the audited financial statements.

.A7 Audited financial statements are deemed to be readily available if a third-party user can obtain the audited financial statements without any further action by the entity (for example, financial statements on an entity's website may be considered readily available but being available upon request is not considered readily available).

Agreement on the Expected Form and Content of the Report (Ref: par. .09c)

.A8 Agreement with management about the expected form and content of the report on the summary financial statements may include a description of

the types of opinions the auditor may express. It is not necessary to describe the type of opinion expected to be issued. The auditor also may indicate that circumstances may arise in which it is necessary for the auditor to withdraw from the engagement.

Nature of Procedures (Ref: par. .11)

.A9 Adequate disclosure of the summarized nature of summary financial statements and the identity of the audited financial statements, as referred to in paragraph .11a, may, for example, be provided by a title such as "Summary Financial Statements Prepared From the Audited Financial Statements as of and for the Year Ended December 31, 20X1."

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report (Ref: par. .15)

.A10 An auditor who is engaged to report on summary financial statements does not report in the same manner as the auditor reported on the complete set of financial statements from which they are derived. To do so might lead users to assume, erroneously, that the summary financial statements include all the disclosures necessary for the complete set of financial statements. For the same reason, summary financial statements need to adequately disclose their summarized nature, as referred to in paragraphs .11a and .A9. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Title (Ref: par. .15a)

.A11 A title that includes the word *independent* to clearly indicate the report is the report of an independent auditor (for example, *Report of the Independent Auditor*) affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Identification of the Summary Financial Statements (Ref: par. .15c)

.A12 When the auditor is aware that the summary financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented. This helps readers identify the summary financial statements that relate to the auditor's report. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Date of the Auditor's Report on the Summary Financial Statements and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements (Ref: par. .15c(iv))

.A13 The auditor's report on the summary financial statements may be dated as of the same date or later than the date of the auditor's report on the audited financial statements, depending on when the procedures in paragraph .11 are performed and, as required by paragraph .16, when the auditor has obtained sufficient appropriate evidence on which to base the opinion. When the auditor reports on the summary financial statements after the completion of the financial statement audit, the auditor is not required to obtain additional audit evidence on the audited financial statements, or report on the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements because the summary financial statements are

derived from the audited financial statements and do not update them. In such cases, however, paragraph .15c(iv) requires the auditor's report to state that the summary financial statements and the audited financial statements do not reflect the effects of events, if any, that occurred subsequent to the date of the auditor's report on the audited financial statements. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Reference to the Auditor's Report on the Audited Financial Statements **(Ref: par. .18)**

.A14 If the auditor's report on the audited financial statements contains a qualified opinion, the auditor may determine that, due to the effect on the summary financial statements, it is inappropriate to express an opinion on the summary financial statements. In such circumstances, the auditor may adapt and apply the requirement in paragraph .19. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A15 Paragraph .18a requires the auditor to include a statement in the auditor's report on the summary financial statements when the auditor's report on the audited financial statements includes communication of one or more key audit matters in accordance with section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. However, the auditor is not required to describe the individual key audit matters in the auditor's report on the summary financial statements. [Paragraph added, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.A16 The statements and descriptions required by paragraph .18 are intended to draw attention to those matters and are not a substitute for reading the auditor's report on the audited financial statements. The required descriptions are intended to convey the nature of the matters and need not repeat the corresponding text in the auditor's report on the audited financial statements in its entirety. [Paragraph added, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

.A17 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, paragraph .19 requires the auditor to withdraw from the engagement to report on the summary financial statements, when withdrawal is possible under applicable law or regulation. When an entity is required by law or regulation to provide a report on summary financial statements, the auditor is neither precluded from withdrawing, nor required to withdraw, from the engagement. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Modified Opinion on the Summary Financial Statements **(Ref: par. .20)**

.A18 If the summary financial statements are not consistent, in all material respects, with the audited financial statements in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor is required by paragraph .20 to express an adverse opinion on the summary financial statements. Due to the summarized nature of the summary financial statements, a qualified opinion would not be appropriate; the summary financial statements either are or are not consistent, in all material

respects, with the audited financial statements, in accordance with the applied criteria. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Comparatives (Ref: par. .22)

.A19 If the audited financial statements contain comparative financial statements, a presumption exists that the summary financial statements also would contain comparatives. Section 700 addresses the auditor's responsibilities regarding comparative financial statements in an audit of financial statements.⁶ [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A20 Circumstances that may affect the auditor's determination whether an omission of comparatives is reasonable include:

- The nature and objective of the summary financial statements
- The applied criteria
- The information needs of the intended users of the summary financial statements

[Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Unaudited Information Presented With Summary Financial Statements (Ref: par. .25)

.A21 Section 700 contains a requirement and guidance related to information presented in the financial statements that is not required by the applicable financial reporting framework.⁷ Such requirement and guidance, adapted as necessary in the circumstances, may be helpful in applying the requirement in paragraph .25. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Other Information in Documents Containing Summary Financial Statements (Ref: par. .26–.27)

.A22 Section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, contains requirements and guidance relating to reading other information included in an entity's annual report and responding when a material inconsistency appears to exist or other information appears to be materially misstated. Adapted as necessary in the circumstances, these requirements and related guidance may be helpful in applying the requirements in paragraphs .26–.27. [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 137. Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

Auditor Association (Ref: par. .28–.29)

.A23 Other appropriate actions the auditor may take when management does not take the requested action may include informing the intended users and other known third-party users of the inappropriate reference to the auditor,

⁶ Paragraphs .45–.52 of section 700. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

⁷ Paragraph .59 of section 700. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Footnote renumbered by the issuance of SAS No. 139, March 2020.]

including that the auditor did not report, and does not express an opinion on, the summary financial statements. The auditor's course of action depends on the auditor's association with misleading information and the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice. [Paragraph renumbered by the issuance of SAS No. 139, March 2020.]

.A24

Exhibit — Illustrations of Reports on Summary Financial Statements

Illustration 1 — An Unmodified Opinion Is Expressed on the Summary Financial Statements (the Auditor's Report on the Summary Financial Statements Is Dated Later Than the Date of the Auditor's Report on the Financial Statements From Which the Summary Financial Statements Are Derived)

Illustration 2 — An Unmodified Opinion Is Expressed on the Summary Financial Statements and a Qualified Opinion Is Expressed on the Audited Financial Statements

Illustration 3 — An Adverse Opinion Is Expressed on the Audited Financial Statements (as a Result of the Adverse Opinion on the Audited Financial Statements, It Is Inappropriate to Express, and the Auditor Does Not Express, an Opinion on the Summary Financial Statements)

Illustration 4 — An Adverse Opinion Is Expressed on the Summary Financial Statements Because They Are Not Consistent, in All Material Respects, With the Audited Financial Statements, in Accordance With the Applied Criteria

Illustration 1 — An Unmodified Opinion Is Expressed on the Summary Financial Statements (the Auditor's Report on the Summary Financial Statements Is Dated Later Than the Date of the Auditor's Report on the Financial Statements From Which the Summary Financial Statements Are Derived)

Circumstances include all of the following:

- An unmodified opinion is expressed on the audited financial statements.
- Criteria are developed by management for the preparation of the summary financial statements and are adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.
- An unmodified opinion is expressed on the summary financial statements.
- The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which the summary financial statements are derived.^{1, 2}

Independent Auditor's Report on Summary Financial Statements

[Appropriate Addressee]

Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those audited financial statements in our report dated February 15, 20X2.

In our opinion, the accompanying summary financial statements of ABC Company as of and for the year ended December 31, 20X1 referred to above are consistent, in all material respects, with the audited financial statements from which they have been derived, on the basis described in Note X.

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by *[describe financial reporting framework applied in the preparation of the financial statements of ABC Company]*. Reading the summary financial statements and the auditor's report hereon, therefore, is not a substitute for reading

¹ If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, the following statement is added to the Summary Financial Statements section of the report: "The audited financial statements, and the summary financial statements derived therefrom, do not reflect the effects of events, if any, that occurred subsequent to the date of our report on the audited financial statements." [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

² If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, the following statement is added to the Auditor's Responsibility section of the report: "We did not perform any audit procedures regarding the audited financial statements after the date of the report on those financial statements." [As amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

the audited financial statements and the auditor's report thereon. The summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of our report on the audited financial statements.

Responsibility of Management for the Summary Financial Statements

Management is responsible for the preparation of the financial statements in accordance with the criteria described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the basis described in Note X. We did not perform any audit procedures regarding the audited financial statements after the date of our report on those financial statements.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — An Unmodified Opinion Is Expressed on the Summary Financial Statements and a Qualified Opinion Is Expressed on the Audited Financial Statements

Circumstances include all of the following:

- A qualified opinion is expressed on the audited financial statements.
- Criteria are developed by management for the preparation of the summary financial statements and are adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.
- An unmodified opinion is expressed on the summary financial statements.
- The auditor's report on the summary financial statements is dated the same as the date of the auditor's report on the financial statements from which the summary financial statements are derived.

Independent Auditor's Report on Summary Financial Statements

[Appropriate Addressee]

Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1. We expressed a qualified audit opinion on those audited financial statements in our report dated February 15, 20X2 (see below).

In our opinion, the accompanying summary financial statements of ABC Company as of and for the year ended December 31, 20X1, referred to above are consistent, in all material respects, with the audited financial statements from which they have been derived, in accordance with the criteria described in Note X.

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in the preparation of the financial statements of ABC Company]. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon.

The Audited Financial Statements and Our Report Thereon

The basis for our qualified audit opinion was that management has not stated the inventories at the lower of cost or net realizable value but has stated them solely at cost, which constitutes a departure from [describe financial reporting framework applied in the preparation of the financial statements of ABC Company]. The Company's records indicate that, had management stated the inventories at the lower of cost or net realizable value, an amount of \$XXX would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by \$XXX, and income tax, net income, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, respectively.

Responsibilities of Management for the Summary Financial Statements

Management is responsible for the preparation of the summary financial statements in accordance with the criteria described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the basis described in Note X.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 3 — An Adverse Opinion Is Expressed on the Audited Financial Statements (as a Result of the Adverse Opinion on the Audited Financial Statements, It Is Inappropriate to Express, and the Auditor Does Not Express, an Opinion on the Summary Financial Statements)

Circumstances include both of the following:

- An adverse opinion is expressed on the audited financial statements. As a result of the adverse opinion on the audited financial statements, it is inappropriate to express, and the auditor does not express, an opinion on the summary financial statements, as described in paragraph .19.
- Criteria are developed by management for the preparation of the summary financial statements and are adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.
- The auditor's report on the summary financial statements is dated the same as the date of the auditor's report on the financial statements from which the summary financial statements are derived.

Independent Auditor's Report on Summary Financial Statements

[Appropriate Addressee]

Disclaimer of Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1.

As a result of the adverse opinion on the audited financial statements discussed in the Audited Financial Statements and Our Report Thereon section of our report, it is inappropriate to express, and we do not express, an opinion on the accompanying summary financial statements.

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by *[describe financial reporting framework applied in the preparation of the audited financial statements of ABC Company]*. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon.

The Audited Financial Statements and Our Report Thereon

In our report dated February 15, 20X2, we expressed an adverse audit opinion on the financial statements of ABC Company as of and for the year ended December 31, 20X1. The basis for our adverse audit opinion was *[describe basis for adverse audit opinion]*. Our adverse audit opinion stated that *[describe adverse audit opinion]*.

Responsibility of Management for the Summary Financial Statements

Management is responsible for the preparation of these summary financial statements on the basis described in Note X.

Auditor's Responsibility

We were engaged to express an opinion on whether the summary financial statements are consistent, in all material respects, with the audited financial

statements based on our procedures, which were conducted in accordance with auditing standards generally accepted in the United States of America. However, as a result of the adverse opinion on the audited financial statements as discussed above, we do not express an opinion on the accompanying summary financial statements.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 4 — An Adverse Opinion Is Expressed on the Summary Financial Statements Because They Are Not Consistent, in All Material Respects, With the Audited Financial Statements, in Accordance With the Applied Criteria

Circumstances include all of the following:

- An unmodified opinion is expressed on the audited financial statements.
- Established criteria for the preparation of summary financial statements exist.
- The auditor expresses an adverse opinion on the summary financial statements because they are not consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria.
- The auditor's report on the summary financial statements is dated the same as the date of the auditor's report on the financial statements from which the summary financial statements are derived.

Independent Auditor's Report on Summary Financial Statements

[Appropriate Addressee]

Adverse Opinion

The summary financial statements, which comprise the summary balance sheet as of December 31, 20X1, the summary income statement, summary statement of changes in stockholders' equity, and summary cash flow statement for the year then ended, and the related notes, are derived from the audited financial statements of ABC Company as of and for the year ended December 31, 20X1. We expressed an unmodified audit opinion on those audited financial statements in our report dated February 15, 20X2.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section, the summary financial statements of ABC Company as of and for the year ended December 31, 20X1 referred to above are not consistent with the audited financial statements from which they have been derived, on the basis described in Note X.

Basis for Adverse Opinion

[Describe matter that caused the summary financial statements not to be consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria.]

Summary Financial Statements

The summary financial statements do not contain all the disclosures required by *[describe financial reporting framework applied in the preparation of the financial statements of ABC Company]*. Reading the summary financial statements and the auditor's report thereon, therefore, is not a substitute for reading the audited financial statements and the auditor's report thereon.

Responsibilities of Management for the Summary Financial Statements

Management is responsible for the preparation of the summary financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion about whether the summary financial statements are consistent, in all material respects, with the audited financial statements based on our procedures, which were conducted in accordance

with auditing standards generally accepted in the United States of America. The procedures consisted principally of comparing the summary financial statements with the related information in the audited financial statements from which the summary financial statements have been derived and evaluating whether the summary financial statements are prepared in accordance with the basis described in Note X.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Paragraph renumbered and amended, effective for engagements to report on summary financial statements for periods ending on or after December 15, 2021, by SAS No. 139.]

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AU-C Section 905

Alert That Restricts the Use of the Auditor's Written Communication

Source: SAS No. 125; SAS 130.

Effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012. For all other engagements conducted in accordance with GAAS, this section is effective for the auditor's written communications issued on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility, when required or the auditor decides, to include in the auditor's report or other written communication issued by the auditor in connection with an engagement conducted in accordance with generally accepted auditing standards (GAAS) (hereinafter referred to in this section as auditor's written communication) language that restricts the use of the auditor's written communication. This language is referred to in this section as an alert. In an auditor's report, such language is included in an other-matter paragraph. (Ref: par. .A1 and .A3)

.02 Appendix A, "List of AU-C Sections Relating to the Restricted Use of the Auditor's Written Communication," identifies sections that contain specific requirements to include an alert that restricts the use of the auditor's written communication or that otherwise address the inclusion of such alerts. Accordingly, the requirements in this section regarding the form of such alert apply. (Ref: par. .A2)

Effective Date

.03 This section is effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012. For all other engagements conducted in accordance with GAAS, this section is effective for the auditor's written communications issued on or after December 15, 2012.

Objective

.04 The objective of the auditor is to restrict the use of the auditor's written communication by including an alert when the potential exists for the auditor's written communication to be misunderstood if taken out of the context in which the auditor's written communication is intended to be used.

Definition

.05 For purposes of GAAS, the following term has the meaning attributed as follows:

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

Requirements

Alert That Restricts the Use of the Auditor's Written Communication

.06 The auditor's written communication should include an alert, in a separate paragraph, that restricts its use when the subject matter of the auditor's written communication is based on (Ref: par. .A2-.A3)

- a. measurement or disclosure criteria that are determined by the auditor to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria,
- b. measurement or disclosure criteria that are available only to the specified parties, or
- c. matters identified by the auditor during the course of the audit engagement when the identification of such matters is not the primary objective of the audit engagement (commonly referred to as a by-product report). (Ref: par. .A4-.A7)

.07 Unless specified otherwise by this section or other relevant sections, the alert that restricts the use of the auditor's written communication required by paragraph .06 should

- a. state that the auditor's written communication is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended. In situations covered by paragraph .06c, the specified parties should only include management, those charged with governance, others within the entity, the parties to the contract or agreement, or the regulatory agencies to whose jurisdiction the entity is subject, as appropriate in the circumstances.
- c. state that the auditor's written communication is not intended to be and should not be used by anyone other than the specified parties. (Ref: par. .A8-.A9)

Adding Other Specified Parties (Ref: par. .A10)

.08 When, in accordance with paragraph .06, the auditor includes an alert that restricts the use of the auditor's written communication to certain specified parties, and the auditor is requested to add other parties as specified parties, the auditor should determine whether to agree to add the other parties as specified parties. In situations covered by paragraph .06c, the auditor should not agree to add as specified parties any other parties not described in paragraph .07b.

.09 When the auditor agrees to add other parties as specified parties, the auditor should obtain affirmative acknowledgment, in writing, from the other parties of their understanding of

- a. the nature of the engagement resulting in the auditor's written communication,
- b. the measurement or disclosure criteria related to the subject matter of the auditor's written communication, and
- c. the auditor's written communication.

.10 If the other parties are added after the release of the auditor's written communication, in addition to the requirements of paragraph .09, the auditor should take one of the following actions:

- a. Amend the auditor's written communication to add the other parties. In such circumstances, the auditor should not change the original date of the auditor's written communication.
- b. Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties. The auditor should state in the acknowledgment that no procedures were performed subsequent to the original date of the auditor's written communication or the date that the engagement was completed, as appropriate.

Alert for Engagements Performed in Accordance With Government Auditing Standards (Ref: par. .A11)

.11 The alert language required by paragraph .07 should not be used when

- a. the engagement is performed in accordance with *Government Auditing Standards*, and
- b. the auditor's written communication pursuant to that engagement is issued in accordance with
 - i. section 265, *Communicating Internal Control Related Matters Identified in an Audit*;
 - ii. section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*;
 - iii. section 935, *Compliance Audits*; or
 - iv. section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*.

Instead, the alert required by paragraph .06 should

- a. describe the purpose of the auditor's written communication and
- b. state that the auditor's written communication is not suitable for any other purpose.

[As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130.]

Application and Other Explanatory Material

Alert That Restricts the Use of the Auditor's Written Communication (Ref: par. .01-.02 and .06)

.A1 In addition to auditor's reports, auditor's written communications may include letters or presentation materials (for example, letters communicating internal control related matters or presentations addressing communications with those charged with governance).

.A2 Certain sections, identified in appendix A, contain specific requirements to include an alert that restricts the use of the auditor's written communication or that otherwise address the inclusion of such alerts. The need for an alert that restricts the use of the auditor's written communication arises from the potential for the auditor's written communication to be misunderstood if

taken out of the context in which the auditor's written communication is intended to be used. The context in which the auditor's written communication is intended to be used may consist of a number of circumstances, including

- the purpose of the auditor's written communication;
- the nature of the procedures applied in its preparation;
- the basis of, or assumptions used in, its preparation; and
- the extent to which the procedures performed generally are known or understood.

.A3 Auditor's reports on financial statements prepared in accordance with a general purpose framework ordinarily do not include an alert that restricts their use. However, nothing in GAAS precludes an auditor from including such an alert in any auditor's report or other auditor's written communication. For example, financial statements prepared specifically for use in connection with an acquisition may be prepared in accordance with a general purpose framework because the parties involved in the transaction have agreed that such general purpose financial statements are appropriate for their purposes. Nevertheless, when the terms of the engagement to audit those financial statements require the auditor to supply the auditor's report only to specified parties, the auditor may consider it necessary in the circumstances to include an other-matter paragraph in the auditor's report that restricts the use of the auditor's report.¹

.A4 The subject matter of the auditor's written communication may be based on matters identified by the auditor during the course of the audit engagement when identification of such matters is not the primary objective of the audit engagement (commonly referred to as a by-product report) (for example, communication about internal control or compliance related matters identified in an audit of financial statements, the primary objective of which is to express an opinion on the financial statements). Because such communication can only be understood in relation to the primary objective of the audit engagement, it may be misinterpreted or misunderstood. Accordingly, paragraph .06c requires such auditor's written communication to include an alert that restricts its use.

Alert That Restricts the Use of the Auditor's Written Communication Included in General Use Communications

.A5 An auditor's written communication that is required by paragraph .06 to include an alert that restricts its use may be included in a document that also contains an auditor's written communication that is for general use. In such circumstances, the use of the general use communication is not affected.

.A6 An auditor may also issue a single combined auditor's written communication that includes (a) communications that are required by paragraph .06 to include an alert that restricts their use and (b) communications that are for general use. If these two types of communications are clearly differentiated within the combined communication, such as through the use of appropriate headers, the alert that restricts the use of the auditor's written communication may be limited to the communications required by paragraph .06 to include such an alert. In such circumstances, the use of the general use communication is not affected. An example of a single combined auditor's written communication addressing a matter that was not the primary objective of the audit engagement

¹ Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

that is included in a general use communication is provided in the exhibit "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements," of section 806.²

Distribution of the Auditor's Written Communication

.A7 An auditor is not responsible for controlling, and cannot control, distribution of the auditor's written communication after its release. The alert that restricts the use of the auditor's written communication is designed to avoid misunderstandings related to the use of the auditor's written communication, particularly if the auditor's written communication is taken out of the context in which the auditor's written communication is intended to be used. An auditor may consider informing the entity or other specified parties that the auditor's written communication is not intended for distribution to parties other than those specified in the auditor's written communication. The auditor may, in connection with establishing the terms of the engagement, reach an understanding with the entity that the intended use of the auditor's written communication will be restricted and may obtain the entity's agreement that the entity and specified parties will not distribute such auditor's written communication to parties other than those identified therein.

Illustrative Alert Language (Ref: par. .07)

.A8 The alert that restricts the use of the auditor's written communication may list the specified parties or refer to the specified parties listed elsewhere in the auditor's written communication. The following illustrates language that includes the elements required by paragraph .07:

This [report, letter, presentation, or communication] is intended solely for the information and use of [list or refer to the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

.A9 Other sections, such as section 920, *Letters for Underwriters and Certain Other Requesting Parties*, may include specific requirements relating to the matters to be included in the alert that restrict the use of the auditor's written communication, as required by paragraph .06, including identifying the specified parties.

Adding Other Specified Parties (Ref: par. .08-.10)

.A10 When the auditor is requested to add other parties as specified parties, the auditor may agree to add the other parties as specified parties based on the auditor's consideration of factors such as the identity of the other parties and the intended use of the auditor's written communication.

Alert for Engagements Performed in Accordance With Government Auditing Standards (Ref: par. .11)

.A11 *Government Auditing Standards* regard the auditor's written communications issued pursuant to the sections, identified in paragraph .11, to be an integral part of the audit engagement for the purpose of assessing the

² Illustration 5, "Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified," in the exhibit "Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements," of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*.

results of the engagement. Accordingly, different alert language is used. The following illustrates language that includes the elements of the alert required by paragraph .11:

The purpose of this *[report, letter, presentation, or communication]* is solely to *[describe the purpose of the auditor's written communication, such as to describe the scope of our testing of internal control over financial reporting and compliance, and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control over financial reporting or on compliance]*. This *[report, letter, presentation, or communication]* is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering *[describe the results that are being assessed, such as the entity's internal control over financial reporting and compliance]*. Accordingly, this *[report, letter, presentation, or communication]* is not suitable for any other purpose.

.A12

Appendix A—List of AU-C Sections Relating to the Restricted Use of the Auditor's Written Communication

This appendix identifies paragraphs in other sections that contain specific requirements to include an alert that restricts the use of the auditor's written communication or that otherwise address the inclusion of such alerts. The list is not a substitute for considering the requirements and related application and other explanatory material in the other sections.

- Paragraph .17 of section 260, *The Auditor's Communication With Those Charged With Governance*
 - Paragraphs .14d, .A32, and .A38–.A39 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
 - Paragraph .A16 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
 - Paragraphs .20, .A26–.A27, and .A33 of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
 - Paragraphs .12–.13 and .A6–.A8 of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
 - Paragraphs .14f and .A6 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*
 - Paragraphs .33 and .A34 of section 920, *Letters for Underwriters and Certain Other Requesting Parties*
 - Paragraphs .30, .31i, and .A33 of section 935, *Compliance Audits*
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AU-C Section 910

Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

Source: SAS No. 124; SAS No. 134; SAS No. 138; SAS No. 140.

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

Introduction

Scope of This Section

.01 This section addresses circumstances in which an auditor practicing in the United States is engaged to report on financial statements that have been prepared in accordance with a financial reporting framework generally accepted in another country not adopted by a body designated by the Council of the AICPA (Council) to establish generally accepted accounting principles (GAAP) (hereinafter referred to as a financial reporting framework generally accepted in another country) when such audited financial statements are intended for use outside the United States. This section is not intended to preclude the use of such audited financial statements in the United States.

.02 Pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001), the Council designates the bodies to establish GAAP. This section does not apply to financial statements prepared in accordance with financial reporting frameworks established by the bodies designated by the Council. Section 700, *Forming an Opinion and Reporting on Financial Statements*, applies to engagements to report on such financial statements, including financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.03 This section is applicable to engagements to report on financial statements prepared in accordance with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement in an appropriate note to the financial statements that its financial statements are in compliance with IFRS as promulgated by the IASB.

.04 This section does not apply to engagements to report on financial statements of a U.S. subsidiary of a foreign registrant parent company that are presented in the parent company's filing with the U.S. Securities and Exchange Commission when the subsidiary's financial statements have been prepared in accordance with a financial reporting framework used by the parent company and audited in accordance with auditing standards generally accepted in the United States of America (GAAS).

Effective Date

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

Objective

.06 The objective of the auditor, when engaged to report on financial statements prepared in accordance with a financial reporting framework generally accepted in another country, when such audited financial statements are intended for use outside the United States, is to address appropriately the special considerations that are relevant to

- a. the acceptance of the engagement,
- b. the planning and performance of the engagement, and
- c. forming an opinion and reporting on the financial statements.

Requirements

Considerations When Accepting the Engagement (Ref: par. .A1)

.07 Section 210A, *Terms of Engagement*, requires the auditor, as part of establishing whether the preconditions for an audit are present prior to accepting the engagement, to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements.¹ In an audit of financial statements prepared in accordance with a financial reporting framework generally accepted in another country, the auditor should obtain an understanding of

- a. The purpose for which the financial statements are prepared and whether the financial reporting framework applied in the preparation of the financial statements is a fair presentation framework.
- b. The intended users of the financial statements.
- c. The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

.08 When the auditor plans to use the form and content of the auditor's report of another country, the auditor should obtain an understanding of the applicable legal responsibilities involved. (Ref: par. .A8)

Performance (Ref: par. .A2–.A3)

.09 When auditing financial statements prepared in accordance with a financial reporting framework generally accepted in another country that are intended for use only outside the United States, the auditor should comply with GAAS, except for requirements related to the form and content of the report in the situation described in paragraph .12. The auditor should determine whether the application of GAAS requires special consideration in the circumstances of the engagement.

.10 Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatements*, requires the auditor to obtain an

¹ See paragraph .06 of section 210A, *Terms of Engagement*.

understanding of the entity's selection and application of accounting policies.² When reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country, the auditor should obtain an understanding of such framework.

Application of Auditing Standards of Another Country

.11 If the auditor is engaged to audit financial statements prepared in accordance with a financial reporting framework generally accepted in another country, and the agreed-upon terms of engagement require the auditor to apply either the auditing standards of that country or International Standards on Auditing (ISAs), the auditor should obtain an understanding of and apply those relevant auditing standards, as well as GAAS, except for requirements related to the form and content of the report in the situation described in paragraph .12. (Ref: par. .A4–.A6)

Reporting

Reporting—Use Only Outside the United States

.12 If the auditor is reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country that are intended for use only outside the United States, the auditor should report using either

- a. a U.S. form of report that reflects that the financial statements being reported on have been prepared in accordance with a financial reporting framework generally accepted in another country, including (Ref: par. .A7)
 - i. the elements required by section 700 and
 - ii. a statement that refers to the note to the financial statements that describes the basis of presentation of the financial statements on which the auditor is reporting, including identification of the country of origin of the accounting principles, or
- b. the report form and content of the other country (or, if applicable, as set forth in the ISAs), provided that
 - i. such a report would be issued by auditors in the other country in similar circumstances,
 - ii. the auditor understands and has obtained sufficient appropriate audit evidence to support the statements contained in such a report, and
 - iii. the auditor has complied with the reporting standards of that country and identifies the other country in the report. (Ref: par. .A8–.A9)

Reporting—Use in the United States

.13 If financial statements prepared in accordance with a financial reporting framework generally accepted in another country also are intended for use in the United States, the auditor should report using the U.S. form of report.³

² See paragraph .12(c) of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

³ See section 700, *Forming an Opinion and Reporting on Financial Statements*.

In addition, the auditor should include in the auditor's report an emphasis-of-matter paragraph⁴ that

- a. identifies the financial reporting framework used in the preparation of the financial statements,
- b. refers to the note to the financial statements that describes that framework, and
- c. indicates that such framework differs from accounting principles generally accepted in the United States of America. (Ref: par. .A7 and .A10)

Application and Other Explanatory Material

Considerations When Accepting the Engagement (Ref: par. .07–.08)

.A1 In obtaining an understanding of the purpose for which the financial statements are prepared and of the intended users, the auditor may consider whether the intended users are likely to be familiar with the applicable financial reporting framework. For example, if the financial statements are to be used in the United States in addition to the other country(ies) for which they are intended, the auditor may consider whether intended users within the United States deal directly with the entity and whether the financial statements are to be used in a manner that permits such users to discuss with the entity differences from accounting and reporting practices in the United States and their significance. Accordingly, an auditor may conclude that financial statements prepared in accordance with a financial reporting framework generally accepted in another country are not appropriate for use in a private placement memorandum to be distributed widely in the United States.

Performance (Ref: par. .09–.10)

.A2 The accounting principles used to prepare financial statements in accordance with a financial reporting framework generally accepted in another country may differ from those used to prepare financial statements in accordance with accounting principles generally accepted in the United States of America, and such differences may affect the auditor's risk assessment and design of further audit procedures. For example, the financial reporting framework generally accepted in another country may require that certain assets be revalued to adjust for the effects of inflation—in which case, the auditor may find it necessary to perform procedures to test the revaluation adjustments. As another example, a particular country's financial reporting framework may not require or permit recognition of deferred taxes; consequently, procedures for testing deferred tax balances would not be applicable.

.A3 An understanding of the financial reporting framework generally accepted in another country may be obtained by reading the statutes or professional literature, or codifications thereof, which establish or describe the financial reporting framework generally accepted in the other country. Often, the application of accounting principles to a particular situation requires practical experience, and accordingly, the auditor may consult with persons having expertise in applying the financial reporting framework of the other country.

⁴ See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

Application of Auditing Standards of Another Country (Ref: par. .11)

.A4 Applying either the auditing standards of another country or the ISAs may require the auditor to perform procedures in addition to those procedures required by GAAS.

.A5 An understanding of the auditing standards of another country or the ISAs may be obtained by reading the statutes or professional literature, or codifications thereof, which establish or describe such standards.

.A6 Statutes or professional literature, or codifications thereof, however, may not include a complete description of the auditing practices in another country. The auditor may consult with persons having expertise in, including practical experience in applying, the auditing standards of the other country or the ISAs, as relevant.

Reporting (Ref: par. .08 and .12–.13)

.A7 The exhibit "Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country" contains illustrations of auditor's reports on financial statements incorporating the elements required by paragraphs .12–.13.

Reporting—Use Only Outside the United States (Ref: par. .08 and .12)

.A8 Even when the form and content of the auditor's report used in another country appears similar to that used in the United States, the report may convey a different meaning and entail different legal responsibilities for the auditor due to custom or culture. Issuing a report of another country may require the auditor to report on statutory compliance or otherwise require understanding of local laws and regulations. When issuing the auditor's report of another country, the auditor is required by paragraph .08 to obtain an understanding of applicable legal responsibilities, in addition to the auditing standards and the financial reporting framework generally accepted in the other country, as required by paragraphs .07 and .10–.11. Accordingly, depending on the nature and extent of the auditor's knowledge and experience, the auditor may consult with persons having expertise in the audit reporting practices of the other country and associated legal responsibilities to obtain the understanding needed to issue that country's report.

.A9 An entity that prepares financial statements in accordance with GAAP also may prepare financial statements in accordance with a financial reporting framework generally accepted in another country for use outside the United States (for example, financial statements prepared in accordance with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement of compliance with IFRS as issued by the IASB). In such circumstances, the auditor may report on the financial statements that are in accordance with a financial reporting framework generally accepted in another country by reporting in accordance with paragraph .12. The auditor may include in one or both of the reports a statement that another report has been issued on the financial statements for the entity that have been prepared in accordance with a financial reporting framework generally accepted in another country. The auditor's statement may also reference any note disclosure in the financial statements that describes significant differences between the accounting principles used and GAAP. An example of

such a statement, which may be included in an emphasis-of-matter paragraph, is as follows:

We also have reported separately on the financial statements of ABC Company for the same period presented in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*. (The significant differences between the *[specify the financial reporting framework generally accepted]* in *[name of country]* and accounting principles generally accepted in the United States of America are summarized in Note X.)

Reporting—Use in the United States (Ref: par. .13)

.A10 When reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country that will be used in the United States and outside the United States, the auditor may issue two reports: one of the reports described in paragraph .12 for use outside the United States and the U.S. form of report with an emphasis-of-matter paragraph, as described in paragraph .13, for use in the United States.

.A11

Exhibit — Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country (Ref: par. .A7)

Illustration 1 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

Illustration 2 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

Illustration 1 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

Independent Auditor's Report

[Appropriate Addressee]

Opinion on the Financial Statements

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of *[specify the financial reporting framework generally accepted]* in *[name of country]*.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) (and in *[name of country]*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.¹
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

¹ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

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

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

Independent Auditor's Report

[Appropriate Addressee]

Opinion on the Financial Statements

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of *[specify the financial reporting framework generally accepted]* in *[name of country]*.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) (and in *[name of country]*). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the Company prepares its financial statements in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*, which differ(s) from accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS

will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.¹
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 134. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 138. As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

¹ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed." [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 915

Reports on Application of Requirements of an Applicable Financial Reporting Framework

Source: SAS No. 122; SAS No. 123; SAS No. 125.

Effective for engagements that end on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the reporting accountant's responsibilities when requested to issue a written report on

- a. the application of the requirements of an applicable financial reporting framework to a specific transaction or
- b. the type of report that may be issued on a specific entity's financial statements. (Ref: par. .A1)

.02 This section also applies to oral advice provided by the reporting accountant

- a. that the reporting accountant concludes is intended to be used by a principal to the transaction as an important factor considered in reaching a decision on the application of the requirements of an applicable financial reporting framework to a specific transaction or
- b. on the type of report that may be issued on a specific entity's financial statements.

.03 Differing interpretations may exist concerning whether and, if so, how existing accounting policies in an applicable financial reporting framework apply to new transactions or how new accounting policies in an applicable financial reporting framework apply to existing transactions. Management and others may consult with accountants on the application of the requirements of an applicable financial reporting framework to those transactions or to increase their knowledge of specific financial reporting issues. Such consultations may provide relevant information and insights not otherwise available.

.04 This section does not apply to

- a. a continuing accountant with respect to the specific entity whose financial statements the continuing accountant has been engaged to report on,
- b. engagements either to assist in litigation involving accounting or auditing matters or to provide expert testimony in connection with such litigation, or
- c. professional advice provided to another accountant in public practice.

.05 This section also does not apply to communications such as position papers prepared by an accountant for the purpose of presenting views on an issue involving the application of the requirements of an applicable financial reporting framework, provided that these communications are not intended to provide guidance on the application of these requirements to a specific transaction. Position papers include newsletters, articles, speeches, and texts thereof; lectures and other forms of public presentations; and letters for the public record to professional and governmental standards-setting bodies.

Effective Date

.06 This section is effective for engagements that end on or after December 15, 2012.

Objective

.07 The objective of the reporting accountant, when engaged to issue a written report or provide oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements, is to address appropriately

- a. the acceptance of the engagement.
- b. the planning and performance of the engagement.
- c. reporting on the specific transaction or type of report.

Definitions

.08 For purposes of this section, the following terms have the meanings attributed as follows:

Continuing accountant. An accountant who has been engaged to report on the financial statements of a specific entity or entities of which the specific entity is a component.

Hypothetical transaction. A transaction or financial reporting issue that does not involve facts or circumstances of a specific entity.

Reporting accountant. An accountant, other than a continuing accountant, in public practice, as described in ET section 0.400, *Definitions*, who prepares a written report or provides oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction or on the type of report that may be issued on a specific entity's financial statements.^[1] (A reporting accountant who is also engaged to provide accounting and reporting advice to a specific entity on a recurring basis is commonly referred to as an advisory accountant.) (Ref: par. .A4)

Specific transaction. A completed or proposed transaction or group of related transactions or a financial reporting issue involving facts and circumstances of a specific entity.

Written report. Any written communication that provides a conclusion on the appropriate application of the requirements of an applicable financial reporting framework to a specific transaction

^[1] [Footnote deleted, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

or on the type of report that may be issued on a specific entity's financial statements.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Engagement Acceptance

.09 In determining whether to accept the engagement, the reporting accountant should consider

- a. the circumstances under which the written report or oral advice is requested,
- b. the purpose of the request, and
- c. the intended use of the written report or oral advice.

For purposes of this section, the reporting accountant is not required to be independent of the entity.

.10 The reporting accountant should accept an engagement to issue a written report on the application of the requirements of an applicable financial reporting framework to a specific transaction only when the transaction involves facts or circumstances of a specific entity. The reporting accountant should not accept an engagement to issue a written report on hypothetical transactions.

.11 If the reporting accountant has determined in accordance with paragraphs .09–.10 that it is appropriate to accept an engagement to be performed in accordance with this section, the reporting accountant should establish an understanding with the requesting party that

- a. responsibility for the proper accounting treatment rests with management, who is expected to consult with its continuing accountant;
- b. management acknowledges that the reporting accountant may need to consult with the continuing accountant and that, upon request, management will authorize the continuing accountant to respond fully to the reporting accountant's inquiries; and
- c. management will notify those charged with governance and the continuing accountant concerning the nature of the engagement.

If management refuses to agree to authorize the continuing accountant to respond fully to the reporting accountant's inquiries, the reporting accountant should inquire about the reasons and consider the implications of that refusal when determining whether to accept the engagement.

Engagement Planning and Performance

.12 The reporting accountant should

- a. obtain an understanding of the form and substance of the specific transaction(s) or the conditions relevant to the type of report that may be issued on a specific entity's financial statements;
- b. review the relevant requirements of the applicable financial reporting framework, if appropriate;
- c. consult with other professionals, experts, or regulatory authorities, if appropriate;

- d. perform research or other procedures, as appropriate, to identify and consider existing creditable precedents or analogies;
- e. except as provided in paragraph .13, request permission from the entity's management to consult with the continuing accountant and request the entity's management to authorize the continuing accountant to respond fully to the reporting accountant's inquiries; and
- f. except as provided in paragraph .13, consult with the continuing accountant to determine the available facts relevant to forming a conclusion. (Ref: par. .A2–.A3)

Consulting With the Continuing Accountant

.13 The reporting accountant should consult with the continuing accountant to determine whether the reporting accountant has obtained the available facts relevant to form a conclusion, unless

- a. the reporting accountant is engaged to issue a written report or provide oral advice on the application of the requirements of an applicable financial reporting framework to a specific transaction, as described in paragraphs .01*a* and .02*a*, and
- b. the reporting accountant is engaged to provide recurring accounting and reporting advice (for example, bookkeeping or assistance in formulating accounting positions in selected matters, which are services commonly performed by an advisory accountant) and
 - i. does not believe that a second opinion is being requested,
 - ii. has full access to management, and
 - iii. believes that the relevant information has been obtained in order to issue a written report or provide oral advice regarding the application of the requirements of an applicable financial reporting framework to an entity's specific transaction.

If the reporting accountant determines in accordance with the preceding *a–b* that it is not necessary to consult with the continuing accountant, the reporting accountant should document the rationale for not consulting. (Ref: par. .A2–.A4)

Written Report (Ref: par. .A5–.A7)

.14 The reporting accountant's written report should be addressed to the requesting party (for example, management or those charged with governance) and should include the following:

- a. A brief description of the nature of the engagement and a statement that the engagement was performed in accordance with this section.
- b. Identification of the specific entity; a description of the specific transaction(s), if applicable; a statement of the relevant facts, circumstances, and assumptions; and a statement about the source of such information.
- c. A statement describing the appropriate application of the requirements of an applicable financial reporting framework (including the country of origin) to the specific transaction or type of report that may be issued on the entity's financial statements and, if appropriate, a description of the reasons for the reporting accountant's conclusion.

- d. A statement that the responsibility for the proper accounting treatment rests with the preparers of the financial statements, who should consult with their continuing accountant.
- e. A statement that any difference in the facts, circumstances, or assumptions presented may change the report.
- f. An alert that restricts the use of the report solely to the specified parties, as required by section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.²
- g. If the reporting accountant is not independent of the entity, a statement indicating the reporting accountant's lack of independence. The reporting accountant is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the reporting accountant chooses to provide the reasons for the lack of independence, the reporting accountant should include all the reasons therefor.

[As amended, December 2011, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01b)

.A1 Examples of the types of reports or illustrative report wording that a reporting accountant may provide include the following:

- A report expressing a modified opinion versus a report expressing an unmodified opinion
- A report prepared in accordance with auditing standards generally accepted in the United States of America versus a report prepared in accordance with international auditing standards
- Wording that might be included in a modified opinion

Engagement Planning and Performance

.A2 The responsibilities of an entity's continuing accountant to respond to inquiries by the reporting accountant are the same as the responsibilities of a predecessor auditor to respond to inquiries by the auditor. Section 210A, *Terms of Engagement*, addresses the responsibilities of a predecessor auditor.³ (Ref: par. .12f–.13)

.A3 The continuing accountant may provide information related to the form and substance of the specific transaction that is not otherwise available to the reporting accountant regarding, for example, the following:

- How management has applied the requirements of an applicable financial reporting framework to similar transactions
- Whether the method of accounting recommended by the continuing accountant is disputed by management

² See paragraphs .06a–b and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

³ Paragraph .A30 of section 210A, *Terms of Engagement*. [Footnote renumbered by the issuance of SAS No. 125, December 2012.]

- The continuing accountant's conclusion on the application of the requirements of an applicable financial reporting framework to the specific transaction or the type of report that may be issued on the entity's financial statements (Ref: par. .12f-.13)

.A4 When determining whether the criteria in paragraph .13 are satisfied such that consultation with the continuing accountant is not necessary, the reporting accountant may consider the following:

- The nature of the engagement
- Whether the reporting accountant believes that full knowledge of the form and substance of the transaction has been obtained
- How management has applied the requirements of the applicable financial reporting framework to similar transactions in the past
- Whether management has discussed the method of accounting with the continuing accountant

A recurring engagement for a reporting accountant may constitute the effective outsourcing of certain controllership or other financial reporting functions or involve financial reporting advisory services. Such an engagement may allow the reporting accountant to have complete access to management. (Ref: par. .08 and .13)

Written Report (Ref: par. .14)

.A5 Although the reporting requirements in paragraph .14 only apply to written reports, reporting accountants may find the requirements useful when providing oral advice.

.A6 The alert that restricts the use of the reporting accountant's written report referred to in paragraph .14f is not intended to preclude distribution of the report to the continuing accountant. [As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

.A7 The exhibit "Illustrative Written Report to the Requesting Entity" provides an example of a written report to the requesting party.

.A8

Exhibit—Illustrative Written Report to the Requesting Party

The following is an illustration of the reporting accountant's written report to the requesting party (for example, management or those charged with governance) on the application of the requirements of accounting principles generally accepted in the United States of America to a specific transaction.

Introduction

We have been engaged to report on the appropriate application of the requirements of accounting principles generally accepted in the United States of America to the specific transaction described below. This report is being issued to ABC Company for assistance in evaluating accounting policies for the described specific transaction. Our engagement has been conducted in accordance with Statement on Auditing Standards No. 122 section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*.

Description of Transaction

The facts, circumstances, and assumptions relevant to the specific transaction as provided to us by the management of ABC Company are as follows:
[Text discussing the facts, circumstances, and assumptions relevant to the specific transaction]

Appropriate Accounting Principles

[Text discussing accounting principles generally accepted in the United States of America and how they apply to the described transaction]

Concluding Comments

The ultimate responsibility for the decision on the appropriate application of the requirements of accounting principles generally accepted in the United States of America for an actual transaction rests with the preparers of financial statements, who should consult with their continuing accountant. Our conclusion on the appropriate application of the requirements of accounting principles generally accepted in the United States of America for the described specific transaction is based solely on the facts provided to us as previously described; should these facts and circumstances differ, our conclusion may change.

Restricted Use

This report is intended solely for the information and use of those charged with governance and management of ABC Company and is not intended to be and should not be used by anyone other than these specified parties.

AU-C Section 920

Letters for Underwriters and Certain Other Requesting Parties

Source: SAS No. 122; SAS No. 125; SAS No. 129; SAS No. 140.

Effective for comfort letters issued on or after December 15, 2014, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when engaged to issue letters (commonly referred to as *comfort letters*) to requesting parties in connection with a nonissuer entity's financial statements included in registration statements filed with the Securities and Exchange Commission (SEC) under the Securities Act of 1933 (the 1933 Act) (for example, inclusion of the non-issuer entity's financial statements as required by either Rule 3-05 or 3-09 of Regulation S-X) or included in other securities offerings.

.02 Auditors' services include audits or reviews of financial statements included in securities offerings. In connection with the securities offerings, auditors are often requested to issue comfort letters to certain requesting parties. The auditor is not required by generally accepted auditing standards (GAAS) to accept an engagement to issue a comfort letter.

.03 The service of providing letters for underwriters developed following the passing of the 1933 Act. Section 11 of the 1933 Act provides that underwriters, among others, could be liable if any part of a registration statement contains material omissions or misstatements. The 1933 Act also provides for an affirmative defense for underwriters if it can be demonstrated that, after a reasonable investigation, the underwriter has reasonable grounds to believe that no material omissions or misstatements existed in a securities offering. An auditor issuing a comfort letter is one of a number of procedures that may be used to establish that an underwriter has conducted a reasonable investigation. Consequently, underwriters may request auditors to assist them in developing a record of reasonable investigation.

.04 The subjects that may be covered in a comfort letter include

- the independence of the auditor.
- whether the audited financial statements included in the securities offering comply regarding form, in all material respects, with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC.
- unaudited financial statements, condensed interim financial information, capsule financial information, pro forma financial information, financial forecasts, management's discussion and analysis (MD&A), and changes in selected financial statement items during a period subsequent to the date and period of the latest financial statements included in the securities offering.

- tables, statistics, and other financial information included in the securities offering.
- negative assurance about whether certain nonfinancial statement information included in the securities offering complies regarding form, in all material respects, with Regulation S-K.¹

Effective Date

.05 This section is effective for comfort letters issued on or after December 15, 2012.

Objectives

.06 The objectives of the auditor, when engaged to issue a letter to a requesting party in connection with an entity's financial statements included in a securities offering, are to

- a. address appropriately the acceptance of the engagement and the scope of services; and
- b. issue a letter with the appropriate form and content.

Definitions

.07 For purposes of this section, the following terms have the meanings attributed as follows:

Capsule financial information. Unaudited summarized interim financial information for periods subsequent to the periods covered by the audited financial statements or unaudited interim financial information included in the securities offering. Capsule financial information may be presented in narrative or tabular form and is often provided for the most recent interim period and for the corresponding period of the prior year.

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

Closing date. The date on which the issuer of the securities or selling security holder delivers the securities in exchange for the proceeds of the offering.

Comfort letter. A letter issued by an auditor in accordance with this section to requesting parties in connection with an entity's financial statements included in a securities offering.

Comparison date and comparison period. The date as of which, and period for which, data at the cut-off date and data for the change period are to be compared.

Cut-off date. The date through which certain procedures described in the comfort letter are to relate.

Effective date. The date on which the securities offering becomes effective.

¹ Regulation S-K, "Standard Instructions for Filing Forms Under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975."

Entity. The party whose financial statements are the subject of the engagement.

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

Requesting party. One of the following specified parties requesting a comfort letter, which has negotiated an agreement with the entity:

- An underwriter
- Other parties that are conducting a review process that is, or will be, substantially consistent with the due diligence process performed when the securities offering is, or if the securities offering was, being registered pursuant to the 1933 Act, as follows:
 - A selling shareholder, sales agent, or other party with a statutory due diligence defense under Section 11 of the 1933 Act
 - A broker-dealer or other financial intermediary acting as principal or agent in a securities offering in connection with the following types of securities offerings:
 - Foreign offerings, including Regulation S, Eurodollar, and other offshore offerings
 - Transactions that are exempt from the registration requirements of Section 5 of the 1933 Act, including those pursuant to Regulation A, Regulation D, and Rule 144A
 - Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the 1933 Act
 - The buyer or seller in connection with acquisition transactions in which there is an exchange of stock (Ref: par. .A1)

Securities offerings. One of the following types of securities offerings:

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

- Acquisition transactions in which there is an exchange of stock

Underwriter. As defined in the 1933 Act

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

Except when the context otherwise requires, the word *underwriter*, as used in this section, refers to the managing, or lead, underwriter, who typically negotiates the underwriting agreement or purchase agreement (hereafter referred to as the *underwriting agreement*) for a group of underwriters whose exact composition is not determined until shortly before a securities offering becomes effective. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.08 References in this section to information that is *included* in a document are to be read to also encompass information that is *incorporated by reference* in that document.

Requirements

Engagement Acceptance

.09 The auditor should determine whether to accept an engagement to issue a comfort letter in connection with financial statements included in a securities offering. The auditor is neither required to accept such an engagement nor required to provide comfort on every matter requested when accepting an engagement to issue a comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.10 The auditor should provide a comfort letter in connection with financial statements included in a securities offering only to

- underwriters.
- other parties meeting the definition of a *requesting party* in paragraph .07.

.11 The auditor should request the requesting party to provide either

- a written opinion from external legal counsel that the requesting party has a statutory due diligence defense under Section 11 of the 1933 Act; or (Ref: par. .A2)
- a representation letter that
 - is addressed to the auditor;
 - contains the statement, "The review process applied to the information relating to the issuer of the securities is (will

be) substantially consistent with the due diligence process that we would perform if this securities offering were being registered pursuant to the Securities Act of 1933. We are knowledgeable with respect to that due diligence process."; and (Ref: par. .A3–.A4)

- iii. is signed by the requesting party. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.12 If a requesting party, other than an underwriter, requests a comfort letter but does not provide the legal opinion or representation letter described in paragraph .11, the auditor should not provide negative assurance on the financial statements as a whole, or on any of the specified elements, accounts, or items thereof. In such circumstances, the comfort letter should include the following statements: (Ref: par. .A5)

- a. It should be understood that we have no responsibility for establishing (and did not establish) the scope and nature of the procedures enumerated in the preceding paragraphs; rather, the procedures enumerated therein are those that the requesting party asked us to perform. Accordingly, we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraphs; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages previously listed as set forth in the *[offering memorandum]*. Further, we have addressed ourselves solely to the foregoing data and make no representations regarding the adequacy of disclosures or whether any material facts have been omitted. This letter relates only to the financial statement items previously specified and does not extend to any financial statement of the company as a whole. (Ref: par. .A6)
- b. The foregoing procedures do not constitute an audit or a review conducted in accordance with generally accepted auditing standards. Had we performed additional procedures or had we conducted an audit or a review of the company's *[give dates of any interim financial statements]* consolidated financial statements in accordance with auditing standards generally accepted in the United States of America, other matters might have come to our attention that would have been reported to you.
- c. These procedures should not be taken to supplant any additional inquiries or procedures that you would undertake in your consideration of the proposed offering.
- d. This letter is solely for your information and to assist you in your inquiries in connection with the offering of the securities covered by the *[offering memorandum]*. It is not to be used, circulated, quoted, or otherwise referred to for any other purpose, including but not limited to, the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the offering document or any other document, except that reference may be made to it in any list of closing documents pertaining to the offering of the securities covered by the offering document.
- e. We have no responsibility to update this letter for events and circumstances occurring after *[cut-off date]*. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.13 The auditor should not provide a comfort letter to any parties other than a requesting party as defined in this section. (Ref: par. .A7)

.14 When issuing a letter in accordance with this section, the auditor should not circumvent the requirements of this section by issuing any additional letters or reports to a requesting party in connection with the securities offering in which the auditor comments on items for which commenting is otherwise precluded by this section.

Agreeing Upon the Scope of Services

.15 The auditor should obtain an understanding of the specific matters to be addressed in the comfort letter. (Ref: par. .A8)

.16 The auditor should ask to meet with the requesting party and the entity to discuss the procedures to be followed in connection with an engagement to issue a comfort letter. (Ref: par. .A9–.A10)

.17 The auditor should clearly communicate that the auditor cannot provide any assurance regarding the sufficiency of the procedures for the requesting party's purposes. (Ref: par. .A11–.A14) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.18 The auditor should provide the requesting party with a draft of the form of the letter the auditor expects to furnish. To the extent possible, the draft should deal with all matters to be covered in the final letter and should use exactly the same terms as those to be used in the final letter, subject to the understanding that the comments in the final letter cannot be determined until the procedures underlying it have been performed. The draft letter should be identified as a draft to avoid giving the impression that the procedures described therein have been performed. (Ref: par. .A15) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.19 In both the draft and final forms of the comfort letter, the auditor should clearly describe the procedures performed by the auditor. The auditor should not state or imply that the auditor is carrying out such procedures as the auditor considers necessary because such statements or implications may lead to misunderstanding about the responsibility for the sufficiency of the procedures for the requesting party purposes.

.20 If the auditor has been unable to have a discussion with the requesting party about the auditor's planned procedures, the auditor should describe in the draft letter those procedures specified in the draft underwriting agreement that the auditor is willing to perform. (Ref: par. .A16–.A17)

.21 Situations may exist in which one or more component auditor's report is included in the securities offering. When comfort letters are issued to requesting parties by those component auditors, the auditor of the group financial statements should read those comfort letters. The auditor of the group financial statements should state in the comfort letter that the procedures relating to those components consisted solely of reading the component auditors' comfort letters. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.22 When comfort letters are requested from more than one auditor, the requirements of this section apply to each auditor. (Ref: par. .A19)

.23 In competitive bidding situations in which legal counsel for the requesting party acts as the requesting party's representative prior to opening and acceptance of the bid, the auditor should carry out the discussions and other communications required by this section with the legal counsel until the requesting party is selected. In such circumstances, the auditor should not agree

to provide a comfort letter addressed to the entity, legal counsel, or a nonspecific addressee, such as "any or all underwriters to be selected." If the auditor agrees to provide a draft comfort letter, the draft comfort letter should include a legend describing the letter's purpose and limitations. (Ref: par. .A20–.A23)

Format and Contents of Comfort Letters

Dating

.24 The letter should state that the inquiries and other procedures described in the letter did not cover the period from the cut-off date to the date of the letter. (Ref: par. .A24–.A25)

.25 When an additional letter, dated at or shortly before the closing date, is requested, the auditor should carry out the specified procedures and inquiries as of the cut-off date for each letter. The subsequent letter should relate only to information in the securities offering as most recently amended. (Ref: par. .A26)

Addressee

.26 The letter should be addressed only to the requesting party, or both the requesting party and the entity, and should not be provided to any other parties. (Ref: par. .A27)

Introductory Paragraph

.27 The letter should contain an introductory paragraph that identifies the financial statements and the securities offering.

Auditor's Report

.28 The auditor should, in the comfort letter, make reference to, but not repeat, the report on the audited financial statements included in the securities offering. (Ref: par. .A28)

.29 When the auditor's report on the audited financial statements included in the securities offering contains an emphasis-of-matter or other-matter paragraph or a separate section in the auditor's report addressing matters other than consistency of application of accounting policies,² the auditor should refer to that fact in the comfort letter and discuss the subject matter of the paragraph. In those instances in which the SEC accepts a modified opinion on historical financial statements, the auditor should refer to the modification in the opening paragraph of the comfort letter and discuss the subject matter of the modification. (Ref: par. .A29–.A30) [As amended, effective for comfort letters issued on or after December 15, 2021, by SAS No. 140.]

.30 The auditor should not provide negative assurance regarding the auditor's report or regarding financial statements that have been audited and are reported on in the securities offering by other auditors. (Ref: par. .A31)

.31 In the introductory paragraph of the comfort letter, if the auditor refers to reports that the auditor has previously issued other than the report on the audited financial statements included in the securities offering, the auditor should not repeat the reports in the comfort letter or otherwise imply that the auditor is reporting as of the date of the comfort letter or assuming responsibility for the sufficiency of the procedures for the requesting party's purposes. (Ref: par. .A32–.A33)

² See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

[.32] [Paragraph deleted, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

.33 The auditor should not mention, refer to, or attach to the comfort letter any report or other auditor's written communication that includes an alert that restricts the use of the auditor's written communication, in accordance with section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, or any restricted use reports issued in accordance with Statements on Standards for Attestation Engagements or Statements on Standards for Accounting and Review Services. (Ref: par. .A34) [As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125.]

Representations

.34 The auditor should refer in the comfort letter to the requesting party's representations when the representation letter described in paragraph .11 has been provided. (Ref: par. .A35)

Independence

.35 The auditor should state in the comfort letter that the auditor is independent, or the date through which the auditor was independent, with respect to the entity, and identify the applicable independence rules. (Ref: par. .A36–.A38)

Compliance With SEC Requirements

.36 If the auditor is requested to include an opinion in the comfort letter on whether the financial statements covered by the auditor's report comply as to form with the pertinent accounting requirements adopted by the SEC, the auditor's opinion should refer to compliance as to form, in all material respects, with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC. (Ref: par. .A39–.A41)

.37 Certain financial statements may be incorporated in a registration statement under the 1933 Act by reference to filings under the Securities Exchange Act of 1934 (the 1934 Act). If the auditor is requested to include an opinion in the comfort letter on whether the financial statements covered by the auditor's report comply as to form with the pertinent accounting requirements adopted by the SEC, the auditor's opinion should refer to whether the audited financial statements incorporated by reference in the registration statement comply as to form, in all material respects, with the applicable accounting requirements of the 1934 Act and the related rules and regulations adopted by the SEC. However, the auditor should not opine on compliance with the provisions of the 1934 Act regarding internal control over financial reporting.

.38 If the auditor has been requested to include an opinion in the comfort letter on whether the financial statements covered by the auditor's report comply as to form with the pertinent accounting requirements adopted by the SEC, and a material departure from the pertinent rules and regulations adopted by the SEC exists, the auditor should disclose the departure in the comfort letter. (Ref: par. .A42)

.39 The auditor should express an opinion on compliance as to form with requirements under the rules and regulations adopted by the SEC only with respect to those rules and regulations applicable to the form and content of financial statements that the auditor has audited. When the financial statements or financial statement schedules have not been audited, the auditor is limited to providing negative assurance on compliance as to form.

.40 The auditor should not comment in a comfort letter on compliance as to form of MD&A with rules and regulations adopted by the SEC. (Ref: par. .A43)

Commenting in a Comfort Letter on Information Other Than Audited Financial Statements

General

.41 When commenting in a comfort letter on information other than audited financial statements, the auditor should

- a. describe the procedures performed by the auditor, as required by paragraph .19. (Ref: par. .A44–.A46)
- b. describe the criteria specified by the requesting party.
- c. state that the procedures performed with respect to interim periods may not disclose matters of significance regarding certain matters about which negative assurance is requested. (Ref: par. .A47–.A48)

.42 The auditor should not, in the comfort letter

- a. make any statements, or imply, that the auditor has applied procedures that the auditor determined to be necessary or sufficient for the requesting party's purposes.
- b. use terms of uncertain meaning (such as *general review*, *limited review*, *reconcile*, *check*, or *test*) in describing the work unless the procedures encompassed by these terms are described in the comfort letter.
- c. make a statement that nothing else has come to the auditor's attention that would be of interest to the requesting party as a result of carrying out the specified procedures. (Ref: par. .A49)

.43 When the report on the audited financial statements in the securities offering is a modified report, the auditor should consider the effect on providing negative assurance in the comfort letter regarding subsequent interim financial information included in the securities offering or regarding an absence of specified subsequent changes. The auditor should also follow the requirements of paragraph .29. (Ref: par. .A50)

Knowledge of Internal Control

.44 The auditor should obtain an understanding of the entity's internal control over financial reporting for both annual and interim periods when commenting in a comfort letter on

- a. unaudited interim financial information, including unaudited condensed interim financial information;
- b. capsule financial information;
- c. a financial forecast when historical financial statements provide a basis for one or more significant assumptions for the forecast; or
- d. subsequent changes in specified financial statement items. (Ref: par. .A51)

Unaudited Interim Financial Information

.45 The auditor should provide negative assurance on unaudited interim financial information included in the securities offering only if the auditor has

conducted a review of the interim financial information in accordance with GAAS applicable to reviews of interim financial information. If the auditor has not conducted a review in accordance with GAAS applicable to reviews of interim financial information, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A52)

.46 The negative assurance provided regarding such unaudited interim financial information should be about whether

- a. any material modifications should be made to the unaudited interim financial information for it to be in accordance with the applicable financial reporting framework, and
- b. the unaudited interim financial information complies as to form in all material respects with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC, if applicable. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.47 If the auditor states in the comfort letter that the auditor has issued a review report on the unaudited interim financial information, the auditor should attach the review report to the letter unless the review report is already included in the securities offering. (Ref: par. .A53) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.48 The auditor should specifically identify, in the comfort letter, any unaudited interim financial information and should state that the auditor has not audited the interim financial information in accordance with GAAS and does not express an opinion concerning such information. (Ref: par. .A54–.A55)

Capsule Financial Information

.49 The auditor should not provide negative assurance regarding whether the selected capsule financial information is in accordance with the applicable financial reporting framework unless

- a. the auditor has performed a review of the financial statements underlying the capsule financial information in accordance with GAAS applicable to reviews of interim financial information, and
- b. the selected capsule financial information is in accordance with minimum disclosure requirements of the applicable financial reporting framework for interim financial information.

If these conditions have not been met, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A56) [Renumbered by the issuance of SAS No. 129, July 2014.]

.50 The auditor should not provide negative assurance on selected capsule financial information regarding whether the dollar amounts were determined on a basis substantially consistent with that of the corresponding amounts in the audited financial statements unless the auditor has performed a review of the financial statements underlying the capsule financial information in accordance with GAAS applicable to reviews of interim financial information. Otherwise, the auditor is limited to reporting procedures performed and findings obtained. [Renumbered and amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.51 When the auditor is requested by the requesting party to provide negative assurance on unaudited condensed interim financial information, or information extracted therefrom, for a period ending after the latest financial statements included in the securities offering, the requirements in paragraphs

.45-.48 apply. When the auditor provides negative assurance on such information, a copy of the unaudited interim financial information should be attached to the comfort letter. (Ref: par. .A57) [Renumbered and amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Pro Forma Financial Information

.52 The auditor should not comment in a comfort letter on pro forma financial information unless the auditor has an appropriate level of knowledge of the accounting and financial reporting practices of the entity. (Ref: par. .A58)

.53 The auditor should not provide negative assurance in a comfort letter on pro forma financial information, including negative assurance on

- the application of pro forma adjustments to historical amounts,
- the compilation of pro forma financial information, or
- whether the pro forma financial information complies as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X,³ or with the pro forma bases as described in the pro forma financial information, as applicable,

unless the auditor has obtained the required knowledge described in paragraph .52 and has performed

- a. an audit of the annual financial statements, or
- b. a review of the interim financial information, in accordance with GAAS applicable to reviews of interim financial information,

of the entity (or, in the case of a business combination, of a significant constituent part of the combined entity) to which the pro forma adjustments were applied. In the case of a business combination, the historical financial statements of each constituent part of the combined entity on which the pro forma financial information is based should be audited or reviewed. If these conditions are not met, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A59) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Financial Forecasts

.54 When performing procedures agreed to with the requesting party on a financial forecast and commenting thereon in a comfort letter, the auditor should

- a. obtain an understanding of the entity's internal control over financial reporting for both annual and interim periods, as required by paragraph .44;
- b. perform procedures required by AR-C section 80A, *Compilation Engagements*, for reporting on the compilation of a forecast;^[4]
- c. issue a report on the compilation of prospective financial information in accordance with AR-C section 80A and attach the report thereon to the comfort letter;^[5] and

³ Regulation S-X, "Form and Content of and Requirements for Financial Statements, Securities Act of 1933, Securities Exchange Act of 1934, Public Utility Holding Company Act of 1935, Investment Company Act of 1940, and Energy Policy and Conservation Act of 1975."

^[4] [Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

^[5] [Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

- d. perform additional procedures as requested by the requesting party and report the findings in the comfort letter. (Ref: par. .A60–.A61)

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

.55 The auditor should not provide negative assurance on the results of procedures performed on a financial forecast.

.56 The auditor should not provide negative assurance with respect to compliance of the financial forecast with Rule 11-03 of Regulation S-X unless the auditor has performed an examination of the financial forecast in accordance with AT-C section 305, *Prospective Financial Information*. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.57 If a financial forecast that the auditor has not examined is included in the securities offering, the auditor should not issue a comfort letter unless the financial forecast is accompanied by an indication that the auditor has not examined the financial forecast and, therefore, does not express an opinion on it. (Ref: par. .A62) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Subsequent Changes

.58 The auditor should base comments regarding subsequent changes in specified financial statement items solely on the limited procedures performed with respect to the change period as determined by the requesting party. (Ref: par. .A63–.A65)

.59 The auditor should provide negative assurance in the comfort letter regarding subsequent changes in specified financial statement items only as of a date less than 135 days from the end of the most recent period for which the auditor has performed an audit or a review. (Ref: par. .A66)

.60 When the requesting party requests negative assurance regarding subsequent changes in specified financial statement items as of a date 135 days or more from the end of the most recent period for which the auditor has performed an audit or a review, the auditor is limited to reporting procedures performed and findings obtained. (Ref: par. .A67) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.61 In commenting on subsequent changes, the auditor should not characterize subsequent changes using ambiguous terms, such as referring to the change as "adverse." The auditor should note in the comfort letter if there has been a change in the application of the requirements of the applicable financial reporting framework. (Ref: par. .A68) [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.62 The auditor should comment only on the occurrence of subsequent changes in specified financial statement items that are not disclosed in the securities offering. Accordingly, the auditor should include the phrase *except for changes, increases, or decreases that the securities offering discloses have occurred or may occur* in the comfort letter when it has come to the auditor's attention that a change, increase, or decrease has occurred during the change period, and the amount of such change, increase, or decrease is disclosed in the securities offering. This phrase need not be included in the letter when no changes, increases, or decreases in the specified financial statement items are disclosed in the securities offering. (Ref: par. .A69–.A70)

.63 The auditor should identify in the comfort letter in both draft and final form the dates as of which, and periods for which, data at the cut-off date and data for the change period are to be compared, whether or not specified in the underwriting agreement. (Ref: par. .A71–.A72)

.64 If the requesting party requests the use of a change period or periods other than those described in paragraph .07, the auditor should explain to the requesting party the implications of using an earlier date. If the requesting party, nonetheless, requests the use of a change period or periods other than those described in paragraph .07, the auditor is permitted to use the period or periods requested. (Ref: par. .A73)

Tables, Statistics, and Other Financial Information

.65 The auditor should not comment in a comfort letter on tables, statistics, and other financial information appearing in the securities offering unless the information

- a. is expressed in dollars (or percentages derived from such dollar amounts) and has been obtained from accounting records that are subject to internal control over financial reporting, or
- b. has been derived directly from such accounting records by analysis or computation. (Ref: par. .A74)

.66 The auditor should not comment in a comfort letter on quantitative information that has been obtained from accounting records unless the information is subject to the same controls over financial reporting as the dollar amounts.

.67 The auditor should not comment in a comfort letter on tables, statistics, and other financial information relating to an unaudited period unless the auditor has

- a. performed an audit of the entity's financial statements for a period including, or immediately prior to, the unaudited period or completed an audit for a later period, or
- b. otherwise obtained knowledge of the entity's internal control over financial reporting.

.68 The auditor should not use the term *presents fairly* in comments concerning tables, statistics, and other financial information (Ref: par. .A75) and should not comment on

- a. information subject to legal interpretation, such as beneficial share ownership;
- b. nonfinancial data presented in MD&A, unless the auditor has conducted an examination or review of MD&A in accordance with AT-C section 395, *Management's Discussion and Analysis*; or (Ref: par. .A76)
- c. matters merely because the auditor is capable of reading, counting, measuring, or performing other functions that might be applicable.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.69 The auditor's comments in the comfort letter concerning tables, statistics, and other financial information included in the securities offering should include

- a. a clear identification of the specific information commented on;

- b. a description of the procedures performed; and
- c. the findings, expressed in terms of agreement between items compared. (Ref: par. .A77–.A78)

.70 With respect to the acceptability of methods of allocation used in deriving the figures commented on, the auditor should comment only to the extent to which such allocation is made in, or can be derived directly by analysis or computation from, the entity's accounting records. Such comments, if made, should make clear that

- a. such allocations may be, to a substantial extent, arbitrary.
- b. the method of allocation used is not the only acceptable method.
- c. other acceptable methods of allocation might produce significantly different results.

.71 The comfort letter should state that the auditor makes no representations regarding

- a. any matter of legal interpretation;
- b. the completeness or adequacy of disclosure; and
- c. the adequacy of the procedures followed, and that such procedures would not necessarily disclose material misstatements or omissions in the information to which the comments relate. (Ref: par. .A79–.A80)

Compliance as to Form With Regulation S-K

.72 The auditor should not provide negative assurance about whether certain financial information in registration statements, included because of specific requirements of Regulation S-K, is in conformity with the disclosure requirements of Regulation S-K unless the following conditions are met:

- a. The information is derived, directly or by analysis or computation, from the accounting records subject to internal control over financial reporting.
- b. The information is capable of evaluation against reasonable criteria that have been established by the SEC. (Ref: par. .A81 and .A84–.A87)

.73 The auditor should not express an opinion on conformity with the disclosure requirements of Regulation S-K. (Ref: par. .A82–.A83)

Concluding Paragraph

.74 The comfort letter should include a concluding paragraph restricting the use of the comfort letter for the information of the addressees and to assist the requesting parties in connection with the securities offering. (Ref: par. .A88)

Disclosure of Subsequently Discovered Matters

.75 The auditor should inform the entity when the auditor has discovered matters that require mention in the final comfort letter but were not mentioned in the draft letter that has been furnished to the requesting party. If the entity decides that disclosure will not be made in the securities offering, the auditor should inform the entity that the matters will be mentioned in the comfort letter and should recommend that the requesting party be informed promptly. (Ref: par. .A89–.A90)

Application and Other Explanatory Material

Definitions (Ref: par. .07)

.A1 An example of a comfort letter in connection with an acquisition transaction in which there is an exchange of stock is a cross-comfort letter related to a typical Form S-4 or merger proxy situation. An auditor's report on a preliminary investigation in connection with a proposed transaction (for example, a merger, an acquisition, or a financing) is not covered by this section; the guidance in AT-C section 215, *Agreed-Upon Procedures Engagements*, may apply to such engagements. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Engagement Acceptance (Ref: par. .09–.13)

.A2 An attorney's letter indicating that a party "may" be deemed to be an underwriter or has liability substantially equivalent to that of an underwriter under the securities laws would not meet this requirement.

.A3 What is "substantially consistent" may vary from situation to situation and may not be the same as that done in a registered offering of the same securities for the same entity. Whether the procedures being, or to be, followed will be "substantially consistent" is determined by the requesting party on a case-by-case basis. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A4 Exhibit A, "Illustration of Representation Letter From Requesting Party," contains illustrative wording for a representation letter when the requesting party is not an underwriter.

.A5 Exhibit B, "Examples of Comfort Letters," contains examples of comfort letters. Example Q, "Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11," of this exhibit provides an example of a comfort letter issued to a requesting party that has not provided the representation letter described in paragraph .11.

.A6 Interpretation No. 1, "Responding to Requests for Reports on Matters Relating to Solvency" (AT-C sec. 9105 par. .01–.11), of AT-C section 105, *Concepts Common to All Attestation Engagements*, contains guidance on additional statements to be included if this comfort letter is requested in connection with a secured debt offering. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A7 Although the auditor is not permitted to provide a comfort letter other than to requesting parties, the auditor, instead, may provide a report on agreed-upon procedures. AT-C section 215 provides guidance on such reports. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Agreeing Upon the Scope of Services (Ref: par. .15–.23)

.A8 The underwriting agreement may specify the matters to be addressed in the comfort letter. If the underwriting agreement or draft underwriting agreement is not available or does not specify the matters to be addressed, the understanding of the scope of the comfort letter may be obtained from a description furnished by the entity or requesting party. Obtaining this understanding as early as possible, and before the auditor provides a draft of the form

of the letter the auditor expects to furnish, assists the auditor in determining whether the auditor will be able to furnish a letter in acceptable form.

.A9 If the requesting party refuses to meet together with the entity, the auditor may consider the implications in determining whether to accept the engagement.

.A10 During this meeting, the auditor may describe procedures that are frequently followed. Exhibit B provides examples of comfort letters that include these procedures. Because of the auditor's knowledge of the entity, such a meeting may assist the requesting party in reaching a decision about procedures to be followed by the auditor.

.A11 When financial information in a securities offering has not been audited in accordance with GAAS and, accordingly, is not covered by an auditor's opinion, the nature of the comments that the auditor can properly make with respect to that financial information is limited. As noted in paragraph .03, obtaining a comfort letter from an auditor is one procedure used by a requesting party to establish that the requesting party has conducted a "reasonable investigation," as a defense against possible claims under Section 11 of the 1933 Act. What constitutes a reasonable investigation of unaudited financial information sufficient to satisfy a requesting party's purposes is a matter of legal interpretation. Consequently, only the requesting party can determine what is sufficient for the requesting party's purposes.

.A12 The assistance that the auditor can provide by way of a comfort letter is subject to limitations. One limitation is that auditors can properly comment in their professional capacity only on matters to which their professional expertise is relevant. Another limitation is that procedures contemplated in a comfort letter, which do not constitute an audit of financial statements, do not provide the auditor with a basis for expressing an opinion. Such limited procedures may bring to the auditor's attention significant findings or issues affecting the financial information, but they do not provide assurance that the auditor will become aware of any or all significant findings or issues that would be disclosed in an audit. Accordingly, a risk exists that the auditor may have provided negative assurance on the absence of conditions or matters that may prove to have existed.

.A13 Comfort letters are not required under the 1933 Act, and copies are not filed with the SEC. Nonetheless, it is a common condition of an underwriting agreement in connection with the offering for sale of securities registered with the SEC under the 1933 Act that the auditor is to furnish a comfort letter. Some underwriters do not make the receipt of a comfort letter a condition of the underwriting agreement but, nevertheless, ask for such a letter.

.A14 Exhibit B, example A-1, "Typical Comfort Letter for a 1933 Act Offering," provides an illustration of an appropriate way of expressing that the auditor cannot provide any assurance regarding the sufficiency of the procedures for the requesting party's purposes.⁶

.A15 By providing a draft letter early in the process, the auditor has the opportunity to clearly show the requesting party what they may expect to receive from the auditor. Thus, the requesting party has the opportunity to discuss further with the auditor the procedures that the auditor expects to perform and to request any additional procedures that the requesting party may desire. If the additional procedures pertain to matters relevant to the auditor's professional

⁶ Paragraph 4 of example A-1, "Typical Comfort Letter for a 1933 Act Offering," in exhibit B, "Examples of Comfort Letters."

competence and the auditor is willing to perform them, a revised draft may be prepared.

.A16 Acceptance by the requesting party of the draft comfort letter (and subsequently by acceptance of the comfort letter in final form) is an indication to the auditor that the requesting party considers the procedures described to be sufficient for the requesting party's purposes. Clearly describing the procedures to be followed by the auditor in the comfort letter avoids misunderstanding about the basis on which the auditor's comments have been made and assists the requesting party in deciding whether the procedures performed are sufficient for the requesting party's purposes.

.A17 The following is an example of a paragraph that may be placed on the draft letter for identification and explanation of its purposes and limitations.

This draft is furnished solely for the purpose of indicating the form of letter that we would expect to be able to furnish [*name of requesting party*] in response to their request, the matters expected to be covered in the letter, and the nature of the procedures that we would expect to carry out with respect to such matters. Based on our discussions with [*name of requesting party*], it is our understanding that the procedures outlined in this draft letter are those they wish us to follow. Unless [*name of requesting party*] informs us otherwise, we shall assume that there are no additional procedures they wish us to follow. The text of the letter itself will depend, of course, on the results of the procedures, which we would not expect to complete until shortly before the letter is given and in no event before the cut-off date indicated therein.

If the auditor has not had any discussions with the requesting party about the auditor's planned procedures, the second sentence in this paragraph would be revised as follows: "In the absence of any discussions with [*name of requesting party*], we have set out in this draft letter those procedures referred to in the draft underwriting agreement (of which we have been furnished a copy) that we are willing to follow."

[.A18] [Paragraph deleted by the issuance of SAS No. 129, July 2014.]

.A19 Comfort letters are requested occasionally from more than one auditor, for example, in connection with securities offerings to be used in the subsequent sale of shares issued in recently effected mergers and from predecessor auditors. In such circumstances, it is the entity's responsibility, at the earliest practicable date, to inform any other auditors who may be involved about any letter that may be requested of them and arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter and for the performance of their procedures. The entity or requesting party is also responsible for arranging for a copy of the comfort letters of component auditors in draft and final form to be provided to the auditor of the group financial statements.

.A20 In certain circumstances, regulations under the 1933 Act permit companies to register a designated amount of securities for continuous or delayed offerings during an extended period by filing one "shelf" registration statement. At the effective date of a shelf registration statement, the registrant may not yet have selected an underwriter. An entity or the legal counsel designated to represent the underwriting group may, however, ask the auditor to issue a comfort letter at the effective date of a shelf registration statement to expedite the due diligence activities of the underwriter when subsequently designated and to avoid later corrections of financial information included in an effective prospectus. However, as stated in paragraph .A11, only the underwriter can determine the procedures that will be sufficient for the underwriter's purposes.

.A21 The auditor may agree to furnish the entity or legal counsel for the underwriting group with a draft comfort letter describing the procedures that the auditor has performed and the comments that the auditor is willing to express as a result of those procedures.

.A22 The following is an example of a legend describing the letter's purpose and limitations.

This draft describes the procedures that we have performed and represents a letter we would be prepared to sign if the managing underwriter had been chosen and requested such a letter. The text of the final letter will depend, of course, on whether the managing underwriter who is selected requests that these and other procedures be performed to meet his or her needs and whether the managing underwriter requests that any of the procedures be updated to the date of issuance of the signed letter.

.A23 A signed comfort letter may be issued to the underwriter selected for the portion of the issue then being offered when the underwriting agreement for an offering is signed and on each closing date.

Format and Contents of Comfort Letters

Dating (Ref: par. .24–.25)

.A24 The letter ordinarily is dated on, or shortly after, the underwriting agreement is signed.

.A25 The underwriting agreement ordinarily specifies the date, often referred to as the *cut-off date*, to which certain procedures described in the letter are to relate, for example, a date five days before the date of the letter. A factor in considering whether to accept the engagement is whether the period between the cut-off date and the date of the letter provides sufficient time to allow the auditor to perform the procedures and prepare the letter.

.A26 Comments included in an earlier letter that relate to information in the securities offering as most recently amended may be incorporated by reference in a subsequent letter. Exhibit B, example C, "Letter Reaffirming Comments as of a Later Date," provides an example of such reference. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Addressee (Ref: par. .26)

.A27 An example of an appropriate form of address for this purpose is "The Blank Company and XYZ & Company, as Representative of the Several Underwriters." Copies of a comfort letter addressed in accordance with the requirements in paragraph .26 may be provided to the auditor of the group financial statements when a comfort letter related to a component included in group financial statements is issued by a component auditor.

Auditor's Report (Ref: par. .28–.33)

.A28 The requesting party might request that the auditor repeat in the comfort letter the report on the audited financial statements included in the securities offering. Because of the significance of the date of the auditor's report, the auditor is not permitted to agree to this request. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A29 An example of a matter addressed in an emphasis-of-matter or other-matter paragraph in the auditor's report that does not affect the opinion on the basic financial statements is interim financial information accompanying or

included in the notes to audited financial statements.⁷ An example of a matter addressed in a separate section in the auditor's report that does not affect the opinion on the basic financial statements is required supplementary information described in section 730, *Required Supplementary Information*.⁸ [As amended, effective for comfort letters issued on or after December 15, 2021, by SAS No. 140.]

.A30 A requesting party may request that the auditor comment in the comfort letter on

- unaudited interim financial information required by item 302(a) of Regulation S-K, or
- required supplementary information.

Section 930, *Interim Financial Information*, applies to unaudited interim financial information, and section 730 applies to required supplementary information. These sections require the auditor to modify the auditor's report on the audited financial statements to refer to such information when

- the scope of the procedures with regard to the information was restricted, or
- when the information appears not to be presented in accordance with the applicable financial reporting framework or, for required supplementary information, applicable guidelines.

Such modifications of the auditor's report in the securities offering would ordinarily be referred to in the opening paragraph of the comfort letter (see also paragraph .43). Additional comments on such unaudited information are, therefore, unnecessary. However, if the requesting party requests that the auditor perform procedures with regard to such information in addition to those procedures performed in connection with the review or audit as prescribed by section 930 and section 730, the auditor may do so and report the findings. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A31 The requesting party might request negative assurance regarding the auditor's report. Because auditors have a statutory responsibility with respect to their opinion as of the effective date of a securities offering and because the additional significance, if any, of negative assurance is unclear and such assurance may, therefore, give rise to misunderstanding, the auditor is not permitted to provide such negative assurance. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A32 In the introductory paragraph of the comfort letter, the auditor may refer to the fact that the auditor has issued reports on

- summary financial statements that are derived from audited financial statements.⁹
- interim financial information.¹⁰
- pro forma financial information.¹¹

⁷ Paragraphs .40–.41 of section 930, *Interim Financial Information*. [Footnote amended, effective for comfort letters issued on or after December 15, 2021, by SAS No. 140.]

⁸ Paragraphs .07–.09 of section 730, *Required Supplementary Information*.

⁹ See section 810, *Engagements to Report on Summary Financial Statements*.

¹⁰ See section 930.

¹¹ See AT-C section 310, *Reporting on Pro Forma Financial Information*, and AR-C section 120, *Compilation of Pro Forma Financial Information*. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 22.]

- a financial forecast.¹²
- MD&A.¹³

.A33 When the auditor makes reference to having issued a review report on the interim financial information, the auditor is required by paragraph .47 to attach the review report to the comfort letter if the review report is not included in the securities offering. The other reports listed in paragraph .A32 may also be attached to the comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A34 An example of an auditor's written communication that includes an alert that restricts the use of the auditor's written communication that is not permitted to be mentioned, referred to, or attached to the comfort letter is an auditor's written communication issued in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*. Examples of restricted use reports that are not permitted to be mentioned, referred to, or attached to the comfort letter include a report on agreed-upon procedures and any restricted use report issued in connection with procedures performed on the entity's internal control over financial reporting, in accordance with section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*. [As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125; Revised, December 2016, to reflect conforming changes necessary to reflect the issuance of SAS No. 130.]

Representations (Ref: par. .34)

.A35 Exhibit B, example A-2, "Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained," contains a reference to the requesting party's representations.

Independence (Ref: par. .35)

.A36 Exhibit B, example A-1 contains an illustration of an appropriate statement confirming the auditor's independence under SEC rules and regulations in conjunction with SEC filings.

.A37 Exhibit B, example A-2 includes an illustration of an appropriate statement confirming the auditor's independence in conjunction with a securities offering when the auditor is independent under AICPA standards.

.A38 The auditors for previously nonaffiliated entities recently acquired by the registrant would not be required to have been independent with respect to the entity whose shares are being registered. Exhibit B, example B, "Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Form 8-K by Reference," includes an illustration of an appropriate statement concerning the auditor's independence in such a case.

Compliance With SEC Requirements (Ref: par. .36–.40)

.A39 Although the guidance in this section generally addresses comfort letters issued in connection with securities offerings registered pursuant to the 1933 Act, it also provides guidance on comfort letters issued in other securities transactions. However, the guidance that specifically refers to compliance of the information commented on with SEC rules and regulations, such as compliance

¹² See AR-C section 80A. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

¹³ See AT-C section 395, *Management's Discussion and Analysis*. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

with Regulation S-X or S-K, generally applies only to comfort letters issued in connection with securities offerings registered pursuant to the 1933 Act.

.A40 The phrase *rules and regulations adopted by the SEC* is used because auditors are not expected to be familiar with, or express opinions on compliance with, informal positions of the SEC staff.

.A41 An illustration of an appropriate opinion regarding compliance as to form with pertinent accounting requirements adopted by the SEC is as follows:

In our opinion [*include phrase except as disclosed in the registration statement if applicable*], the [*identify the financial statements and financial statement schedules*] audited by us and included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC.

.A42 Exhibit B, example K, "Alternate Wording When the SEC Has Agreed to a Departure From Its Accounting Requirements," illustrates an appropriate manner of disclosing a material departure from the pertinent rules and regulations adopted by the SEC.

.A43 The auditor may agree to examine or review MD&A in accordance with AT-C section 395. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Commenting in a Comfort Letter on Information Other Than Audited Financial Statements

General (Ref: par. .41–.43)

.A44 Comments included in the letter will often concern

- unaudited interim financial information.
- capsule financial information.
- pro forma financial information.
- financial forecasts.
- subsequent changes in specified financial statement items.

When the auditor has been requested to provide negative assurance on interim financial information or capsule financial information, the procedures involved in a review performed in accordance with GAAS applicable to reviews of interim financial information need not be specified.

.A45 Exhibit B, example A-1 contains an illustration of how the procedures performed by the auditor may be described.¹⁴

.A46 If the auditor states that the auditor has performed a review in accordance with GAAS applicable to reviews of interim financial information, this does not imply that those procedures are sufficient for the requesting party's purposes. The requesting party may ask the auditor to perform additional procedures. For example, the requesting party may request that the auditor apply additional procedures and specify items of financial information to be reviewed and the materiality level for changes in those items that would necessitate further inquiry by the auditor.

.A47 The procedures performed with respect to interim periods may not disclose subsequent changes in the specified financial statement items, inconsistencies in the application of the applicable financial reporting framework,

¹⁴ Paragraph 4 of example A-1 in exhibit B.

instances of noncompliance as to form with accounting requirements of the SEC, or other matters about which negative assurance is requested.

.A48 An illustration of an appropriate manner of noting the limitations of procedures performed is shown in example A-1 of exhibit B.¹⁵

.A49 Because there is no way for the auditor to anticipate other matters that would be of interest to a requesting party, the auditor is precluded, in accordance with paragraph .42, from making a statement that nothing else has come to the auditor's attention that would be of interest to the requesting party.

.A50 Exhibit B, example I, "Alternate Wording When Auditor's Report on Audited Financial Statements Contains an Emphasis-of-Matter Paragraph," contains an illustration of alternate wording when the auditor's report on audited financial statements is a modified report.

Knowledge of Internal Control (Ref: par. .44)

.A51 The auditor may have obtained a sufficient understanding of an entity's internal control over financial reporting for both annual and interim periods through performing an audit on the entity's financial statements for one or more periods.

Unaudited Interim Financial Information (Ref: par. .45–.48)

.A52 The SEC requirements specify condensed financial statements. However, the requirements in paragraphs .45–.48 also apply to complete financial statements. For purposes of this section, interim financial information may be for a 12-month period ending on a date other than the entity's normal year-end. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A53 The auditor may, but is not required to, state in the comfort letter that the auditor has performed a review of interim financial information in accordance with GAAS applicable to reviews of interim financial information, and has issued a report on the review.

.A54 Exhibit B, example A-1 provides an illustration of a description related to the procedures specified for a review in accordance with GAAS applicable to reviews of interim financial information.¹⁶ Exhibit B, example O, "Alternate Wording When the Procedures That the Requesting Party Has Requested the Auditor to Perform on Interim Financial Information Are Less Than a Review in Accordance With Generally Accepted Auditing Standards Applicable to Reviews of Interim Financial Information," provides an illustration of alternate wording when the procedures that the requesting party has requested the auditor to perform on interim financial information are less than a review in accordance with GAAS applicable to reviews of interim financial information.

.A55 Exhibit B, example A-1 includes an illustration of an appropriate manner of making clear that the auditor is not expressing an opinion on unaudited interim financial information.¹⁷

Capsule Financial Information (Ref: par. .50–.51)

.A56 In some securities offerings, supplementary capsule financial information comprising unaudited summarized interim financial information for

¹⁵ See the last three sentences in paragraph 4 of example A-1 in exhibit B.

¹⁶ Paragraphs 4a and 5a of example A-1 in exhibit B.

¹⁷ Paragraph 3 of example A-1 in exhibit B.

subsequent periods accompanies the information shown in the audited financial statements or unaudited interim financial information. This capsule financial information (either in narrative or tabular form) often is provided for the most recent interim period and for the corresponding period of the prior year.

.A57 The requesting party may ask the auditor to provide negative assurance with respect to the unaudited interim financial information, or unaudited condensed interim financial information that underlie the capsule financial information, and ask the auditor to state that the capsule financial information agrees with amounts set forth in such financial information. Exhibit B, example L, "Alternate Wording When Recent Earnings Data Are Presented in Capsule Form," provides an illustration of the auditor's comments in these circumstances.¹⁸

Pro Forma Financial Information (Ref: par. .52–.53)

.A58 An appropriate level of knowledge of the accounting and financial reporting practices of the entity may be obtained by the auditor auditing or reviewing, in accordance with GAAS, historical financial statements of the entity (or, in the case of a business combination, of a significant constituent part of the combined entity) for the most recent annual or interim period for which the pro forma financial information is presented.

.A59 Exhibit B, example D, "Comments on Pro Forma Financial Information," provides illustrations of wording regarding negative assurance on pro forma financial information as to compliance with the applicable accounting requirements of Rule 11-02 of Regulation S-X or with the pro forma bases as described in the pro forma financial information. Exhibit B, example O, provides an illustration of wording regarding procedures performed and findings obtained for pro forma financial information. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Financial Forecasts (Ref: par. .54–.57)

[.A60] [Paragraph deleted by the issuance of SAS No. 129, July 2014.]

.A61 Exhibit B, example E, "Comments on a Financial Forecast," provides illustrations of appropriate wording describing procedures performed on a financial forecast.

.A62 The attestation standards that apply to financial forecasts provide for examinations of and agreed-upon procedures related to financial forecasts but not reviews. AR-C section 80A, *Compilation Engagements*, applies when reporting on the compilation of a financial forecast. If a compilation report on the financial forecast has been issued in connection with the comfort letter, the report need not be included in the securities offering. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18 and SSARS No. 23.]

Subsequent Changes (Ref: par. .58–.64)

.A63 Comments regarding subsequent changes typically relate to whether, during the change period, there has been any

- change in capital stock;
- increase in long-term debt; or

¹⁸ Paragraphs 4b and 5b of example L, "Alternate Wording When Recent Earnings Data Are Presented in Capsule Form," in exhibit B.

- decreases in other specified financial statement items.

These comments might also address such matters as subsequent changes in the amounts of

- net current assets or stockholders' equity attributable to the entity.
- net sales and income from continuing operations and of net income or net income attributable to the entity. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A64 Procedures may include

- reading minutes and discussing with those charged with governance those meetings for which minutes have not been approved, and
- making inquiries of entity officials relating to the whole of the change period and obtaining appropriate written representations of the entity officials to support the answers to the inquiries.

.A65 Exhibit B, example A-1 provides an illustration of a description of procedures related to subsequent changes.¹⁹

.A66 Examples of the application of the requirements of paragraph .59 are as follows:

- When the auditor has audited the December 31, 20X0 financial statements, the auditor may provide negative assurance about changes in specified financial statement items as of any date through May 14, 20X1 (134 days subsequent to December 31).
- When the auditor has audited the December 31, 20X0 financial statements and has also conducted a review of the interim financial information as of and for the quarter ended March 31, 20X1, in accordance with GAAS applicable to reviews of interim financial information, the auditor may provide negative assurance about changes in specified financial statement items as of any date through August 12, 20X1 (134 days subsequent to March 31).

.A67 An appropriate manner of expressing negative assurance regarding subsequent changes is shown in exhibit B, in example A-1 if there has been no change, increase, or decrease, as applicable, and in example M, "Alternate Wording When Auditors Are Aware of a Decrease in a Specified Financial Statement Item," if there has been a decrease.²⁰ Example M may be modified when auditors are aware of a change or increase. Exhibit B, example O provides an illustration of reporting procedures performed and findings obtained relating to the subsequent change period. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A68 In commenting on subsequent changes, the auditor may use terms such as *change*, *increase*, or *decrease*. Terms such as *adverse* are not clearly understood and may cause the comments on subsequent changes to be ambiguous.

.A69 The comparison for the change period relates to the entire period and not to portions of that period. A decrease during one part of the period may be offset by an equal or larger increase in another part of the period. Because no decrease for the period as a whole existed, the comfort letter would not report

¹⁹ Paragraph 6 of example A-1 in exhibit B.

²⁰ Paragraphs 5b and 6 of example A-1 in exhibit B.

the decrease occurring during one part of the period. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A70 When more than one auditor is involved, the auditor of the group financial statements may comment that there were no decreases in the consolidated financial statement items, when appropriate, despite the possibility that decreases have been mentioned in a comfort letter issued by a component auditor. Exhibit B, example J, "Alternate Wording When Component Auditors Are Involved," contains an illustration of wording when more than one auditor is involved. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A71 The underwriting agreement usually specifies the dates as of which, and periods for which, data at the cut-off date and data for the change period are to be compared. For balance sheet items, the comparison date is normally that of the latest balance sheet included in the securities offering (that is, immediately prior to the beginning of the change period). For income statement items, the comparison period or periods might be, but are not limited to, the corresponding period of the preceding year or a period of corresponding length immediately preceding the change period.

.A72 The reasons for identifying the date and period used for comparison are to avoid misunderstandings about the matters being compared, and so that the requesting party can determine whether the comparison period is suitable for the requesting party's purposes.

.A73 The requesting party might request that the change period begin immediately after the date of the latest audited balance sheet (which is, ordinarily, also the closing date of the latest audited statement of income) in the securities offering, even though the securities offering includes a more recent unaudited balance sheet and statement of income. The use of the earlier date may defeat the requesting party's purpose because it is possible that an increase in one of the items referred to in paragraph .A63 occurring between the dates of the latest audited and unaudited balance sheets included in the securities offering might more than offset a decrease occurring after the latter date. A similar situation might arise in the comparison of income statement items. In these circumstances, the decrease occurring after the date of the latest unaudited interim financial information included in the securities offering would not be reported in the comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

Tables, Statistics, and Other Financial Information (Ref: par. .65–.71)

.A74 Other financial information appearing in the securities offering does not include financial information that is covered by the auditor's opinion on the financial statements.

.A75 Because the term *presents fairly*, when used by independent auditors, ordinarily relates to presentations of financial statements, the use of the term in commenting on other types of information may be misleading.

.A76 When the auditor has conducted an examination or a review of MD&A in accordance with AT-C section 395, the auditor may agree to trace nonfinancial data presented outside MD&A to similar data included in the MD&A presentation. When the auditor does not perform a review or an examination of MD&A or does not attach or refer to a report on MD&A, the auditor may perform procedures agreed to with the requesting party with respect to items in MD&A subject to internal control over financial reporting. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A77 Options for describing the procedures performed and the findings obtained include

- describing them individually for each item of specific information commented on.
- grouping or summarizing some or all of the descriptions, as long as
 - the procedures and findings are adequately described,
 - the applicability of the descriptions to items in the securities offering is clear, and
 - the descriptions do not imply that the auditor assumes responsibility for the adequacy of the procedures.
- presenting a matrix listing the financial information and common procedures employed and indicating the procedures applied to the specific items.
- identifying procedures performed with specified symbols and identifying items to which those procedures have been applied directly on a copy of the securities offering, which is attached to the comfort letter. [As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A78 Exhibit B, examples F, "Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings," G, "Comments on Tables, Statistics, and Other Financial Information—Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information," and H, "Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols," provide illustrations of appropriate ways of expressing comments on tables, statistics, and other financial information.

.A79 Except with respect to requirements for financial statements and certain Regulation S-K items discussed in paragraph .72, the question of what constitutes appropriate information for compliance with the requirements of a particular item of the securities offering form is a matter of legal interpretation outside the competence of auditors.

.A80 Exhibit B, example F contains an illustration of an appropriate way of stating the limitations regarding the sufficiency of the auditor's procedures.²¹

Compliance as to Form With Regulation S-K (Ref: par. .72–.73)

.A81 The following are the disclosure requirements of Regulation S-K that generally meet the criteria in paragraph .72:

- Item 301, "Selected Financial Data"
- Item 302, "Supplementary Financial Information"
- Item 402, "Executive Compensation"
- Item 503(d), "Ratio of Earnings to Fixed Charges"

²¹ Paragraph 9 of example F, "Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings," in exhibit B.

.A82 Because information relevant to Regulation S-K disclosure requirements other than those noted previously is generally not derived from the accounting records subject to internal control over financial reporting, it is not appropriate for the auditor to comment on conformity of this information with Regulation S-K.

.A83 The auditor's inability to comment on conformity with Regulation S-K does not preclude the auditor from performing procedures and reporting findings with respect to this information.

.A84 Item 305, "Quantitative and Qualitative Disclosures About Market Risk," of Regulation S-K does not meet the criteria in paragraph .65 for the auditor to provide comments on the Item 305 qualitative disclosures because the disclosures are not derived from the accounting records but are descriptive and hypothetical or forward-looking in nature.

.A85 Item 305 does not meet the criteria in paragraph .72 for the auditor to provide negative assurance on conformity with Item 305. Although some information needed to comply with Item 305 is derived from the accounting records, registrants must also provide a substantial amount of information that is not derived from accounting records subject to internal control over financial reporting.

.A86 Item 305 requires quantitative disclosures that may be presented in the form of a tabular presentation, sensitivity analysis, or value-at-risk disclosures. The auditor may perform limited procedures related to tabular presentations to the extent that such information is derived from the accounting records subject to internal control over financial reporting.

.A87 The appendix, "Commenting in a Comfort Letter on Quantitative Disclosures About Market Risk Made in Accordance With Item 305 of Regulation S-K," provides guidance on providing comments on Item 305 quantitative disclosures and examples of very simplified procedures, findings, and limitations related to Item 305 tabular presentation disclosures.

Concluding Paragraph (Ref: par. .74)

.A88 An illustration of an appropriate concluding paragraph is shown in exhibit B, examples A-1, A-2, and B.

Disclosure of Subsequently Discovered Matters (Ref: par. .75)

.A89 Subsequently discovered matters may include changes in specified items not disclosed in the securities offering, as discussed in paragraph .62.

.A90 The auditor's participation in the meeting may be helpful when the entity and requesting party discuss such matters.

.A91

Appendix—Commenting in a Comfort Letter on Quantitative Disclosures About Market Risk Made in Accordance With Item 305 of Regulation S-K

.A91-1 Regulation S-K, Item 305, Quantitative and Qualitative Disclosures About Market Risk, requires certain quantitative and qualitative disclosures with respect to derivative financial instruments, generally as defined in Financial Accounting Standards Board *Accounting Standards Codification* glossary.

.A91-2 In addition to qualitative (that is, descriptive) disclosures, Item 305 requires quantitative disclosures that may be presented in the form of a tabular presentation, sensitivity analysis, or value-at-risk disclosures. Disclosures generally include a combination of historical and fair value data and the hypothetical effects on such data of assumed changes in interest rates, foreign currency exchange rates, commodity prices, and other relevant market rates. The quantitative and qualitative information required by Item 305 are disclosed outside the financial statements and related notes thereto.

.A91-3 Item 305 does not meet the criteria in paragraph .65 for the auditor to provide comments on the Item 305 qualitative disclosures because the disclosures are descriptive and are not derived from the accounting records because they are hypothetical or forward-looking in nature.

.A91-4 Although some information needed to comply with Item 305 is derived from the accounting records, registrants must also provide a substantial amount of information that is not derived from accounting records subject to internal control over financial reporting. As a result, Item 305 does not meet the criteria in paragraph .72 for the auditor to provide negative assurance on conformity with Item 305 of Regulation S-K.

.A91-5 The three alternative forms of quantitative disclosures under Item 305 reflect hypothetical effects on market risk sensitive instruments and result in differing presentations. The forward-looking information used to prepare these presentations may be substantially removed from the accounting records that are subject to internal control over financial reporting. Further, paragraph .68 also states that the auditor should not comment on matters merely because the auditor is capable of reading, counting, measuring, or performing other functions that might be applicable. Accordingly, an auditor's ability to comment on these disclosures is largely dependent upon the degree to which the forward-looking information used to prepare these disclosures is linked to such accounting records.

.A91-6 The tabular presentation includes the fair values of market risk sensitive instruments and contract terms to determine the future cash flows from those instruments that are categorized by expected maturity dates. This approach may require the use of yield curves and implied forward rates to determine expected maturity dates, as well as assumptions regarding prepayments and weighted average interest rates.

.A91-7 The term *sensitivity analysis* describes a general class of models that are designed to assess the risk of loss in market risk sensitive instruments, based upon hypothetical changes in market rates or prices. Sensitivity analysis does not refer to any one, specific model and may include duration analysis or other

"sensitivity" measures. The disclosures are dependent upon assumptions about theoretical future market conditions and, therefore, are not derived from the accounting records.

.A91-8 The term *value at risk* describes a general class of models that provide a probabilistic assessment of the risk of loss in market risk sensitive instruments over a selected period of time, with a selected likelihood of occurrences based upon selected confidence intervals. Value-at-risk disclosures are extremely aggregated and, in addition to the assumptions made for sensitivity analyses, may include additional assumptions regarding correlation between asset classes and future market volatilities. As a result, these disclosures are not derived from the accounting records.

.A91-9 Of the three disclosure alternatives, the tabular presentation contains the most limited number of assumptions and least complex mathematical calculations. Furthermore, certain information, such as contractual terms, included in a tabular presentation is derived from the accounting records. Accordingly, auditors may perform limited procedures related to tabular presentations to the extent that such information is derived from the accounting records subject to internal control over financial reporting.

.A91-10 The modeling techniques and underlying assumptions utilized for sensitivity analysis and value-at-risk disclosures generally will be highly complex. The resultant disclosures may be substantially different from the basic historical financial input derived directly from the accounting records. Due to the hypothetical and forward-looking nature of these disclosures and the potentially limited usefulness of any procedures that may be performed, sensitivity analysis or value-at-risk disclosures do not meet the criteria in paragraph .65 for the auditor to agree to make any comments or perform any procedures related to sensitivity analysis or value-at-risk disclosures.

.A91-11 When performing procedures related to tabular presentation disclosures, the auditor is required by paragraph .65 to consider whether the entity's documentation of its contractual positions in derivatives, commodities, and other financial instruments is subject to internal control over financial reporting and whether it provides a complete record of the entity's market risk sensitive instruments. In addition, the auditor is not permitted to express positive or negative assurance about the reasonableness of the assumptions underlying the disclosures.

.A91-12 Item 305 requires registrants to stratify financial instruments according to market risk category, that is, interest rate risk, foreign exchange risk, and equity price risk. Item 305 stipulates that if an instrument is at risk in more than one category, the instrument should be included in the disclosures for each applicable category. The stratifications and the company's determination of market risk categories are not derived from the company's accounting records. Accordingly, the auditor is not permitted to provide any findings that the company's stratifications are complete or comply as to form with Item 305 requirements and should disclaim with respect to the company's determination of market risk categories.

.A91-13 Item 305 encourages registrants to provide quantitative and qualitative information about market risk in terms of, among other things, the magnitude of actual past market movements and estimates of possible near-term market movements. As market data is not derived from the company's accounting records, the auditor is not permitted to agree to perform any procedures related to such market data.

.A91-14 Further, the auditor may need to utilize a specialist in performing procedures related to those disclosures.

.A91-15 The following examples, based on example H, "Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols," of exhibit B, "Examples of Comfort Letters," provide very simplified procedures, findings, and limitations related to Item 305 tabular presentation disclosures. In practice, the procedures generally will be substantially more complex.

Symbol	Procedures and Findings
√	Compared with a schedule prepared by the Company from its accounting records. We (a) compared the amounts on the schedule to corresponding amounts appearing in the accounting records and found such amounts to be in agreement, and (b) determined that the schedule was mathematically correct. However, we make no comment as to the appropriateness or completeness of the Company's classification of its market-risk-sensitive instruments into market risk categories, nor as to its determination of the expected maturity dates or amounts. (Note: This is an example of procedures related to tabular presentations of face amounts, carrying amounts, fair values, and notional amounts, which stratify such amounts as to interest rate risk.)
⊗	Compared with a schedule prepared by the Company from its accounting records to calculate weighted average fixed interest rates and weighted average fixed pay and receive rates and found such percentages to be in agreement. We (a) compared the amounts on the schedule to corresponding amounts appearing in the accounting records and found such amounts to be in agreement, and (b) determined that the schedule was mathematically correct. However, we make no comment as to the appropriateness of the Company's methodology in calculating weighted average fixed rates. (Note: It may be necessary to provide a more complete description of the procedures performed in other circumstances.) We make no comment as to the appropriateness or completeness of the Company's determination of the Regulation S-K requirements for quantitative and qualitative disclosures about market risks or with respect to the reasonableness of the assumptions underlying the disclosures.

[The following is an extract from a registration statement that illustrates how an auditor can document procedures performed on a tabular presentation of market risk disclosures made in accordance with Item 305 of Regulation S-K.]

INTEREST RATE SENSITIVITY

The following table provides information about the Company's derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, including interest rate swaps and debt obligations. For debt obligations, the table presents principal cash flows and related weighted average interest rates by expected maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. Weighted average variable rates

are based on implied forward rates in the yield curve at the reporting date. The information is presented in U.S. dollar equivalents, which is the Company's reporting currency. The instrument's actual cash flows are denominated in both U.S. dollars (\$US) and German deutschmarks (DM), as indicated in parentheses.

	Expected maturity dates						
	<u>20X2¹</u>	<u>20X3¹</u>	<u>20X4¹</u>	<u>20X5¹</u>	<u>Thereafter¹</u>	<u>Total</u>	<u>Fair Value</u>
Liabilities							
Long-Term Debt:	(\$US equivalent in millions)						
Fixed Rate (\$US)	\$XXX	\$XXX	\$XXX	\$XXX	\$XXX	\$XXX ✓	\$XXX ✓
Average interest rate	XX%	XX%	XX%	XX%	XX%	XX% ⊗	
Fixed Rate (DM)	XXX	XXX	XXX	XXX	XXX	XXX ✓	XXX ✓
Average interest rate	XX%	XX%	XX%	XX%	XX%	XX% ⊗	
Variable Rate (\$US)	XXX	XXX	XXX	XXX	XXX	XXX ✓	XXX ✓
Average interest rate	XX%	XX%	XX%	XX%	XX%	XX% ¹	
Interest Rate Derivatives	(\$US equivalent in millions)						
Interest Rate Swaps:							
Variable to fixed (\$US)	\$XXX	\$XXX	\$XXX	\$XXX	\$XXX	\$XXX ✓	\$XXX ✓
Average pay rate-fixed	XX%	XX%	XX%	XX%	XX%	XX% ⊗	
Average receive rate-variable	XX%	XX%	XX%	XX%	XX%	XX% ¹	
Fixed to Variable (\$US)	XXX	XXX	XXX	XXX	XXX	XXX ✓	XXX ✓
Average pay rate-variable	XX%	XX%	XX%	XX%	XX%	XX% ¹	
Average receive rate-fixed	XX%	XX%	XX%	XX%	XX%	XX% ⊗	

¹ Because these disclosures include either management's expectations of future cash flows or the use of implied forward rates applied to such expected cash flows, such information does not meet the criteria of paragraph .65. Accordingly, the auditor is not permitted to express findings on amounts in these columns.

.A92

Exhibit A—Illustration of Representation Letter From Requesting Party (Ref: par. .A4)

The following is an example of a letter from a nonunderwriter when the securities offering is not being registered under the Securities Act of 1933. If requested to provide a definition of substantially consistent, the following language may be added to the letter:

What is substantially consistent may vary from situation to situation and may not be the same as that done in a registered offering of the same securities for the same entity. Whether the procedures being, or to be, followed will be substantially consistent is determined by us on a case-by-case basis.

[Date]

Dear ABC Accountants:

[Name of requesting party], as principal or agent, in the placement of [identify securities] to be issued by [name of issuer of the securities], will be reviewing certain information relating to [issuer of the securities] that will be included (incorporated by reference) in the document [if appropriate, identify the document], which may be delivered to investors and utilized by them as a basis for their investment decision. This review process, applied to the information relating to the issuer of the securities, is (will be) substantially consistent with the due diligence review process that an underwriter would perform if this placement [issuance] of securities were being registered pursuant to the Securities Act of 1933 (the Act). We are knowledgeable with respect to the due diligence review process that would be performed if this placement of securities were being registered pursuant to the Act. We hereby request that you deliver to us a "comfort" letter concerning the financial statements of the issuer of the securities and certain statistical and other data included in the offering document. We will contact you to identify the procedures we wish you to follow and the form we wish the comfort letter to take.

Very truly yours,

[Name of Requesting Party]

[As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129.]

.A93**Exhibit B—Examples of Comfort Letters****Example A — Typical Comfort Letters .A93-3–.A93-4****Example A-1 — Typical Comfort Letter for a 1933 Act Offering .A93-3****Example A-2 — Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained .A93-4****Example B — Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Form 8-K by Reference .A93-5****Example C — Letter Reaffirming Comments as of a Later Date .A93-6****Example D — Comments on Pro Forma Financial Information .A93-7–.A93-8****Example D-1 — Negative Assurance on Pro Forma Financial Information as to Compliance With The Applicable Accounting Requirements of Rule 11-02 of Regulation S-X .A93-7****Example D-2 — Negative Assurance on Pro Forma Financial Information as to Compliance With Pro Forma Bases as Described in the Pro Forma Financial Information .A93-8****Example E — Comments on a Financial Forecast .A93-9****Example F — Comments on Tables, Statistics, and Other Financial Information — Complete Description of Procedures and Findings .A93-10****Example G — Comments on Tables, Statistics, and Other Financial Information — Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information .A93-11****Example H — Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols .A93-12****Example I — Alternate Wording When Auditor's Report on Audited Financial Statements Contains an Emphasis-of-Matter Paragraph .A93-13****Example J — Alternate Wording When Component Auditors Are Involved .A93-14****Example K — Alternate Wording When the SEC Has Agreed to a Departure From Its Accounting Requirements .A93-15****Example L — Alternate Wording When Recent Earnings Data Are Presented in Capsule Form .A93-16****Example M — Alternate Wording When Auditors Are Aware of a Decrease in a Specified Financial Statement Item .A93-17****Example N — Alternate Wording of the Letter for Companies That Are Permitted to Present Interim Earnings Data for a 12-Month Period .A93-18**

Example O — Alternate Wording When the Procedures That the Requesting Party Has Requested the Auditor to Perform on Interim Financial Information Are Less Than a Review in Accordance With Generally Accepted Auditing Standards Applicable to Reviews of Interim Financial Information **.A93-19**

Example P — Intentionally Omitted (See example A-2)

Example Q — Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11 **.A93-20**

Example R — Alternate Wording When Reference to Examination of Annual Management's Discussion and Analysis and Review of Interim Management's Discussion and Analysis Is Made **.A93-21**

Introduction

.A93-1 The contents of comfort letters vary depending on the extent of the information in the securities offering and the wishes of the requesting party. Shelf registration statements may have several closing dates and different underwriters. Descriptions of procedures and findings regarding interim financial information, tables, statistics, or other financial information that is incorporated by reference from previous Securities Exchange Act of 1934 filings may have to be repeated in several comfort letters. To avoid restating these descriptions in each comfort letter, the auditor may initially issue the comments in a format (such as an appendix) that can be referred to in, and attached to, subsequently issued comfort letters.

.A93-2 A typical comfort letter includes

- a. a statement regarding the independence of the auditor. (Ref: par. .35)
- b. if applicable, an opinion regarding whether the audited financial statements included (incorporated by reference) in the securities offering comply as to form in all material respects with the applicable accounting requirements of the Securities Act of 1933 (the 1933 Act) and related rules and regulations adopted by the Securities and Exchange Commission (SEC). (Ref: par. .36–.40)
- c. negative assurance on whether
 - i. if applicable, the unaudited interim financial information included (incorporated by reference) in the securities offering (Ref: par. .45–.48) complies as to form in all material respects with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC.
 - ii. any material modifications should be made to the unaudited interim financial information included (incorporated by reference) in the securities offering for them to be in conformity with the applicable financial reporting framework.
- d. negative assurance on whether, during a specified period following the date of the latest financial statements in the securities offering, there has been any change in capital stock, increase in

long-term debt, or any decrease in other specified financial statement items. (Ref: par. .58–.64)

Example A-1 contains a typical comfort letter for a 1933 Act offering and example A-2 contains a typical comfort letter for a non-1933 Act offering. Letters that cover some of the items may be developed by omitting inapplicable portions of these examples. Examples B, D–O, and R contain additional or alternate wording for examples A-1 or A-2, as applicable, for various scenarios.

Although the illustrations in this exhibit describe procedures that may be followed by auditors as a basis for their comments, this section does not necessarily prescribe such procedures.

Example A—Typical Comfort Letters

Example A-1—Typical Comfort Letter for a 1933 Act Offering

.A93-3 Example A-1 is an example of a letter that the auditor of a nonissuer may provide when a registrant is including the nonissuer's financial statements in a securities offering to be filed with the SEC. Appropriate modifications would be made if additional financial information is covered by the comfort letter. Example A-1 assumes the following circumstances:

- The prospectus includes audited consolidated balance sheets as of December 31, 20X5 and 20X4, and audited consolidated statements of income, stockholders' equity, and cash flows for each year in the three-year period ended December 31, 20X5. Note that the example assumes all the net income is attributable to the company. If that were not the case, the references to net income would be modified, or additional references would be included as appropriate.
- The prospectus also includes an unaudited condensed consolidated balance sheet as of March 31, 20X6, and unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, reviewed in accordance with generally accepted auditing standards applicable to reviews of interim financial information; however the review report is not included in the securities offering. If the review report is included in the securities offering, the auditor may state that the auditor has issued a review report on the interim financial information in the introductory paragraph of the comfort letter, as follows:

Also, we have reviewed the unaudited condensed consolidated financial statements as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5, as indicated in our report dated May 15, 20X6, which is included (incorporated by reference) in the registration statement.

The cut-off date is June 23, 20X6, and the letter is dated June 28, 20X6. The effective date is June 28, 20X6.

- The auditors are reporting independence under the SEC rules and regulations. If the auditors were not required to be independent under the SEC rules and regulations in conjunction with an SEC filing, paragraph 1 in example A-1 would be replaced with paragraph 1 in example A-2.

The auditor may agree to comment in the comfort letter on whether the interim financial information complies as to form in all material respects with the

applicable accounting requirements of the rules and regulations adopted by the SEC.

The example also assumes that there has been no change in the application of a requirement of generally accepted accounting principles during the interim period. If there has been such a change, a reference to that change would be included in paragraph 5 of example A-1.

Each of the comments in the letter is in response to a requirement of the underwriting agreement. For purposes of example A-1, the income statement items of the current interim period are to be compared with those of the corresponding period of the preceding year.

June 28, 20X6

[Addressee]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included in The Issuer Company's (the registrant) registration statement (no. 33-00000) on Form S-1 filed by the registrant under the Securities Act of 1933 (the Act); our report with respect thereto is also included in that registration statement. The registration statement, as amended on June 28, 20X6, is herein referred to as the registration statement.

In connection with the registration statement—

1. We are independent certified public accountants with respect to the company within the meaning of the 1933 Act and the applicable rules and regulations thereunder adopted by the SEC.
2. In our opinion [*include the phrase except as disclosed in the registration statement if applicable*], the consolidated financial statements audited by us and included in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.
3. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although, we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registration statement, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.
4. For purposes of this letter we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [*include*

other appropriate committees, if any] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, of officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [dates]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

- a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—
 - (i) Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registration statement.
 - (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in a(i) comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.
- b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—
 - (i) Read the unaudited consolidated financial information of the company and subsidiaries for April and May of both 20X5 and 20X6 furnished us by the company, officials of the company having advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. [If applicable: The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statements of cash flows and other disclosures.]
 - (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited consolidated financial information referred to in b(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the registration statement.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

a.

- (i) Any material modifications should be made to the unaudited condensed consolidated financial statements described in 4a(i), included in the registration statement, for them to be in conformity with generally accepted accounting principles.¹
- (ii) The unaudited condensed consolidated financial statements described in 4a(i) do not comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b.

- (i) At May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the registration statement, or
- (ii) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared to the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income, except in all instances for changes, increases, or decreases that the registration statement discloses have occurred or may occur.

6. As mentioned in 4b, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (a) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6, unaudited condensed consolidated balance sheet included in the registration statement, or (b) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the registration statement discloses have occurred or may occur.

¹ Section 930, *Interim Financial Information*, does not require the auditor to modify the report on a review of interim financial information for a lack of consistency in the application of accounting policies provided that the interim financial information appropriately discloses such matters.

7. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to in whole or in part in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or in any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example A-2—Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained

.A93-4 Example A-2 is applicable when a comfort letter is issued in a non-1933 Act offering. Example A-2 assumes the following:

- The offerer is not an SEC registrant.
- The requesting party has given the auditor a representation letter as required by paragraph .11 and illustrated in paragraph .A92.
- The securities offering includes audited consolidated balance sheets as of December 31, 20X5 and 20X4, and audited consolidated statements of income, stockholders' equity, and cash flows for each year in the three-year period ended December 31, 20X5. Note that the example assumes all the net income is attributable to the company. If that were not the case, the references to net income would be modified, or additional references would be included as appropriate.
- The securities offering also includes an unaudited condensed consolidated balance sheet as of March 31, 20X6, and unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, reviewed in accordance with generally accepted auditing standards applicable to reviews of interim financial information; however, the review report is not included in the securities offering. If the review report is included in the securities offering, the auditor may state that the auditor has issued a review report on the interim financial information. in the introductory paragraph of the comfort letter, as follows:

Also, we have reviewed the unaudited condensed consolidated financial statements as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5, as indicated in our report dated May 15, 20X6, which is included (incorporated by reference) in the securities offering.

- The auditor did not perform an audit of the effectiveness of internal control over financial reporting in any period.
- There has not been a change in the application of a requirement of generally accepted accounting principles during the interim period. If there has been such a change, a reference to that change would be included in paragraph 4.

The cut-off date is June 23, 20X6, and the letter is dated June 28, 20X6.

Each of the comments in the letter is in response to a request from the requesting party. For purposes of example A-2, the income statement items of the current interim period are to be compared with those of the corresponding period of the preceding year.

June 28, 20X6

[Addressee]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included [or *incorporated by reference*] in the offering memorandum for \$30,000,000 of Senior Debt due May 30, 20Z6. Our report with respect thereto is included in the offering memorandum. This offering memorandum, dated June 28, 20X6, is herein referred to as the Offering Memorandum.

This letter is being furnished in reliance upon your representation to us that—

- a. You are knowledgeable with respect to the due diligence review process that would be performed if this placement of securities were being registered pursuant to the Securities Act of 1933 (the Act).
- b. In connection with the offering of Senior Debt, the review process you have performed is substantially consistent with the due diligence review process that you would have performed if this placement of securities were being registered pursuant to the Act.

In connection with the Offering Memorandum—

1. We are independent certified public accountants with respect to the company under the "Independence Rule" of the AICPA's Code of Professional Conduct and its interpretations.
2. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although, we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any interim period within that year. Therefore, we are unable to and do not express any opinion on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, of cash flows, and of changes in stockholders' equity for the three-month periods ended March 31, 20X5 and 20X6, included in the Offering Memorandum, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.
3. For purposes of this letter, we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [include other appropriate committees, if any] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all

such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [dates]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

- a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—
 - (i) Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the Offering Memorandum.
- b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—
 - (i) Read the unaudited consolidated financial information of the company and subsidiaries for April and May of both 20X5 and 20X6 furnished us by the company, officials of the company having advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. *[If applicable: The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statement of cash flows and other disclosures.]*
 - (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited consolidated financial information referred to in b(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

4. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

a.

- (i) Any material modifications should be made to the unaudited condensed consolidated financial statements described in 3a(i), included in the Offering Memorandum, for them to be in conformity with generally accepted accounting principles.²

² Section 930 does not require the auditor to modify the report on a review of interim financial information for a lack of consistency in the application of accounting policies provided that the interim financial information appropriately discloses such matters.

b.

- (i) At May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum, or
 - (ii) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared to the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income, except in all instances for changes, increases, or decreases that the Offering Memorandum discloses have occurred or may occur.
- 5. As mentioned in 3*b*, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 20X6 are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 3. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (a) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum, or (b) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 3, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the Offering Memorandum discloses have occurred or may occur.
- 6. This letter is solely for the information of the addressees and to assist the requesting party in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the Offering Memorandum, and it is not to be used, circulated, quoted, or otherwise referred to for any purpose, including but not limited to the purchase or sale of securities, nor is it to be filed with or referred to in whole or in part in the Offering Memorandum or any other document, except that reference may be made to it in the Purchase Contract or in any list of closing documents pertaining to the offering of the securities covered by the Offering Memorandum.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Example B—Letter When a Short-Form Registration Statement Is Filed Incorporating Previously Filed Form 8-K by Reference

A93-5 Example B is an example of modifications to the letter that the auditor of a nonissuer may provide when a registrant has acquired the nonissuer, and the registrant uses a short-form registration statement (for example, Form S-3), which incorporates a previously filed Form 8-K that includes the nonpublic company's financial statements. The auditor was independent of the nonissuer but is not independent with respect to the registrant.

June 28, 20X6

[Addressee]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included in The Issuer Company's (the registrant) current report on Form 8-K dated May 15, 20X6, and incorporated by reference in the registration statement (no. 33-00000) on Form S-3 filed by the registrant under the Securities Act of 1933 (the Act); our report with respect thereto is also incorporated by reference in that registration statement. The registration statement, as amended on June 28, 20X6, is herein referred to as the registration statement.

In connection with the registration statement—

1. As of [insert date of the auditor's most recent report on the financial statements of the entity] and during the period covered by the financial statements on which we reported, we were independent certified public accountants with respect to the company under the "Independence Rule" of the AICPA's Code of Professional Conduct and its interpretations.
2. In our opinion, the consolidated financial statements audited by us and incorporated by reference in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the Securities Exchange Act of 1934 and the related rules and regulations adopted by the SEC.
3. We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the consolidated financial statements for any interim period within that year. Therefore, we are unable to, and do not express any opinion on, the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registrant's current report on Form 8-K dated May 15, 20X6, incorporated by reference in the registration statement, or on the financial position, results of

operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.

4. For purposes of this letter, we have read the 20X6 minutes of the meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein, and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):

With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—

- (i) Performed a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the registrant's current report on Form 8-K dated May 15, 20X6, incorporated by reference in the registration statement.
- (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in (i) comply as to form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 and the related rules and regulations adopted by the SEC.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations about the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—
 - (i) Any material modifications should be made to the unaudited condensed consolidated financial statements described in 4(i), incorporated by reference in the registration statement, for them to be in conformity with generally accepted accounting principles.
 - (ii) The unaudited condensed consolidated financial statements described in 4(i) do not comply as to form in all material respects with the applicable accounting requirements of the Securities Exchange Act of 1934 and the related rules and regulations adopted by the SEC.
6. This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement,

and for use of the auditors of the registrant in furnishing their letter to the underwriters, and it is not to be used, circulated, quoted, or otherwise referred to within the underwriting group for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or any list of closing documents pertaining to the offering of the securities covered by the registration statement.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Example C—Letter Reaffirming Comments as of a Later Date

.A93-6 If more than one comfort letter is requested, the subsequent letter may, in appropriate situations, refer to information appearing in the earlier letter without repeating such information (see paragraph .25 of this section and paragraph .A93-1 of this exhibit). Example C reaffirms and updates the information in example A-1. In a non-1933 Act offering, the last paragraph in example C would be replaced with the last paragraph in example A-2.

July 25, 20X6

[Addressee]

Dear Ladies and Gentlemen:

We refer to our letter of June 28, 20X6, relating to the registration statement (no. 33-00000) of The Nonissuer Company, Inc. (the company). We reaffirm as of the date hereof (and as though made on the date hereof) all statements made in that letter except that, for the purposes of this letter

- a. The registration statement to which this letter relates is as amended on July 13, 20X6 [effective date].
- b. The reading of minutes described in paragraph 4 of that letter has been carried out through July 20, 20X6 [the new cut-off date].
- c. The procedures and inquiries covered in paragraph 4 of that letter were carried out to July 20, 20X6 [the new cut-off date] (our work did not extend to the period from July 21, 20X6 to July 25, 20X6 [date of letter], inclusive).
- d. The period covered in paragraph 4b of that letter is changed to the period from April 1, 20X6 to June 30, 20X6, officials of the company having advised us that no financial statements as of any date or for any period subsequent to June 30, 20X6, were available.
- e. The references to May 31, 20X6 in paragraph 5b of that letter are changed to June 30, 20X6.
- f. The references to May 31, 20X6 and June 23, 20X6 in paragraph 6 of that letter are changed to June 30, 20X6 and July 20, 20X6, respectively.

This letter is solely for the information of the addressees and to assist the underwriters in conducting and documenting their investigation of the affairs of the company in connection with the offering of the securities covered by the registration statement, and it is not to be used, circulated, quoted, or otherwise referred to within or without the underwriting group for any other purpose, including but not limited to the registration,

purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in the registration statement or any other document, except that reference may be made to it in the underwriting agreement or any list of closing documents pertaining to the offering of the securities covered by the registration statement.

Example D—Comments on Pro Forma Financial Information

Example D-1—Negative Assurance on Pro Forma Financial Information as to Compliance With The Applicable Accounting Requirements of Rule 11-02 of Regulation S-X

.A93-7 Example D-1 is applicable when the auditor is asked to provide negative assurance on (a) whether the pro forma financial information included in a securities offering complies as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X, and (b) the application of pro forma adjustments to historical amounts in the compilation of the pro forma financial information (see paragraphs .52–.53). The material in this example is intended to be inserted between paragraphs 6 and 7 in example A-1 or between paragraphs 5 and 6 in example A-2. The example assumes that the auditor has not previously reported on the pro forma financial information. If the auditor did previously report on the pro forma financial information, the auditor may refer in the introductory paragraph of the comfort letter to the fact that the auditor has issued a report, and the report may be attached to the comfort letter (see paragraphs .A31–.A32). In that circumstance, the procedures in 7b(i) and 7c ordinarily would not be performed, and therefore the auditor would not separately comment on the application of pro forma adjustments to historical financial information because that assurance is encompassed in the auditor's report on pro forma financial information. The auditor may, however, agree to comment on compliance as to form with the applicable accounting requirements of Rule 11-02 of Regulation S-X.

7. At your request, we have—

- a. Read the unaudited pro forma condensed consolidated balance sheet as of March 31, 20X6, and the unaudited pro forma condensed consolidated statements of income for the year ended December 31, 20X5, and the three-month period ended March 31, 20X6, included in the *[registration statement or Offering Memorandum, as applicable]*.
- b. Inquired of certain officials of the company who have responsibility for financial and accounting matters about
 - (i) the basis for their determination of the pro forma adjustments and
 - (ii) whether the unaudited pro forma condensed consolidated financial statements referred to in 7a comply as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X.
- c. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed consolidated financial statements.

The foregoing procedures are substantially less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion on management's assumptions, the pro

forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion or conclusion. The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representation about the sufficiency of such procedures for your purposes.

8. Nothing came to our attention as a result of the procedures specified in paragraph 7, however, that caused us to believe that the unaudited pro forma condensed consolidated financial statements referred to in 7a included in the [registration statement or Offering Memorandum, *as applicable*] do not comply as to form in all material respects with the applicable accounting requirements of Rule 11-02 of Regulation S-X and that the pro forma adjustments have not been properly applied to the historical amounts in the compilation of the unaudited pro forma condensed consolidated financial statements. Had we performed additional procedures or had we made an examination or review of the pro forma condensed consolidated financial statements, other matters might have come to our attention that would have been reported to you.

Example D-2—Negative Assurance on Pro Forma Financial Information as to Compliance With Pro Forma Bases as Described in the Pro Forma Financial Information

.A93-8 Example D-2 is applicable when the auditor is asked to provide negative assurance on (a) whether the pro forma financial information included in a securities offering complies as to form in all material respects with the pro forma bases described in the pro forma financial statements, and (b) the application of pro forma adjustments to historical amounts in the compilation of the pro forma financial information (see paragraphs .52–.53). The material in this example is intended to be inserted between paragraphs 5 and 6 in example A-2.

The example assumes that the auditor has not previously reported on the pro forma financial information. If the auditor did previously report on the pro forma financial information, the auditor may refer in the introductory paragraph of the comfort letter to the fact that the auditor has issued a report, and the report may be attached to the comfort letter (see paragraphs .A31–.A32). In that circumstance, the procedures in 6b(i) and 6c ordinarily would not be performed, and therefore the auditor would not separately comment on the application of pro forma adjustments to historical financial information because that assurance is encompassed in the auditor's report on pro forma financial information. The auditor may, however, agree to comment on compliance as to form with the pro forma bases described in the pro forma financial statements.

6. At your request, we have—
 - a. Read the unaudited pro forma condensed consolidated balance sheet as of March 31, 20X6, and the unaudited pro forma condensed consolidated statements of income for the year ended December 31, 20X5, and the three-month period ended March 31, 20X6, included in the Offering Memorandum.
 - b. Inquired of certain officials of the company who have responsibility for financial and accounting matters about
 - (i) the basis for their determination of the pro forma adjustments, and

- (ii) whether the unaudited pro forma condensed consolidated financial statements referred to in 6a comply as to form in all material respects with the pro forma bases described in the pro forma condensed consolidated financial statements.
- c. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed consolidated financial statements.

The foregoing procedures are substantially less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion or conclusion. The foregoing procedures would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representation about the sufficiency of such procedures for your purposes.

7. Nothing came to our attention as a result of the procedures specified in paragraph 6, however, that caused us to believe that the unaudited pro forma condensed consolidated financial statements referred to in 6a included in the Offering Memorandum do not comply in all material respects with the pro forma bases described in the pro forma condensed consolidated financial statements and that the pro forma adjustments have not been properly applied to the historical amounts in the compilation of the unaudited pro forma condensed consolidated financial statements. Had we performed additional procedures or had we made an examination or a review of the pro forma condensed consolidated financial statements, other matters might have come to our attention that would have been reported to you.

Example E—Comments on a Financial Forecast

.A93-9 Example E is applicable when an auditor is asked to comment on a financial forecast (see paragraph .54). The material in this example is intended to be inserted between paragraphs 6 and 7 in example A-1 or between paragraphs 5 and 6 in example A-2. The example assumes that the auditor has previously reported on the compilation of the financial forecast and that the report is attached to the letter (see paragraphs .A31–.A32).

7. At your request, we performed the following procedure with respect to the forecasted consolidated balance sheet and consolidated statements of income and cash flows as of December 31, 20X6, and for the year then ending. With respect to forecasted rental income, we compared the occupancy statistics about expected demand for rental of the housing units to statistics for existing comparable properties and found them to be the same.
8. Because the procedure described above does not constitute an examination of prospective financial statements in accordance with standards promulgated by the American Institute of Certified Public Accountants, we do not express an opinion on whether the prospective financial statements are presented in conformity with AICPA presentation guidelines or on whether the underlying assumptions provide a reasonable basis for the presentation.

Had we performed additional procedures or had we made an examination of the forecast in accordance with standards promulgated by the AICPA, matters might have come to our attention that would have been reported to you. Furthermore, there will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material.

Example F—Comments on Tables, Statistics, and Other Financial Information—Complete Description of Procedures and Findings

.A93-10 Example F is applicable when the auditor is asked to comment on tables, statistics, or other compilations of information appearing in a securities offering (paragraphs .65–.71). Each of the comments is in response to a specific request. The paragraphs in example F are intended to follow paragraph 6 in example A-1 or paragraph 5 in example A-2. In a non-1933 Act securities offering, paragraph 9c(iii) generally would not be included.

In some cases, the auditor may choose to combine in one paragraph the substance of paragraphs 7 and 9 shown as follows. This may be done by expanding the identification of items in paragraph 9 to provide the identification information included in paragraph 7. In such cases, the introductory sentences in paragraphs 7 and 9 and the text of paragraph 8 might be combined as follows: "For purposes of this letter, we have also read the following information and have performed the additional procedures stated below with respect to such information. Our audit of the consolidated financial statements. . ."

7. For purposes of this letter, we have also read the following, set forth in the [registration statement or Offering Memorandum, as applicable] securities offering on the indicated pages.

Item	Page	Description
a	4	"Capitalization." The amounts under the captions "Amount Outstanding as of May 31, 20X6" and "As Adjusted." The related notes, except the following in Note 2: "See Transactions With Interested Persons." From the proceeds of this offering the company intends to prepay \$900,000 on these notes, pro rata. See "Use of Proceeds."
b	13	"History and Business—Sales and Marketing." The table following the first paragraph.
c	33	"Selected Financial Data."

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, or any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions such as those enumerated above, and, accordingly, we express no opinion thereon.
9. However, for purposes of this letter, we have performed the following additional procedures, which were applied as indicated with respect to the items enumerated above.

Item in 7	Procedures and Findings
a	We compared the amounts and numbers of shares listed under the caption, "Amount Outstanding as of May 31, 20X6," with the balances in the appropriate accounts in the company's general ledger and found them to be in agreement. We compared the amounts and numbers of shares listed under the caption, "Amount Outstanding as of May 31, 20X6," adjusted for the issuance of the debentures to be offered by means of the securities offering and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption, "As Adjusted," and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of the "Use of Proceeds" or whether such use will actually take place.)
b	We compared the amounts of military sales, commercial sales, and total sales shown in the securities offering with the balances in the appropriate accounts in the company's accounting records for the respective fiscal years and for the unaudited interim periods and found them to be in agreement. We proved the arithmetic accuracy of the percentages of such amounts of military sales and commercial sales to total sales for the respective fiscal years and for the unaudited interim periods. We compared such computed percentages with the corresponding percentages appearing in the [registration statement or Offering Memorandum, as applicable] and found them to be in agreement.
c	i. We compared the amounts of net sales and income from continuing operations for the years ended December 31, 20X5, 20X4, and 20X3, with the respective amounts in the consolidated financial statements on pages 27 and 28 and the amounts for the years ended December 31, 20X2 and 20X1, with the respective amounts in the consolidated financial statements for 20X2 and 20X1 and found them to be in agreement. ii. We compared the amounts of total assets, long-term obligations, and redeemable preferred stock at December 31, 20X5 and 20X4, with the respective amounts in the consolidated financial statements on pages 27 and 28 and the amounts at December 31, 20X3, 20X2, and 20X1, with the corresponding amounts in the consolidated financial statements for 20X3, 20X2, and 20X1 and found them to be in agreement. iii. We compared the information included under the heading "Selected Financial Data" with the disclosure requirements of Item 301 of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether this information conforms in all material respects with the disclosure requirements of Item 301 of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Item 301 of Regulation S-K.

10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the [*registration statement or Offering Memorandum, as applicable*] and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

Example G—Comments on Tables, Statistics, and Other Financial Information—Summarized Description of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information

.A93-11 Example G illustrates, in paragraph 8a, a method of summarizing the descriptions of procedures and findings regarding tables, statistics, and other financial information in order to avoid repetition in the comfort letter. Each of the comments is in response to a specific request. The paragraphs in example G are intended to follow paragraph 6 in example A-1 or paragraph 5 in example A-2. In a non-1933 Act securities offering, paragraph 9a(ii) generally would not be included.

Other methods of summarizing the descriptions may also be appropriately used. For example, the letter may present a matrix listing the financial information and common procedures employed and indicating the procedures applied to specific items.

7. For purposes of this letter, we have also read the following, set forth in the [*registration statement or Offering Memorandum, as applicable*] on the indicated pages.

<i>Item</i>	<i>Page</i>	<i>Description</i>
<i>a</i>	4	"Capitalization." The amounts under the captions "Amount Outstanding as of May 31, 20X6" and "As Adjusted." The related notes, except the following in Note 2: "See Transactions With Interested Persons." From the proceeds of this offering the company intends to prepay \$900,000 on these notes, pro rata. See "Use of Proceeds."
<i>b</i>	13	"History and Business—Sales and Marketing." The table following the first paragraph.
<i>c</i>	33	"Selected Financial Data."

8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, or any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions, such as those enumerated above, and, accordingly, we express no opinion thereon.

9. However, for purposes of this letter and with respect to the items enumerated in 7 above—
 - a.
 - i. Except for item 7a, we have (i) compared the dollar amounts either with the amounts in the audited consolidated financial statements described in the introductory paragraph of this letter or, for prior years, included in the company's accounting records, or with amounts in the unaudited consolidated financial statements described in paragraph 3 to the extent such amounts are included in or can be derived from such statements and found them to be in agreement; (ii) compared the amounts of military sales, commercial sales, and total sales with amounts in the company's accounting records and found them to be in agreement; (iii) compared other dollar amounts with amounts shown in analyses prepared by the company and found them to be in agreement; and (iv) proved the arithmetic accuracy of the percentages based on the data in the above-mentioned financial statements, accounting records, and analyses.
 - ii. We compared the information in item 6c with the disclosure requirements of Item 301 of Regulation S-K. We also inquired of certain officials of the company who have responsibility for financial and accounting matters whether this information conforms in all material respects with the disclosure requirements of Item 301 of Regulation S-K. Nothing came to our attention as a result of the foregoing procedures that caused us to believe that this information does not conform in all material respects with the disclosure requirements of Item 301 of Regulation S-K.
 - b. With respect to item 7a, we compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of May 31, 20X6" with the balances in the appropriate accounts in the company's general ledger at May 31, 20X6, and found them to be in agreement. We compared the amounts and numbers of shares listed under the caption "Amount Outstanding as of May 31, 20X6," adjusted for the issuance of the debentures to be offered by means of the securities offering and for the proposed use of a portion of the proceeds thereof to prepay portions of certain notes, as described under "Use of Proceeds," with the amounts and numbers of shares shown under the caption, "As Adjusted" and found such amounts and numbers of shares to be in agreement. (However, we make no comments regarding the reasonableness of "Use of Proceeds" or whether such use will actually take place.)
10. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily

reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the [registration statement or Offering Memorandum, as applicable] and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

Example H—Comments on Tables, Statistics, and Other Financial Information: Descriptions of Procedures and Findings Regarding Tables, Statistics, and Other Financial Information—Attached Securities Offering (or Selected Pages) Identifies Items to Which Procedures Were Applied Through the Use of Designated Symbols

.A93-12 This example illustrates an alternate format, which could facilitate reporting when the auditor is requested to perform procedures on numerous statistics included in a securities offering. Each of the comments is in response to a specific request. The paragraph in example H is intended to follow paragraph 6 in example A-1 or paragraph 5 in example A-2.

7. For purposes of this letter, we have also read the items identified by you on the attached copy of the [registration statement or Offering Memorandum, as applicable] and have performed the following procedures, which were applied as indicated with respect to the symbols explained below:
 - ✓ Compared the amount with The Nonissuer Company, Inc.'s financial statements for the period indicated included in the securities offering and found them to be in agreement.
8. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, nor any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions, such as those enumerated above, and, accordingly, we express no opinion thereon.
9. It should be understood that we make no representations regarding questions of legal interpretation or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraph; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above. Further, we have addressed ourselves solely to the foregoing data as set forth in the [registration statement or Offering Memorandum, as applicable] and make no representations regarding the adequacy of disclosure or regarding whether any material facts have been omitted.

[The following is an extract from a securities offering that illustrates how an auditor can document procedures performed on numerous statistics included in the securities offering.]

Summary Financial Information of The Nonissuer Company, Inc.
(In thousands)

Income statement data	The Nonissuer Company, Inc. Year Ended December 31,		
	20X3	20X4	20X5
Revenue from home sales	\$104,110✓	\$115,837✓	\$131,032✓
Gross profit from sales	23,774✓	17,099✓	22,407✓
Income from home building net of tax	7,029✓	1,000✓	3,425✓

Example I—Alternate Wording When Auditor’s Report on Audited Financial Statements Contains an Emphasis-of-Matter Paragraph

.A93-13 Example I is applicable when the auditor's report on the audited financial statements included in the securities offering contains an emphasis-of-matter paragraph regarding a matter that would also affect the unaudited condensed consolidated interim financial information included in the securities offering. The introductory paragraph would be revised as follows:

Our report with respect thereto (which contains an emphasis-of-matter paragraph that describes a lawsuit to which the company is a defendant, discussed in note 8 to the consolidated financial statements), is also included in the [registration statement or Offering Memorandum, as applicable].

The matter described in the emphasis-of-matter paragraph would also be evaluated to determine whether it also requires mention in the comments on the unaudited condensed consolidated interim financial information (paragraph 5*b* of example A-1 and paragraph 4*b* of example A-2). If it is concluded that mention of such a matter in the comments on unaudited condensed consolidated financial information is appropriate, a sentence would be added at the end of paragraph 5*b* in example A-1 and paragraph 4*b* of example A-2 as follows:

Reference should be made to the introductory paragraph of this letter, which states that our audit report covering the consolidated financial statements as of and for the year ended December 31, 20X5, includes an emphasis-of-matter paragraph that describes a lawsuit to which the company is a defendant, discussed in note 8 to the consolidated financial statements.

Example J—Alternate Wording When Component Auditors Are Involved

.A93-14 Example J applies when one or more component auditors are involved in the audit of group financial statements, and the group engagement team has obtained a copy of the comfort letter of the component auditors (see paragraph .21). Example J consists of an addition to paragraph 4, a substitution for the applicable part of paragraph 5, and an addition to paragraph 6 of example A-1 and corresponding changes to paragraphs 3, 4, and 5 of example A-2, respectively.

- [4]c. We have read the letter dated _____ of [the other auditors] with regard to [the related company].
5. Nothing came to our attention as a result of the foregoing procedures (which, so far as [the related company] is concerned,

consisted solely of reading the letter referred to in 4c), however, that caused us to believe that . . .

6. ...On the basis of these inquiries and our reading of the minutes and the letter dated _____ of [*the other auditors*] with regard to [*the related company*], as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the [*registration statement or Offering Memorandum, as applicable*] discloses have occurred or may occur.

Example K—Alternate Wording When the SEC Has Agreed to a Departure From Its Accounting Requirements

.A93-15 Example K is applicable when (a) there is a departure from the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC, and (b) representatives of the SEC have agreed to the departure. Paragraph 2 of example A-1 would be revised to read as follows:

2. In our opinion [*include the phrase except as disclosed in the registration statement if applicable*], the consolidated financial statements and financial statement schedules audited by us and included (incorporated by reference) in the registration statement comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC; however, as agreed to by representatives of the SEC, statements of assets acquired and liabilities assumed and statements of revenues and direct operating expenses of The Nonissuer Company, Inc. have been presented in lieu of separate financial statements required by Rule 3-05 of Regulation S-X.

Example L—Alternate Wording When Recent Earnings Data Are Presented in Capsule Form

.A93-16 Example L is applicable when (a) the statement of income in the securities offering is supplemented by later information regarding sales and earnings (capsule financial information), (b) the auditor is asked to comment on that information (paragraphs .49–.51), and (c) the auditor has conducted a review in accordance with generally accepted auditing standards applicable to reviews of interim financial information of the financial statements from which the capsule financial information is derived. The same facts exist as in example A-1, or for a non-1933 Act filing as in example A-2, except for the following:

- Sales and net income (no extraordinary items) for the six-month periods ended June 30, 20X6 and 20X5 (both unaudited), are included in capsule form more limited than that specified by Financial Accounting Standards Board *Accounting Standards Codification* 270, *Interim Reporting*.
- No financial statements later than those for June 20X6 are available.
- The letter is dated July 25, 20X6, and the cut-off date is July 20, 20X6.

Paragraphs 4, 5, and 6 of example A-1, or paragraphs 3, 4 and 5 of example A-2, would be revised to read as follows; in a non-1933 Act securities offering, paragraphs 4a(ii) and 5a(ii) generally would not be included:

4. For purposes of this letter, we have read the 20X6 minutes of the meetings of the stockholders, the board of directors, and *[include other appropriate committees, if any]* of the company and its subsidiaries as set forth in the minute books at July 20, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and discussed with us the unapproved minutes of meetings held on *[dates]*; we have carried out other procedures to July 20, 20X6, as follows (our work did not extend to the period from July 21, 20X6 to July 25, 20X6, inclusive):
 - a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—
 - (i) Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the *[registration statement or Offering Memorandum, as applicable]*.
 - (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a(i)* comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.
 - b. With respect to the six-month periods ended June 30, 20X6 and 20X5, we have—
 - (i) Read the unaudited amounts for sales and net income for the six-month periods ended June 30, 20X6 and 20X5, as set forth in paragraph *[identify location]*.
 - (ii) Performed the procedures specified for a review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information, on the unaudited condensed consolidated balance sheet as of June 30, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the six-month periods ended June 30, 20X6 and 20X5, from which the unaudited amounts referred to in *b(i)* are derived.
 - (iii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited amounts referred to in *b(i)* are stated on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income.

The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Also, they would not necessarily reveal matters of significance with respect to the comments in the following paragraph. Accordingly, we make no representations regarding the sufficiency of the foregoing procedures for your purposes.

5. Nothing came to our attention as a result of the foregoing procedures, however, that caused us to believe that—

a.

- (i) Any material modifications should be made to the unaudited condensed consolidated financial statements described in 4a(i), included in the [*registration statement or Offering Memorandum, as applicable*], for them to be in conformity with generally accepted accounting principles.
- (ii) The unaudited condensed consolidated financial statements described in 4a(i) do not comply as to form in all material respects with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b.

- (i) The unaudited amounts for sales and net income for the six-month periods ended June 30, 20X6 and 20X5, referred to in 4b(i) do not agree with the amounts set forth in the unaudited condensed consolidated financial statements for those same periods.
- (ii) The unaudited amounts referred to in 4b(i) were not determined on a basis substantially consistent with that of the corresponding amounts in the audited consolidated statements of income.

c. At June 30, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [*registration statement or Offering Memorandum, as applicable*], except in all instances for changes, increases, or decreases that the [*registration statement or Offering Memorandum, as applicable*] discloses have occurred or may occur.

6. Company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to June 30, 20X6 are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after June 30, 20X6 have, of necessity, been even more limited than those with respect to the periods referred to in 4. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (a) at July 20, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance

sheet included in the [registration statement or Offering Memorandum, as applicable]; or (b) for the period from July 1, 20X6 to July 20, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the [registration statement or Offering Memorandum, as applicable] discloses have occurred or may occur.

Example M—Alternate Wording When Auditors Are Aware of a Decrease in a Specified Financial Statement Item

.A93-17 Example M covers a situation in which auditors are aware of a decrease in a financial statement item on which they are requested to comment (see paragraphs .58–.64). Example M may be modified when auditors are aware of a change or increase. The same facts exist as in example A-1 or example A-2, as applicable, except for the decrease covered in the following change in paragraph 5b in example A-1 or paragraph 4b in example A-2:

- b.
- (i) At May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or any decrease in consolidated stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [registration statement or Offering Memorandum, as applicable], or
 - (ii) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or income from continuing operations or of net income, except in all instances for changes, increases, or decreases that the [registration statement or Offering Memorandum, as applicable] discloses have occurred or may occur and except that the unaudited consolidated balance sheet as of May 31, 20X6, which we were furnished by the company, showed a decrease from March 31, 20X6, in consolidated net current assets as follows (in thousands of dollars):

	Current Assets	Current Liabilities	Net Current Assets
March 31, 20X6	\$4,251	\$1,356	\$2,895
May 31, 20X6	3,986	1,732	2,254

6. As mentioned in 4b, company officials have advised us that no consolidated financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even

more limited than those with respect to the periods referred to in 4. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (a) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [registration statement or Offering Memorandum, as applicable]; or (b) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. On the basis of these inquiries and our reading of the minutes as described in 4, nothing came to our attention that caused us to believe that there was any such change, increase, or decrease, except in all instances for changes, increases, or decreases that the [registration statement or Offering Memorandum, as applicable] discloses have occurred or may occur and except as described in the following sentence: We have been informed by officials of the company that there continues to be a decrease in net current assets that is estimated to be approximately the same amount as set forth in 5b [or whatever other disclosure fits the circumstances].

Example N—Alternate Wording of the Letter for Companies That Are Permitted to Present Interim Earnings Data for a 12-Month Period

.A93-18 Certain types of companies are permitted to include earnings data for a 12-month period to the date of the latest balance sheet furnished in lieu of earnings data for both the interim period between the end of the latest fiscal year and the date of the latest balance sheet and the corresponding period of the preceding fiscal year. The following would be substituted for the applicable part of paragraph 3 of example A-1:

3. ...was to enable us to express our opinion on the financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any period included in part within that year. Therefore, we are unable to, and do not express any opinion on, the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the related unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the 12 months then ended included in the registration statement.

Example O—Alternate Wording When the Procedures That the Requesting Party Has Requested the Auditor to Perform on Interim Financial Information Are Less Than a Review in Accordance With Generally Accepted Auditing Standards Applicable to Reviews of Interim Financial Information

.A93-19 The example assumes that the requesting party has asked the auditor to perform specified procedures on the interim financial information and report

thereon in the comfort letter. The letter is dated June 28, 20X6; procedures were performed through June 23, 20X6, the cut-off date. Because a review in accordance with generally accepted auditing standards applicable to reviews of interim financial information was not performed on the interim financial information as of March 31, 20X6, and for the quarter then ended, the auditor is limited to reporting procedures performed and findings obtained on the interim financial information.

The following would be substituted for paragraphs 4–6 of example A-1 or paragraphs 3–5 of example A-2. In a non-1933 Act securities offering, the two statements in paragraph 4(a)(ii) with respect to compliance as to form, in all material respects, with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC, would not be included. Example O assumes there has not been a change in the application of a requirement of generally accepted accounting principles during the interim period. If there has been such a change, a reference to that change would be included in subparagraph *a(ii)* that follows:

4. For purposes of this letter, we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and [*include other appropriate committees, if any*] of the company and its subsidiaries as set forth in the minute books at June 23, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on [*dates*]; we have carried out other procedures to June 23, 20X6, as follows (our work did not extend to the period from June 24, 20X6 to June 28, 20X6, inclusive):
 - a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—
 - (i) Read the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the [*registration statement or Offering Memorandum, as applicable*], and agreed the amounts included therein with the company's accounting records as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5.
 - (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a(i)*: (1) are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the [*registration statement or Offering Memorandum, as applicable*], and (2) comply as to form, in all material respects, with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC. Those officials stated that the unaudited condensed consolidated

financial statements (1) are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements, and (2) comply as to form, in all material respects, with the applicable accounting requirements of the Act and the related rules and regulations adopted by the SEC.

b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—

- (i) Read the unaudited consolidated financial information of the company and subsidiaries for April and May of both 20X5 and 20X6 furnished us by the company, and agreed the amounts contained therein to the company's accounting records. Officials of the company have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. *[If applicable: The financial information for April and May of both 20X5 and 20X6 is incomplete in that it omits the statements of cash flows and other disclosures.]*
- (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether (1) the unaudited consolidated financial information referred to in b(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the *[registration statement or Offering Memorandum, as applicable]*; (2) at May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or any decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the *[registration statement or Offering Memorandum, as applicable]*; and (3) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

Those officials stated that (1) the unaudited consolidated financial information referred to in 4b(i) is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the *[registration statement or Offering Memorandum, as applicable]*; (2) at May 31, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decrease in net current assets or stockholders' equity of the consolidated companies as compared

with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [registration statement or Offering Memorandum, as applicable]; and (3) there were no decreases for the period from April 1, 20X6 to May 31, 20X6, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

- c. As mentioned in 4b(i), company officials have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in 4a and 4b. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (a) at June 23, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the [registration statement or Offering Memorandum, as applicable], or (b) for the period from April 1, 20X6 to June 23, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income. Those officials stated that (1) at June 23, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet, and (2) for the period from April 1, 20X6 to June 23, 20X6, there were no decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

The foregoing procedures do not constitute an audit or a review conducted in accordance with generally accepted auditing standards. We make no representations regarding the sufficiency of the foregoing procedures for your purposes. Had we performed additional procedures or had we conducted an audit or a review of the company's March 31, April 30, or May 31, 20X6 and 20X5 condensed consolidated financial statements, other matters might have come to our attention that would have been reported to you.

5. At your request, we also—
- a. Read the unaudited pro forma condensed consolidated balance sheet as of March 31, 20X6, and the unaudited pro forma condensed consolidated statements of income for the year ended December 31, 20X5, and the three-month period ended March 31, 20X6, included in the [registration statement or Offering Memorandum, as applicable].

- b. Inquired of certain officials of the company and of XYZ Company (the company being acquired) who have responsibility for financial and accounting matters as to whether all significant assumptions regarding the business combination had been reflected in the pro forma adjustments and whether the unaudited pro forma condensed consolidated financial statements referred to in (a) comply as to form in all material respects with the *[applicable accounting requirements of Rule 11-02 of Regulation S-X or pro forma bases described in the pro forma condensed consolidated financial statements, as applicable]*.

Those officials referred to above stated, in response to our inquiries, that all significant assumptions regarding the business combination had been reflected in the pro forma adjustments and that the unaudited pro forma condensed consolidated financial statements referred to in (a) comply as to form in all material respects with the *[applicable accounting requirements of Rule 11-02 of Regulation S-X or pro forma bases described in the pro forma condensed consolidated financial statements, as applicable]*.

- c. Compared the historical financial information for the company included on page 20 in the *[registration statement or Offering Memorandum, as applicable]* with historical financial information for the company on page 12 and found them to be in agreement.

We also compared the financial information included on page 20 of the *[registration statement or Offering Memorandum, as applicable]* with the historical information for XYZ Company on page 13 and found them to be in agreement.

- d. Proved the arithmetic accuracy of the application of the pro forma adjustments to the historical amounts in the unaudited pro forma condensed consolidated financial statements.

The foregoing procedures are less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion or conclusion. We make no representation about the sufficiency of the foregoing procedures for your purposes. Had we performed additional procedures or had we made an examination or review of the pro forma financial information, other matters might have come to our attention that would have been reported to you.

Example P—Intentionally Omitted (See example A-2)³**Example Q—Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11**

.A93-20 This example illustrates the letter to be provided in accordance with paragraph .11 in which the auditor does not provide negative assurance. This example assumes that these procedures are being performed at the request of the placement agent on information included in an offering memorandum in connection with a private placement of unsecured notes. The letter is dated June 30, 20X6; procedures were performed through June 25, 20X6, the cut-off date. The statements in paragraphs 4–8 of the example are illustrative of the statements required to be included by paragraph .12.

This example may also be used in connection with a filing under the 1933 Act when a party other than a named underwriter (for example, a selling shareholder) has not provided the auditor with the representation letter described in paragraph .11. In such a situation, this example may be modified to include the auditor's comments on independence and compliance as to form of the audited financial statements and financial statements schedules with the applicable accounting requirements of the 1933 Act and the related rules and regulations adopted by the SEC. Paragraph 1a(ii) may include an inquiry, and the response of company officials, on compliance as to form of the unaudited condensed interim financial information.

June 30, 20X6

[Addressee]

Dear Ladies and Gentlemen:

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the consolidated financial statements, all included in the offering memorandum for \$30,000,000 of notes due June 30, 20Z6. Our report with respect thereto is included in the offering memorandum. The offering memorandum dated June 30, 20X6, is herein referred to as the Offering Memorandum.

We are independent certified public accountants with respect to the company under the "Independence Rule" of the AICPA's Code of Professional Conduct and its interpretations.

We have not audited any financial statements of the company as of any date or for any period subsequent to December 31, 20X5; although, we have conducted an audit for the year ended December 31, 20X5, the purpose (and, therefore, the scope) of the audit was to enable us to express our opinion on the consolidated financial statements as of December 31, 20X5, and for the year then ended, but not on the financial statements for any interim

³ Example P, "A Typical Comfort Letter in a Non-1933 Act Offering, Including the Required Underwriter Representations," in AU section 634, *Letters for Underwriters and Certain Other Requesting Parties*, was moved to example A-2, "Typical Comfort Letter for a Non-1933 Act Offering When the Required Representation Letter Has Been Obtained," in this section when AU section 634 was redrafted for clarity, and is intentionally blank to retain the letters assigned to the other examples.

period within that year. Therefore, we are unable to, and do not express any opinion on, the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows for the three-month periods ended March 31, 20X6 and 20X5, included in the Offering Memorandum, or on the financial position, results of operations, or cash flows as of any date or for any period subsequent to December 31, 20X5.

1. At your request, we have read the 20X6 minutes of meetings of the stockholders, the board of directors, and *[include other appropriate committees, if any]* of the company as set forth in the minute books at June 25, 20X6, officials of the company having advised us that the minutes of all such meetings through that date were set forth therein and having discussed with us the unapproved minutes of meetings held on *[dates]*; we have carried out other procedures to June 25, 20X6, as follows (our work did not extend to the period from June 26, 20X6 to June 30, 20X6, inclusive):
 - a. With respect to the three-month periods ended March 31, 20X6 and 20X5, we have—
 - (i) Read the unaudited condensed consolidated balance sheet as of March 31, 20X6, and the unaudited condensed consolidated statements of income, stockholders' equity, and cash flows of the company for the three-month periods ended March 31, 20X6 and 20X5, included in the Offering Memorandum, and agreed the amounts included therein with the company's accounting records as of March 31, 20X6, and for the three-month periods ended March 31, 20X6 and 20X5.
 - (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether the unaudited condensed consolidated financial statements referred to in *a*(i) are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum. Those officials stated that the unaudited condensed consolidated financial statements are in conformity with generally accepted accounting principles applied on a basis substantially consistent with that of the audited consolidated financial statements.
 - b. With respect to the period from April 1, 20X6 to May 31, 20X6, we have—
 - (i) Read the unaudited condensed consolidated financial information of the company for April and May of both 20X5 and 20X6, furnished us by the company, and agreed the amounts included therein with the company's accounting records. Officials of the company have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, were available. *[if applicable: The financial information for April and May of both 20X5 and 20X6 is incomplete*

in that it omits the statements of cash flows and other disclosures.]

- (ii) Inquired of certain officials of the company who have responsibility for financial and accounting matters whether (1) the unaudited condensed consolidated financial information referred to in *b(i)* is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum; (2) at May 31, 20X6, there was any change in the capital stock, increase in long-term debt, or any decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum; and (3) for the period from April 1, 20X6 to May 31, 20X6, there were any decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

Those officials stated that (1) the unaudited condensed consolidated financial information referred to in *b(ii)* is stated on a basis substantially consistent with that of the audited consolidated financial statements included in the Offering Memorandum; (2) at May 31, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decrease in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum; and (3) there were no decreases for the period from April 1, 20X6 to May 31, 20X6, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

- c. As mentioned in *1b*, company officials have advised us that no financial statements as of any date or for any period subsequent to May 31, 20X6, are available; accordingly, the procedures carried out by us with respect to changes in financial statement items after May 31, 20X6, have, of necessity, been even more limited than those with respect to the periods referred to in *1a* and *1b*. We have inquired of certain officials of the company who have responsibility for financial and accounting matters whether (i) at June 25, 20X6, there was any change in the capital stock, increase in long-term debt, or any decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6 unaudited condensed consolidated balance sheet included in the Offering Memorandum, or (ii) for the period from April 1, 20X6 to June 25, 20X6, there were any

decreases, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

Those officials referred to above stated that (i) at June 25, 20X6, there was no change in the capital stock, no increase in long-term debt, and no decreases in consolidated net current assets or stockholders' equity of the consolidated companies as compared with amounts shown in the March 31, 20X6, unaudited condensed consolidated balance sheet, and (ii) there were no decreases for the period from April 1, 20X6 to June 25, 20X6, as compared with the corresponding period in the preceding year, in consolidated net sales or in income from continuing operations or of net income.

2. For purposes of this letter, we have also read the items identified by you on the attached copy of the Offering Memorandum and have performed the following procedures, which were applied as indicated with respect to the symbols explained below:
 - ✓ Compared the amount with the company's financial statements for the period indicated and found them to be in agreement.
 - ✗ Compared the amount with the company's financial statements for the period indicated included in the Offering Memorandum and found them to be in agreement.
 - Ⓢ Compared with a schedule or report prepared by the company and found them to be in agreement.
3. Our audit of the consolidated financial statements for the periods referred to in the introductory paragraph of this letter comprised audit tests and procedures deemed necessary for the purpose of expressing an opinion on such financial statements as a whole. For none of the periods referred to therein, nor for any other period, did we perform audit tests for the purpose of expressing an opinion on individual balances of accounts or summaries of selected transactions, such as those enumerated above, and, accordingly, we express no opinion thereon.
4. It should be understood that we have no responsibility for establishing (and did not establish) the scope and nature of the procedures enumerated in paragraphs 1–3 above; rather, the procedures enumerated therein are those the requesting party asked us to perform. Accordingly, we make no representations regarding questions of legal interpretation⁴ or regarding the sufficiency for your purposes of the procedures enumerated in the preceding paragraphs; also, such procedures would not necessarily reveal any material misstatement of the amounts or percentages listed above as set forth in the Offering Memorandum. Further, we have addressed ourselves solely to the foregoing data and make no representations regarding the adequacy of disclosures or whether any material facts have been omitted. This letter relates only to the financial statement items specified above and does not extend to any financial statement of the company as a whole.

⁴ Paragraph .A6 of this section.

5. The foregoing procedures do not constitute an audit conducted in accordance with generally accepted auditing standards. Had we performed additional procedures or had we conducted an audit or a review of the company's March 31, April 30, or May 31, 20X6 and 20X5 condensed consolidated financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you.
6. These procedures should not be taken to supplant any additional inquiries or procedures that you would undertake in your consideration of the proposed offering.
7. This letter is solely for your information and to assist you in your inquiries in connection with the offering of the securities covered by the Offering Memorandum, and it is not to be used, circulated, quoted, or otherwise referred to for any other purpose, including but not limited to the registration, purchase, or sale of securities, nor is it to be filed with or referred to, in whole or in part, in the Offering Memorandum or any other document, except that reference may be made to it in any list of closing documents pertaining to the offering of the securities covered by the offering document.
8. We have no responsibility to update this letter for events and circumstances occurring after June 25, 20X6.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Example R—Alternate Wording When Reference to Examination of Annual Management's Discussion and Analysis and Review of Interim Management's Discussion and Analysis Is Made

.A93-21 This example is applicable when the auditor is making reference to an examination of annual MD&A and a review of interim MD&A. The same facts exist as in example A-1, except for the following:

- The auditor has examined the company's Management's Discussion and Analysis (MD&A) for the year ended December 31, 20X5, in accordance with AT-C section 395, *Management's Discussion and Analysis*.
- The auditor has also performed reviews of the company's unaudited condensed consolidated financial statements in accordance with generally accepted auditing standards applicable to reviews of interim financial information and the company's MD&A for the three-month period ended March 31, 20X6, in accordance with AT-C section 395.
- The accountant's reports on the examination and review of MD&A have been previously issued, but not distributed publicly; none of these reports is included in the securities offering. In this example, the auditor has elected to attach the previously issued reports to the comfort letter (see paragraph .A32).

Appropriate modifications would be made to the opening paragraph of the comfort letter if the auditor has performed a review of the company's annual MD&A.

The following would be substituted for the first paragraph of example A-1.

We have audited the consolidated financial statements of The Nonissuer Company, Inc. (the company) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, the related notes to the consolidated financial statements, and the related financial statement schedules, all included in The Issuer Company's (the registrant) registration statement (no. 33-00000) on Form S-1 filed by the registrant under the Securities Act of 1933 (the Act); our reports with respect thereto are also included in that registration statement. The registration statement, as amended on June 28, 20X6, is herein referred to as the registration statement. Also, we have examined the company's Management's Discussion and Analysis (MD&A) for the year ended December 31, 20X5, included in the registration statement, as indicated in our report dated March 28, 20X6; our report with respect thereto is attached. We have also reviewed the unaudited condensed consolidated financial statements as of March 31, 20X6 and 20X5, and for the three-month periods then ended, included in the registration statement, as indicated in our report dated May 15, 20X6, and have also reviewed the company's MD&A for the three-month period ended March 31, 20X6, included in the registration statement, as indicated in our report dated May 15, 20X6; our reports with respect thereto are attached.

The following paragraph would be added after paragraph 3 of example A-1:

4. We have not examined any MD&A of the company as of or for any period subsequent to December 31, 20X5; although we have made an examination of the company's MD&A for the year ended December 31, 20X5, included in the registration statement, the purpose (and, therefore, the scope) of the examination was to enable us to express our opinion on such MD&A, but not on the MD&A for any interim period within that year. Therefore, we are unable to and do not express any opinion on the MD&A for the three-month period ended March 31, 20X6, included in the registration statement, or for any period subsequent to March 31, 20X6.

[As amended, effective for comfort letters issued on or after December 15, 2014, by SAS No. 129. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

AU-C Section 925

Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933

Source: SAS No. 122; SAS No. 133.

Effective for filings under the Securities Act of 1933 that include audited financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section (Ref: par. .A1)

.01 This section addresses the auditor's responsibilities in connection with financial statements of a nonissuer included or incorporated by reference in a registration statement filed with the U.S. Securities and Exchange Commission (SEC) under the Securities Act of 1933, as amended. Exhibit A, "Background," provides background information on certain liability provisions of Section 11 of the Securities Act of 1933, including Section 11(b)(3)(B).

Effective Date

.02 This section is effective for filings under the Securities Act of 1933 that include audited financial statements for periods ending on or after December 15, 2012.

Objective

.03 The objective of the auditor, in connection with audited financial statements of a nonissuer that are separately included or incorporated by reference in a registration statement filed under the Securities Act of 1933, is to perform specified procedures at or shortly before the effective date of the registration statement to sustain the burden of proof that the auditor has performed a reasonable investigation, as referred to in Section 11(b)(3)(B) of the Securities Act of 1933.

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Auditor's consent. A statement signed and dated by the auditor that indicates that the auditor consents to the use of the auditor's report, and other references to the auditor, in a registration statement filed under the Securities Act of 1933.

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

Effective date of the registration statement. The date on which the registration statement filed under the Securities Act of 1933 becomes effective for purposes of evaluating the auditor's liability under Section 11 of the Securities Act of 1933. (Ref: par. .A2 and .A14)

.05 References to *included* or *the inclusion of* in a registration statement in this section means *included* or *incorporated by reference* in a registration statement filed under the Securities Act of 1933.

Requirements

Effective Date of the Registration Statement (Ref: par. .A3)

.06 Because the effective date of a registration statement filed under the Securities Act of 1933 may not necessarily coincide with the filing date, the auditor should request management to keep the auditor advised of the progress of the registration proceedings through the effective date of the registration statement.

The Prospectus and Other Information (Ref: par. .A4–.A8)

.07 When the auditor's report on audited financial statements is included in a registration statement filed under the Securities Act of 1933, the auditor should perform the procedures described in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, on the prospectus and pertinent portions of the registration statement (including material that is incorporated by reference). [Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

.08 In connection with the procedures required by paragraph .07, the auditor should determine that the auditor's name is not being used in a way that indicates that the auditor's responsibility is greater than the auditor intends.

Subsequent Events Procedures (Ref: par. .A9–.A11)

.09 When the most recent separate financial statements of the entity and related auditor's report are included in the registration statement, the auditor should perform the following procedures described in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or shortly before the effective date of the registration statement:¹

- a. Audit procedures designed to identify events occurring between the date of the auditor's report and the effective date of the registration statement that require adjustment to, or disclosure in, the financial statements. Such procedures, which take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, should include
 - i. obtaining an understanding of any procedures that management has established to ensure that such events are identified.
 - ii. inquiring of management and, when appropriate, those charged with governance about whether any such events have occurred that might affect the financial statements.

¹ Paragraphs .09–.10 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

- iii. reading minutes, if any, of the meetings of the entity's owners, management, and those charged with governance that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
 - iv. reading the entity's latest subsequent interim financial statements, if any.
- b. Obtain updated written representations from management at or shortly before the effective date of the registration statement, about whether
- i. any information has come to management's attention that would cause management to believe that any of the previous representations should be modified.
 - ii. any events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements.

.10 When the auditor has audited the most recent period for which separate audited financial statements of the entity are included in the registration statement and

- a. the entity has been acquired by another entity,
- b. the acquirer's audited financial statements included in the registration statement reflect a period that includes the date of acquisition, and
- c. the auditor is a predecessor auditor because the auditor is not the continuing auditor of the entity,

the auditor may be unable to perform all of the procedures in paragraph .09. In such circumstances, the auditor should obtain written representations from management and the successor auditor as described in section 560 at or shortly before the effective date of the registration statement.²

.11 If a predecessor auditor audited the entity's separate financial statements for a prior period included in the registration statement but has not audited the entity's separate financial statements for the most recent audited period for which the entity's audited financial statements are included in the registration statement, then the predecessor auditor should perform the following procedures described in section 560 through a date at or shortly before the effective date of the registration statement:³

- a. Read the financial statements of the subsequent period to be presented on a comparative basis
- b. Compare the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis
- c. Obtain written representations from management at or shortly before the effective date
- d. Obtain a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor

² Paragraph .19c–d of section 560.

³ Paragraph .19 of section 560.

.12 If the auditor becomes aware of subsequently discovered facts, the auditor should not provide the auditor's consent until the auditor's consideration of subsequently discovered facts, including the effect on the auditor's report on the financial statements, has been satisfactorily completed in accordance with section 560.⁴ If management does not revise the audited financial statements in circumstances in which the auditor believes they need to be revised, then the auditor should determine whether to withhold the auditor's consent (and the awareness letter, if applicable). (Ref: par. .A11)

Unaudited Annual Financial Statements or Unaudited Interim Financial Information

.13 If the auditor concludes, based on known facts, that unaudited annual financial statements or unaudited interim financial information included in a registration statement filed under the Securities Act of 1933 is not in conformity with the requirements of the applicable financial reporting framework, then the auditor should request that management revise the unaudited annual financial statements or unaudited interim financial information appropriately.

.14 If management does not revise the unaudited annual financial statements or unaudited interim financial information appropriately and

- a. the auditor has reported on a review of the unaudited annual financial statements or unaudited interim financial information,
- b. the auditor's review report is included in the registration statement, and
- c. the subsequently discovered facts are such that they would have affected the report had they been known to the auditor at the date of the report,

the auditor should perform the applicable procedures described in section 560.⁵

.15 If management does not revise the unaudited annual financial statements or unaudited interim financial information appropriately and

- a. the auditor has not reported on a review of the unaudited annual financial statements or unaudited interim financial information or
- b. the auditor's review report is not included in the registration statement,

the auditor should modify the report on the audited financial statements to describe the departure from the requirements of the applicable financial reporting framework contained in the unaudited annual financial statements or unaudited interim financial information, as described in section 930, *Interim Financial Information*.⁶

.16 Additionally, the auditor should determine whether to withhold the auditor's consent (and the awareness letter, if applicable). (Ref: par. .A11)

⁴ Paragraphs .15–.18 of section 560.

⁵ Paragraphs .14 and .17–.18 of section 560.

⁶ Paragraph .35 of section 930, *Interim Financial Information*.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 This section is written from the perspective of a registration statement filed under the Securities Act of 1933. The liability provisions under the Securities Act of 1933 differ from those (Section 10[b] and Rule 10[b]5), in particular) under the Securities Exchange Act of 1934.

Definitions

Effective Date of the Registration Statement (Ref: par. .04)

.A2 Exhibit A describes the process commonly referred to as *shelf registration*. Exhibit A also provides additional guidance about the effective date of a registration statement, including situations in which a posteffective amendment is made or a prospectus supplement is filed.⁷ Both of these situations may create a new effective date. Exhibit A also discusses the auditor's liability under Section 11 of the Securities Act of 1933 with regard to these situations.

Effective Date of the Registration Statement (Ref: par. .06)

.A3 Requesting management to keep the auditor advised of the progress of the registration proceedings through the effective date is important so that the auditor's consideration of events occurring after the date of the auditor's report up to the effective date, or as close thereto as reasonable and practicable, can be completed by the effective date of the registration statement. Generally, the filing date of a registration statement will precede the effective date. In addition to performing the procedures required by this section at or shortly before the effective date, the auditor may also perform some or all of the procedures in this section at or shortly before the filing date.

The Prospectus and Other Information (Ref: par. .07–.08)

.A4 The reading of the entire prospectus (including any supplemental prospectuses and documents incorporated by reference—such as forms 10-K, 10-Q, and 8-K) assists the auditor in fulfilling the auditor's statutory responsibilities to perform a reasonable investigation, as described in Section 11(c) of the Securities Act of 1933.

References to the Auditor as an Expert in Connection With a Securities Act of 1933 Registration Statement

.A5 The requirements in paragraphs .07–.08 assist the auditor in determining that the references to the auditor in the Securities Act of 1933 registration statement are appropriate. For example, management's disclosure in the "experts" section cannot imply that the financial statements have been prepared by the auditor or that the financial statements are not the direct representations of management.

.A6 The SEC does not require an entity to include an auditor's review report on unaudited interim financial information in the registration statement unless the registration statement states that the unaudited interim financial

⁷ Paragraphs 8–12 of exhibit A, "Background."

information has been reviewed by an independent auditor. If the registration statement includes the auditor's review report on interim financial information, then the requirements in paragraphs .07–.08 assist the auditor in determining that the issuer discloses the fact that an interim review report is not a report on, or a part of, the registration statement prepared or certified by the auditor, within the meaning of Section 7 and Section 11 of the Securities Act of 1933, and that the auditor's liability under Section 11 does not extend to the auditor's review report.

.A7 The auditor is not considered an expert with respect to the auditor's review report on interim financial information and, therefore, it is important that this fact is clearly described. For example, the disclosures relating to the auditor's report on the audited financial statements may be included under a heading titled "Experts," and the disclosures in paragraph .A6 would then be included under a heading titled "Independent Auditors." Alternatively, the disclosures described in paragraph .A6 may be included under an "experts" section together with language stating the fact that an interim review report is not a report on, or a part of, the registration statement prepared or certified by the auditor, within the meaning of Section 7 and Section 11 of the Securities Act of 1933, and that the auditor's liability under Section 11 does not extend to the auditor's review report.

.A8 Exhibit A describes the disclosures relating to the auditor's report on the audited financial statements. Exhibit B, "Illustrative Disclosures and Reports," provides an illustration of this disclosure.

Subsequent Events Procedures (Ref: par. .09–.12)

.A9 An example of the conditions described in paragraphs .09–.11 would be a situation in which an issuer recently acquired a nonissuer that is considered significant to the issuer based on quantitative thresholds specified in the SEC's rules and regulations. In this case, the issuer's registration statement may need to include the separate audited financial statements of the acquired nonissuer for one or more periods.

.A10 In addition to the procedures required by paragraph .09, the auditor may consider it necessary and appropriate to inquire of, or extend previous oral or written inquiries to, the entity's legal counsel concerning litigation, claims, and assessments, as described in section 501, *Audit Evidence—Specific Considerations for Selected Items*.

.A11 In making the determination whether to withhold the auditor's consent, the auditor may consider it appropriate to obtain legal advice. (Ref: par. .12 and .16)

Exhibits

.A12 Exhibit A provides detailed background guidance on the following: (Ref: par. .04)

- The liability provisions of Section 11 of the Securities Act of 1933
- The auditor's consent and awareness letter
- The effective date of the registration statement
- References to the auditor as an expert in connection with a Securities Act of 1933 registration statement

- References to the auditor as an expert in a document other than a Securities Act of 1933 registration statement
- Letters similar to a consent prepared in connection with a document that is not a Securities Act of 1933 registration statement

.A13 Exhibit B provides illustrative disclosures and reports.

.A14

Exhibit A—Background

Exhibit A is intended to provide limited background information only. Exhibit A is not intended to be, and does not constitute, a comprehensive or complete discussion of the liability provisions of the Securities Act of 1933, as amended. Exhibit A is not legal advice and reading it as such is inappropriate. Auditors are advised to consult with their legal counsel regarding the information provided in Exhibit A and the entire content of Section 11 of the Securities Act of 1933.

1. When an auditor's report is included in a registration statement filed under the Securities Act of 1933, the auditor's responsibility, generally, is in substance no different from that involved in other types of reporting. However, the nature and extent of this responsibility are specified in some detail in the applicable statutes and the related rules and regulations.

Liability Provisions of Section 11 of the Securities Act of 1933

2. Liability under the Securities Act of 1933 is defined in several sections of that act. One important section for auditors is Section 11.

3. Section 11(a) imposes civil liability on a number of parties that are involved in a registration statement filed under the Securities Act of 1933. One of the parties specifically mentioned in Section 11(a) is an auditor who has consented to the use of the auditor's report on audited financial statements in connection with a registration statement filed under the Securities Act of 1933 (Section 11[a][4]).

4. Section 11(b)(3)(B) of the Securities Act of 1933 provides that the auditor is not liable under Section 11(a) if the auditor

sustain[s] the burden of proof . . . that . . . as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert.

5. Section 11(c) of the Securities Act of 1933 indicates that for the purpose of determining what constitutes reasonable investigation and reasonable ground to believe, "the standard of reasonableness shall be that required of a prudent man in the management of his own property."

Auditor's Consent and Awareness Letter

6. Section 7 of the Securities Act of 1933 requires an issuer to provide the consent of any auditor whose report on audited financial statements is included in a Securities Act of 1933 registration statement. The issuer's responsibility to file the auditor's consent is further discussed in Rule 436 of the Securities Act of 1933.

7. Rule 436(c) of the Securities Act of 1933 indicates that an auditor's report based on a review of interim financial information is not a report within the meaning of Section 11. Thus, the auditor does not have a similar statutory responsibility for such reports as of the effective date of the registration statement. Accordingly, the auditor's consent would not refer to the auditor's report on interim financial statements. However, the issuer is required to file an awareness letter from an auditor if the auditor's review report on interim financial information is included in a registration statement filed under the Securities Act of 1933.

Effective Date of the Registration Statement

8. The information in a registration statement filed under the Securities Act of 1933 is evaluated as of its effective date. Accordingly, the auditor who has consented to the inclusion of the auditor's report on audited financial statements in such a registration statement has a statutory responsibility that is determined in light of the circumstances on that date. The effective date for purposes of evaluating liability under Section 11 may be different for different parties. For instance, the effective date for determining liability under Section 11 for the issuer or for an underwriter may be later than the effective date for determining Section 11 liability for the auditor.

9. Certain Securities Act of 1933 rules and forms (for example, Rule 415 and Form S-3) permit issuers to register offerings of securities to be offered and sold on a delayed or continuous basis. This process is commonly referred to as *shelf registration*.

10. The prospectus included in a shelf registration statement at the time it becomes effective is commonly referred to as a *base prospectus*. Many issuers follow a "bare bones" approach to preparing the base prospectus by relying entirely on the documents incorporated by reference (for example, forms 10-K, 10-Q, and 8-K) to provide most, if not all, of the issuer-related disclosures. The base prospectus also generally omits information relating to the specific amount of each security to be offered and pricing information. That information is typically provided through a prospectus supplement filed pursuant to Rule 424(b) of the Securities Act of 1933 at the time the securities are sold (commonly referred to as *taken off the shelf* or a *shelf takedown*).

11. At the time of filing a shelf registration statement, the issuer undertakes to update the prospectus for a number of items. The issuer's undertakings are set forth in Item 512 of Regulation S-K. Information omitted from the base prospectus, as well as the information that the issuer has undertaken to provide at a later date, may be conveyed to investors

- by a posteffective amendment to the registration statement,
- by a prospectus supplement filed pursuant to Rule 424(b) of the Securities Act of 1933, or
- through the incorporation by reference of the information from a report filed under the Securities Exchange Act of 1934 (for example, Form 10-K or Form 8-K).

12. As previously discussed, liability under Section 11 of the Securities Act of 1933 is assessed based on the information included in the registration statement as of its effective date. As also previously noted, the effective date for purposes of evaluating liability under Section 11 as it relates to the auditor may differ from the effective date as it relates to other parties (for example, the issuer or any underwriters). From the auditor's perspective, the effective date

in connection with a Securities Act of 1933 registration statement is the latest of the following:

- The date the original registration statement (for example, on Form S-3) becomes effective
- The effective date of any posteffective amendment
- The filing date of a prospectus supplement if the filing of the prospectus supplement creates a new effective date for the auditor (for example, the prospectus supplement may contain new or revised audited financial statements or other information about which the auditor is an expert and for which a new consent is required, as described in Rule 430B(f)(3) of the Securities Act of 1933)
- The filing date of any report (for example, under the Securities Exchange Act of 1934) that includes or amends audited financial statements and is incorporated by reference into the already effective registration statement

For example, assume an issuer with an already effective shelf registration statement on Form S-3 acquires a private company, and the issuer is required to file the acquired company's audited financial statements pursuant to the requirements of Form 8-K. In this case, the issuer will be required to file an auditor's consent from the acquired company's auditor as an exhibit to Form 8-K. The guidance in this section is applicable to the acquired company's auditor in connection with providing the auditor's consent to the issuer.

References to the Auditor as an Expert in Connection With a Securities Act of 1933 Registration Statement

13. Although not required, most Securities Act of 1933 registration statements relating to underwritten offerings contain a section titled "Experts." This section can be defined as management's disclosure in a Securities Act of 1933 registration statement that states that audited financial statements are included in the registration statement in reliance upon the auditor's report on the audited financial statements. The "experts" section also typically indicates that the auditor's report on the audited financial statements has been given on the auditor's authority as an expert in accounting and auditing.

14. Exhibit B, "Illustrative Disclosures and Reports," provides an example of a typical "experts" section.

15. As with all sections of the registration statement, the disclosures in the "experts" section are the issuer's responsibility. However, Rule 436(b) of the Securities Act of 1933 requires the issuer to file an auditor's consent to being named as an expert.

References to the Auditor as an Expert in a Document Other Than a Securities Act of 1933 Registration Statement

16. The term *expert* has a specific statutory meaning under the Securities Act of 1933. Outside the Securities Act of 1933 context, the term *expert* is typically undefined. Accordingly, except as described in paragraph 18 of this exhibit, when an issuer wishes to make reference to the auditor's role in an offering document in connection with a securities offering that is not registered under the Securities Act of 1933, the caption to that section of the document would generally be titled "Independent Auditors" (or something similar) rather than "Experts," with no reference to the auditor as an expert anywhere in the document.

17. There may be situations in which the term *expert* is sufficiently defined such that the auditor may agree to be referred to as an expert outside the context of a registration statement filed under the Securities Act of 1933. For example, if the term *expert* is defined under applicable state law, the auditor may agree to be named as an expert in an offering document in an intrastate securities offering. An understanding of any auditor liability provisions that may be included in the applicable federal or state statutes is an important consideration. In such circumstances, the auditor may consider it appropriate to obtain legal advice.

Letters Similar to Consents Prepared in Connection With a Document That Is Not a Securities Act of 1933 Registration Statement

18. When an auditor's report is used in connection with an offering transaction that is not registered under the Securities Act of 1933, it is not usually necessary for the auditor to provide any type of written consent. If the auditor is asked to provide a written consent for use in connection with a document other than a Securities Act of 1933 registration statement, then the auditor may provide a letter indicating that the auditor agrees to the inclusion of the auditor's report on the audited financial statements in the offering materials. Section 945 addresses the auditor's responsibilities when an auditor is involved with an exempt offering document.

[As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133.]

.A15

Exhibit B—Illustrative Disclosures and Reports

The following is an example of a typical "experts" section in a registration statement filed under the Securities Act of 1933:

Experts

The consolidated balance sheets of Company X as of December 31, 20X2 and 20X1, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, included in this prospectus, have been so included in reliance on the report of ABC & Co, independent auditors, given on the authority of that firm as experts in auditing and accounting.

The following is an example of a disclosure for a registration statement filed under the Securities Act of 1933 that includes the auditor's review report on unaudited interim financial information when such disclosure is included in a separate section. This disclosure may also be included under a section titled "Experts":

Independent Auditors

With respect to the unaudited interim financial information of Company X for the three-month periods ended March 31, 20X3 and 20X2, included in this prospectus, ABC & Co. has reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated May XX, 20X3, included herein, states that they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. ABC & Co. is not subject to the liability provisions of section 11 of the Securities Act of 1933 for their report on the unaudited interim financial information because that report is not a "report" or a "part" of the registration statement prepared or certified by the accountants within the meaning of Sections 7 and 11 of the Act.

[As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, by SAS No. 133.]

AU-C Section 930

Interim Financial Information

Source: SAS No. 122; SAS No. 132; SAS No. 135; SAS No. 140.

Effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2012, unless otherwise indicated.

NOTE

In October 2021, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when engaged to review interim financial information under the conditions specified in this section. The term *auditor* is used throughout this section, not because the auditor is performing an audit but because the scope of this section is limited to a review of interim financial information performed by an auditor of the financial statements of the entity.

.02 This section applies to a review of interim financial information when

- a. the entity's latest annual financial statements have been audited by the auditor or a predecessor auditor;
- b. the auditor either
 - i. has been engaged to audit the entity's current year financial statements or
 - ii. audited the entity's latest annual financial statements, and in situations in which it is expected that the current year financial statements will be audited, the engagement of another auditor to audit the current year financial statements is not effective prior to the beginning of the period covered by the review; (Ref: par. .A1)

- c. the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements; and
- d. all of the following conditions are met if the interim financial information is condensed:
 - i. The condensed interim financial information purports to be prepared in accordance with an appropriate financial reporting framework, which includes appropriate form and content of interim financial information. (Ref: par. .A2)
 - ii. The condensed interim financial information includes a note that the financial information does not represent complete financial statements and is to be read in conjunction with the entity's latest audited annual financial statements.
 - iii. The condensed interim financial information accompanies the entity's latest audited annual financial statements, or such audited annual financial statements are made readily available by the entity. (Ref: par. .A3)

Statements on Standards for Accounting and Review Services provide guidance for review engagements for which this section is not applicable.

.03 An auditor may find this section, adapted as necessary in the circumstances, useful when that auditor has not been engaged to perform a review of interim financial information but has nonetheless decided to perform review procedures on such financial information (for example, in connection with the inclusion of the auditor's report on the annual financial statements in an unregistered securities offering document).

Effective Date

.04 This section is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2012.

Objective

.05 The objective of the auditor when performing an engagement to review interim financial information is to obtain a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework through performing limited procedures. (Ref: par. .A4–.A5)

Definition

.06 For purposes of this section, the following term has the meaning attributed as follows:

Interim financial information. Financial information prepared and presented in accordance with an applicable financial reporting framework that comprises either a complete or condensed set of financial statements covering a period or periods less than one full year or covering a 12-month period ending on a date other than the entity's fiscal year end.

Requirements

Acceptance

.07 Before accepting an engagement to review an entity's interim financial information for a new client, the auditor should follow the procedures for initial engagements required by section 210A, *Terms of Engagement*.¹

.08 Before accepting an engagement to perform a review of interim financial information, the auditor should

- a. determine whether the financial reporting framework to be applied in the preparation of the interim financial information is acceptable and
- b. obtain the agreement of management that it acknowledges and understands its responsibility
 - i. for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework;
 - ii. for the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with the applicable financial reporting framework;
 - iii. to provide the auditor with
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the interim financial information, such as records, documentation, and other matters;
 - (2) additional information that the auditor may request from management for the purpose of the review; and
 - (3) unrestricted access to persons within the entity of whom the auditor determines it necessary to make inquiries;² and
 - iv. to include the auditor's review report in any document containing interim financial information that indicates that such information has been reviewed by the entity's auditor.

.09 The auditor should not accept an engagement to review interim financial information if

- a. the auditor has determined that the financial reporting framework to be applied in the preparation of the interim financial information is unacceptable.
- b. the agreement referred to in paragraph .08b has not been obtained.

¹ Paragraphs .11–.12 of section 210A, *Terms of Engagement*.

² Paragraph .06 of section 210A.

Agreement on Engagement Terms

.10 The auditor should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be recorded in an engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A6)

- a. The objectives and scope of the engagement
- b. The responsibilities of management set forth in paragraph .08b
- c. The responsibilities of the auditor
- d. The limitations of a review engagement
- e. Identification of the applicable financial reporting framework for the preparation of the interim financial information

Procedures for a Review of Interim Financial Information***Understanding the Entity and Its Environment, Including Its Internal Control***

.11 To plan and conduct the engagement, the auditor should have an understanding of the entity and its environment, including its internal control as it relates to the preparation and fair presentation of both annual and interim financial information, sufficient to be able to

- a. identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.
- b. select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework.

.12 To update or, in the case of an auditor who has not yet performed an audit of the entity's annual financial statements, obtain the understanding required by paragraph .11, the auditor should perform the following procedures: (Ref: par. .A7–.A8)

- a. Read available documentation of the preceding year's audit and of reviews of the prior interim period(s) of the current year and the corresponding interim period(s) of the prior year to the extent necessary, based on the auditor's judgment, to enable the auditor to identify matters that may affect the current period interim financial information. In reading such documents, the auditor should specifically consider the nature of any (Ref: par. .A9–.A10)
 - i. corrected material misstatements;
 - ii. matters identified in any summary of uncorrected misstatements;
 - iii. identified risks of material misstatement due to fraud, including the risk of management override of controls; and
 - iv. significant financial accounting and reporting matters that may be of continuing significance, such as significant deficiencies and material weaknesses.
- b. Read the most recent annual and comparable prior interim period financial information.

- c. Consider the results of any audit procedures performed with respect to the current year's financial statements.
- d. Inquire of management about changes in the entity's business activities.
- e. Inquire of management about the identity of, and nature of transactions with, related parties.
- f. Inquire of management about whether significant changes in internal control, as it relates to the preparation and fair presentation of interim financial information, have occurred subsequent to the preceding annual audit or prior review of interim financial information, including changes in the entity's policies, procedures, and personnel, as well as the nature and extent of such changes.

Analytical Procedures, Inquiries, and Other Review Procedures

Analytical Procedures

.13 The auditor should apply analytical procedures to the interim financial information to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Such analytical procedures should include the following: (Ref: par. .A11–.A13)

- a. Comparing the interim financial information with comparable information for the immediately preceding interim period, if applicable, and with the corresponding period(s) in the previous year, giving consideration to knowledge about changes in the entity's business and specific transactions
- b. Considering plausible relationships among both financial and, when relevant, nonfinancial information (Ref: par. .A14)
- c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the auditor through identifying and using relationships that are reasonably expected to exist, based on the auditor's understanding of the entity and the industry in which the entity operates
- d. Comparing disaggregated revenue data (Ref: par. .A15)

Inquiries and Other Review Procedures

.14 The auditor should make the following inquiries and perform the following other review procedures when conducting a review of interim financial information:

- a. Read the available minutes of meetings of stockholders, directors, and appropriate committees and inquire about matters dealt with at meetings for which minutes are not available to identify matters that may affect the interim financial information. (Ref: par. .A16)
- b. Obtain reports from component auditors, if any, related to reviews performed of the interim financial information of significant components of the reporting entity, including its investees, or inquire of those auditors if reports have not been issued. (Ref: par. .A17)
- c. Inquire of management about
 - i. whether the interim financial information has been prepared and fairly presented in accordance with the applicable financial reporting framework consistently applied.

Special Considerations in the United States

- ii. unusual or complex situations that may have an effect on the interim financial information. (Ref: par. .A18)
 - iii. significant transactions occurring or recognized in the interim period, particularly those in the last several days of the interim period.
 - iv. the status of uncorrected misstatements identified during the previous audit and interim review (that is, whether adjustments had been recorded subsequent to the periods covered by the prior audit or interim review and, if so, the amounts recorded and period in which such adjustments were recorded).
 - v. matters about which questions have arisen in the course of applying the review procedures.
 - vi. events subsequent to the date of the interim financial information that could have a material effect on the fair presentation of such information.
 - vii. its knowledge of any fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others when the fraud could have a material effect on the financial information.
 - viii. whether management is aware of allegations of fraud or suspected fraud affecting the entity communicated by employees, former employees, regulators, or others.
 - ix. significant journal entries and other adjustments.
 - x. communications from regulatory agencies.
 - xi. significant deficiencies and material weaknesses in the design or operation of internal control as it relates to the preparation and fair presentation of both annual and interim financial information.
 - xii. changes in related parties or significant new related party transactions.
- d. Obtain evidence that the interim financial information agrees or reconciles with the accounting records. In addition, the auditor should inquire of management about the reliability of the records to which the interim financial information was compared or reconciled. (Ref: par. .A19)
- e. Read the interim financial information to consider whether, based on the results of the review procedures performed and other information that has come to the auditor's attention, the information to be reported is in accordance with the applicable financial reporting framework.
- f. Read other information in documents containing the interim financial information to consider whether such information or the manner of its presentation is materially inconsistent with the interim financial information. If the auditor concludes that a material inconsistency exists or becomes aware of information that the auditor believes is a material misstatement of fact, the auditor should take action based on the auditor's professional judgment. (Ref: par. .A22–.A23)

Inquiry Concerning Litigation, Claims, and Assessments

.15 If information comes to the auditor's attention regarding litigation, claims, or assessments that leads the auditor to question whether the interim financial information has been prepared, in all material respects, in accordance with the applicable financial reporting framework, and the auditor believes that the entity's internal or external legal counsel may have relevant information, the auditor should inquire of such legal counsel concerning litigation, claims, and assessments. (Ref: par. .A22)

Inquiry Concerning an Entity's Ability to Continue as a Going Concern

.16 If the applicable financial reporting framework includes requirements for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information, the auditor should perform interim review procedures related to (a) whether the going concern basis of accounting is appropriate; (b) management's evaluation of whether there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern; (c) if there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern, management's plans to mitigate those matters; and (d) the adequacy of the related disclosures in the interim financial information. (Ref: par. .A23–.A24) [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.17 If the applicable financial reporting framework does not include a requirement for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information and (a) conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (b) in the course of performing review procedures on the current period interim financial information, the auditor becomes aware of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, the auditor should

- a. inquire of management whether the going concern basis of accounting is appropriate,
- b. inquire of management about its plans for dealing with the adverse effects of the conditions and events, and (Ref: par. .A25)
- c. consider the adequacy of the disclosure about such matters in the interim financial information. (Ref: par. .A26)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

Consideration of Management's Responses and Extension of Interim Review Procedures

.18 The auditor should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the auditor's knowledge of the entity's business and its internal control. However, the auditor is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.19 When a matter comes to the auditor's attention that leads the auditor to question whether the interim financial information has been prepared in accordance with the applicable financial reporting framework in all material respects, the auditor should make additional inquiries of management or

others or perform other procedures to provide a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information. (Ref: par. .A27) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Evaluating the Results of Interim Review Procedures

.20 The auditor should accumulate misstatements, including inadequate disclosure, identified by the auditor in performing the review procedures or brought to the auditor's attention during the performance of the review. (Ref: par. .A28) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.21 The auditor should evaluate, individually and in the aggregate, misstatements, including inadequate disclosure, accumulated in accordance with paragraph .20 to determine whether material modification should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework. (Ref: par. .A29–.A30) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Written Representations From Management

.22 For all interim financial information presented and for all periods covered by the review, the auditor should request management to provide written representations, as of the date of the auditor's review report (Ref: par. .A31–.A32)

- a. that management has fulfilled its responsibility for the preparation and fair presentation of the interim financial information, in accordance with the applicable financial reporting framework, as set out in the terms of the engagement.
- b. that management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of interim financial statements, including its responsibility to prevent and detect fraud.
- c. that management has disclosed to the auditor all significant deficiencies and material weaknesses in the design or operation of internal control of which management is aware as it relates to the preparation and fair presentation of both annual and interim financial information.
- d. that management has provided the auditor with all relevant information and access, as agreed upon in the terms of the engagement.
- e. that all transactions have been recorded and are reflected in the interim financial information.
- f. that management has disclosed to the auditor the results of its assessment of the risk that the interim financial information may be materially misstated as a result of fraud.
- g. that management has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving
 - i. management,
 - ii. employees who have significant roles in internal control, or
 - iii. others when the fraud could have a material effect on the interim financial information.

- h.* that management has disclosed to the auditor its knowledge of any allegations of fraud or suspected fraud affecting the entity's interim financial information communicated by employees, former employees, regulators, or others.
- i.* that management has disclosed to the auditor all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing interim financial information.
- j.* about whether management believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the interim financial information as a whole. A summary of such items should be included in, or attached to, the written representation. (Ref: par. .A33)
- k.* that management has disclosed to the auditor all known actual or possible litigation and claims whose effects should be considered when preparing the interim financial information, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.
- l.* about whether management believes that significant assumptions used by it in making accounting estimates are reasonable.
- m.* that management has disclosed to the auditor the identity of all the entity's related parties and all the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.
- n.* that all events occurring subsequent to the date of the interim financial information and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2021, by SAS No. 135.]

.23 If the auditor has concerns about the reliability of the representations or if management does not provide the requested written representations, the auditor should take appropriate action. When management does not provide the written representations described in paragraph .22*a–e*, the auditor should withdraw from the engagement to review the interim financial information. (Ref: par. .A34) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Communications With Management and Those Charged With Governance

Matters Affecting the Completion of the Review

.24 If the auditor cannot complete the review, the auditor should communicate to the appropriate level of management and those charged with governance

- a.* the reason why the review cannot be completed;
- b.* that an incomplete review does not provide a basis for reporting and, accordingly, that the auditor is precluded from issuing a review report; and

- c. any material modifications of which the auditor has become aware that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework, in accordance with paragraphs .25–.27. (Ref: par. .A35)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.25 The auditor should communicate to the appropriate level of management, as soon as practicable, matters that come to the auditor's attention during the conduct of the review that cause the auditor to believe that

- a. material modification should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework, or
- b. the entity issued the interim financial information before the completion of the review.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.26 If, in the auditor's judgment, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform those charged with governance of the matters as soon as practicable. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.27 If, in the auditor's judgment, those charged with governance do not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should consider whether to withdraw (a) from the engagement to review the interim financial information and (b) if applicable, from serving as the entity's auditor. (Ref: par. .A36) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Other Matters

.28 If the auditor becomes aware that fraud may have occurred, the auditor should communicate the matter as soon as practicable to the appropriate level of management. If the fraud involves senior management or results in a material misstatement of the interim financial information, the auditor should communicate the matter directly to those charged with governance. If the auditor becomes aware of matters involving identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing interim financial information, the auditor should communicate the matters to those charged with governance, other than when the matters are clearly inconsequential. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.29 The auditor should communicate relevant matters of governance interest arising from the review of interim financial information to those charged with governance, including the following:

- a. Significant deficiencies or material weaknesses in internal control as it relates to the preparation and fair presentation of annual and interim financial information (Ref: par. .A37)
- b. Any of the matters described in section 260, *The Auditor's Communication With Those Charged With Governance*, that have been identified, as they relate to the interim financial information (Ref: par. .A38–.A40)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

The Auditor's Report on a Review of Interim Financial Information

Form of the Auditor's Review Report

.30 The auditor's review report should be in writing. (Ref: par. .A41–.A42) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.31 The written review report should include the following: (Ref: par. .A43–.A44)

- a. A title that clearly indicates that it is the report of an independent auditor.
- b. An addressee as appropriate based on the circumstances of the engagement. (Ref: par. .A45)
- c. The first section of the auditor's report on a review of interim financial information should include the auditor's conclusion and the heading, "Results of Review of Interim Financial Information," and the following elements:
 - i. The name of the entity whose interim financial information has been reviewed
 - ii. A statement that the interim financial information identified in the report was reviewed
 - iii. The title of each statement that interim financial information comprises (Ref: par. .A46–.A47)
 - iv. A reference to the notes
 - v. The dates of or periods covered by each financial statement that the interim financial information comprises
 - vii. A statement about whether the auditor is aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with the applicable financial reporting framework and that identifies the country of origin of those accounting principles, if applicable (Ref: par. .A48–.A51)
- d. A section, directly following the "Results of Interim Financial Information" section, that includes the heading, "Basis for Review Results," and does the following: (Ref: par. . A52)
 - i. States that the review was conducted in accordance with generally accepted auditing standards applicable to reviews of interim financial information and identifies the United States of America as the country of origin of those standards (Ref: par. .A53)
 - ii. Includes a statement that a review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters
 - iii. Includes a statement that a review of interim financial information is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, the auditor does not express such an opinion

- iv. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the review (Ref: par. .A54–.A55)
- v. States whether the auditor believes that the results of the review procedures provide a reasonable basis for the auditor's conclusion
- e. A section that includes the heading "Responsibilities of Management for the Interim Financial Information" and includes a statement that management is responsible for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.
- f. The manual or printed signature of the auditor's firm. (Ref: par. .A56–.A58)
- g. The city and state where the auditor's report is issued. (Ref: par. .A59)
- h. The date of the review report, which should be dated no earlier than the date on which the auditor completed procedures sufficient to obtain a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information in order for it to be in accordance with the applicable financial reporting framework, including evidence of the following: (Ref: par. .A60)
 - i. All the statements and disclosures that the interim financial information comprises have been prepared.
 - ii. Management has asserted that it has taken responsibility for the interim financial information.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.32 The auditor should determine that management has clearly marked as unaudited each page of the interim financial information accompanying the review report. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Comparative Interim Financial Information That Has Not Been Reviewed Presented With Reviewed Interim Financial Information

.33 If an auditor is engaged to perform a review of the most recent interim period in accordance with this section, and such financial information will be presented in comparative form with interim financial information of a prior period that has not been reviewed, such interim financial information should be accompanied by an indication in the auditor's review report that the auditor has not reviewed the prior period interim financial information and that the auditor assumes no responsibility for it. (Ref: par. .A61) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Interim Financial Information Presented With Condensed Balance Sheet Information for the Most Recent Year End

.34 When a condensed balance sheet derived from audited financial statements is presented on a comparative basis with the interim financial information, the auditor should report on the condensed balance sheet only when the auditor audited the financial statements from which the condensed balance sheet was derived. The auditor should compare the condensed balance sheet with the related information in the audited financial statements to determine whether the condensed balance sheet agrees with, or can be recalculated from, the related information in the audited financial statements. The auditor's report on the interim financial information should include a paragraph addressing the condensed balance sheet that

- a. identifies the condensed balance sheet on which the auditor is reporting.
- b. identifies the audited financial statements from which the condensed balance sheet was derived and indicates that such financial statements are not separately presented.
- c. refers to the auditor's report on the audited financial statements, the date of that report, and the type of opinion expressed and, if the opinion is modified, the basis for the modification.
- d. describes the nature of any emphasis-of-matter paragraph or other-matter paragraph included in the auditor's report.
- e. includes an opinion about whether the condensed balance sheet is consistent, in all material respects, in relation to the audited financial statements from which it has been derived. (Ref: par. .A62)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Modification of the Auditor's Review Report

.35 When the interim financial information has not been prepared in accordance with the applicable financial reporting framework in all material respects, the auditor should consider whether modification of the auditor's review report on the interim financial information is sufficient to address the departure from the applicable financial reporting framework. (Ref: par. .A63–.A66) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.36 If the auditor concludes that modification of the standard review report is sufficient to address the departure, the auditor should modify the review report. The modification should describe the nature of the departure and, if practicable, should state the effects on the interim financial information. If the departure is due to inadequate disclosure, the auditor should, if practicable, include the information in the report that the auditor believes is necessary for adequate disclosure in accordance with the applicable financial reporting framework. (Ref: par. .A67) [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.37 If the auditor believes that modification of the review report is not sufficient to address the deficiencies in the interim financial information, the auditor should withdraw from the review engagement and provide no further services with respect to such interim financial information. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Separate Section in the Auditor's Review Report Regarding Going Concern

.38 The auditor should include a separate section in the auditor's review report with the heading "Substantial Doubt About an Entity's Ability to Continue as a Going Concern" in any of the following circumstances, regardless of whether the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists: (Ref : par. .A68–.A70)

- a. Such a section was included in the prior year's auditor's report and
 - i. the conditions or events that caused the auditor to conclude that substantial doubt about the entity's ability to continue as a going concern continue to exist and
 - ii. those conditions or events continue to raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and management's plans do not alleviate them.
- b. Such a section was not included in the prior year's auditor's report and
 - i. management is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists and
 - ii. management has included such statement in the notes to the interim financial information.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. As amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.39 The description in the "Going Concern" section about the entity's ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The auditor should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Subsequent Discovery of Facts Existing at the Date of the Auditor's Review Report

.40 If, subsequent to the date of the auditor's review report, the auditor becomes aware that facts existed at the date of the review report that might have affected the auditor's review report had the auditor then been aware of those matters, the auditor should apply the requirements and guidance, adapted as necessary, in section 560, *Subsequent Events and Subsequently Discovered Facts*. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Other Considerations

.41 If management does not include the auditor's review report in a report, document, or written communication containing the reviewed interim financial

information that indicates that such information has been reviewed by the entity's auditor, despite having agreed in the terms of the engagement to do so, the auditor should perform the following procedures:

- Request that management amend the report, document, or written communication to include the auditor's review report and reissue the report, document, or written communication
- If management does not comply with the request to amend and reissue the report, document, or written communication, request that the auditor's name not be associated with the interim financial information or referred to in the report, document, or written communication because the auditor will not permit either the use of the auditor's name or reference to the auditor unless the auditor's review report is included with the reviewed interim financial information in these circumstances
- Communicate management's noncompliance with the requests to those charged with governance
- When appropriate, recommend that the entity consult with its legal counsel about the application of relevant laws and regulations to the circumstances
- Consider what other actions might be appropriate (Ref: par. .A71)

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.42 If the auditor has issued a modified review report due to a departure from the applicable financial reporting framework, and management issues the interim financial information without including the review report in the document containing the interim financial information, the auditor should determine the appropriate course of action in the circumstances, including whether to withdraw from the engagement to audit the annual financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Interim Financial Information Accompanying Audited Financial Statements

.43 The auditor should include an other-matter paragraph in the auditor's report on the audited financial statements when all the following conditions exist:

- a. The interim financial information that has been reviewed in accordance with this section is included in a document containing audited financial statements.
- b. The interim financial information accompanying audited financial statements does not appear to be presented in accordance with the applicable financial reporting framework.
- c. The auditor's separate review report, which refers to the departure from the applicable financial reporting framework, is not presented with the interim financial information.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.44 The auditor is required by section 700, *Forming an Opinion and Reporting on Financial Statements*, to address in the auditor's report on the audited financial statements information that is not required by the applicable

financial reporting framework but is nevertheless presented as part of the basic financial statements if it cannot be clearly differentiated.³ When the interim financial information included in a note to the financial statements, including information that has been reviewed in accordance with this section, is not appropriately marked as unaudited, the auditor should, in the auditor's report on the audited financial statements, disclaim an opinion on the interim financial information. (Ref: par. .A72–.A73) [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Documentation

.45 The auditor should prepare documentation in connection with a review of interim financial information that will enable an experienced auditor, having no previous connection to the review, to understand

- a. the nature, timing, and extent of the review procedures performed;
- b. the results of the review procedures performed and the evidence obtained; and
- c. significant findings or issues arising during the review, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.46 The documentation should include the communications required by this section, whether written or oral. (Ref: par. .A74–.A75) [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .02)

.A1 The ability to apply this section even when the auditor does not expect to be engaged to audit the current year financial statements provides for appropriate transitions between the predecessor auditor and the auditor of the current year financial statements.

.A2 Appropriate financial reporting frameworks for condensed interim financial information may include, for example, Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 270, *Interim Reporting*, and Article 10 of Securities and Exchange Commission (SEC) Regulation S-X, with respect to accounting principles generally accepted in the United States of America, or International Accounting Standard 34, *Interim Financial Reporting*, with respect to International Financial Reporting Standards issued by the International Accounting Standards Board. FASB ASC 270 outlines the application of U.S. generally accepted accounting principles (GAAP) to the determination of income when interim financial information is presented, provides for the use of estimated effective income tax rates, and specifies certain disclosure requirements for condensed interim financial information issued by public companies and may be adapted by nonissuers as a fair presentation framework for

³ Paragraph .59 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131.]

condensed interim financial information. In addition to FASB ASC 270, other FASB ASC topics also include disclosure requirements for interim financial information.

The Meaning of Readily Available (Ref: par. .02d(iii))

.A3 Audited financial statements are deemed to be readily available if a third-party user can obtain the financial statements without any further action by the entity (for example, financial statements on an entity's website may be considered readily available, but being available upon request is not considered readily available).

Objective (Ref: par. .05)

.A4 The objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with auditing standards generally accepted in the United States of America. A review of interim financial information does not provide a basis for expressing an opinion about whether the interim financial information is presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

.A5 A review, in contrast to an audit, is not designed to provide the auditor with a basis for obtaining reasonable assurance that the interim financial information is free from material misstatement. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters and does not contemplate (a) tests of accounting records through inspection, observation, or confirmation; (b) tests of controls to evaluate their effectiveness; (c) the obtainment of corroborating evidence in response to inquiries; or (d) the performance of certain other procedures ordinarily performed in an audit. A review may bring to the auditor's attention significant findings or issues affecting the interim financial information, but it does not provide assurance that the auditor will become aware of all significant findings or issues that would be identified in an audit.

Acceptance

Agreement on Engagement Terms (Ref: par. .10)

.A6 The engagement letter or other suitable form of written agreement documenting the agreed-upon terms of the engagement with the entity regarding a review of interim financial information may use the following wording to include the information necessary to meet the requirements of paragraph .10:

Objectives and scope of the engagement

- The objective of a review of interim financial information is to provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to be in accordance with the applicable financial reporting framework.
- A review includes obtaining sufficient knowledge of the entity's business and internal control, as it relates to the preparation and fair presentation of both annual and interim financial information, to enable the auditor to
 - identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.

- select the inquiries and analytical procedures that will provide the auditor with a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information for it to conform with the applicable financial reporting framework.

Management's responsibilities

- Management is responsible for the following:
 - Preparing and presenting the interim financial information in accordance with the applicable financial reporting framework.
 - Designing, implementing, and maintaining internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with the applicable financial reporting framework.
 - Providing the auditor with (a) access to all information of which management is aware that is relevant to the preparation and fair presentation of the interim financial information, such as records, documentation, and other matters; (b) additional information that the auditor may request from management for the purpose of the review; and (c) unrestricted access to persons within the entity of whom the auditor determines it necessary to make inquiries.
 - Including the auditor's review report in any document containing interim financial information that indicates that such information has been reviewed by the entity's auditor.
 - Identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
 - Providing the auditor, at the conclusion of the engagement, with a letter confirming certain representations made during the review.
 - Adjusting the interim financial information to correct material misstatements. Although a review of interim financial information is not designed to provide the auditor with reasonable assurance that the interim financial information is free from material misstatement, management nonetheless is responsible for affirming in its representation letter to the auditor that the effects of any uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the current year period(s) under review are immaterial, both individually and in the aggregate, to the interim financial information as a whole.

The auditor's responsibilities

- The auditor is responsible for conducting the review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of performing analytical procedures and making inquiries of persons

responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information as a whole. Accordingly, the auditor will not express an opinion on the interim financial information.

Limitations of the engagement

- A review does not provide a basis for expressing an opinion about whether the interim financial information is presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
- A review does not provide the auditor with a basis for obtaining reasonable assurance that the auditor will become aware of all significant findings or issues that would be identified in an audit.
- A review is not designed to provide the auditor with a basis for obtaining reasonable assurance on internal control or to identify significant deficiencies or material weaknesses in internal control; however, the auditor is responsible for communicating to management and those charged with governance any significant deficiencies or material weaknesses in internal control that the auditor identifies during the performance of review procedures.

Procedures for a Review of Interim Financial Information

Understanding the Entity and Its Environment, Including Its Internal Control (Ref: par. .11–.12)

.A7 As required by section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the auditor who has audited the entity's financial statements for one or more annual periods would have obtained an understanding of the entity and its environment, including its internal control as it relates to the preparation and fair presentation of annual financial information, that was sufficient to conduct the audit. Internal control over the preparation and fair presentation of interim financial information may differ from internal control over the preparation and fair presentation of annual financial statements because certain accounting principles and practices used for interim financial information may differ from those used for the preparation of annual financial statements (for example, the use of estimated effective income tax rates for the preparation of interim financial information).

.A8 The auditor is unable to complete the review if the entity's internal control appears to contain deficiencies so significant that it would be impracticable for the auditor to effectively perform review procedures that would achieve the objective stated in paragraph .05. Paragraph .24 addresses the auditor's responsibilities when the review cannot be completed.

.A9 In an initial review of interim financial information, when performing the procedures for a new client required by paragraph .07, the auditor also may consider requesting access to review the predecessor auditor's documentation related to reviews of an interim period or interim periods in the prior year. However, the inquiries made and analytical procedures performed, or other procedures performed in the initial review, and the conclusions reached are solely the responsibility of the auditor. Therefore, the auditor is not permitted to make reference to the report or work of the predecessor auditor as the basis, in part, for the auditor's own report.

.A10 If the predecessor auditor does not respond to the auditor's inquiries or does not allow the auditor to review the predecessor auditor's documentation, the auditor may inquire why and use alternative procedures to obtain the understanding required by paragraph .11.

Analytical Procedures, Inquiries, and Other Review Procedures

Analytical Procedures (Ref: par. .13)

.A11 Procedures for conducting a review of interim financial information generally are limited to analytical procedures, inquiries, and other procedures that address significant accounting and disclosure matters relating to the interim financial information. The auditor's understanding of the entity and its environment, including its internal control, the results of the risk assessments relating to the preceding audit, and the auditor's consideration of materiality as it relates to the interim financial information, influences the nature and extent of the inquiries made and analytical procedures performed. For example, if the auditor becomes aware of a significant change in the entity's control activities at a particular location, the auditor may consider the following procedures:

- Making additional inquiries, such as whether management monitored the changes and considered whether they were operating as intended
- Employing analytical procedures with a more precise expectation

.A12 Examples of analytical procedures that an auditor may consider performing when conducting a review of interim financial information are contained in appendix A, "Analytical Procedures the Auditor May Consider Performing When Conducting a Review of Interim Financial Information." The auditor also may find the guidance in section 520, *Analytical Procedures*, useful in conducting a review of interim financial information.

.A13 Expectations developed by the auditor in performing analytical procedures in connection with a review of interim financial information ordinarily are less precise than those developed in an audit. Also, in a review, the auditor is not required to corroborate management's responses with other evidence.

.A14 In considering plausible relationships, the auditor may consider information developed and used by the entity (for example, analyses prepared for management or those charged with governance).

.A15 To compare disaggregated revenue data, the auditor may compare, for example, revenue reported by month and product line or operating segment during the current interim period with that of comparable prior periods.

Inquiries and Other Review Procedures (Ref: par. .14)

.A16 Many of the inquiries and review procedures can be performed before, or simultaneously with, the entity's preparation of the interim financial information. For example, the auditor may update the understanding of the entity's internal control and begin reading applicable minutes before the end of an interim period. Performing some of the review procedures earlier in the interim period also permits early identification and consideration of significant findings and issues affecting the interim financial information. In addition, when the auditor performing the review of interim financial information is also engaged to perform an audit of the annual financial statements of the entity, certain auditing procedures associated with the annual audit of the financial statements may be performed concurrently with the review of interim financial information. For example, information gained from reading the minutes of meetings of

the board of directors in connection with the review also may be relevant to the annual audit. Also, there may be significant or unusual transactions occurring during an interim period (for example, business combinations, restructurings, or significant revenue transactions) for which the procedures that would need to be performed for purposes of the audit of the annual financial statements could be performed, to the extent practicable, at the time of the review of the interim period in which the transactions are first recorded.

.A17 The auditor may find the guidance in section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, useful in conducting a review of interim financial information for an entity that prepares group financial statements.

.A18 Examples of unusual or complex situations about which the auditor may inquire of management are contained in appendix B, "Unusual or Complex Situations to Be Considered by the Auditor When Conducting a Review of Interim Financial Information."

.A19 To obtain evidence that the interim financial information agrees or reconciles with the accounting records, the auditor may compare the interim financial information to (a) the accounting records, such as the general ledger; (b) a consolidating schedule derived from the accounting records; or (c) other supporting data in the entity's records.

[.A20] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

[.A21] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

Inquiry Concerning Litigation, Claims, and Assessments (Ref: par. .15)

.A22 A review of interim financial information does not contemplate obtaining corroborating evidence for responses to inquiries, such as those concerning litigation, claims, and assessments. Consequently, the auditor is not required to send an inquiry letter to an entity's legal counsel concerning litigation, claims, and assessments.

Inquiry Concerning an Entity's Ability to Continue as a Going Concern (Ref: par. .16–.17)

.A23 The nature and extent of the auditor's interim review procedures are matters of the auditor's professional judgment. For example, when a history of profitable operations and ready access to financing exists, inquiry alone might be sufficient to review the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.A24 Certain financial reporting frameworks require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing interim financial information.⁴ For example, FASB ASC requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern.⁵ Under FASB ASC, the evaluation period

⁴ See paragraph .11 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, for the definition of *reasonable period of time*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

⁵ "Pending Content" in FASB *Accounting Standards Codification* (ASC) 205-40-50-1. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

is within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).⁶ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.A25 A review of interim financial information is not designed to identify conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. However, conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time may have existed at the date of the prior period financial statements or may be identified as a result of inquiries of management or in the course of performing other review procedures. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

.A26 Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, may provide useful guidance to the auditor when considering whether there is adequate and appropriate disclosure in the interim financial information about the entity's ability to continue as a going concern for a reasonable period of time⁷ when

- a. conditions or events have been identified as of the interim reporting date covered by the review and substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time exists, or
- b. the auditor's report for the prior year end contained an emphasis-of-matter paragraph indicating the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, and the conditions that raised such doubt continued to exist as of the interim reporting date covered by the review.

If the auditor determines that the disclosure related to substantial doubt about the entity's ability to continue as a going concern is inadequate, resulting in a departure from the applicable financial reporting framework, the auditor is required by paragraph .35 to modify the report. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

Consideration of Management's Responses and Extension of Interim Review Procedures (Ref: par. .19)

.A27 The auditor's interim review procedures may lead the auditor to make additional inquiries, such as questioning whether, for example, a significant sales transaction is recorded in accordance with the applicable financial reporting framework. Additional procedures that the auditor may perform to resolve such questions include discussing the terms of the transaction with senior sales and accounting personnel, reading the sales contract, or both. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

⁶ See footnote 5. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

⁷ Paragraphs .22–.23 of section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. Footnote renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132.]

Evaluating the Results of Interim Review Procedures (Ref: par. .20–.21)

.A28 The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts would not have a material effect on the interim financial information.⁸ [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A29 As noted in paragraph .A2, appropriate financial reporting frameworks for interim financial information may include, for example, FASB ASC 270 and Article 10 of SEC Regulation S-X. FASB ASC 270 describes the applicability of GAAP to interim financial information and indicates the types of disclosures necessary to report on a meaningful basis for a period of less than one full year. FASB ASC 270-10-45-16 provides guidance on assessing materiality in interim periods. For example, it states that in determining materiality for the purpose of reporting the correction of an error, amounts shall be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings. Further, Rule 10-01(a)(5) of SEC Regulation S-X states the following:

The interim financial information shall include disclosures either on the face of the financial statements or in accompanying footnotes sufficient so as to make the interim information presented not misleading. Registrants may presume that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual report to security holders or latest audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, and detailed disclosures prescribed by Rule 4-08 of this Regulation, may be omitted. However, disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the registrant. Disclosures should encompass for example, significant changes since the end of the most recently completed fiscal year in such items as: accounting principles and practices; estimates inherent in the preparation of the financial statements; status of long-term contracts; capitalization including significant new borrowings or modification of existing financing arrangements; and the reporting entity resulting from business combinations or dispositions. Notwithstanding the above, where material contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A30 Considerations that may affect the evaluation of whether uncorrected misstatements, individually or in the aggregate, are material include the following:

- The nature, cause (if known), and amount of the misstatements
- Whether the misstatements originated in the preceding year or interim periods of the current year

⁸ Paragraph .A2 of section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote renumbered by the issuance of SAS No. 132, February 2017.]

- Materiality judgments made in conjunction with the current or prior year's annual audit
- The potential effect of the misstatements on future interim or annual periods
- The appropriateness of offsetting a misstatement of an estimated amount with a misstatement of an item capable of precise measurement
- Recognition that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatements in future periods

Section 450, *Evaluation of Misstatements Identified During the Audit*, provides guidance regarding qualitative considerations in evaluating whether misstatements are material. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Written Representations From Management (Ref: par. .22-.23)

.A31 Exhibit A, "Illustrative Management Representation Letters for a Review of Interim Financial Information," contains illustrative representation letters for engagements to review interim financial information. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A32 The auditor may request additional representations, including representations regarding the following:

- Matters specific to the entity's business or industry
- Support for any assertion that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction
- Whether any side agreements or other arrangements (either written or oral) exist that have not been disclosed to the auditor

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2021, by SAS No. 135.]

.A33 If no uncorrected misstatements were identified, the representation regarding uncorrected misstatements is not relevant and, accordingly, is not required. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A34 Appropriate action when management does not provide one or more requested written representations or when the auditor has concerns about the reliability of the representations may include

- discussing the matter with management and, when relevant, those charged with governance;
- reevaluating the integrity of management and evaluating the effect that this may have on the reliability of representations (oral or written) and evidence in general; and
- considering whether to withdraw from the engagement to review the interim financial information and, if applicable, as the entity's auditor.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Communications With Management and Those Charged With Governance

Matters Affecting the Completion of the Review (Ref: par. .24 and .27)

.A35 When an auditor is unable to perform the procedures that the auditor considers necessary to achieve the objective of a review of interim financial information, or management does not provide the auditor with the written representations that the auditor believes are necessary, the review will be incomplete. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A36 The auditor may seek legal advice when considering whether to withdraw from the engagement to review the interim financial information and as the entity's auditor. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

Other Matters (Ref: par. .29)

.A37 Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, provides guidance on identifying and communicating deficiencies in internal control. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A38 As a result of performing the review of the interim financial information, the auditor may become aware of matters that, in the opinion of the auditor, are both significant and relevant to those charged with governance in overseeing the financial reporting and disclosure process. Examples of such matters include the following:

- A change in a significant accounting policy affecting the interim financial information
- Adjustments that either individually or in the aggregate could have a significant effect on the entity's financial reporting process
- Uncorrected misstatements aggregated by the auditor that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial information as a whole

[Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A39 The objective of a review of interim financial information differs significantly from that of an audit. Therefore, any communication that the auditor may make about the quality, not just the acceptability, of the entity's accounting principles as applied to its interim financial reporting generally is limited to the effect of significant events, transactions, and changes in accounting estimates that the auditor considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the auditor will become aware of all matters that might affect the auditor's judgments about the quality of the entity's accounting principles that would be identified as a result of an audit. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

.A40 The communications required by paragraphs .24–.29 may be oral or written. The communications are most helpful when made on a sufficiently timely basis to enable management or those charged with governance to take appropriate action. [Paragraph renumbered by the issuance of SAS No. 132, February 2017.]

The Auditor's Report on a Review of Interim Financial Information

Form of the Auditor's Review Report (Ref: par. .30-.31)

.A41 A written report encompasses reports issued in hard copy format and those using an electronic medium. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A42 Entities may be required by third parties to engage auditors to perform a review of interim financial information, but such third parties may choose to not require that a written auditor's review report on such information be provided to users of the entity's interim financial information. For example, entities that trade unregistered private equity securities on electronic trading platforms, often referred to as private equity exchanges, may be required to provide financial and other information to the qualified investors on the exchange's website. The ongoing reporting requirements of these exchanges are substantially similar to the reporting required of issuers, wherein entities trading securities on such exchanges are required to engage auditors to review their interim financial information but are not required to include written review reports with interim financial information provided to qualified investors. Nonetheless, in accordance with paragraph .30, the auditor's report on the review of the interim financial information is required to be in writing. [Paragraph subsequently renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A43 Reporting considerations related to the dating of reports or subsequent events encountered during a review are similar to those encountered in an audit of financial statements. Sections 560 and 700 provide guidance on these issues. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A44 Exhibit B, "Illustrations of Auditor's Review Reports on Interim Financial Information," contains illustrations of review reports. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Addressee (Ref: par. .31b)

.A45 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose interim financial information is being reviewed or to those charged with governance. A report on the interim financial information of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Results of Review of Interim Financial Information (Ref: par. .31c)

.A46 The identification of the title and the dates of, or periods covered by, each statement that the interim financial information comprises may also be achieved by referencing the table of contents in a document bound with or

accompanying the interim financial information and auditor's report thereon. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A47 When the auditor is aware that the reviewed interim financial information will be included in a document that contains information in addition to the interim financial information and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the reviewed interim financial information is presented. This helps users identify the interim financial information to which the auditor's report relates. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A48 As explained in section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance, requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.⁹ That description is important because it advises users of the financial statements of the framework on which the financial statements are based. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A49 The title of the financial statements identified in the "Results of Review of Interim Financial Information" section describes the information that is the subject of the auditor's conclusion. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A50 The auditor's conclusion covers the *interim financial information*, as defined by the applicable financial reporting framework. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A51 The identification of the applicable financial reporting framework in the auditor's conclusion is intended to advise users of the auditor's report of the context in which the auditor's conclusion is expressed. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles or International Financial Reporting Standards promulgated by the International Accounting Standards Board (IASB) or *International Financial Reporting Standard for Small- and Medium-Sized Entities promulgated by the IASB*. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Basis for Review Results (Ref: par. .31d)

.A52 The "Basis for Review Results" section provides important context about the auditor's conclusion. Accordingly, this section requires the "Basis for Review Results" section to directly follow the "Results of Review of Interim Financial Information" section in the auditor's report. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

⁹ Paragraphs .A2–.A3 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*. [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A53 The reference to the standards used conveys to the users of the auditor's report that the review has been conducted in accordance with established standards. For example, the auditor's report may refer to *auditing standards generally accepted in the United States of America* or *U.S. generally accepted auditing standards applicable to reviews of interim financial information*. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Relevant Ethical Requirements (Ref: par. .31d(v))

.A54 Section 200 explains that *ethical requirements* consist of the AICPA Code of Professional Conduct (AICPA code) together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.¹⁰ When the AICPA code applies, the auditor's other ethical responsibilities relate to the principles of professional conduct "Principles of Professional Conduct" (ET sec. 0.300). [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A55 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA code, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. Section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,¹¹ provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Signature of the Auditor (Ref: par. .31g)

.A56 In some cases, law or regulation may allow for the use of electronic signatures in the auditor's report. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A57 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A58 This section would not preclude a governmental auditor from including the personal name and signature of the auditor in the auditor's report when,

¹⁰ Paragraph .A15 of section 200. [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

¹¹ Paragraphs .22–.23 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

in certain situations, the governmental auditor is required by law or regulation or chooses to do so. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Auditor's Address (Ref: par. .31h)

.A59 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Date of the Auditor's Report (Ref: par. .31i)

.A60 When an engagement quality control review is performed, section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that the auditor's report not be released prior to the completion of the engagement quality control review.¹² [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Comparative Interim Financial Information That Has Not Been Reviewed Presented With Reviewed Interim Financial Information (Ref: par. .33)

.A61 The indication that the auditor has not reviewed the prior period interim financial information and that the auditor assumes no responsibility for it may be worded, for example, as follows:

The accompanying [describe the interim financial information or statements] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month period then ended were not reviewed by us, and accordingly, we do not express any form of assurance on it.

[Paragraph subsequently renumbered by the issuance of SAS No. 132, February 2017. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Interim Financial Information Presented With Condensed Balance Sheet Information for the Most Recent Year End (Ref: par. .34)

.A62 Because interim financial reporting is intended to be an update to year-end reporting, condensed balance sheet information as of the most recent year end often is presented for comparative purposes with the corresponding information as of the latest interim period. Appendix B includes an illustration of a review report on comparative interim financial information that includes a condensed balance sheet derived from audited financial statements. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Modification of the Auditor's Review Report (Ref: par. .35-.36)

.A63 Departures from the applicable financial reporting framework include inadequate disclosure and changes in accounting policies that are not in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

¹² Paragraph .21 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. [Footnote added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A64 Section 700 addresses the reporting requirements when the circumstances contemplated by the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct are present. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014. Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A65 If the interim financial information adequately discloses a lack of consistency in the application of accounting principles affecting the interim financial information, the auditor may, but is not required to, include an emphasis-of-matter paragraph in the auditor's review report. [Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A66 Exhibit C, "Illustrations of Example Modifications to the Auditor's Review Report Due to Departures From the Applicable Financial Reporting Framework," contains illustrative examples of paragraphs modifying the auditor's review report. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A67 The information necessary for adequate disclosure is influenced by the form and context in which the interim financial information is presented. For example, the disclosures considered necessary for interim financial information presented in accordance with the minimum disclosure requirements of FASB ASC 270-10-50-1, which is applicable to condensed financial statements of public companies, are considerably less extensive than those necessary for annual financial statements that present financial position, results of operations, and cash flows in accordance with the applicable financial reporting framework. FASB ASC 270-10-50-3 states that a presumption exists that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by GAAP and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Separate Section in the Auditor's Review Report Regarding Going Concern (Ref: par. .38)

.A68 See exhibit D, "Illustrations of the Separate Section in the Auditor's Review Report Regarding Going Concern," for illustrative examples of such separate section. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A69 If conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, but (a) no statement relating to substantial doubt is included in the notes to the interim financial information because management's plans have alleviated the substantial doubt or (b) the applicable financial reporting framework does not require inclusion of such statement in the notes to the interim financial information, the auditor may include a

separate section when management has disclosed the conditions or events in the notes to the financial statements but a statement related to substantial doubt is not required to be included by the applicable financial reporting framework. The following is an illustration of a separate section in the auditor's review report regarding going concern when no statement relating to substantial doubt is included in the notes to the interim financial information but conditions or events are disclosed:

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's plans in regards to these matters are also described in Note X.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A70 Paragraph .A47 of section 570 provides guidance when conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and (a) management's plans have not alleviated the substantial doubt, and (b) the applicable financial reporting framework does not require inclusion of such statement in the notes to the interim financial information. [Paragraph added, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

Other Considerations (Ref: par. .41)

.A71 The auditor may seek legal advice in considering what actions, if any, may be appropriate in these circumstances. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Interim Financial Information Accompanying Audited Financial Statements (Ref: par. .44)

.A72 Interim financial information may accompany audited financial statements. If management chooses or is required to present interim financial information in a note to the audited financial statements, management is responsible for clearly marking the information as unaudited in the note. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A73 Because the interim financial information has not been audited and is not required for the audited financial statements to be fairly stated in accordance with the applicable financial reporting framework, the auditor ordinarily need not modify the auditor's report on the audited financial statements to refer to the interim financial information accompanying the audited financial statements, including when the auditor has performed a review in accordance with this section. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Documentation (Ref: par. .44–.46)

.A74 The auditor may find the guidance in section 230, *Audit Documentation*, useful in determining the form and content of the review documentation, including guidance on the timing of the final assembly of the engagement documentation. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A75 Examples of findings or issues that, in the auditor's judgment, are significant include the results of review procedures that indicate that the interim financial information could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. [Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A76

Appendix A — Analytical Procedures the Auditor May Consider Performing When Conducting a Review of Interim Financial Information (Ref: par. .A12)

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the interim financial information. Examples of analytical procedures that an auditor may consider performing in a review of interim financial information include the following:

- Comparing current interim financial information with the interim financial information of the immediately preceding interim period, the interim financial information of the corresponding interim period of the preceding financial year, and the most recent audited annual financial statements.
- Comparing current interim financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current interim financial information with corresponding information in (a) budgets, using expected rates, and (b) financial information for prior periods). Caution is necessary when comparing and evaluating current interim financial information with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired interim results.
- Comparing current interim financial information with relevant nonfinancial information.
- Comparing ratios and indicators for the current interim period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current interim financial information and comparing the results with corresponding information for prior periods). Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current interim period with those of entities in the same industry.
- Comparing relationships among elements in the current interim financial information with corresponding relationships in the interim financial information of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables).
- Comparing disaggregated data. The following are examples of how data may be disaggregated:

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- By period (for example, interim financial information items disaggregated into quarterly, monthly, or weekly amounts)
- By product line or operating segment
- By location (for example, subsidiary, division, or branch)

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A77

Appendix B — Unusual or Complex Situations to Be Considered by the Auditor When Conducting a Review of Interim Financial Information (Ref: par. .A18)

The following are examples of situations about which the auditor may inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior quarters
- Infrequent transactions
- Significant unusual transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related party transactions
- Material off-balance-sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. As amended, effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2021, by SAS No. 135. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A78

Exhibit A — Illustrative Management Representation Letters for a Review of Interim Financial Information (Ref: par. .A31)

The following management representation letters, which relate to a review of interim financial information, are presented for illustrative purposes only.

Illustration 1 — Short Form Representation Letter for a Review of Interim Financial Information

Illustration 2 — Detailed Representation Letter for a Review of Interim Financial Information

It is assumed in these illustrations that the applicable financial reporting framework is accounting principles generally accepted in the United States of America, that no conditions or events exist that might be indicative of the entity's possible inability to continue as a going concern, and that no exceptions exist to the requested written representations. If circumstances differ from these assumptions, the representations would need to be modified to reflect the actual circumstances.

Illustration 1 — Short Form Representation Letter for a Review of Interim Financial Information

This representation letter is to be used in conjunction with the representation letter for the audit of the financial statements of the prior year. Management confirms the representations made in the representation letter for the audit of the financial statements of the prior year end, as they apply to the interim financial information, and makes additional representations that may be needed for the interim financial information.

[Date]

To [Independent Auditor]:

This representation letter is provided in connection with your review of the [consolidated] balance sheet as of June 30, 20X1 and the related [consolidated] statements of income, changes in equity, and cash flows for the six-month period then ended of ABC Company for the purpose of reporting whether any material modifications should be made to the [consolidated] interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) [including, if appropriate, an indication as to the appropriate form and content of interim financial information (for example, Article 10 of SEC Regulation S-X)].

We confirm that [, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves] [as of (date of auditor's review report),]:

Interim Financial Information

1. We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated *[insert date]* for the preparation and fair presentation of interim financial information in accordance with U.S. GAAP; in particular the interim financial information is presented in accordance therewith.
2. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.
3. The interim financial information has been adjusted or includes disclosures for all events subsequent to the date of the interim financial information for which U.S. GAAP requires adjustment or disclosure.
4. The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the interim financial information as a whole. A list of the uncorrected misstatements is attached to the representation letter.

[Any other matters that the auditor may consider appropriate]

Information Provided

5. We have provided you with:
 - Access to all information of which we are aware that is relevant to the preparation and fair presentation of the interim financial information such as records, documentation, and other matters;
 - Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared;
 - Additional information that you have requested from us for the purpose of the review; and
 - Unrestricted access to persons within the entity of whom you determined it necessary to make inquiries.
6. We have disclosed to you all significant deficiencies or material weaknesses in the design or operation of internal control of which we are aware, as it relates to the preparation and fair presentation of both annual and interim financial information.
7. We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as a result of fraud.
8. We have *[no knowledge of any]* *[disclosed to you all information of which we are aware in relation to]* fraud or suspected fraud that affects the entity and involves:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others when the fraud could have a material effect on the interim financial information.
9. We have *[no knowledge of any]* *[disclosed to you all information in relation to]* allegations of fraud, or suspected fraud, affecting the

entity's interim financial information communicated by employees, former employees, analysts, regulators, or others.

10. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

[Any other matters that the auditor may consider necessary]

11. We have reviewed our representation letter to you dated *[date of representation letter relating to most recent audit]* with respect to the audited consolidated financial statements as of and for the year ended *[prior year-end date]*. We believe that representations *[references to applicable representations]* within that representation letter do not apply to the interim financial information referred to above. We now confirm those representations *[references to applicable representations]*, as they apply to the interim financial information referred to above, and incorporate them herein, with the following changes:

[Indicate any changes.]

12. *[Add any representations related to new accounting or auditing standards that are being implemented for the first time.]*

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

[Name of Chief Accounting Officer and Title]

Illustration 2 — Detailed Representation Letter for a Review of Interim Financial Information

This representation letter is similar in detail to the management representation letter used for the audit of the financial statements of the prior year and, thus, need not refer to the written management representations received in the most recent audit.

[Date]

To *[Independent Auditor]*:

This representation letter is provided in connection with your review of the *[consolidated]* balance sheet as of June 30, 20X1 and the related *[consolidated]* statements of income, changes in equity, and cash flows for the six-month period then ended of ABC Company for the purpose of reporting whether any material modifications should be made to the *[consolidated]* interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) *[including, if appropriate, an indication as to the appropriate form and content of interim financial information (for example, Article 10 of SEC Regulation S-X)]*.

We confirm that *[, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves] [as of (date of auditor's review report),]*:

Interim Financial Information

1. We have fulfilled our responsibilities, as set out in the terms of the engagement letter dated *[insert date]* for the preparation and fair presentation of the interim financial information in accordance with U.S. GAAP; in particular the interim financial information is presented in accordance therewith.
2. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.
3. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
4. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of U.S. GAAP.
5. The interim financial information has been adjusted or includes disclosures for all events subsequent to the date of the interim financial information for which U.S. GAAP requires adjustment or disclosure.
6. The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the interim financial information as a whole. A list of the uncorrected misstatements is attached to the representation letter.

[Any other matters that the auditor may consider appropriate]

Information Provided

7. We have provided you with:
 - Access to all information of which we are aware that is relevant to the preparation and fair presentation of the interim financial information such as records, documentation, and other matters;
 - Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared;
 - Additional information that you have requested from us for the purpose of the review; and
 - Unrestricted access to persons within the entity of whom you determined it necessary to make inquiries.
8. All transactions have been recorded in the accounting records and are reflected in the interim financial information.
9. We have disclosed to you all significant deficiencies or material weaknesses in the design or operation of internal control of which we are aware, as it relates to the preparation and fair presentation of both annual and interim financial information.
10. We have disclosed to you the results of our assessment of the risk that the interim financial information may be materially misstated as a result of fraud.
11. We have *[no knowledge of any]**[disclosed to you all information of which we are aware in relation to]* fraud or suspected fraud that affects the entity and involves:
 - Management;

Special Considerations in the United States

- Employees who have significant roles in internal control; or
 - Others when the fraud could have a material effect on the interim financial information.
12. We have [*no knowledge of any*][*disclosed to you all information in relation to*] allegations of fraud, or suspected fraud, affecting the entity's interim financial information communicated by employees, former employees, analysts, regulators, or others.
 13. We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing interim financial information.
 14. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.
 15. We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.

[Any other matters that the auditor may consider necessary]

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

[Name of Chief Accounting Officer and Title]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A79

Exhibit B — Illustrations of Auditor's Review Reports on Interim Financial Information (Ref: par. .A44)

Illustration 1 — A Review Report on Interim Financial Information

Illustration 2 — A Review Report on Condensed Comparative Interim Financial Information

Illustration 3 — A Review Report That Refers to a Component Auditor's Review Report on the Interim Financial Information of a Significant Component of a Reporting Entity

Illustration 4 — A Review Report on Comparative Interim Financial Information When the Prior Period Was Reviewed by Another Auditor

Illustration 1 — A Review Report on Interim Financial Information

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying [describe the interim financial information or statements reviewed] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, *accounting principles generally accepted in the United States of America*].

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]* and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — A Review Report on Condensed Comparative Interim Financial Information

The following is an example of a review report on a condensed balance sheet as of March 31, 20X1; the related condensed statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0; and a condensed balance sheet derived from audited financial statements as of December 31, 20X0. If the auditor's report on the preceding year-end financial statements was other than unmodified or included a separate section regarding going concern or an emphasis-of-matter paragraph because of an inconsistency in the application of accounting principles, the last paragraph of the illustrative report would be appropriately modified.

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the condensed consolidated financial statements of ABC Company and subsidiaries, which comprise the balance sheet as of March 31, 20X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0, and the related notes (collectively referred to as the *interim financial information*).

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed interim financial information for it to be in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.]*

Basis for Review Results

We conducted our reviews in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of condensed interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of condensed interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the condensed interim financial information in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]* and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

Report on Condensed Balance Sheet as of [Date]

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated February 15, 20X1. In our opinion, the accompanying condensed consolidated balance sheet of ABC Company and subsidiaries as of December 31, 20X0, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 3 — A Review Report That Refers to a Component Auditor's Review Report on the Interim Financial Information of a Significant Component of a Reporting Entity

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures.
- The auditor is making reference to another auditor's review report on the interim financial information of a significant component of a reporting entity.

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying *[describe the interim financial information or statements reviewed]* of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review, and the review report of other auditors, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.]*

We were furnished with the report of other auditors on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20X1, and whose revenues for the three-month and nine-month periods then ended, constituted 15%, 20%, and 22%, respectively, of the related consolidated totals.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]* and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 4 — A Review Report on Comparative Interim Financial Information When the Prior Period Was Reviewed by Another Auditor

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures as of March 31, 20X1, and for the three-month period then ended.
- Comparative information is presented for the balance sheet as of December 31, 20X0, and for the statements of income and cash flows for the comparable interim period.
- The December 31, 20X0, financial statements were audited, and the March 31, 20X0, interim financial information was reviewed, by another auditor.

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying *[describe the interim financial information or statements reviewed]* of ABC Company and subsidiaries as of March 31, 20X1, and for the three-month period then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review we are not aware of any material modifications that should be made to the accompanying interim financial information as of and for the three months ended March 31, 20X1, for it to be in accordance with *[identify*

the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

The consolidated statements of income and cash flows of ABC Company and subsidiaries for the three-month period ended March 31, 20X0, were reviewed by other auditors whose report dated June 1, 20X0, stated that based on their review, they were not aware of any material modifications that should be made to those statements in order for them to be in accordance with *identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*. The consolidated balance sheet of the Company as of December 31, 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein), were audited by other auditors whose report dated March 15, 20X1, expressed an unmodified opinion on those statements.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with *identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America* and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Paragraph renumbered by the issuance of SAS No. 132, February 2017. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

.A80

Exhibit C — Illustrations of Example Modifications to the Auditor's Review Report Due to Departures From the Applicable Financial Reporting Framework (Ref: par. .A66)

Illustration 1 — Modification Due to a Departure From the Applicable Financial Reporting Framework

Illustration 2 — Modification Due to Inadequate Disclosure

Illustration 1 — Modification Due to a Departure From the Applicable Financial Reporting Framework

The following is an example of a modification of the auditor's review report due to a departure from the applicable financial reporting framework:

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying *[describe the interim financial information or statements reviewed]* of ABC Company and its subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, and the related notes (collectively referred to as the *interim financial information*).

Based on our review, with the exception of the matters described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]*.

Based on information furnished to us by management, we believe that the Company has excluded from property and debt in the accompanying balance sheet certain lease obligations that we believe should be capitalized to be in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]*. This information indicates that if these lease obligations were capitalized at September 30, 20X1, property would be increased by \$_____, long-term debt would be increased by \$_____, and net income would be increased (decreased) by \$_____ and \$_____, respectively, for the three-month and nine-month periods then ended.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion

regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Responsibilities of Management for the Interim Financial Information

Management is responsible for the preparation and fair presentation of the interim financial information in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]* and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — Modification Due to Inadequate Disclosure

The following is an example of the second and third paragraphs of the auditor's review report when such report is modified due to inadequate disclosure:

Based on our review, with the exception of the matters described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America.]*

Management has informed us that the Company is presently defending a claim regarding *[describe the nature of the loss contingency]* and that the extent of the Company's liability, if any, and the effect on the accompanying interim financial information is not determinable at this time. The interim financial information fails to disclose these matters, which we believe are required to be disclosed in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]*.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, SAS No. 140.]

.A81

Exhibit D — Illustrations of Separate Sections Regarding Going Concern in the Auditor's Review Report (Ref: par. .A68)

Illustration 1 — Separate Section When Substantial Doubt Is Disclosed in the Notes to the Latest Annual Audited Financial Statements and the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

Illustration 2 — Separate Section When Substantial Doubt Is Not Disclosed in the Notes to the Latest Annual Audited Financial Statements or the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

Illustration 3 — Separate Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Interim Financial Information That Conditions or Events Have Been Identified and Substantial Doubt Exists, Such Statement Is Included in the Notes to the Interim Financial Information, and a Separate Section Regarding Going Concern Was Not Included in the Prior Year's Audit Report

Illustration 1 — Separate Section When Substantial Doubt Is Disclosed in the Notes to the Latest Annual Audited Financial Statements and the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

The following is an example of situations in which (a) a separate section regarding going concern was included in the prior year's auditor's report, (b) conditions or events have been identified and substantial doubt continues to exist, and (c) the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended, includes a statement that substantial doubt exists about the Company's ability to continue as a going concern. Note 4 of the Company's audited financial

statements also discloses the events and conditions, management's evaluation of the events and conditions, and management's plans regarding these matters, including the fact that the Company was unable to renew its line of credit or obtain alternative financing as of December 31, 20X1. Our auditor's report on those financial statements includes a separate section referring to the matters in Note 4 of those financial statements. As indicated in Note 3 of the accompanying interim financial information as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Illustration 2 — Separate Section When Substantial Doubt Is Not Disclosed in the Notes to the Latest Annual Audited Financial Statements or the Interim Financial Information, a Separate Section Regarding Going Concern Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the Separate Section Have Been Identified and Substantial Doubt Exists

The following is an example of a situation in which (a) a separate section regarding going concern was included in the prior year's auditor's report, (b) conditions or events have been identified and substantial doubt continues to exist, and (c) the entity is not required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended, discloses that the Company was unable to renew its line of credit or obtain alternative financing as of December 31, 20X1. Our auditor's report on those financial statements includes a separate section referring to the matters in Note 4 of those financial statements, indicating that these matters raised substantial doubt about the Company's ability to continue as a going concern. As indicated in Note 3 of the accompanying interim financial information as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2. Management's evaluation of the conditions and events and management's plans regarding these matters are also disclosed in Note 3. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Illustration 3 — Separate Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Interim Financial Information That Conditions or Events Have Been Identified and Substantial Doubt Exists, Such Statement Is Included in the Notes to the Interim Financial Information, and a Separate Section Regarding Going Concern Was Not Included in the Prior Year's Audit Report

The following is an example of a separate section when (a) a separate section regarding going concern was not included in the prior year's auditor's report, (b) the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that conditions or events have been identified and substantial doubt exists, and (c) such statement is included in the notes to the interim financial information.

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the interim financial information, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the conditions and events and management's plans regarding these matters are also described in Note 3. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

[Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2017, by SAS No. 132. Paragraph subsequently renumbered and amended, effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2021, by SAS No. 140.]

AU-C Section 935

Compliance Audits

(Supersedes SAS No. 74.)

Source: SAS No. 117; SAS No. 122; SAS No. 123; SAS No. 125; SAS No. 130; SAS No. 140.

Effective for compliance audits for fiscal periods ending on or after June 15, 2010, unless otherwise indicated. Earlier application is permitted.

NOTE

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

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

Introduction and Applicability

.01 Governments frequently establish governmental audit requirements for entities to undergo an audit of their compliance with applicable compliance requirements. This section is applicable when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all of the following:

- Generally accepted auditing standards (GAAS)
- The standards for financial audits under *Government Auditing Standards*
- A governmental audit requirement that requires an auditor to express an opinion on compliance (Ref: par. .A1–.A2)

.02 This section addresses the application of GAAS to a compliance audit. Compliance audits usually are performed in conjunction with a financial statement audit. This section does not apply to the financial statement audit component of such engagements. Although certain AU-C sections are not applicable to a compliance audit, as identified in the appendix "AU-C Sections That Are Not Applicable to Compliance Audits," all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.03 This section is not applicable when the governmental audit requirement calls for an examination, in accordance with Statements on Standards for Attestation Engagements, of an entity's compliance with specified requirements or an examination of an entity's internal control over compliance. AT-C section 315, *Compliance Attestation*, is applicable to an examination of an

entity's compliance with specified requirements and AT-C section 205, *Examination Engagements*, is applicable to an examination of an entity's internal control over compliance. If the entity is required to undergo a compliance audit and an examination of internal control over compliance, this section is applicable to performing and reporting on the compliance audit, and AT-C section 205 is applicable to performing and reporting on the examination of internal control over compliance. (Ref: par. .A2) [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.04 Sections 200–900 address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, those AU-C sections, or portions thereof, identified in the appendix cannot be adapted to a compliance audit because they address the matters that are not applicable to a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.05 Except for the AU-C sections that are listed in the appendix as not applicable to a compliance audit, all of the other AU-C sections are applicable to a compliance audit. However, the auditor is not required, in planning and performing a compliance audit, to make a literal translation of each procedure that might be performed in a financial statement audit, but rather to obtain sufficient appropriate audit evidence to support the auditor's opinion on compliance. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.06 Some AU-C sections can be adapted and applied to a compliance audit with relative ease, for example, by simply replacing the word *misstatement* with the word *noncompliance*. Other AU-C sections are more difficult to adapt and apply and entail additional modification. For that reason, this section provides more specific guidance on how to adapt and apply certain AU-C sections to a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.07 *Government Auditing Standards* and governmental audit requirements contain certain standards and requirements that are supplementary to those in GAAS, as well as guidance on how to apply those standards and requirements.

Management's Responsibilities

.08 A compliance audit is based on the premise that management is responsible for the entity's compliance with compliance requirements. Management's responsibility for the entity's compliance with compliance requirements includes the following:

- a. Identifying the entity's government programs and understanding and complying with the compliance requirements
- b. Designing, implementing, and maintaining effective controls that provide reasonable assurance that the entity administers government programs in compliance with the compliance requirements
- c. Evaluating and monitoring the entity's compliance with the compliance requirements
- d. Taking corrective action when instances of noncompliance are identified, including corrective action on audit findings of the compliance audit

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Effective Date

.09 The provisions of this section are effective for compliance audits for fiscal periods ending on or after June 15, 2010. Earlier application is permitted.

Objectives (Ref: par. .A3)

.10 The auditor's objectives in a compliance audit are to

- a. obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement about whether the entity complied in all material respects with the applicable compliance requirements; and
- b. identify audit and reporting requirements specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards*, if any, and perform procedures to address those requirements.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Definitions

.11 For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows:

Applicable compliance requirements. Compliance requirements that are subject to the compliance audit.

Audit findings. The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.

Audit risk of noncompliance. The risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. Audit risk of noncompliance is a function of the risks of material noncompliance and detection risk of noncompliance.

Compliance audit. A program-specific audit or an organization-wide audit of an entity's compliance with applicable compliance requirements.

Compliance requirements. Laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to a government program with which the entity is required to comply.

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

not possess the necessary authority or competence to perform the control effectively.

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

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

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

Governmental audit requirement. A government requirement established by law, statute, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers. (Ref: par. .A4)

Grantor. A government agency from which funding for the government program originates.

Known questioned costs. Questioned costs specifically identified by the auditor. Known questioned costs are a subset of likely questioned costs.

Likely questioned costs. The auditor's best estimate of total questioned costs, not just the known questioned costs. Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

Material noncompliance. In the absence of a definition of material noncompliance in the governmental audit requirement, noncompliance with the applicable compliance requirements is considered quantitatively or qualitatively material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the government program as a whole.

Material weakness in internal control over compliance. A deficiency, or combination of deficiencies, in internal control over

compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In this section, a reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Probable. The future event or events are likely to occur.

Organization-wide audit. An audit of an entity's financial statements and an audit of its compliance with the applicable compliance requirements as they relate to one or more government programs that the entity administers.

Pass-through entity. An entity that receives an award from a grantor or other entity and distributes all or part of it to another entity to administer a government program.

Program-specific audit. An audit of an entity's compliance with applicable compliance requirements as they relate to one government program that the entity administers. The compliance audit portion of a program-specific audit is performed in conjunction with either an audit of the entity's or the program's financial statements.

Questioned costs. Costs that are questioned by the auditor because (1) of a violation or possible violation of the applicable compliance requirements, (2) the costs are not supported by adequate documentation, or (3) the incurred costs appear unreasonable and do not reflect the actions that a prudent person would take in the circumstances.

Risk of material noncompliance. The risk that material noncompliance exists prior to the audit. This consists of two components, described as follows:

Inherent risk of noncompliance. The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.

Control risk of noncompliance. The risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

Significant deficiency in internal control over compliance. A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Requirements

Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: par. .A5 and .A40)

.12 When performing a compliance audit, the auditor, using professional judgment, should adapt and apply the AU-C sections to the objectives of a compliance audit, except for the AU-C sections listed in the appendix. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Establishing Materiality Levels (Ref: par. .A6–.A8)

.13 The auditor should establish and apply materiality levels for the compliance audit based on the governmental audit requirement.

Identifying Government Programs and Applicable Compliance Requirements (Ref: par. .A9–.A11)

.14 As discussed in paragraph .08, a compliance audit is based on the premise that management is responsible for identifying the entity's government programs and understanding and complying with the compliance requirements. The auditor should determine which of those government programs and compliance requirements to test (that is, the applicable compliance requirements) in accordance with the governmental audit requirement.

Performing Risk Assessment Procedures (Ref: par. .A12–.A15)

.15 For each of the government programs and applicable compliance requirements selected for testing, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the applicable compliance requirements and the entity's internal control over compliance with the applicable compliance requirements.¹

.16 In performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management's response to findings and recommendations that could have a material effect on the entity's compliance with the applicable compliance requirements (for example, taking corrective action). The auditor should use this information to identify and assess risks of material noncompliance and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

¹ Paragraphs .03–.12b and .12d–.25 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .A16–.A18)

.17 The auditor should identify and assess the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity's compliance because they may affect the entity's compliance with many compliance requirements.^[2] [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Performing Further Audit Procedures in Response to Assessed Risks

.18 If the auditor identifies risks of material noncompliance that are pervasive to the entity's compliance, the auditor should develop an overall response to such risks. (Ref: par. .A19)

.19 The auditor should design and perform further audit procedures, including tests of details (which may include tests of transactions) to obtain sufficient appropriate audit evidence about the entity's compliance with each of the applicable compliance requirements in response to the assessed risks of material noncompliance. Risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance. (Ref: par. .A20–.A23)

.20 The auditor should design and perform further audit procedures in response to the assessed risks of material noncompliance. These procedures should include performing tests of controls over compliance if

- the auditor's risk assessment includes an expectation of the operating effectiveness of controls over compliance related to the applicable compliance requirements;
- substantive procedures alone do not provide sufficient appropriate audit evidence; or
- such tests of controls over compliance are required by the governmental audit requirement.

If any of the conditions in this paragraph are met, the auditor should test the operating effectiveness of controls over each applicable compliance requirement to which the conditions apply in each compliance audit. (Ref: par. .A24–.A25)

Supplementary Audit Requirements

.21 The auditor should determine whether audit requirements are specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards* and perform procedures to address those requirements, if any. (Ref: par. .A26)

.22 In instances where audit guidance provided by a governmental agency for the performance of compliance audits has not been updated for, or otherwise conflicts with, current GAAS or *Government Auditing Standards*, the auditor should comply with the most current applicable GAAS and *Government Auditing Standards* instead of the outdated or conflicting guidance. (Ref: par. .A27)

^[2] [Footnote deleted by the issuance of SAS No. 140, April 2020.]

Written Representations

.23 The auditor should request from management written representations³ that are tailored to the entity and the governmental audit requirement: (Ref: par. .A28)

- a. acknowledging management's responsibility for understanding and complying with the compliance requirements;
- b. acknowledging management's responsibility for the design, implementation, and maintenance of controls that provide reasonable assurance that the entity administers government programs in accordance with the compliance requirements;
- c. stating that management has identified and disclosed to the auditor all of its government programs and related activities subject to the governmental audit requirement;
- d. stating that management has made available to the auditor all contracts and grant agreements, including amendments, if any, and any other correspondence relevant to the programs and related activities subject to the governmental audit requirement;
- e. stating that management has disclosed to the auditor all known noncompliance with the applicable compliance requirements or stating that there was no such noncompliance;
- f. stating whether management believes that the entity has complied with the applicable compliance requirements (except for noncompliance it has disclosed to the auditor);
- g. stating that management has made available to the auditor all documentation related to compliance with the applicable compliance requirements;
- h. identifying management's interpretation of any applicable compliance requirements that are subject to varying interpretations;
- i. stating that management has disclosed to the auditor any communications from grantors and pass-through entities concerning possible noncompliance with the applicable compliance requirements, including communications received from the end of the period covered by the compliance audit to the date of the auditor's report;
- j. stating that management has disclosed to the auditor the findings received and related corrective actions taken for previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit, including findings received and corrective actions taken from the end of the period covered by the compliance audit to the date of the auditor's report;
- k. stating that management has disclosed to the auditor all known noncompliance with the applicable compliance requirements subsequent to the period covered by the auditor's report or stating that there were no such known instances; and
- l. stating that management is responsible for taking corrective action on audit findings of the compliance audit.

³ See section 580, *Written Representations*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.24 If the auditor determines that it is necessary to obtain additional representations related to the entity's compliance with the applicable compliance requirements, the auditor should request such additional representations.

Subsequent Events

.25 The auditor should perform audit procedures up to the date of the auditor's report to obtain sufficient appropriate audit evidence that all subsequent events related to the entity's compliance during the period covered by the auditor's report on compliance have been identified. (Ref: par. .A29)

.26 The auditor should take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which should include, but are not limited to, inquiring of management about and considering

- relevant internal auditors' reports issued during the subsequent period.
- other auditors' reports identifying noncompliance that were issued during the subsequent period.
- reports from grantors and pass-through entities on the entity's noncompliance that were issued during the subsequent period.
- information about the entity's noncompliance obtained through other professional engagements performed for that entity.

.27 The auditor has no obligation to perform any audit procedures related to the entity's compliance during the period subsequent to the period covered by the auditor's report. However, if before the report release date, the auditor becomes aware of noncompliance in the period subsequent to the period covered by the auditor's report that is of such a nature and significance that its disclosure is needed to prevent report users from being misled, the auditor should discuss the matter with management and, if appropriate, those charged with governance, and should include an other-matter paragraph in the auditor's report describing the nature of the noncompliance. (Ref: par. .A30) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion (Ref: par. .A31–.A32)

.28 The auditor should evaluate the sufficiency and appropriateness of the audit evidence obtained.⁴

.29 The auditor should form an opinion, at the level specified by the governmental audit requirement, on whether the entity complied in all material respects with the applicable compliance requirements, and report appropriately. In forming an opinion, the auditor should evaluate likely questioned costs, not just known questioned costs, as well as other material noncompliance that, by its nature, may not result in questioned costs.

⁴ Paragraphs .27–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Reporting

Combined Report on Compliance and Internal Control Over Compliance

.30 The auditor's combined report on compliance and internal control over compliance should be in writing and include the following:

- a. *Title.* The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.
- b. *Addressee.* The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement.
- c. *Report on compliance.* The report on compliance should be presented before the report on internal control over compliance and include the heading "Report on Compliance."
- d. *Opinion.* The first section of the auditor's report on compliance should include the auditor's opinion and section with a heading that includes the word "Opinion" and indicates the reporting level pursuant to the governmental audit requirement. The "Opinion" section of the auditor's report should also do the following (Ref: par. .A34):
 - i. State that the entity's compliance with the applicable compliance requirements has been audited
 - ii. Identify the applicable compliance requirements or include a reference to where they can be found
 - iii. Identify the one or more government programs covered by the compliance audit or reference to a separate schedule containing that information
 - iv. Specify the period covered by the report
 - v. When expressing an unmodified opinion, state that, in the auditor's opinion, the entity complied, in all material respects, with the compliance requirements that are applicable to [indicate the reporting level pursuant to the governmental audit requirement] for the [specify the period covered by the report]
- e. *Basis for opinion.* The auditor's report on compliance should include a section, directly following the "Opinion" section, with the heading, "Basis for Opinion," that does the following:
 - i. States that the audit of compliance was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the governmental audit requirement
 - ii. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement
 - iii. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other

ethical responsibilities in accordance with the relevant ethical requirements relating to the audit⁵

- iv. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion
- v. States that the compliance audit does not provide a legal determination of the entity's compliance with the applicable compliance requirements
- f. *Management's responsibilities.* The auditor's report on compliance should include a section with the heading "Responsibilities of Management for Compliance." This section of the auditor's report should describe management's responsibility for compliance with the applicable compliance requirements and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the entity's government programs. If the document containing the auditor's report contains a separate statement by management about its responsibility for the applicable compliance requirements, the auditor's report should not include a reference to such statement by management.
- g. *Auditor's responsibilities.* The auditor's report on compliance should include a section with the heading "Auditor's Responsibilities for the Audit of Compliance." This section of the auditor's report should do the following:
 - i. State that the objectives of the auditor are to
 - (1) obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error
 - (2) express an opinion on the entity's compliance with the applicable compliance requirements based on the compliance audit
 - ii. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and the governmental audit requirement will always detect material noncompliance when it exists
 - iii. State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - iv. State that noncompliance with the applicable compliance requirements is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance

⁵ See paragraphs .A38–.A39 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

with the requirements of the government program as a whole

- v. Describe an audit by stating that, in performing an audit in accordance with GAAS, *Government Auditing Standards*, and [insert the name of the governmental audit requirement or program-specific audit guide] the auditor's responsibilities are to
 - (1) exercise professional judgment and maintain professional skepticism throughout the audit.
 - (2) identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the entity's compliance with applicable compliance requirements and performing such other procedures as the auditor considered necessary in the circumstances.
 - (3) obtain an understanding of the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [the governmental audit requirement], but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.
- vi. State that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit^[6]
- h. If noncompliance that does not result in a modified opinion but is required to be reported by the governmental audit requirement is identified, the auditor's report should include an other-matter paragraph, in a separate section with the heading "Other Matter" or another appropriate heading,⁷ that includes a description of such noncompliance or a reference to a description of such noncompliance in an accompanying schedule. (Ref: par. .A36)
- i. *Report on Internal Control Over Compliance.* The auditor's combined report on compliance and internal control over compliance should include a section with the heading "Report on Internal Control Over Compliance" that does the following:
 - i. Includes the definitions of *deficiency in internal control over compliance*, *material weakness in internal control over compliance*, and *significant deficiency in internal control over compliance*.

^[6] [Footnote renumbered and deleted by the issuance of SAS No. 140, April 2020.]

⁷ Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- ii. States that the auditor's consideration of the entity's internal control over compliance was for the limited purpose described in the "Auditor's Responsibilities for the Audit of Compliance" section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Therefore, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.
- iii. Describes any identified material weaknesses and significant deficiencies in internal control over compliance or a reference to an accompanying schedule containing such a description.
- iv. If no material weaknesses in internal control over compliance were identified, includes a statement to that effect.
- v. States that the audit was not designed for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.
- j. If the criteria used to evaluate compliance are
 - i. established or determined by contractual agreement or regulatory provisions that are developed solely for the parties to the agreement or regulatory agency responsible for the provisions or
 - ii. available only to the specified parties,

an alert describing the purpose of the auditor's report on compliance and internal control over compliance and that the report is not suitable for any other purpose, as required by section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.⁸

- k. The manual or printed signature of the auditor's firm.
- l. The city and state where the auditor's report is issued.
- m. The date of the auditor's report. The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on compliance, including evidence that management has asserted that it has identified the entity's government programs and has taken responsibility for understanding and complying with the compliance requirements. (Ref: par. .A35)

A combined report on compliance and internal control over compliance is presented in the exhibit "Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (Unmodified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)." [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

⁸ See paragraphs .06a–b, .11, and .A11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. Footnote renumbered by the issuance of SAS No. 140, April 2020.]

Separate Reports on Compliance and Internal Control Over Compliance

.31 If the auditor issues separate reports on compliance and internal control over compliance, the separate report on compliance would omit the elements related to internal control over compliance (paragraph .30*i*). The separate report on internal control over compliance would omit the elements related to compliance (paragraph .30*c–h*) and would include the following additional statements:

- a. A statement that the auditor audited the entity's compliance with applicable compliance requirements pertaining to [*identify the government program or programs and the period audited*] and a reference to the auditor's report on compliance
- b. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the governmental audit requirement
- c. A statement that management is responsible for designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to government programs
- d. A statement that in planning and performing the compliance audit, the auditor considered the entity's internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance
- e. A statement that the auditor is not expressing an opinion on internal control over compliance

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

[.32] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

.33 The auditor should report noncompliance as well as other matters that are required to be reported by the governmental audit requirement in the manner specified by the governmental audit requirement. If the other matters required to be reported by the governmental audit requirement are not appropriate for the auditor to report on, the auditor should follow paragraph .39. (Ref: par. .A36)

Other Reporting Considerations

.34 The auditor should modify the auditor's opinion on compliance in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, if any of the following conditions exist:

- a. The auditor concludes that, based on the audit evidence obtained, material noncompliance with the applicable compliance requirements exists.

- b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude whether material noncompliance with the applicable compliance requirements exists.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.35 When noncompliance results in a modified opinion, the "Basis for Opinion" section, with an appropriately modified heading, should include a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule, and a statement that compliance with such requirements is necessary, in the auditor's opinion, for the entity to comply with the applicable compliance requirements.⁹ [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.36 The auditor should modify the report described in paragraphs .30 and .31 when the auditor makes reference to the report of another auditor as the basis, in part, for the auditor's report. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

[.37] [Paragraph renumbered and deleted by the issuance of SAS No. 140, April 2020.]

.38 The auditor also should communicate to those charged with governance of the auditor's responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement, an overview of the planned scope and timing of the compliance audit, and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the compliance audit.^{10, 11} (Ref: par. .A37–.A38) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.39 Printed forms, schedules, or reports designed or adopted by government agencies with which they are to be filed sometimes contain prescribed wording. If a printed form, schedule, or report requires the auditor to make a statement that the auditor has no basis to make, the auditor should accordingly reword the form, schedule, or report or attach an appropriately worded separate report. (Ref: par. .A39) [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Documentation (Ref: par. .A40)

.40 The auditor should document the risk assessment procedures performed, including those related to gaining an understanding of internal control

⁹ Paragraph .21 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

¹⁰ See section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently [moved and] renumbered by the issuance of SAS No. 140, April 2020.]

¹¹ See section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

over compliance.¹² [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.41 The auditor should document the auditor's responses to the assessed risks of material noncompliance, the procedures performed to test compliance with the applicable compliance requirements, and the results of those procedures, including any tests of controls over compliance.¹³ [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.42 The auditor should document materiality levels and the basis on which they were determined. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.43 The auditor should document how the auditor complied with the specific governmental audit requirements that are supplementary to GAAS and *Government Auditing Standards*. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Reissuance of the Compliance Report (Ref: par. .A41–.A42)

.44 If an auditor reissues the auditor's report, the reissued report should include an other-matter paragraph stating that the report is replacing a previously issued report and describing the reasons why the report is being reissued, and any changes from the previously issued report. If additional procedures are performed to obtain sufficient appropriate audit evidence for all of the government programs being reported on, the auditor's report date should be updated to reflect the date the auditor obtained sufficient appropriate audit evidence regarding the events that caused the auditor to perform the new procedures. If, however, additional procedures are performed to obtain sufficient appropriate audit evidence for only some of the government programs being reported on, the auditor should dual date the report with the updated report date reflecting the date the auditor obtained sufficient appropriate audit evidence regarding the government programs affected by the circumstances and referencing the government programs for which additional audit procedures have been performed. Reissuance of an auditor-prepared document required by the governmental audit requirement that is incorporated by reference into the auditor's report is considered to be a reissuance of the report. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Application and Other Explanatory Material

Introduction and Applicability

.A1 An example of an engagement to which this section is applicable is an audit performed in accordance with the provisions of Title 2 U.S. Code of Federal

¹² Paragraph .33a–b and .33d of section 315A. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

¹³ Paragraph .30 of section 330. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). This section is applicable because the Uniform Guidance is a governmental audit requirement that requires the auditor to perform a compliance audit in accordance with both GAAS and *Government Auditing Standards* and to express an opinion on compliance. Another example is a department specific requirement such as the U.S. Department of Housing and Urban Development *Audit Requirements Related to Entities Such As Public Housing Agencies, Nonprofit and For-Profit Housing Projects, and Certain Lenders*. An example of an engagement to which this section is not applicable is an engagement performed to satisfy a law or regulation requiring the entity to have an auditor determine whether the entity has spent transportation excise tax monies in accordance with the specific purposes outlined in the law or regulation, but not requiring that the audit be performed in accordance with both GAAS and *Government Auditing Standards*. Such an engagement could be performed under AT-C section 315; AT-C section 205; or AT-C section 215, *Agreed-Up Procedures Engagements*, depending on the requirements of the government.

Law or regulation will not always indicate which standards to follow. In such cases, professional judgment will be needed to determine, based on the circumstances, the appropriate standards to follow. (Ref: par. .01) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A2 An example of a governmental audit requirement that calls for an examination of an entity's compliance with specified requirements in accordance with AT-C section 315 is the compliance attestation engagement of third-party servicers included in the U.S. Department of Education's audit guide *Guide for Audits of Proprietary Schools and For Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs*. (Ref: par. .01 and .03) [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Objectives

.A3 Most governmental audit requirements specify that the auditor's opinion on compliance is at the program level. However, some governmental audit requirements may specify a different level (for example, at the applicable compliance requirement level). (Ref: par. .10) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Definitions

Governmental Audit Requirement

.A4 Governmental audit requirements also may set forth specific supplementary requirements of the compliance audit (for example, procedures to be performed by the auditor, documentation requirements, the form of reporting, and continuing professional education requirements with which the auditor is required to comply). (Ref: par. .11) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: par. .12)

.A5 AU-C sections often identify audit procedures and contain examples that are specific to a financial statement audit. The auditor is not expected to adapt or apply all such procedures to the compliance audit, only those that, in the auditor's professional judgment, are relevant and necessary to meet the objectives of the compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Establishing Materiality Levels (Ref: par. .13)

.A6 In a compliance audit, the auditor's purpose for establishing materiality levels is to

- a. determine the nature and extent of risk assessment procedures.
- b. identify and assess the risks of material noncompliance.
- c. determine the nature, timing, and extent of further audit procedures.
- d. evaluate whether the entity complied with the applicable compliance requirements.
- e. report findings of noncompliance and other matters required to be reported by the governmental audit requirement.

.A7 Generally, for all of the purposes identified in paragraph .A6, the auditor's consideration of materiality is in relation to the government program as a whole. However, the governmental audit requirement may specify a different level of materiality for one or more of these purposes. For example, the Uniform Guidance states that the auditor's determination of whether noncompliance is material for the purpose of reporting an audit finding is in relation to a type of compliance requirements identified in the *OMB Compliance Supplement (Compliance Supplement)*. (See paragraph .A10 for further information about the *Compliance Supplement*.) [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A8 Because the governmental audit requirement usually is established by the grantors and the auditor's report on compliance is primarily for their use, the auditor's determination of materiality usually is influenced by the needs of the grantors. However, in a compliance audit, the auditor's judgment about matters that are material to users of the auditor's report also is based on consideration of the needs of users as a group, including grantors.

Identifying Government Programs and Applicable Compliance Requirements (Ref: par. .14)

.A9 Some governmental audit requirements specifically identify the applicable compliance requirements. Other governmental audit requirements provide a framework for the auditor to determine the applicable compliance requirements. For example, the *Compliance Supplement* provides such a framework for compliance audits under the Uniform Guidance. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A10 The following are some of the sources an auditor may consult when identifying and obtaining an understanding of the applicable compliance requirements:

- a. The *Compliance Supplement*, which is issued by the OMB, and used in compliance audits under the Uniform Guidance, contains the compliance requirements that typically are applicable to federal government programs, as well as suggested audit procedures when compliance requirements are applicable and have a direct and material effect on the entity's compliance. Part 7 of the *Compliance Supplement* provides guidance for identifying compliance requirements for programs not included therein.
- b. The applicable program-specific audit guide issued by the grantor agency, which contains the compliance requirements pertaining to the government program and suggested audit procedures to test for compliance with the applicable compliance requirements.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A11 The following are procedures the auditor may perform to identify and obtain an understanding of the applicable compliance requirements if the *Compliance Supplement* or a program-specific audit guide is not applicable:

- a. Reading laws, statutes, regulations, rules, and provisions of contracts or grant agreements that pertain to the government program
- b. Making inquiries of management and other knowledgeable entity personnel (for example, the chief financial officer, internal auditors, legal counsel, compliance officers, or grant or contract administrators)
- c. Making inquiries of appropriate individuals outside the entity, such as
 - i. the office of the federal, state, or local program official or auditor, or other appropriate audit oversight organizations or regulators, about the laws and regulations applicable to entities within their jurisdiction, including statutes and uniform reporting requirements
 - ii. a third-party specialist, such as an attorney
- d. Reading the minutes of meetings of the governing board of the entity being audited
- e. Reading audit documentation about the applicable compliance requirements prepared during prior years' audits or other engagements
- f. Discussing the applicable compliance requirements with auditors who performed prior years' audits or other engagements

The procedures listed in this paragraph also may assist the auditor in obtaining a further understanding of the applicable compliance requirements even when the *Compliance Supplement* or program-specific audit guide is applicable. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Performing Risk Assessment Procedures (Ref: par. .15–.16)

.A12 Obtaining an understanding of the government program, the applicable compliance requirements, and the entity's internal control over compliance establishes a frame of reference within which the auditor plans the compliance audit and exercises professional judgment about assessing risks of material noncompliance and responding to those risks throughout the compliance audit.

.A13 The nature and extent of the risk assessment procedures the auditor performs may vary from entity to entity and are influenced by factors such as the following:

- The newness and complexity of the applicable compliance requirements
- The auditor's knowledge of the entity's internal control over compliance with the applicable compliance requirements obtained in previous audits or other professional engagements
- The nature of the applicable compliance requirements
- The services provided by the entity and how they are affected by external factors
- The level of oversight by the grantor or pass-through entity
- How management addresses findings

.A14 Performing risk assessment procedures to obtain an understanding of the entity's internal control over compliance includes an evaluation of the design of controls and whether the controls have been implemented. Internal control consists of the following five interrelated components: the control environment, the entity's risk assessment, information and communication systems, control activities, and monitoring.^[14] Section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains a detailed discussion of these components.¹⁵ [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A15 The auditor's procedures described in paragraph .16, related to understanding how management has responded to findings and recommendations that could have a material effect on the entity's compliance with the applicable compliance requirements, are performed to assist the auditor in understanding whether management responded appropriately to such findings. Examples of external monitoring include regulatory reviews, program reviews by government agencies or pass-through entities, and grantor reviews. Examples of internal monitoring include reports prepared by the internal audit function and internal quality assessments.

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .17)

.A16 Factors the auditor may consider in identifying and assessing the risks of material noncompliance are as follows:

- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements

^[14] [Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

¹⁵ Paragraphs .15–.25 and appendix B, "Internal Control Components," of section 315A. [Footnote added to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

- The auditor's observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements
- The auditor's assessment of the risks of material misstatement in the financial statement audit

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A17 In identifying and assessing the risks of material noncompliance, the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A18 Examples of situations in which there may be a risk of material noncompliance that is pervasive to the entity's noncompliance are as follows:

- An entity that is experiencing financial difficulty and for which there is an increased risk that grant funds will be diverted for unauthorized purposes
- An entity that has a history of poor recordkeeping for its government programs

Performing Further Audit Procedures in Response to Assessed Risks

.A19 Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides guidance that may be adapted when developing an overall response to the risks of material noncompliance.¹⁶ (Ref: par. .18) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.A20 A compliance audit includes designing procedures to detect both intentional and unintentional material noncompliance. The auditor can obtain reasonable, but not absolute, assurance about the entity's compliance because of factors such as the need for judgment, the use of sampling, the inherent limitations of internal control over compliance with applicable compliance requirements, and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between entity personnel and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance with applicable compliance requirements exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the auditor. (Ref: par. .19)

¹⁶ Paragraphs .A1–.A3 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

.A21 An auditor may decide to use audit sampling to obtain sufficient appropriate audit evidence in a compliance audit. Section 530, *Audit Sampling*, discusses the factors to be considered in planning, designing, and evaluating audit samples, including sampling for tests of controls. In addition, the AICPA Audit Guide Government Auditing Standards and *Single Audits* contains guidance on sampling in the context of a compliance audit. (Ref: par. .19) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A22 To test for compliance with applicable laws and regulations, tests of details (including tests of transactions) may be performed in the following areas:

- Grant disbursements or expenditures
- Eligibility files
- Cost allocation plans
- Periodic reports filed with grantor agencies (Ref: par. .19)

.A23 The use of analytical procedures to gather substantive evidence is generally less effective in a compliance audit than it is in a financial statement audit. However, substantive analytical procedures may contribute some evidence when performed in addition to tests of transactions and other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence. (Ref: par. .19)

.A24 Section 330 provides guidance related to designing and performing further audit procedures in response to the assessed risks of material noncompliance.¹⁷ However, the paragraphs in section 330 that address the use of audit evidence about the operating effectiveness of controls obtained in prior audits are not applicable to a compliance audit.¹⁸ (Ref: par. .20) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A25 Some governmental audit requirements, for example, in the Uniform Guidance, require tests of the operating effectiveness of controls identified as likely to be effective, even if the auditor believes that such testing would be inefficient. (Ref: par. .20) [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

Supplementary Audit Requirements

.A26 Examples of supplementary audit requirements are the requirements in the Uniform Guidance for the auditor to

- perform specified procedures to identify major programs.

¹⁷ Paragraphs .06–.12, .15–.18, and .22–.25 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

¹⁸ Paragraph .13–.14 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

- follow up on prior audit findings and perform procedures to assess the reasonableness of the summary schedule of prior audit findings. (Ref: par. .21)

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A27 When there is conflicting guidance, the auditor may decide to consult with the government agency responsible for establishing audit guidance or that provides the funding. (Ref: par. .22)

Written Representations

.A28 In some cases, management may include qualifying language in the written representations to the effect that representations are made to the best of management's knowledge and belief. However, such qualifying language is not appropriate for the representations in paragraph .23*a–b* and .23*l*. (Ref: par. .23)

Subsequent Events

.A29 Two types of subsequent events may occur. The first type consists of events that provide additional evidence with respect to conditions that existed at the end of the reporting period that affect the entity's compliance during the reporting period. The second type consists of events of noncompliance that did not exist at the end of the reporting period but arose subsequent to the reporting period. (Ref: par. .25)

.A30 An example of a matter of noncompliance that may occur subsequent to the period being audited but before the report release date that may warrant disclosure to prevent report users from being misled is the discovery of noncompliance in the subsequent period of such magnitude that it caused the grantor to stop funding the program. (Ref: par. .27)

Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion (Ref: par. .28–.29)

.A31 In determining whether an entity has materially complied with the applicable compliance requirements, the auditor may consider the following factors:

- a. The frequency of noncompliance with the applicable compliance requirements identified during the compliance audit
- b. The nature of the noncompliance with the applicable compliance requirements identified
- c. The adequacy of the entity's system for monitoring compliance with the applicable compliance requirements and the possible effect of any noncompliance on the entity
- d. Whether any identified noncompliance with the applicable compliance requirements resulted in likely questioned costs that are material to the government program

.A32 The auditor's evaluation of whether the entity materially complied with applicable compliance requirements includes consideration of noncompliance identified by the auditor, regardless of whether the entity corrected the noncompliance after the auditor brought it to management's attention.

Reporting

[**A33**] [Paragraph deleted by the issuance of SAS No. 125, December 2011.]^[19]

A34 An appropriate heading for the "Opinion" section indicates the level specified by the governmental audit requirement. For example, an appropriate heading for reports on compliance audits under the Uniform Guidance would be "Opinion on Each Major Federal Program." (Ref: par. .30d) [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

A35 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.²⁰ When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.²¹ (Ref: par. .30m) [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

A36 If the report is a matter of public record or available for public inspection, removing personally identifiable information in the compliance audit report and findings of noncompliance will reduce the likelihood of sensitive information being disclosed. (Ref: par. .30k–m and .33) [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

A37 *Government Auditing Standards* also requires the auditor to obtain and report views of responsible officials concerning the findings, conclusions, and recommendations included in the auditor's report as well as any planned corrective actions.²² (Ref: par. .38) [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

A38 If views of responsible officials are included in the auditor's report or in an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report, the auditor may add a paragraph to the auditor's written communication disclaiming an opinion on management's response. Following is an example of such a paragraph: (Ref: par. .38)

Government Auditing Standards requires the auditor to perform limited procedures on Example Entity's response, described in the accompanying [insert name of document], to the [insert type of findings, such as noncompliance or

^[19] [Footnote deleted by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

²⁰ See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

²¹ Paragraph .21 of section 220A. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

²² See the "Reporting Views of Responsible Officials" section of *Government Auditing Standards*. [Footnote renumbered and revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

internal control over compliance] findings identified in our compliance audit. Example Entity's response was not subjected to the other auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

[Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A39 If the auditor is submitting a reworded form, schedule, or report or appropriately worded separate report, the auditor may include a separate communication to the agency explaining why the auditor's report was modified. (Ref: par. .39) [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Documentation (Ref: par. .12 and .40–.43)

.A40 The auditor is not expected to prepare specific documentation of how the auditor adapted and applied each of the applicable AU-C sections to the objectives of a compliance audit. The documentation of the audit strategy, audit plan, and work performed cumulatively demonstrate whether the auditor has complied with the requirement in paragraph .12. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Reissuance of the Compliance Report (Ref: par. .44)

.A41 The following are examples of situations in which the auditor might reissue the compliance report:

- A quality control review performed by a governmental agency indicates that the auditor did not test an applicable compliance requirement.
- The discovery subsequent to the date of the compliance report that the entity had another government program that was required to be tested.

[Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A42 An example of an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report is the schedule of findings and questioned costs in a compliance audit under the Uniform Guidance. [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A43

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits^[1]

The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor's opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<i>210A, Terms of Engagement</i>	Paragraphs .06a and .08a
<i>240, Consideration of Fraud in a Financial Statement Audit</i>	Paragraphs .26 and .32b
<i>250, Consideration of Laws and Regulations in an Audit of Financial Statements</i>	All
<i>315A, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	Paragraphs .12c, .26–.30, and .33c
<i>330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>	Paragraphs .13–.14, .19–.21, .26, and .31–.32
<i>501, Audit Evidence — Specific Considerations for Selected Items</i>	All
<i>505, External Confirmations</i>	All
<i>510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	Paragraphs .06, .08–.13, and .15–.17
<i>540A, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i>	All
<i>550, Related Parties</i>	All
<i>560, Subsequent Events and Subsequently Discovered Facts</i>	Paragraphs .09–.11 and .19–.20
<i>570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i>	All
<i>600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	Paragraphs .26, .39, .41c, .41d, .55, and .56c
<i>700, Forming an Opinion and Reporting on Financial Statements</i>	Paragraphs .13–.17, .21–.44, and .45–.61

^[1] [Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<i>701, Communicating Key Audit Matters in the Independent Auditor's Report</i>	All
<i>703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>	All
<i>705, Modifications to the Opinion in the Independent Auditor's Report</i>	Paragraphs .18–.20
<i>706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i>	Paragraphs .06–.07
<i>708, Consistency of Financial Statements</i>	All
<i>720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports</i>	All
<i>725, Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
<i>730, Required Supplementary Information</i>	All
<i>800, Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	All
<i>805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All
<i>806, Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	All
<i>810, Engagements to Report on Summary Financial Statements</i>	All
<i>910, Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	All
<i>915, Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	All
<i>920, Letters for Underwriters and Certain Other Requesting Parties</i>	All
<i>925, Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	All
<i>930, Interim Financial Information</i>	All
<i>940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	All
<i>945, Auditor Involvement With Exempt Offering Documents</i>	All

[Revised, January 2011, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS Nos. 122 and 123. Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126. As amended, effective for audits for periods ending on or after

December 15, 2016, by SAS No. 130; Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. Revised, December 2021, to reflect conforming changes necessary due to the issuance of SAS No. 137.]

.A44

Exhibit — Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — *(Unmodified Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)*

The following is an illustrative combined report on compliance with applicable requirements and internal control over compliance that contains the elements in paragraph .30. This illustrative report contains an unmodified opinion on compliance with no material weaknesses or significant deficiencies in internal control over compliance identified. The AICPA Audit Guide Government Auditing Standards and *Single Audits* contains illustrative language for other types of reports, including reports containing qualified or adverse opinions on compliance with either material weaknesses in internal control over compliance, significant deficiencies in internal control over compliance, or both identified.

Independent Auditor's Report

[Addressee]

Report on Compliance

Opinion on [indicate the reporting level pursuant to governmental audit requirement]

We have audited Example Entity's compliance with the [identify the applicable compliance requirements or refer to the document that describes the applicable compliance requirements] applicable to Example Entity's [identify the government program(s) audited or refer to a separate schedule that identifies the program(s)] for the year ended June 30, 20X1.

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that are applicable to [indicate the reporting level pursuant to governmental audit requirement] for the year ended June 30, 20X1.

Basis for Opinion

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards*^[1] (*Government Auditing Standards*) issued by the Comptroller General of the United States; and [insert the name of the governmental audit requirement or program-specific audit guide]. Our responsibilities under those standards and [insert the name of the governmental audit requirement or program-specific audit guide] are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Example Entity and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide

^[1] [Footnote deleted by the issuance of SAS No. 140, April 2020.]

a legal determination of Example Entity's compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the Example Entity's government programs.

Auditor's Responsibilities for the Audit of Compliance

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Example Entity's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and [insert the name of the governmental audit requirement or program-specific audit guide] will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Example Entity's compliance with the requirements of the government program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and [insert the name of the governmental audit requirement or program-specific audit guide], we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding Example Entity's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of Example Entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [insert the name of the governmental audit requirement or program-specific audit guide], but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in

the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the "Auditor's Responsibilities for the Audit of Compliance" section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that have not been identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the *[insert the name of the governmental audit requirement or program-specific audit guide]*. Accordingly, this report is not suitable for any other purpose.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2013, to reflect conforming changes necessary due to the issuance of SAS No. 125. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 940

An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

Source: SAS No. 130; SAS No. 135; SAS No. 140.

Effective for integrated audits for periods ending on or after December 15, 2016, unless otherwise indicated.

NOTE

In October 2021, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, which contains amendments to this section.

The amendments are effective for audits of financial statements for periods ending on or after December 15, 2023, and can be viewed in appendix G of section 315 until the effective date, when they will be applied to this section.

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

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

Introduction

Scope of This Section

.01 This section establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting (ICFR) that is integrated with an audit of financial statements (*integrated audit*). (Ref: par. .A1)

.02 Generally accepted auditing standards (GAAS) are written in the context of an audit of financial statements but are to be adapted as necessary in the circumstances when applied to an audit of ICFR that is integrated with an audit of financial statements.¹ This section includes special considerations related to performing an integrated audit.

Effective Date

.03 This section is effective for integrated audits for periods ending on or after December 15, 2016.

¹ Paragraph .02 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

Objectives

- .04 The objectives of the auditor in an audit of ICFR are to
- obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment about the effectiveness of ICFR (*as of date*) and
 - express an opinion on the effectiveness of ICFR in a written report, and communicate with management and those charged with governance as required by this section, based on the auditor's findings. (Ref: par. .A2–.A4)

Definitions

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

Audit of ICFR. An audit of the design and operating effectiveness of an entity's ICFR.

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

Criteria. The benchmarks used to measure or evaluate the subject matter. (Ref: par. .A5)

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

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

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the applicable financial reporting framework, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and
- provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

ICFR has inherent limitations. ICFR is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. ICFR also

can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements will not be prevented, or detected and corrected, on a timely basis by ICFR. (Ref: par. .A6–.A7)

Management's assessment about ICFR. Management's conclusion about the effectiveness of the entity's ICFR, based on suitable and available criteria. Management's assessment is included in management's report on ICFR. (Ref: par. .A8)

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

Requirements

Preconditions for the Audit of ICFR

.06 Section 210A, *Terms of Engagement*, requires the auditor to establish whether the preconditions for an audit are present.² In an audit of ICFR, the auditor should

- a. obtain the agreement of management that it acknowledges and understands its responsibility for
 - i. designing, implementing, and maintaining effective ICFR.
 - ii. evaluating the effectiveness of the entity's ICFR using suitable and available criteria.
 - iii. providing management's assessment about ICFR in a report that accompanies the auditor's report (see paragraph .55).
 - iv. supporting its assessment about the effectiveness of the entity's ICFR with sufficient evaluations and documentation.
 - v. providing the auditor with
 - (1) access to all information of which management is aware that is relevant to management's assessment of ICFR, such as records, documentation, and other matters;
 - (2) additional information that the auditor may request from management for the purpose of the audit of ICFR; and
 - (3) unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence. (Ref: par. .A9–.A12)
- b. determine that the as of date corresponds to the balance sheet date (or period ending date) of the period covered by the financial statements. (Ref: par. .A13)

.07 The auditor should evaluate the effectiveness of the entity's ICFR using the same suitable and available criteria used by management for its assessment. (Ref: par. .A14–.A17)

² Paragraph .06 of section 210A, *Terms of Engagement*.

Requesting a Written Assessment

.08 In accordance with paragraph .06a(iii), the auditor should request from management a written assessment about the effectiveness of the entity's ICFR. Management's refusal to provide a written assessment represents a scope limitation, and the auditor should apply the requirements in paragraphs .74–.77.

Integrating the Audit of ICFR With the Financial Statement Audit

.09 Although the objectives of an audit of ICFR and an audit of financial statements are not the same, the auditor should plan and perform the integrated audit to achieve their respective objectives simultaneously. The auditor should design tests of controls

- a. to obtain sufficient appropriate audit evidence to support the auditor's opinion on ICFR as of the date specified in management's assessment about ICFR and
- b. to obtain sufficient appropriate audit evidence to support the auditor's control risk assessments for purposes of the audit of financial statements. (Ref: par. .A18–.A19)

.10 If the auditor is engaged to audit the effectiveness of an entity's ICFR for a period of time, the requirements and guidance in this section should be modified accordingly, and the auditor should integrate the audit of ICFR with an audit of financial statements covering the same period of time.

.11 The auditor should consider the effect of the results of the financial statement auditing procedures on the auditor's risk assessments and the testing necessary to conclude on the operating effectiveness of a control.

.12 If, during the audit of ICFR, the auditor identifies a deficiency in ICFR, the auditor should determine the effect of the deficiency, if any, on the nature, timing, and extent of substantive procedures to be performed to reduce audit risk in the audit of the financial statements to an acceptably low level. See paragraphs .52–.54 for requirements on evaluating the effects of findings, including those from the financial statement audit, when forming an opinion on the effectiveness of ICFR.

.13 When concluding on the effectiveness of controls for the purpose of the financial statement audit, the auditor should evaluate the results of any additional tests of controls performed by the auditor to achieve the objective related to expressing an opinion on the entity's ICFR. (Ref: par. .A20)

Planning the Audit of ICFR

.14 In accordance with section 300, *Planning an Audit*, the auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit of ICFR and that guides the development of the audit plan.³ (Ref: par. .A21)

Role of Risk Assessment

.15 The auditor should focus more attention on areas of higher risk. A direct relationship exists between the degree of risk that a material weakness could exist in a particular area of the entity's ICFR and the amount of attention that would be devoted to that area. In addition, an entity's ICFR is less likely to prevent, or detect and correct, a misstatement caused by fraud than a

³ Paragraph .07 of section 300, *Planning an Audit*.

misstatement caused by error. It is not necessary to test controls that, even if deficient, would not present a reasonable possibility of material misstatement to the financial statements. (Ref: par. .A22–.A24)

Addressing the Risk of Fraud

.16 The auditor should evaluate whether the entity's controls sufficiently address identified risks of material misstatement due to fraud and the risk of management override of other controls. (Ref: par. .A25)

.17 Section 240, *Consideration of Fraud in a Financial Statement Audit*, requires the auditor to consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud.⁴ If the auditor identifies deficiencies in controls designed to prevent, or detect and correct, misstatements caused by fraud during the audit of ICFR, the auditor should take into account those deficiencies when developing the response to risks of material misstatement during the financial statement audit.⁵

Using the Work of Internal Auditors or Others

.18 The external auditor should obtain an understanding of the work of the internal audit function and others sufficient to identify those activities related to the effectiveness of ICFR that are relevant to planning and performing the audit of ICFR. (Ref: par. .A26)

.19 The external auditor should evaluate the extent to which the external auditor will use the work of internal auditors or others to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor. When using the work of internal auditors, section 610, *Using the Work of Internal Auditors*, is applicable. When the external auditor plans to use the work of others in obtaining audit evidence or to provide direct assistance in the audit of ICFR, the external auditor should apply the requirements in section 610 as if others were internal auditors. (Ref: par. .A27–.A30)

Materiality

.20 The auditor should use the same materiality for planning and performing the audit of ICFR and the financial statement audit. (Ref: par. .A31)

Using a Top-Down Approach

.21 The auditor should use a top-down approach to the audit of ICFR to select the controls to test. (Ref: par. .A32–.A33)

Entity-Level Controls

.22 The auditor should identify and test those entity-level controls that are important to the auditor's conclusion about whether the entity has effective ICFR. (Ref: par. .A34–.A37)

Evaluating the Components of ICFR

.23 In an integrated audit, the auditor should evaluate the components of ICFR and determine whether

- a.* the components are present and functioning in the design, implementation, and operation of ICFR, and

⁴ Paragraph .23 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

⁵ See paragraphs .28–.33 of section 240.

- b. the components are operating together in an integrated manner to achieve the entity's financial reporting objectives. (Ref: par. .A38–.A48)

Period-End Financial Reporting Process

.24 Because of its importance to financial reporting and to the integrated audit, the auditor should evaluate the period-end financial reporting process, which includes the following:

- a. Procedures used to enter transaction totals into the general ledger
- b. Procedures related to the selection and application of accounting policies
- c. Procedures used to initiate, authorize, record, and process journal entries in the general ledger
- d. Procedures used to record recurring and nonrecurring adjustments to the financial statements
- e. Procedures for preparing financial statements (Ref: par. .A49)

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

- a. the inputs, procedures performed, and outputs of the processes the entity uses to produce its financial statements;
- b. the extent of IT involvement in the period-end financial reporting process;
- c. who participates from management;
- d. the locations involved in the period-end financial reporting process;
- e. the types of adjusting and consolidating entries; and
- f. the nature and extent of the oversight of the process by management and those charged with governance.

Identifying Significant Classes of Transactions, Account Balances, and Disclosures, and Their Relative Assertions

.26 The auditor should identify significant classes of transactions, account balances, and disclosures, and their relevant assertions. To identify significant classes of transactions, account balances, and disclosures, and their relevant assertions, the auditor should evaluate the qualitative and quantitative risk factors related to the financial statement line items and disclosures. (Ref: par. .A50–.A52)

.27 As part of identifying significant classes of transactions, account balances, and disclosures, and their relevant assertions, the auditor should determine the likely sources of potential misstatements that would cause the financial statements to be materially misstated. (Ref: par. .A53–.A54)

.28 When an entity has components, the auditor should identify significant classes of transactions, account balances, and disclosures, and their relevant assertions, based on the group financial statements. (Ref: par. .A55)

Understanding Likely Sources of Misstatement

.29 To further understand the likely sources of potential misstatements, and as a part of selecting the controls to test, the auditor should

- a. understand the flow of transactions related to the relevant assertions, including how these transactions are initiated, authorized, recorded, processed, and reported.
- b. identify the points within the entity's processes at which a misstatement, including a misstatement due to fraud, could arise that, individually or in combination with other misstatements, would be material (for example, points at which information is initiated, transferred, or otherwise modified).
- c. identify the controls that management has implemented to address these potential misstatements.
- d. identify the controls that management has implemented over the prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements. (Ref: par. .A56–.A57)

.30 Because of the degree of judgment necessary, the auditor should either directly perform the procedures that achieve the requirements in paragraph .29 or supervise the work of the internal auditors or others who provide direct assistance to the auditor.

.31 The auditor should understand how IT affects the entity's flow of transactions and, as required by section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, how the entity has responded to risks arising from IT.⁶ (Ref: par. .A58)

Selecting Controls to Test

.32 The auditor should identify and test those controls that are important to the auditor's conclusion about whether the entity's controls sufficiently address the assessed risk of material misstatement to each relevant assertion. (Ref: par. .A59–.A60)

Testing Controls

Evaluating Design Effectiveness

.33 The auditor should evaluate the design effectiveness of controls by determining whether the entity's controls, if operated as prescribed by persons possessing the necessary authority and competence to perform them effectively, satisfy the entity's control objectives, and can effectively prevent, or detect and correct, misstatements caused by errors or fraud that could result in material misstatements in the financial statements. (Ref: par. .A61–.A62)

Testing Operating Effectiveness

.34 The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. (Ref: par. .A63–.A64)

Relationship of Risk to the Evidence to Be Obtained

.35 As the risk associated with the control being tested increases, the sufficiency and appropriateness of evidence that the auditor obtains should also increase. (Ref: par. .A65–.A68)

⁶ Paragraph .22 of section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

.36 The auditor should obtain evidence about the effectiveness of selected controls for each relevant assertion. The auditor is not responsible for obtaining sufficient appropriate audit evidence to support an opinion about the effectiveness of each individual control. (Ref: par. .A69–.A75)

.37 To obtain evidence about whether a selected control is effective, the auditor should test the control.

.38 When the auditor identifies control deviations, the auditor should determine the effect of the deviations on the auditor's assessment of the risk associated with the control being tested and the evidence to be obtained, as well as on the operating effectiveness of the control. (Ref: par. .A76)

Timing and Extent of Tests of Controls

.39 To express an opinion on ICFR as of a point in time, the auditor should obtain evidence that ICFR has operated effectively for a sufficient period of time, which may be less than the entire period (ordinarily one year) covered by the entity's financial statements. The auditor should balance performing the tests of controls closer to the as of date with the need to test controls over a sufficient period of time to obtain sufficient appropriate audit evidence of operating effectiveness. (Ref: par. .A77–.A80)

Rollforward Procedures

.40 When the auditor reports on the effectiveness of controls as of a specific date and obtains evidence about the operating effectiveness of controls at an interim date, the auditor should determine what additional evidence concerning the operation of the controls for the remaining period is necessary. (Ref: par. .A81–.A82)

Special Considerations for Subsequent Years' Audits

.41 In subsequent years' audits, the auditor should incorporate knowledge obtained during past audits performed by the auditor of the entity's ICFR into the decision-making process for determining the nature, timing, and extent of testing necessary. (Ref: par. .A83–.A85)

.42 The auditor should vary the nature, timing, and extent of testing of controls from period to period to introduce unpredictability into the testing and respond to changes in circumstances. (Ref: par. .A86)

Identifying Deficiencies in ICFR

.43 The auditor should determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in ICFR. (Ref: par. .A87)

Determination of Whether Material Weaknesses Exist as of the Date Specified in Management's Assessment About ICFR

.44 For purposes of forming an opinion on the effectiveness of ICFR, the auditor should evaluate the severity of each deficiency in ICFR to determine whether the deficiency, individually or in combination, is a material weakness as of the date specified in management's assessment about ICFR. In performing such evaluation, the auditor should determine whether deficiencies that affect the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR, collectively result in a material weakness. (Ref: par. .A88–.A94)

.45 The auditor should evaluate the effect of compensating controls when determining whether a deficiency, or combination of deficiencies, in ICFR is a material weakness as of the date specified in management's assessment about

ICFR. The auditor should test the operating effectiveness of such compensating controls to determine whether they operate at a level of precision that would prevent, or detect and correct, a material misstatement. (Ref: par. .A95)

.46 If the auditor initially determines that a deficiency, or a combination of deficiencies, in ICFR is not a material weakness, the auditor should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion. (Ref: par. .A96)

Determination of Whether Significant Deficiencies Exist During the Integrated Audit

.47 The auditor should evaluate the severity of each deficiency in ICFR to determine whether the deficiency, individually or in combination, is a significant deficiency. In performing such evaluation, the auditor should determine whether deficiencies that affect the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR collectively result in a significant deficiency. (Ref: par. .A97–.A98)

Subsequent Events

.48 The auditor should inquire of management and, when appropriate, those charged with governance, about whether there were any changes in ICFR or conditions that might significantly affect ICFR subsequent to the as of date but before the date of the auditor's report. To obtain additional information about changes in ICFR or other conditions that might significantly affect the effectiveness of the entity's ICFR, the auditor should inquire about and read, for this subsequent period, the following: (Ref: par. .A99)

- a. Relevant internal audit (or similar functions, such as loan review in a financial institution) reports issued during the subsequent period
- b. Reports regarding deficiencies issued by other independent auditors
- c. Regulatory agency reports on the entity's ICFR
- d. Information about the effectiveness of the entity's ICFR obtained through other engagements performed for the entity by the auditor

.49 If, as a result of the subsequent events procedures, the auditor obtains knowledge about a material weakness that existed as of the date specified in management's assessment about ICFR, the auditor should issue an adverse opinion, as required by paragraph .68. The auditor should also follow paragraph .72 if management's assessment about ICFR states that ICFR is effective. If the auditor is unable to determine the effect of the subsequent event on the effectiveness of the entity's ICFR as of the date specified in management's assessment about ICFR, the auditor should disclaim an opinion. The auditor should disclaim an opinion on management's disclosures about corrective actions taken by the entity, if any. (Ref: par. .A100)

.50 If the auditor obtains knowledge about conditions that did not exist at the as of date but arose subsequent to that date and before the release of the auditor's report and such subsequent information has a material effect on the entity's ICFR, the auditor should include in the auditor's report an emphasis-of-matter paragraph directing the reader's attention to the subsequently discovered fact and its effects as disclosed in management's report or an other-matter paragraph describing the subsequently discovered fact and its effects. (Ref: par. .A101)

.51 The auditor has no responsibility to keep informed of events subsequent to the date of the auditor's report; however, the auditor should respond appropriately to facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

Concluding Procedures

Forming an Opinion

.52 The auditor should form an opinion on the effectiveness of ICFR by evaluating evidence obtained from all sources, including

- a. the auditor's testing of controls for the ICFR audit,
- b. any additional tests of controls performed to achieve the objective related to expressing an opinion on the financial statements,
- c. misstatements detected during the financial statement audit, and
- d. any identified deficiencies.

.53 As part of evaluating evidence obtained from all sources, the auditor should review reports issued during the year by the internal audit function (or similar functions) that address controls related to ICFR and evaluate deficiencies identified in those reports.

.54 In addition to evaluating the findings from the auditor's testing of controls for the audit of ICFR, the auditor should evaluate the effect of the findings of the substantive procedures performed in the audit of financial statements on the effectiveness of ICFR. This evaluation should include, at a minimum,

- a. the risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud;
- b. findings with respect to noncompliance with laws and regulations;
- c. findings with respect to related party transactions and complex or unusual transactions;
- d. indications of management bias in making accounting estimates and selecting accounting principles; and
- e. the nature and extent of misstatements detected by substantive procedures.

.55 After forming an opinion on the effectiveness of the entity's ICFR, the auditor should evaluate management's report, which will accompany the auditor's report, to determine whether it contains the following:

- a. A statement regarding management's responsibility for ICFR
- b. A description of the subject matter of the audit (for example, controls over the preparation of the entity's financial statements in accordance with accounting principles generally accepted in the United States of America)
- c. An identification of the criteria against which ICFR is measured
- d. Management's assessment about ICFR
- e. A description of the material weakness(es), if any
- f. The date as of which management's assessment about ICFR is made

.56 If the auditor determines that any required element of management's report is incomplete or improperly presented, the auditor should request management to revise its report. (Ref: par. .A102)

Obtaining Written Representations

.57 In an audit of ICFR, the auditor should obtain written representations from management

- a. acknowledging management's responsibility for establishing and maintaining effective ICFR;
- b. stating that management has performed an assessment of the effectiveness of the entity's ICFR and specifying the criteria;
- c. stating that management did not use the auditor's procedures performed during the integrated audit as part of the basis for management's assessment about ICFR;
- d. stating management's assessment about the effectiveness of the entity's ICFR based on the criteria as of a specified date;
- e. stating that management has disclosed to the auditor all deficiencies in the design or operation of ICFR, including separately disclosing to the auditor all such deficiencies that it believes to be significant deficiencies or material weaknesses;
- f. describing any fraud resulting in a material misstatement to the entity's financial statements and any other fraud that does not result in a material misstatement to the entity's financial statements, but involves senior management or management or other employees who have a significant role in the entity's ICFR;
- g. stating whether the significant deficiencies and material weaknesses identified and communicated to management and those charged with governance during previous engagements pursuant to paragraph .59 have been resolved and specifically identifying any that have not; and
- h. stating whether there were, subsequent to the date being reported on, any changes in ICFR or other conditions that might significantly affect ICFR, including any corrective actions taken by management with regard to significant deficiencies and material weaknesses (Ref: par. .A103)

.58 If management does not provide the written representations required by paragraph .57, the auditor should apply the requirements in paragraph .73. (Ref: par. .A104)

Communicating ICFR-Related Matters

.59 The auditor should communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified during the integrated audit, including those that were remediated during the integrated audit and those that were previously communicated but have not yet been remediated. (Ref: par. .A105–.A107)

.60 If the auditor concludes that the oversight of the entity's financial reporting and ICFR by the audit committee (or similar subgroups with different names) is ineffective, the auditor should communicate that conclusion in writing to the board of directors or other similar governing body.

.61 The written communications referred to in paragraphs .59–.60 should be made by the report release date, which is the date the auditor grants the entity permission to use the auditor's report. For a governmental entity, if such written communications would be publicly available prior to management's report on ICFR, the entity's financial statements, and the auditor's report thereon, the auditor is not required to make the written communications by the report release date. In that circumstance, the written communications

should be made as soon as practicable, but no later than 60 days following the report release date. (Ref: par. .A108–.A109)

.62 The auditor should communicate in writing to management all deficiencies identified during the integrated audit on a timely basis, but no later than 60 days following the report release date, and inform those charged with governance when such a communication was or is expected to be made. In making the written communication referred to in this paragraph, the auditor is not required to communicate those deficiencies that are not material weaknesses or significant deficiencies that were included in previous written communications, regardless of whether those communications were made by the auditor, internal auditors, or others within the organization. (Ref: par. .A110–.A112)

.63 Because the integrated audit does not provide the auditor with reasonable assurance that the auditor has identified all deficiencies less severe than a material weakness, the auditor should not issue a report stating that no such deficiencies were identified during the integrated audit. Also, because the auditor issues a report that expresses an opinion on the effectiveness of the entity's ICFR, the auditor should not issue a report indicating that no material weaknesses were identified during the integrated audit.

Reporting on ICFR

.64 The auditor's report on the audit of ICFR should be in writing and should include the following:

- a. *Title.* The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.
- b. *Addressee.* The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement.
- c. *Auditor's opinion on ICFR.* The first section of the auditor's report should include the auditor's opinion on ICFR and should have the heading "Opinion on Internal Control Over Financial Reporting." The "Opinion on Internal Control Over Financial Reporting" section of the auditor's report should also do the following:
 - i. Identify the entity whose ICFR has been audited
 - ii. State that the entity's ICFR has been audited
 - iii. Identify the as of date
 - iv. Identify the criteria against which ICFR is measured
 - v. Include the auditor's opinion on whether the entity maintained, in all material respects, effective ICFR as of the specified date, based on the criteria
- d. *Basis for opinion.* The auditor's report should include a section, directly following the "Opinion on Internal Control Over Financial Reporting" section, with the heading "Basis for Opinion," that does the following:
 - i. States that the audit was conducted in accordance with GAAS and identifies the United States of America as the country of origin of those standards (Ref: par. .A113)
 - ii. Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS
 - iii. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other

ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit⁷

- iv. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion
- e. *Responsibilities of management.* The auditor's report should include a section with the heading "Responsibilities of Management for Internal Control Over Financial Reporting." This section of the auditor's report should do the following:
 - i. State that management is responsible for designing, implementing, and maintaining effective ICFR
 - ii. State that management is responsible for its assessment about the effectiveness of ICFR
 - iii. Include a reference to management's report on ICFR
- f. *Auditor's responsibilities.* The auditor's report should include a section with the heading "Auditor's Responsibility for the Audit of Internal Control Over Financial Reporting." This section of the auditor's report should do the following:
 - i. State that the objectives of the auditor are to
 - (1) obtain reasonable assurance about whether effective ICFR was maintained in all material respects
 - (2) issue an auditor's report that includes the auditor's opinion on ICFR
 - ii. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists
 - iii. Describe the audit by stating that, in performing an audit of ICFR in accordance with GAAS, the auditor's responsibilities are to
 - (1) exercise professional judgment and maintain professional skepticism throughout the audit
 - (2) obtain an understanding of ICFR, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of ICFR based on the assessed risk

Definition and Inherent Limitations of Internal Control Over Financial Reporting

- g. The auditor's report should include a section with the heading "Definition and Inherent Limitations of Internal Control Over Financial Reporting" or other appropriate heading that includes the following:
 - i. A definition of ICFR (the auditor should use the same description of the entity's ICFR as management uses in its report)

⁷ See paragraphs .A38–.A39 of section 700, *Forming an Opinion and Reporting on Financial Statements*. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

- ii. A paragraph stating that because of inherent limitations, ICFR may not prevent, or detect and correct, misstatements and that projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate
- h. *Signature of the auditor.* The auditor's report should include the manual or printed signature of the auditor's firm.
- i. *Auditor's address.* The auditor's report should name the city and state where the auditor's report is issued.
- j. *Date of the auditor's report.* The auditor's report should be dated, as required by paragraph .66

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Separate Report on ICFR

.65 If the auditor issues a separate report on ICFR, the auditor should add the following paragraph, following the opinion paragraph within the "Opinion" section, to the auditor's report on the financial statements:

We also have audited, in accordance with auditing standards generally accepted in the United States of America, [entity name]'s internal control over financial reporting as of December 31, 20X8, based on [identify criteria] and our report dated [date of report, which should be the same as the date of the report on the financial statements] expressed [include nature of opinion].

The auditor also should add the following paragraph, following the opinion paragraph within the "Opinion on Internal Control Over Financial Reporting" section, to the report on ICFR:

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [identify financial statements] of [entity name] and our report dated [date of report, which should be the same as the date of the report on ICFR] expressed [include nature of opinion]. (Ref: par. .A115–.A117)

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Report Date

.66 The auditor should date the report on ICFR no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion. Because the audit of ICFR is integrated with the audit of the financial statements, when issuing separate reports on the entity's financial statements and on ICFR, the dates of the reports should be the same. (Ref: par. .A117) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Report Modifications

.67 The auditor should modify the report on ICFR if any of the following conditions exist:

- a. One or more material weaknesses exist.
- b. Elements of management's report are incomplete or improperly presented.

- c. There is a limitation on the scope of the engagement. (Ref: par. .A118)
- d. The auditor decides to refer to the report of a component auditor as the basis, in part, for the auditor's own opinion.
- e. There is other information contained in management's report.

Adverse Opinions

.68 If there are deficiencies that, individually or in combination, result in one or more material weaknesses as of the date specified in management's assessment about ICFR, the auditor should express an adverse opinion on the entity's ICFR, unless there is a limitation on the scope of the engagement. (Ref: par. .A119–.A120)

.69 The auditor should determine the effect an adverse opinion on ICFR has on the auditor's opinion on the financial statements. Additionally, the auditor should disclose, as a separate paragraph within the "Adverse Opinion on Internal Control Over Financial Reporting" section to the report, whether the auditor's opinion on the financial statements was affected by the material weakness. (Ref: par. .A122) Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.70 When ICFR is not effective because one or more material weaknesses exist, the auditor's report should include the following in the "Basis for Adverse Opinion on Internal Control Over Financial Reporting" section:

- a. The definition of a material weakness
- b. A statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assessment about ICFR. (Ref: par. .A121)

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.71 If one or more material weaknesses have not been included in management's report accompanying the auditor's report, the auditor's report should be modified to state that one or more material weaknesses have been identified but not included in management's report. Additionally, the auditor's report should include a description of each material weakness not included in management's report. The auditor's description should include specific information about the nature of each material weakness and its actual and potential effect on the presentation of the entity's financial statements issued during the existence of the weakness. In this case, the auditor also should communicate, in writing, to those charged with governance that one or more material weaknesses were not disclosed or identified as a material weakness in management's report. If one or more material weaknesses have been included in management's report but the auditor concludes that the disclosure of such material weaknesses is not fairly presented in all material respects, the auditor's report should describe this conclusion as well as the information necessary to fairly describe each material weakness. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Elements of Management's Report Are Incomplete or Improperly Presented

.72 If the auditor determines that any required element of management's report, as described in paragraph .55, is incomplete or improperly presented and management does not revise its report, the auditor should modify the report on ICFR to include an other-matter paragraph describing the reasons for

this determination. If the auditor determines that the required disclosure about one or more material weaknesses is not fairly presented in all material respects, the auditor should apply the requirements in paragraph .71.

Scope Limitations

.73 If, after accepting the integrated audit engagement, there is a limitation on the scope of the engagement with respect to ICFR, the auditor should withdraw from the integrated audit engagement or disclaim an opinion on ICFR and consider the implications on the financial statement audit.

.74 When a scope limitation arises because management refuses to furnish a written assessment about the effectiveness of ICFR, the auditor should withdraw from the integrated audit engagement. When withdrawal is not possible under applicable law or regulation, the auditor should disclaim an opinion on ICFR and consider the implications on the financial statement audit. (Ref: par. .A123)

.75 When disclaiming an opinion because of a scope limitation, the auditor should state that the auditor does not express an opinion on the effectiveness of ICFR within the "Disclaimer of Opinion on Internal Control Over Financial Reporting" section and state the substantive reasons for the disclaimer within the "Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting" section. The auditor should amend the basis of opinion and auditor's responsibilities sections and should not identify the procedures that were performed nor include the statements describing the characteristics of an audit of ICFR, as described in paragraph .64d(i), paragraph .64d(ii), paragraph .64d(iv), and paragraph .64f; to do so might overshadow the disclaimer. (Ref: par. .A124–.A125) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.76 When the auditor disclaims an opinion but has concluded that one or more material weaknesses exist, the auditor's report also should include the following:

- a. The definition of a material weakness.
- b. A statement that if one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective.
- c. A statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assessment about ICFR.
- d. A description of the material weaknesses identified in the entity's ICFR. This description should provide the users of the report with specific information about the nature of any material weakness and its actual and potential effect on the presentation of the entity's financial statements issued during the existence of the weakness.

The auditor also should apply the requirements in paragraphs .69 and .71. (Ref: par. .A126) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.77 If the auditor concludes that the auditor cannot express an opinion because there has been a limitation on the scope of the audit, the auditor should communicate, in writing, to management and those charged with governance that the audit of ICFR cannot be satisfactorily completed.

Making Reference to a Component Auditor and Assuming Responsibility for the Work of a Component Auditor

.78 When an entity includes one or more components, the group engagement partner should evaluate whether the group engagement team will be able to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or making reference to the audit of ICFR of a component auditor in the auditor's report) to act as the auditor of the ICFR over the group financial statements and report as such on the ICFR over the group financial statements, as required by section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.⁸ (Ref: par. .A127)

.79 As required by section 600, the group engagement partner should determine whether to make reference to a component auditor in the report on the ICFR over the group financial statements.⁹ Reference to the audit of a component auditor in the auditor's report on the ICFR over the group financial statements should not be made unless

- a. the engagement partner has determined that the component auditor has performed an audit of the component's ICFR in accordance with the relevant requirements of GAAS (or, if applicable, the standards promulgated by the PCAOB) and
- b. the component auditor has issued an auditor's report on ICFR that is not restricted as to use. (Ref: par. .A128–.A129)

Additional Information

.80 When management includes, either within management's report or in a document containing management's report and the related auditor's report, information in addition to the elements that are subject to the auditor's evaluation as described in paragraph .55, the auditor should do the following: (Ref: par. .A130–.A131)

- a. Read the additional information to identify material inconsistencies with management's report and remain alert for material misstatements of fact while reading the additional information.
- b. If the auditor identifies a material inconsistency or becomes aware of a material misstatement of fact, request management to correct the information, and to do the following, as applicable:
 - i. If management agrees to make the correction, determine that the correction has been made.
 - ii. If management refuses to make the correction, communicate the matter to those charged with governance and request that the correction be made.
 - iii. If the correction is not made after communicating with those charged with governance, the auditor should do one or more of the following:
 - (1) Consider the implications for the auditor's report and communicate to those charged with governance about how the auditor plans to address the

⁸ Paragraph .14 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

⁹ Paragraph .24 of section 600. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- material inconsistency or material misstatement of fact in the auditor's report
- (2) Withhold the auditor's report
 - (3) Withdraw from the engagement, when withdrawal is possible under the applicable law or regulation
- c. When the additional information subject to the requirements of paragraph .80a is included in management's report and no material inconsistencies or material misstatements of fact are identified, the auditor should disclaim an opinion, in an other-matter paragraph, on the additional information.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Special Topics

Entities With Multiple Components

.81 In determining the components at which to perform tests of controls, the group engagement team should assess the risk of material misstatement to the financial statements associated with the component and correlate the amount of attention devoted to the component with the degree of risk. (Ref: par. .A132–.A134)

.82 In assessing and responding to risk, the group engagement team should test, or have a component auditor test on the group engagement team's behalf, controls over specific risks that present a reasonable possibility of material misstatement to the group financial statements. (Ref: par. .A135)

.83 In applying the requirement in paragraph .42 regarding special considerations for subsequent years' audits, the group engagement team should vary the nature, timing, and extent of tests of controls at components from year to year.

Special Situations

.84 For equity method investment components, the scope of the audit should include controls over the reporting in the entity's financial statements of the entity's portion of the investees' income or loss, the investment balance, adjustments to the income or loss and investment balance, and related disclosures, in accordance with the applicable financial reporting framework. (Ref: par. .A136)

.85 Except as indicated in paragraph .86, the scope of the audit should include entities that are acquired on or before the date specified in management's assessment about ICFR and operations that are accounted for as discontinued operations on the date specified in management's assessment about ICFR that are reported in accordance with the applicable financial reporting framework in the entity's financial statements.

.86 In situations in which management elects to limit its assessment by excluding certain entities, the auditor should evaluate whether it is appropriate, in the auditor's judgment, to do so. If the auditor concludes that it is appropriate, the auditor should include in either the "Opinion on Internal Control Over Financial Reporting" or "Basis or Opinion" section of the report a disclosure similar to management's regarding the exclusion of an entity from the scope of both management's assessment about ICFR and the auditor's audit of ICFR. Additionally, the auditor should evaluate the appropriateness of management's

disclosure related to such a limitation. (Ref: par. .A137) [As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.87 If the auditor believes that management's disclosure about the limitation requires modification, the auditor should communicate the matter to the appropriate level of management. If, in the auditor's judgment, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform those charged with governance of the matter as soon as practicable. If management and those charged with governance do not respond appropriately, the auditor should modify the auditor's report on the audit of ICFR to include an other-matter paragraph describing the reasons why the auditor believes management's disclosure requires modification.

Use of Service Organizations

.88 When the entity uses the services of a service organization, the auditor should consider the activities of the service organization when determining the evidence required to support the auditor's opinion on the effectiveness of an entity's ICFR. (Ref: par. .A138–.A139)

.89 The auditor is required to perform the procedures in section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, with respect to the activities performed by the service organization.¹⁰ In an audit of ICFR, the auditor should also obtain evidence that controls at the service organization that are relevant to the auditor's opinion on ICFR are operating effectively. (Ref: par. .A140–.A141)

.90 If the auditor plans to use a type 2 report as audit evidence that controls are operating effectively, the auditor should determine whether the type 2 report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the auditor's opinion by evaluating

- a. the time period covered by the tests of controls and its relation to the as of date;
- b. the scope of the service auditor's work and the services and processes covered, the controls tested, and the tests that were performed and the way in which tested controls relate to the entity's controls; and
- c. the results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls. (Ref: par. .A142)

.91 The auditor should determine whether complementary user entity controls identified in the type 2 report are relevant in addressing the risks of material misstatement and, if so, evaluate the entity's design and implementation of the relevant complementary user entity controls and test their operating effectiveness. (Ref: par. .A143)

.92 In determining whether the type 2 report provides sufficient appropriate audit evidence to support the auditor's opinion on ICFR, the auditor should be satisfied regarding the following:

- a. The service auditor's professional competence and independence from the service organization. (Ref: par. .A144)
- b. The adequacy of the standards under which the type 2 report was issued. (Ref: par. .A145)

¹⁰ Paragraphs .09–.19 of section 402, *Audit Considerations Relating to an Entity Using a Service Organization*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

.93 The auditor should inquire of management to determine whether management has identified any changes in the service organization's controls subsequent to the period covered by the service auditor's report. If management has identified such changes, the auditor should evaluate the effect of such changes on the effectiveness of the entity's ICFR. The auditor also should evaluate whether the results of other procedures the auditor performed indicate that there have been changes in the controls at the service organization. (Ref: par. .A146)

.94 The auditor should determine whether to obtain additional evidence about the operating effectiveness of controls at the service organization based on the procedures performed by management or the auditor and the results of those procedures and on an evaluation of the following risk factors:

- a. The elapsed time between the time period covered by the tests of controls in the service auditor's report and the as of date
- b. The significance of the activities of the service organization
- c. Whether there are errors that have been identified in the service organization's processing
- d. The nature and significance of any changes in the service organization's controls identified by management or the auditor (Ref: par. .A147)

.95 When a significant period of time has elapsed between the time period covered by the tests of controls in the service auditor's report and the as of date, additional procedures should be performed to obtain sufficient appropriate audit evidence about the operating effectiveness of the controls at the service organization that are relevant to the auditor's opinion on ICFR.

.96 The auditor should not refer to the service auditor's report when expressing an opinion on ICFR.

Benchmarking of Automated Controls

.97 To determine whether to use a benchmarking strategy for testing an automated application control, the auditor should assess the following risk factors:

- a. The extent to which the application control can be matched to a defined program within an application
- b. The extent to which the application is stable (that is, there are few changes from period to period)
- c. The availability and reliability of a report of the compilation dates of the programs placed in production (Ref: par. .A148–.A151)

.98 When using a benchmarking strategy, the auditor should obtain evidence to determine that the automated application control has not changed. (Ref: par. .A152–.A153)

.99 After a period of time, the length of which depends upon the circumstances, the baseline of the operation of an automated application control should be reestablished. To determine when to reestablish a baseline, the auditor should evaluate the following factors:

- a. The effectiveness of the IT control environment, including controls over application and system software acquisition and maintenance, access controls, and computer operations
- b. The auditor's understanding of the nature of changes, if any, on the specific programs that contain the controls
- c. The nature and timing of other related tests

- d. The consequences of errors associated with the application control that was benchmarked
- e. Whether the control is sensitive to other business factors that may have changed (Ref: par. .A154)

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Certain regulatory bodies, such as the FDIC, require the audit of ICFR and the audit of financial statements to be performed by the same auditor.¹¹ Inherent difficulties exist when integrating the audit of ICFR and the audit of the financial statements to meet the requirements of this section when the audit of the financial statements is performed by a different auditor. Nonetheless, if the audit of the financial statements and the audit of ICFR are performed by different auditors, the audits are required by this section to be integrated.

Objectives (Ref: par. .04)

.A2 See section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for additional explanation related to the auditor's objective to obtain reasonable assurance.¹²

.A3 Effective ICFR provides an entity with reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with the applicable financial reporting framework. If one or more material weakness exists, the entity's ICFR cannot be considered effective. The evaluation of the effectiveness of the entity's ICFR required by this section encompasses all relevant control objectives of the entity's ICFR; therefore, the identification of one material weakness in ICFR does not justify the auditor ceasing to perform procedures to evaluate the effectiveness of all relevant control objectives of the entity's ICFR.

.A4 The auditor is not required to plan and perform the integrated audit to identify deficiencies that, individually or in combination, are less severe than a material weakness.

Definitions (Ref: par. .05)

Criteria

.A5 For purposes of this section, the subject matter is ICFR.

Internal Control Over Financial Reporting

.A6 The auditor's procedures performed as part of the integrated audit are not part of an entity's ICFR.

.A7 For insured depository institutions (IDIs) subject to the internal control reporting requirements of Section 112 of the Federal Deposit Insurance

¹¹ See Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (Section 36 of the Federal Deposit Insurance Act [FDI Act], 12 U.S.C. 1831m) and its implementing regulation, 12 CFR Part 363.3(b). [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

¹² Paragraph .06 of section 200. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

Corporation Improvement Act (FDICIA), ICFR includes controls over the preparation of the IDI's financial statements in accordance with generally accepted accounting principles (GAAP) and with the instructions to the Consolidated Financial Statements for Bank Holding Companies. ICFR also includes controls over the preparation of the IDI's financial statements in accordance with GAAP and controls over the preparation of schedules equivalent to the basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (Call Report Instructions).

Management's Assessment About ICFR

.A8 Exhibit C, "Illustrative Management Report," includes an illustration of a management report.

Preconditions for the Audit of ICFR (Ref: par. .06–.07)

.A9 Management is responsible for identifying and documenting the controls and the control objectives that they were designed to achieve. Such documentation serves as a basis for management's assessment about ICFR. Documentation of the design of controls, including changes to those controls, is evidence that controls upon which management's assessment about ICFR is based are

- identified.
- capable of being communicated to those responsible for their performance.
- capable of being monitored and evaluated by the entity.

.A10 Management's documentation may take various forms, for example, entity policy manuals, accounting manuals, narrative memoranda, flowcharts, decision tables, procedural write-ups, or completed questionnaires. No one particular form of documentation is prescribed, and the extent of documentation may vary depending upon the size and complexity of the entity and the entity's monitoring activities.

.A11 Management's monitoring activities also may provide evidence of the design and operating effectiveness of ICFR in support of management's assessment about ICFR. Monitoring of controls is a process to assess the effectiveness of ICFR performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the organization, and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing evaluations, separate evaluations, or a combination of the two.

.A12 Ongoing evaluations are often built into the normal recurring activities of an entity and include regular management and supervisory activities. The greater the degree and effectiveness of ongoing evaluations, the less need for separate evaluations. Management may perform a combination of ongoing and separate evaluations. The scope and frequency of separate evaluations is a matter of management judgment.

.A13 Ordinarily, the auditor is engaged to audit the effectiveness of the entity's ICFR as of the end of the entity's fiscal year; however, management may select a different date. If the auditor is engaged to audit the effectiveness of an entity's ICFR at a date different from the end of the entity's fiscal year,

the audit is, nevertheless, required by paragraph .06b to be integrated with a financial statement audit as of the date specified in management's assessment.

.A14 Appropriate criteria are both suitable and available to the intended users of management's report on ICFR. Suitable criteria exhibit all of the following characteristics:

- *Relevance.* Criteria are relevant to ICFR.
- *Objectivity.* Criteria are free from bias.
- *Measurability.* Criteria permit reasonably consistent measurements, qualitative or quantitative, of ICFR.
- *Completeness.* Criteria are complete when the evaluation of the effectiveness of ICFR prepared in accordance with the criteria does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of management's report on ICFR.

.A15 Management may select criteria for ICFR that are available publicly in published frameworks or criteria that are available only to specified parties (for example, terms of a contract or criteria issued by an industry association that are available only to those in the industry). When criteria are available only to specified parties, section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, requires that the auditor's report include an other-matter paragraph that restricts the use of the auditor's report.¹³

.A16 *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 COSO framework) and the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (the Green Book), provide suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's ICFR. If management selects another framework, see paragraph .A14 for guidance on evaluating the suitability of the framework selected by management.

.A17 *Internal control*, as defined by the framework used by management, may be more broadly defined than ICFR. However, this section focuses only on ICFR.

Integrating the Audit of ICFR With the Financial Statement Audit (Ref: par. .09–.13)

.A18 Obtaining sufficient appropriate audit evidence to support the operating effectiveness of controls for purposes of the financial statement audit ordinarily allows the auditor to modify the substantive procedures that otherwise would have been necessary to opine on the financial statements.

.A19 Section 500A, *Audit Evidence*, provides additional explanation with respect to obtaining sufficient appropriate audit evidence.

.A20 Consideration of the results of tests of controls may cause the auditor to alter the nature, timing, and extent of substantive procedures and to plan and perform further tests of controls, particularly in response to identified deficiencies.

¹³ Paragraph .06 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

Planning the Audit of ICFR (Ref: par. .14)

.A21 Evaluating whether the following matters are important to the entity's financial statements and ICFR and, if so, how they may affect the auditor's procedures may assist the auditor in planning the audit of ICFR:

- Knowledge of the entity's ICFR obtained during other engagements performed by the auditor or, if applicable, during a review of a predecessor auditor's working papers
- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, and capital structure
- The extent of recent changes, if any, in the entity, its operations, or its ICFR
- The auditor's preliminary judgments about financial statement materiality, risk, and other factors relating to the determination of material weaknesses
- Deficiencies previously communicated to those charged with governance or management
- Legal or regulatory matters of which the entity is aware
- The type and extent of available evidence related to the effectiveness of the entity's ICFR
- Preliminary judgments about the effectiveness of ICFR
- Public information about the entity relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the entity's ICFR
- Knowledge about risks related to the entity evaluated as part of the auditor's client acceptance and retention evaluation
- The relative complexity of the entity's operations

Role of Risk Assessment (Ref: par. .15)

.A22 Risk assessment underlies the entire audit process described by this section, including the determination of significant classes of transactions, account balances, and disclosures, and their relevant assertions, the selection of controls to test, and the determination of the evidence necessary to conclude on the effectiveness of a given control. The risk assessment procedures described in section 315A support both the financial statement audit and the audit of ICFR.

Scaling the Audit

.A23 The size and complexity of the entity, its business processes, and structure may affect the way in which the entity achieves many of its control objectives. Many smaller entities have less complex operations. Additionally, some larger, complex entities may have less complex units or processes. Factors that might indicate less complex operations include fewer business lines; less complex business processes and financial reporting systems; more centralized accounting functions; extensive involvement by senior management in the day-to-day activities of the business; and fewer levels of management, each with a wide span of control. Accordingly, a smaller, less complex entity, or even a larger, less complex entity might achieve its control objectives differently from a more complex entity.

.A24 The size and complexity of the entity, its business processes, and structure also may affect the auditor's risk assessment and the determination of the necessary procedures and the controls necessary to address those risks. Scaling is most effective as a natural extension of the risk-based approach and applicable to audits of all entities.

Addressing the Risk of Fraud (Ref: par. .16–.17)

.A25 Section 240 addresses the auditor's identification and assessment of the risks of material misstatement due to fraud.¹⁴ Controls that might address these risks include

- controls over significant unusual transactions, particularly those that result in late or unusual journal entries;
- controls over journal entries and adjustments made in the period-end financial reporting process;
- controls over related party transactions;
- controls related to significant management estimates; and
- controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results.

[As amended, effective for integrated audits for periods ending on or after December 15, 2021, by SAS No. 135.]

Using the Work of Internal Auditors or Others (Ref: par. .18–.19)

.A26 The extent of the procedures necessary to obtain the understanding required by paragraph .18 will vary, depending on the nature of those activities. In performing risk assessment procedures, the auditor is required to inquire of appropriate individuals within the internal audit function (if such function exists).¹⁵ Section 315A provides guidance with respect to such inquiries and certain additional procedures based on the responses to such inquiries.¹⁶

.A27 In an audit of ICFR, the external auditor may use the work of the internal audit function in obtaining audit evidence or use internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor. For purposes of the audit of ICFR, however, the auditor also may use the work performed by, or receive direct assistance from, others. Others include entity personnel (in addition to internal auditors) and third parties working under the direction of management or those charged with governance that provide evidence about the effectiveness of ICFR. In an integrated audit, the auditor also may use the work of internal auditors or others to obtain evidence supporting the assessment of control risk for purposes of the financial statement audit.

.A28 As the risk associated with a control increases, the need for the auditor to directly perform work on the control increases (for example, for controls that address specific fraud risks, use of the work of the internal audit function or others would be limited, if it could be used at all).

.A29 For purposes of evaluating the competence and objectivity of others in accordance with section 610, *competence* means the attainment and

¹⁴ Paragraphs .25–.27 of section 240. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

¹⁵ Paragraph .06a of section 315A. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

¹⁶ Paragraphs .A9–.A13 of section 315A. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

maintenance of a level of understanding, knowledge, and skills that enables that person to ably perform the tasks assigned to them, and *objectivity* means the ability to perform those tasks impartially and with intellectual honesty, without allowing bias, conflict of interest, or undue influence of others to override professional judgments.¹⁷ The more objective and the higher level of competence, the more likely the external auditor may use the work of others and make use of it in more areas.

.A30 Others may have an approach that differs from that of an internal audit function, particularly with respect to the level of formality. However, it would be inappropriate to use the work of others that do not have a systematic and disciplined approach, including quality control, as required by section 610. Section 610 provides additional requirements and guidance in determining when to use the work, in which areas, and to what extent.

Materiality (Ref: par. .20)

.A31 Section 320, *Materiality in Planning and Performing an Audit*, provides additional explanation of materiality.

Using a Top-Down Approach (Ref: par. .21)

.A32 The *top-down approach* describes the auditor's sequential thought process in identifying risks and the controls to test, not necessarily the order in which the auditor will perform the audit procedures.

.A33 A top-down approach involves

- beginning at the financial statement level;
- using the auditor's understanding of the overall risks to ICFR;
- focusing on entity-level controls;
- working down to significant classes of transactions, account balances, and disclosures, and their relevant assertions;
- directing attention to classes of transactions, accounts, disclosures, and assertions that present a reasonable possibility of material misstatement of the financial statements;
- verifying the auditor's understanding of the risks in the entity's processes; and
- selecting controls for testing that sufficiently address the assessed risk of material misstatement to each relevant assertion.

Entity-Level Controls (Ref: par. .22)

.A34 The auditor's evaluation of entity-level controls can result in increasing or decreasing the testing that the auditor otherwise would have performed on other controls.

.A35 Entity-level controls include

- controls related to the control environment;
- controls over management override;
- the entity's risk assessment process;

¹⁷ Paragraphs .13 and .A5–.A9 of section 610, *Using the Work of Internal Auditors*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- centralized processing and controls, including shared service environments;
- controls to monitor results of operations;
- controls to monitor other controls, including activities of the internal audit function, those charged with governance, and self-assessment programs;
- controls over the period-end financial reporting process; and
- programs and controls that address significant business risks.

.A36 Entity-level controls vary in nature and precision:

- Some entity-level controls, such as certain control environment controls, have an important but indirect effect on the likelihood that a misstatement will be prevented, or detected and corrected, on a timely basis. These controls might affect the other controls that the auditor selects for testing and the nature, timing, and extent of procedures the auditor performs on other controls.
- Some entity-level controls monitor the effectiveness of other controls. Such controls might be designed to identify possible breakdowns in lower level controls, but not at a level of precision that would, by themselves, sufficiently address the assessed risk that material misstatements to a relevant assertion will be prevented, or detected and corrected, on a timely basis. These controls, when operating effectively, might allow the auditor to reduce the testing of other controls.
- Some entity-level controls might be designed to operate at a level of precision that would adequately prevent, or detect and correct, on a timely basis misstatements to one or more relevant assertions. If an entity-level control sufficiently addresses the assessed risk of material misstatement, the auditor need not test additional controls relating to that risk.

Considerations Specific to Smaller, Less Complex Entities

.A37 Controls over management override are important to effective ICFR for all entities and may be particularly important at smaller, less complex entities because of the increased involvement of senior management in performing controls and in the period-end financial reporting process. For smaller, less complex entities, the controls that address the risk of management override might be different from those at a larger entity. For example, a smaller, less complex entity might rely on more detailed oversight by those charged with governance that focuses on the risk of management override.

Evaluating the Components of ICFR (Ref: par. .23)

.A38 ICFR is often described as consisting of five components: control environment, risk assessment, control activities, information and communication, and monitoring. The components are necessary to an effective system of ICFR.¹⁸ This description does not necessarily reflect how an entity designs, implements, and maintains ICFR nor how it may classify any particular component. Auditors may use different terminology or frameworks to describe the various

¹⁸ Some material in this section relies upon the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control—Integrated Framework*. The copyright is held by COSO, and the material is used with COSO's permission. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

aspects of ICFR and their effect on the audit other than those used in this section, provided that all the components described in this section are addressed. Entities select and develop controls within each component. Controls are inter-related and may support multiple objectives.

.A39 The 2013 COSO framework includes principles related to each component that are suitable to all entities. The 2013 COSO framework presumes that all principles are relevant because they have a significant bearing on the presence and functioning of an associated component. There may be a rare industry, operating, or regulatory situation in which management has determined that a principle is not relevant to a component. Considerations in applying this judgment may include the entity structure recognizing any legal, regulatory, industry, or contractual requirements for governance of the entity, and the level of use and dependence on technology used by the entity. The 2013 COSO framework states that management must support its determination that a principle is not relevant with the rationale of how, in the absence of that principle, the associated component can be present and functioning.¹⁹

.A40 When management uses the 2013 COSO framework, the guidance described in paragraphs .A41–.A48 to evaluate the five components is applicable. When management uses the Green Book or another framework, the auditor may adapt the guidance in paragraphs .A41–.A48, as necessary, based on the criteria contained in the framework used by management. For example, when management uses the Green Book, the auditor assesses the relevant principles in the Green Book in lieu of the principles listed in paragraphs .A41–.A48.

Control Environment

.A41 The following principles are relevant to the auditor's evaluation of whether the control environment is present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

- The entity demonstrates a commitment to integrity and ethical values.
- Those charged with governance demonstrate independence from management and exercise oversight of the development and performance of ICFR.
- Management establishes, with oversight of those charged with governance, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of the entity's financial reporting objectives.
- The entity demonstrates a commitment to attract, develop, and retain competent individuals in alignment with the entity's financial reporting objectives.
- The entity holds individuals accountable for their ICFR responsibilities in the pursuit of the entity's financial reporting objectives.

.A42 The evaluation of whether those charged with governance demonstrate independence from management and exercise oversight of the development and performance of ICFR is performed in the context of the entity's governance structure. As described in section 260, *The Auditor's Communication With Those Charged With Governance*, governance structures may vary by

¹⁹ "Suitability and Relevance of Components and Principles" in section 3, "Effective Internal Control" of *Internal Control—Integrated Framework* (COSO, 2013). [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

entity, reflecting influences such as size and ownership characteristics.²⁰ For example, in some smaller entities, those charged with governance and management may be the same people. In such smaller entities, the independence of those charged with governance from management may not be necessary to support the achievement of the entity's financial reporting objectives.

.A43 The Green Book refers to those charged with governance as the oversight body.

Risk Assessment

.A44 The following principles are relevant to the auditor's evaluation of whether the entity's risk assessment is present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

- a. The entity specifies financial reporting objectives with sufficient clarity to enable the identification and assessment of risks related to these objectives.
- b. The entity identifies risks to the achievement of financial reporting objectives across the entity and analyzes risks as a basis for determining how the risks need to be managed.
- c. The entity considers the potential for fraud in assessing risks to the achievement of financial reporting objectives.
- d. The entity identifies and assesses changes that could significantly impact ICFR.

Control Activities Relevant to the Audit of ICFR

.A45 The following principles are relevant to the auditor's evaluation of whether the entity's control activities relevant to the audit of ICFR are present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

- a. The entity selects and develops control activities that contribute to the mitigation of risks to the achievement of financial reporting objectives to acceptable levels.
- b. The entity selects and develops general control activities over technology to support the achievement of financial reporting objectives.
- c. The entity deploys control activities through policies that establish what is expected and procedures that put policies into action.

.A46 Control activities relevant to the audit of ICFR include those related to each significant class of transactions, account balance, and disclosure, and its relevant assertions (see paragraphs .26–.28).

Information and Communication

.A47 The following principles are relevant to the auditor's evaluation of whether the entity's information and communication, including the related business processes relevant to financial reporting, is present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:

- a. The entity obtains or generates and uses relevant, quality information to support the functioning of ICFR.

²⁰ Paragraph .A6 of section 260, *The Auditor's Communication With Those Charged With Governance*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- b. The entity internally communicates information, including financial reporting objectives and responsibilities, necessary to support the functioning of ICFR.
- c. The entity communicates with external parties regarding matters affecting the functioning of ICFR.

Monitoring Activities

.A48 The following principles are relevant to the auditor's evaluation of whether the entity's monitoring activities are present and functioning in the design, implementation, and operation of ICFR to achieve the entity's financial reporting objectives:²¹

- a. The entity selects, develops, and performs ongoing or separate evaluations to ascertain whether the components of internal control are present and functioning.
- b. The entity evaluates and communicates deficiencies in ICFR in a timely manner to those parties responsible for taking corrective action, including senior management and those charged with governance, as appropriate.

Period-End Financial Reporting Process (Ref: par. .24–.25)

.A49 Because the annual period-end financial reporting process normally occurs after the as of date, those controls usually cannot be tested until after the as of date.

Identifying Significant Classes of Transactions, Account Balances, and Disclosures, and Their Relative Assertions (Ref: par. .26–.28)

.A50 Risk factors relevant to the identification of significant classes of transactions, account balances, and disclosures, and their relevant assertions include

- size and composition of the account;
- susceptibility to misstatement due to errors or fraud;
- volume of activity, complexity, and homogeneity of the individual transactions processed through the account or reflected in the disclosure;
- nature of the account, class of transactions, or disclosure;
- accounting and reporting complexities associated with the account, class of transactions, or disclosure;
- exposure to losses in the account;
- possibility of significant contingent liabilities arising from the activities reflected in the account or disclosure;
- existence of related party transactions in the account; and
- changes from the prior period in the account, class of transactions, or disclosure characteristics.

.A51 The risk factors in paragraph .26 that the auditor is required to evaluate in the identification of significant classes of transactions, account balances, and disclosures, and their relevant assertions, are the same in the audit of ICFR as in the audit of the financial statements; accordingly, significant classes of

²¹ Paragraphs .A102–.A107 and appendix B, "Internal Control Components," of section 315A. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

transactions, account balances, and disclosures, and their relevant assertions, are the same in an integrated audit.

.A52 The risk assessment procedures performed in connection with a financial statement audit are described in section 315A.

.A53 The auditor might determine the likely sources of potential misstatements by asking himself or herself "What could go wrong?" within a given significant class of transactions, account balance, or disclosure.

.A54 The components of a potential significant class of transactions, account balance, or disclosure might be subject to significantly different risks. If so, different controls might be necessary to adequately address those risks.

.A55 Multiple components are discussed further beginning in paragraphs .78 and .81.

Understanding Likely Sources of Misstatement (Ref: par. .29-.31)

.A56 Performing walk-throughs will frequently be the most effective way of achieving the objectives in paragraph .29. A *walk-through* involves following a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial statements, using the same documents and IT that entity personnel use. Walk-through procedures are inquiry of appropriate personnel, observation of the application of specific controls, inspection of relevant documentation, and control reperformance. The auditor may choose any combination of these procedures; however, inquiry alone is not sufficient for achieving the objectives in paragraph .29.

.A57 A walk-through includes questioning the entity's personnel about their understanding of what is required by the entity's prescribed procedures and controls at the points at which important processing procedures occur. These probing questions, combined with the other walk-through procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walk-through may provide an understanding of the different types of significant transactions handled by the process.

.A58 The identification of risks and controls within IT is not a separate evaluation. Instead, it is an integral part of the top-down approach used to identify likely sources of misstatement and the controls to test, as well as to assess risk and allocate audit effort.

Selecting Controls to Test (Ref: par. .32)

.A59 There might be more than one control that addresses the assessed risk of material misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of material misstatement to more than one relevant assertion. It may not be necessary to test all controls related to a relevant assertion nor necessary to test redundant controls, unless redundancy is, itself, a control objective.

.A60 The decision concerning whether a control would be selected for testing depends on which controls, individually or in combination, sufficiently address the assessed risk of material misstatement to a given relevant assertion rather than on how the control is labeled (for example, entity-level control, transaction-level control, control activity, monitoring control, preventive control, or detective control).

Testing Controls

Evaluating Design Effectiveness (Ref: par. .33)

.A61 Procedures performed to evaluate design effectiveness may include a mix of inquiry of appropriate personnel, observation of the application of specific controls, and inspection of relevant documentation. Walk-throughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.

Considerations Specific to Smaller, Less Complex Entities

.A62 A smaller, less complex entity might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex entity might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the entity to implement different controls to achieve its control objectives.

Testing Operating Effectiveness (Ref: par. .34)

.A63 Procedures performed to test operating effectiveness may include a mix of inquiry of appropriate personnel, observation of the application of specific controls, inspection of relevant documentation, and reperformance of the control. Inquiry alone, however, is not sufficient for such purposes. Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides additional guidance on other audit procedures, in combination with inquiry, which may be appropriate when testing the operating effectiveness of controls.²²

.A64 In some situations, particularly in smaller, less complex entities, an entity might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for an entity's financial reporting and associated controls, the auditor may take into account the combined competence of entity personnel and other parties that assist with functions related to financial reporting.

Relationship of Risk to the Evidence to Be Obtained (Ref: par. .35–.38)

.A65 For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness exists.

.A66 Factors that affect the risk associated with a control may include

- the nature and materiality of misstatements that the control is intended to prevent, or detect and correct;
- the inherent risk associated with the related account(s) and assertion(s);
- whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness;
- whether the account has a history of errors;

²² Paragraphs .A28–.A30 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- the effectiveness of entity-level controls, especially controls that monitor other controls;
- the nature of the control and the frequency with which it operates;
- the degree to which the control relies on the effectiveness of other controls (for example, the control environment or IT general controls);
- the competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance;
- whether the control relies on performance by an individual or is automated (that is, an automated control would generally be expected to be lower risk if relevant IT general controls are effective); and
- the complexity of the control and the significance of the judgments that would be made in connection with its operation.

.A67 Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.

Considerations Specific to Smaller, Less Complex Entities

.A68 A smaller, less complex entity or component with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas where off-the-shelf software is used, the auditor's testing of IT controls might focus on the application controls built into the prepackaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls.

.A69 The auditor's objective is to express an opinion on the entity's ICFR overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.

.A70 The evidence provided by the auditor's tests of the effectiveness of controls depends upon the mix of the nature, timing, and extent of the auditor's procedures. Further, for an individual control, different combinations of the nature, timing, and extent of testing may provide sufficient appropriate audit evidence in relation to the risk associated with the control.

.A71 Walk-throughs might provide sufficient appropriate audit evidence of operating effectiveness, depending on

- the risk associated with the control being tested,
- the frequency of operation of the control,
- whether the control is an IT application control,
- the specific procedures performed as part of the walk-through, and
- the results of those procedures.

.A72 The operating effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, informs the auditor's risk assessments in determining the testing necessary to conclude on the operating effectiveness of a control.

Nature of Tests of Controls

.A73 Some types of tests, by their nature, produce greater evidence of the effectiveness of controls than other tests. The following tests that the auditor might perform are presented in order of the evidence that they ordinarily would produce, from least to most: inquiry, observation, inspection of relevant documentation, and reperformance of a control. Inquiry alone, however, does not provide sufficient appropriate audit evidence to support a conclusion about the effectiveness of a control.

.A74 The nature of the tests of effectiveness that will provide sufficient appropriate audit evidence depends, to a large degree, on the nature of the control to be tested, including whether the operation of the control results in documentary evidence of its operation. Documentary evidence of the operation of some controls, such as management's philosophy and operating style, might not exist.

Considerations Specific to Smaller, Less Complex Entities

.A75 A smaller, less complex entity or unit might have less formal documentation regarding the operation of its controls. In those situations, testing controls through inquiry combined with other procedures, such as observation of the application of specific controls, inspection of less formal documentation, or reperformance of certain controls, might provide sufficient appropriate audit evidence about whether the control is effective.

.A76 A *control deviation* occurs when a control does not operate as designed. Control deviations are evaluated when determining whether a deficiency in internal control exists. Because effective ICFR cannot and does not provide absolute assurance of achieving the entity's control objectives, an individual control does not necessarily have to operate without any deviation to achieve the entity's control objectives and to be considered effective.

Timing and Extent of Tests of Controls (Ref: par. .39)

.A77 The objective of the tests of controls in an audit of ICFR is to obtain evidence about the effectiveness of controls to support the auditor's opinion on the entity's ICFR. The auditor's opinion relates to the effectiveness of the entity's ICFR as of a point in time and as a whole. Accordingly, an audit of ICFR may entail testing the design and operating effectiveness of controls not tested when expressing an opinion only on the financial statements; however, in both an audit of ICFR and a financial statement audit, the auditor directs attention to controls that present a reasonable possibility that, if missing or deficient, would result in a material misstatement of the financial statements.

.A78 Testing controls over a longer period of time provides more evidence of the effectiveness of controls than testing over a shorter period of time. Further, testing performed closer to the as of date provides more evidence than testing performed earlier in the year.

.A79 The more extensively a control is tested, the greater the evidence obtained from that test.

.A80 Prior to the as of date, management might implement changes to the entity's controls to make them more effective or efficient or to address deficiencies. If the auditor determines that the new controls achieve the related objectives of the criteria and have been in effect for a sufficient period to permit the auditor to assess their design and operating effectiveness by performing tests of controls, the auditor will not need to test the design and operating effectiveness of the superseded controls for purposes of expressing an opinion on ICFR. If the operating effectiveness of the superseded controls is important to the auditor's

control risk assessment in the financial statement audit, the auditor tests the design and operating effectiveness of those superseded controls, as appropriate.

Rollforward Procedures (Ref: par. .40)

.A81 The additional evidence that is necessary to update the results of testing from an interim date to the entity's period-end depends on the following factors:

- The specific control tested prior to the as of date, including the risks associated with the control, the nature of the control, and the results of those tests
- The sufficiency of the evidence of operating effectiveness obtained at an interim date
- The length of the remaining period
- The possibility that there have been any significant changes in ICFR subsequent to the interim date

.A82 In some circumstances, such as when evaluation of these factors indicates a low risk that the controls are no longer effective during the rollforward period, inquiry alone might be sufficient as a rollforward procedure.

Special Considerations for Subsequent Years' Audits (Ref: par. .41–.42)

.A83 Factors that affect the risk associated with a control in subsequent years' audits include those in paragraph .A66 and the following:

- The nature, timing, and extent of procedures performed in previous audits
- The results of the previous years' testing of the control
- Whether there have been changes in the control or the process in which it operates since the previous audit

.A84 After taking into account the risk factors identified in paragraphs .A66 and .A83, the additional information available in subsequent years' audits might permit the auditor to assess the risk as lower than in the initial year. This, in turn, might permit the auditor to reduce testing in subsequent years.

.A85 The auditor also may use a benchmarking strategy for automated application controls in subsequent years' audits. Benchmarking is described further beginning in paragraph .97.

.A86 The auditor might test controls at a different interim period, increase or reduce the number and types of tests performed, or change the combination of procedures used.

Identifying Deficiencies in ICFR (Ref: par. .43)

.A87 The findings from audit work performed on the financial statements and on ICFR are relevant in determining whether the auditor has identified any deficiencies in ICFR.

Determination of Whether Material Weaknesses Exist as of the Date Specified in Management's Assessment About ICFR (Ref: par. .44–.46)

.A88 The severity of a deficiency, or a combination of deficiencies, in ICFR depends on

- the magnitude of the potential misstatement resulting from the deficiency or deficiencies and

- whether there is a reasonable possibility that the entity's controls will fail to prevent, or detect and correct, a misstatement of a class of transaction, an account balance, or a disclosure.

A material weakness may exist even though the auditor has not identified misstatements during the integrated audit. Paragraph .A96 provides indicators of material weaknesses.

.A89 Factors that affect the magnitude of a misstatement that might result from a deficiency, or deficiencies, in ICFR include, but are not limited to, the following:

- The financial statement amounts or total of transactions exposed to the deficiency
- The volume of activity (in the current period or expected in future periods) in the account or class of transactions exposed to the deficiency

.A90 In evaluating the magnitude of the potential misstatement, the maximum amount by which an account balance or total of transactions can be overstated is generally the recorded amount, whereas understatements could be larger.

.A91 Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in ICFR will result in a misstatement of an account balance or a disclosure. The factors include the following:

- The nature of the financial statement, classes of transactions, account balances, disclosures, and assertions involved
- The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in ICFR
- The susceptibility of the related asset or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control(s) with other controls
- The interaction with other deficiencies in ICFR
- The possible future consequences of the deficiency, or deficiencies, in ICFR
- The importance of controls, such as the following, to the financial reporting process:
 - General monitoring controls (such as oversight of management)
 - Controls over the prevention and detection of fraud
 - Controls over the selection and application of significant accounting policies
 - Controls over significant transactions with related parties
 - Controls over significant unusual transactions
 - Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[As amended, effective for integrated audits for periods ending on or after December 15, 2021, by SAS No. 135.]

.A92 The evaluation of whether a deficiency in ICFR presents a reasonable possibility of misstatement may be made without quantifying the probability

of occurrence as a specific percentage or range. Also, in many cases, the probability of a small misstatement will be greater than the probability of a large misstatement.

.A93 Controls may be designed to operate individually, or in combination, to effectively prevent, or detect and correct, misstatements. For example, controls over accounts receivable may consist of both automated and manual controls designed to operate together to prevent, or detect and correct, misstatements in the account balance.

.A94 A deficiency in ICFR on its own may not be sufficiently important to constitute a material weakness. However, a combination of deficiencies affecting the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR may increase the risks of misstatement to such an extent to give rise to a material weakness. A combination of deficiencies that affect the same significant class of transactions, account balance, or disclosure; relevant assertion; or component of ICFR also may collectively result in a significant deficiency.

.A95 A compensating control can limit the severity of a deficiency in ICFR and prevent it from being a material weakness. Only compensating controls that operate at a level of precision that would prevent, or detect and correct, a material misstatement are capable of having a mitigating effect. Although compensating controls can mitigate the effects of a deficiency in ICFR, they do not eliminate the deficiency.

.A96 Indicators of material weaknesses in ICFR include

- identification of fraud, whether or not material, on the part of senior management. For the purpose of this indicator, the term *senior management* includes the principal executive and financial officers as well as any other members of senior management who play a significant role in the entity's financial reporting process;
- restatement of previously issued financial statements to reflect the correction of a material misstatement due to fraud or error;
- identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's ICFR; and
- ineffective oversight of the entity's financial reporting and ICFR by those charged with governance.

Determination of Whether Significant Deficiencies Exist During the Integrated Audit (Ref: par. .47)

.A97 Paragraphs .A88–.A95 provide guidance related to evaluating the severity of identified deficiencies in ICFR. Paragraph .A96 provides indicators of material weaknesses.

.A98 The evaluation of the severity of each deficiency in ICFR to determine whether the deficiency, individually or in combination, is a significant deficiency is made for purposes of communicating in writing to management and those charged with governance significant deficiencies identified during the integrated audit. See paragraphs .59–.63 for the communication requirements.

Subsequent Events (Ref: par. .48–.51)

.A99 Section 560, *Subsequent Events and Subsequently Discovered Facts*, establishes requirements and provides guidance on subsequent events for a

financial statement audit that are adapted and applied, as necessary, to the audit of ICFR. The auditor is required by paragraph .57 to obtain certain written representations from management relating to subsequent events.

.A100 Refer to paragraph .80 when disclaiming an opinion on management's disclosures about corrective actions.

.A101 The evaluation of such subsequently discovered facts is similar to the evaluation of subsequently discovered facts in an audit of financial statements, as described in section 560.

Concluding Procedures (Ref: par. .52–.56)

.A102 If management does not revise its report, paragraph .72 applies. Paragraph .71 also applies if the auditor determines that management's required disclosure about one or more material weaknesses is not fairly presented in all material respects. If management refuses to furnish a report that includes management's assessment about ICFR, paragraph .74 applies.

Obtaining Written Representations (Ref: par. .57–.58)

.A103 See section 580, *Written Representations*, for additional requirements and guidance with respect to obtaining written representations from management as part of an audit of financial statements. Section 580 addresses matters such as who should sign the letter, the period to be covered by the letter, and when to obtain an updated letter.

.A104 Management's refusal to furnish written representations constitutes a limitation on the scope of the audit.

Communicating ICFR-Related Matters (Ref: par. .59–.63)

.A105 Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, does not apply to integrated audits.

.A106 Early communication to management or those charged with governance may be important for some matters because of their relative significance and the urgency of corrective follow-up action. Regardless of the timing of the written communication of significant deficiencies and material weaknesses, the auditor may communicate these orally in the first instance to management and, when appropriate, those charged with governance to assist them in taking timely remedial action to minimize the risks of material misstatement. However, oral communication does not relieve the auditor of the responsibility to communicate the significant deficiencies and material weaknesses in writing.

.A107 If a previously communicated significant deficiency or material weakness remains, the current year's communication may repeat the description from the previous communication or simply reference the previous communication and the date of that communication.

.A108 See section 230, *Audit Documentation*, for additional guidance related to the report release date.²³

.A109 The auditor's written communication for a governmental entity would generally not be made prior to management's report on ICFR, the entity's financial statements, and the auditor's report thereon, being made publicly available. This is in order to provide the user with the appropriate context

²³ Paragraph .A2 of section 230, *Audit Documentation*. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

to evaluate the significant deficiencies or material weaknesses identified during the integrated audit that are contained in the written communication.

.A110 The auditor is not required to perform procedures that are sufficient to identify all deficiencies; rather, the auditor need only communicate deficiencies of which the auditor is aware.

.A111 Unlike in an audit of financial statements that is not integrated with an audit of ICFR, the auditor is required to communicate in writing deficiencies that do not rise to the level of significant deficiencies or material weaknesses. This is because identifying deficiencies in ICFR is the focus of an audit of ICFR, whereas identifying deficiencies is incidental to an audit of financial statements (that is not integrated with an audit of ICFR), which is focused on identifying misstatements of the financial statements.

.A112 Because the auditor's written communication of deficiencies identified during the integrated audit forms part of the final audit file, the written communication is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis, no later than 60 days following the report release date.²⁴

Reporting on ICFR (Ref: par. .64–.65)

Considerations Specific to Governmental Entities

.A113 When the audit is also conducted in accordance with *Government Auditing Standards* (also known as the Yellow Book), the auditor may state that the audit was conducted in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. If significant deficiencies in ICFR are identified in such an audit and the auditor's report refers to *Government Auditing Standards*, those standards require the auditor to report such deficiencies as findings. The following is an illustration of that communication through the addition of other-matter paragraphs to the auditor's report:

In accordance with *Government Auditing Standards*, we are required to report findings of significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies in ABC Company's internal control described below [or in the accompanying schedule of findings] to be significant deficiencies.

Government Auditing Standards require the auditor to perform limited procedures on ABC Company's response, described below [or in the accompanying schedule of findings], to the findings identified in our audit of internal control over financial reporting. ABC Company's response was not subjected to the other auditing procedures applied in the audit of internal control over financial reporting and, accordingly, we express no opinion on the response.

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

[.A114] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

²⁴ Paragraph .16 of section 230. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

.A115 The auditor may choose to issue a combined report (that is, one report containing both an opinion on the financial statements and an opinion on ICFR) or separate reports on the entity's financial statements and on ICFR.

.A116 If the auditor issues a separate report on ICFR and expresses an adverse opinion on ICFR, the disclosure required by paragraph .69 related to the effect of the adverse opinion on ICFR on the auditor's opinion on the financial statements may be combined with the report language described in paragraph .65.

.A117 Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.²⁵ When an engagement quality control review is performed, section 220A requires that the auditor's report not be released prior to the completion of the engagement quality control review.²⁶ [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

Report Modifications (Ref: par. .67)

.A118 A *limitation on the scope of the audit* refers to the auditor's inability to obtain sufficient appropriate audit evidence, which may arise from the following:

- Circumstances beyond the entity's control
- Circumstances relating to the nature or timing of the auditor's work
- Limitations imposed by management

[Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Adverse Opinions (Ref: par. .68–.71)

.A119 Paragraphs .44–.47 describe the evaluation of deficiencies. See paragraphs .73–.77 when the scope of the engagement has been limited. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A120 Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, establishes requirements and provides guidance on adverse opinions for a financial statement audit that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A, "Illustrative Reports," of this section includes an illustration of the application of the reporting requirements in section 705.²⁷ [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A121 As described in paragraph .A116, if the auditor issues a separate report on ICFR in this circumstance, the disclosure required by paragraph .69 may be combined with the report language described in paragraph .65. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

²⁵ See paragraph .19 of section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

²⁶ Paragraph .21 of section 220A. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

²⁷ Illustration 2, "Adverse Opinion on ICFR," of exhibit A, "Illustrative Reports." [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

.A122 The auditor's report need only refer to the "material weaknesses described in management's report" and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report, as described in paragraph .71. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Scope Limitations (Ref: par. .73–.77)

.A123 The auditor may be separately engaged to audit only the financial statements after withdrawing from the integrated audit. In such circumstances, the auditor cannot disregard knowledge obtained in the integrated audit engagement in determining whether to accept, or in performing, the financial statement audit. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A124 Section 705 establishes requirements and provides guidance on disclaimers of opinion for a financial statement audit that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in section 705.²⁸ [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A125 In an audit of ICFR, the auditor is not required to perform any additional work prior to issuing a disclaimer when the auditor concludes that the auditor will not be able to obtain sufficient appropriate audit evidence to express an opinion. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A126 The auditor's report need only refer to the "material weaknesses described in management's report" and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Making Reference to a Component Auditor and Assuming Responsibility for the Work of a Component Auditor (Ref: par. .78–.79)

.A127 Section 600 addresses special considerations that apply to group audits, in particular those that involve component auditors. Section 600 is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to multiple components discussed beginning in paragraphs .28 and .81. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A128 The group engagement partner may decide to assume responsibility for the work of the component auditor or to make reference to the component auditor in the report on the ICFR over the group financial statements. The decision about whether to make reference to a component auditor in the report on the audit of ICFR might differ from the corresponding decision as it relates to the audit of the financial statements. For example, the audit report on the group financial statements may make reference to the audit of a significant equity investment performed by a component auditor, but the report on the ICFR over the group financial statements might not make a similar reference because management's assessment about ICFR ordinarily would not extend to controls at the equity method investee. See paragraph .84 for further discussion of the evaluation of the controls for an equity method investment. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

²⁸ Illustration 3, "Disclaimer of Opinion on ICFR," of exhibit A. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

.A129 Section 600 establishes requirements and provides guidance when assuming responsibility for the work of a component auditor and when making reference to a component auditor in the auditor's report on the financial statements that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in section 600.²⁹ [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Additional Information (Ref: par. .80)

.A130 The additional information as discussed in paragraph .80 typically relates to circumstances in which management includes a description of a response to an identified material weakness, including plans to remediate but is not limited to those matters. The following is an example of wording used to disclaim an opinion on such additional information.³⁰

Other Matter

We did not perform auditing procedures on [*describe additional information, such as management's cost-benefit statement*], and accordingly, we do not express an opinion or provide any assurance on it.

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021.]

.A131 An entity may publish various documents that contain information in addition to management's report and the auditor's report on ICFR. Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, as well as section 720, may require the auditor to take additional action. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Special Topics

Entities With Multiple Components (Ref: par. .81–.83)

.A132 As indicated in paragraph .A127 of this section, section 600 is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to components discussed in this section. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A133 In determining the components at which to perform tests of controls, the group engagement team may also take into account work performed by the internal audit function or others on behalf of management. For example, if the internal audit function's planned procedures include relevant audit work at various components, the auditor may coordinate work with the internal auditors and reduce the number of components at which the group engagement team, or a component auditor on the group engagement team's behalf, would otherwise need to perform audit procedures. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A134 The group engagement team may eliminate from further consideration components that, individually or when aggregated with others, do not

²⁹ Illustration 4, "Unmodified Opinion on ICFR Making Reference to a Component Auditor," of exhibit A. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

³⁰ The requirements in section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, would also apply if the information and related auditor's reports are included in an entity's annual report. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

present a reasonable possibility of material misstatement to the group financial statements. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A135 In lower risk components, the group engagement team first might evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides sufficient appropriate audit evidence. The group engagement team or a component auditor on the group engagement team's behalf may test the operating effectiveness of controls over specific risks or group-wide controls. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Special Situations (Ref: par. .84–.87)

.A136 The audit of ICFR ordinarily would not extend to controls at the equity method investee. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A137 The auditor may conclude it is appropriate for management to limit the assessment by excluding certain entities when, for example, management has insufficient time to assess the controls at the as of date for a recently acquired business or does not have sufficient access to a consolidated variable interest entity. However, in the case of an acquired entity, it would not be appropriate for management to limit its assessment if the period of such limitation extends beyond one year from the date of acquisition, nor would it be appropriate for management's assessment to be limited for more than one annual management report on ICFR. Law or regulation may specifically address situations in which it is appropriate for management to limit its assessment by excluding certain entities and also may require specific disclosures in these cases. If, in the auditor's judgment, it is appropriate for management to limit its assessment by excluding certain entities, the auditor may limit the audit of ICFR in the same manner, and the auditor's opinion would not be affected by a scope limitation. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

Use of Service Organizations (Ref: par. .88–.96)

.A138 Section 402 contains the requirements and application guidance for auditors of the financial statements of entities that use a service organization (user auditors). Section 402 addresses an auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of an entity that uses one or more service organizations (a user entity). Refer to section 402 for guidance when the service organization uses a subservice organization.³¹

.A139 Section 402 identifies the situations in which a service organization's services and controls over them are part of a user entity's information system.³² If the service organization's services are part of the user entity's information system, as described therein, then they are part of the user entity's ICFR.

.A140 Evidence that the controls that are relevant to the auditor's opinion on ICFR are operating effectively may be obtained by following the procedures

³¹ Paragraph .A20 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

³² Paragraph .03 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

described in section 402.³³ These procedures include one or more of the following:

- a. Obtaining and reading a service auditor's report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls, which includes a description of the service auditor's tests of controls and results (a type 2 report), if available
- b. Performing appropriate tests of controls at the service organization
- c. Using another auditor to perform tests of controls at the service organization on behalf of the auditor

.A141 A report on management's description of a service organization's system and the suitability of the design of controls (a type 1 report) does not include a description of the service auditor's tests of controls and results of those tests or the service auditor's opinion on the operating effectiveness of controls and, therefore, does not provide evidence of the operating effectiveness of controls. Type 1 and type 2 reports are described in section 402.

.A142 These factors are similar to factors the auditor would consider in determining whether the report provides sufficient appropriate audit evidence to support the auditor's assessed level of control risk in an audit of the financial statements, as described in section 402.³⁴

.A143 Section 402 defines *complementary user entity controls* as those controls that management of the service organization assumes, in the design of its service, will be implemented by user entities, and, if necessary to achieve the control objectives stated in management's description of the service organization's system, are identified as such in that description.

.A144 Appropriate sources of information concerning the service auditor's professional competence and independence are discussed in section 402.³⁵

.A145 Standards promulgated by a body designated by Council, pursuant to the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, are presumed to be adequate. Although the International Auditing and Assurance Standards Board (IAASB) is not such a body, AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*, may be helpful when the service auditor's report is issued in accordance with International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*, promulgated by the IAASB.^[36] [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.A146 Changes in the service organization's controls may include

- changes communicated to management from the service organization, including those related to the service organization's processes and information systems.

³³ Paragraphs .16–.17 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

³⁴ Paragraphs .A32–.A39 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

³⁵ Paragraphs .A21–.A22 of section 402. [Footnote renumbered by the issuance of SAS No. 140, April 2020.]

^[36] [Footnote deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

- changes in personnel at the service organization with whom management interacts.
- changes in the design or implementation of controls that were necessary to achieve the control objectives.
- changes in reports or other data received from the service organization.
- changes in contracts or service level agreements with the service organization.
- errors identified in the service organization's processing or incidents of noncompliance with laws and regulations or fraud.

.A147 As risk increases, the need for the auditor to obtain additional evidence increases. If the auditor concludes that additional evidence about the operating effectiveness of controls at the service organization is required, the auditor's additional procedures might include

- evaluating procedures performed by management and the results of those procedures.
- contacting the service organization, through the user entity, to obtain specific information.
- requesting that a service auditor be engaged to perform procedures that will supply the necessary information.
- visiting the service organization and performing such procedures.

Benchmarking of Automated Controls (Ref: par. .97–.99)

.A148 Entirely automated application controls are generally less susceptible to breakdowns due to human failure. This feature may allow the auditor to use a benchmarking strategy. *Benchmarking* is the process of testing an automated application control to establish a baseline that can be combined with effective IT general controls to allow the auditor to conclude that the automated application controls are effective without repeating the specific tests of operating effectiveness.

.A149 When the risk factors assessed in determining a benchmarking strategy indicate lower risk, the control being evaluated might be well-suited for benchmarking. When these factors indicate increased risk, the control being evaluated is less suited for benchmarking.

.A150 A report of the compilation dates of the programs placed in operation may be used as evidence that controls within the program have not changed.

.A151 Benchmarking automated application controls can be especially effective for entities using purchased software when the possibility of program changes is remote (for example, when the vendor does not allow access or modification to the source code).

.A152 If general controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor determines that the automated application control has not changed since the auditor established a baseline (that is, last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year's specific tests of the operation of the automated application control. The nature and extent of the evidence that the auditor obtains to determine that the control has not changed may vary

depending on the circumstances, including the strength of the entity's program change controls.

.A153 The consistent and effective functioning of the automated application controls may be dependent upon the related files, tables, data, and parameters. For example, an automated application for calculating interest income might be dependent on the continued integrity of a rate table used by the automated calculation.

.A154 A control may be sensitive to other business factors that may have changed. For example, an automated control may have been designed with the assumption that only positive amounts will exist in a file. Such a control would no longer be effective if negative amounts (credits) begin to be posted to the account.

.A155

Exhibit A — Illustrative Reports

The following illustrate the report elements described in this section. The illustrations assume that the audit of internal control over financial reporting (ICFR) and the audit of the financial statements were performed by the same auditor. Report modifications are discussed beginning in paragraph .67 of this section.

Illustration 1 — Unmodified Opinion on ICFR

Illustration 2 — Adverse Opinion on ICFR

Illustration 3 — Disclaimer of Opinion on ICFR

Illustration 4 — Unmodified Opinion on ICFR Making Reference to a Component Auditor

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

Illustration 1 — Unmodified Opinion on ICFR

The following is an illustrative report expressing an unmodified opinion on ICFR.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² In our opinion, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion].

Basis for Opinion

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [title of management's report].

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — Adverse Opinion on ICFR

The following is an illustrative report expressing an adverse opinion on ICFR. In this example, the opinion on the financial statements is not affected by the adverse opinion on ICFR.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Adverse Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² In our opinion, because of the effect of the material weakness described in the Basis for Adverse Opinion section on the achievement of the objectives of [identify criteria], ABC Company has not maintained effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion].

We considered the material weakness described in the Basis for Adverse Opinion on Internal Control Over Financial Reporting section in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements

Basis for Adverse Opinion on Internal Control Over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. The following material weakness has been identified and included in the accompanying [title of management's report].

[Identify the material weakness described in management's report].³

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

³ See paragraphs .68–.71 of this section for specific reporting requirements. The auditor's report need only refer to the material weaknesses described in management's report and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report.

to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [title of management's report].

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 3 — Disclaimer of Opinion on ICFR

The following is an illustrative report expressing a disclaimer of opinion on ICFR. In this example, the auditor is applying paragraph .76 of this section because a material weakness was identified during the limited procedures performed by the auditor.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Disclaimer of Opinion on Internal Control Over Financial Reporting

We were engaged to audit ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² Because of the significance of the matter described in the Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting section, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the effectiveness of ABC Company's internal control over financial reporting.

We have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion].

We considered the material weakness described in the [include section title of where the material weakness information is included in the report]³ section in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.

Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting

[Provide description of the matter giving rise to the disclaimer of opinion]

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting included in the accompanying [title of management's report].

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

³ In this illustration, the material weakness information is included in a separate section with the title "Material Weakness." [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021.]

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our responsibility is to conduct an audit of ABC Company's internal control over financial reporting in accordance with GAAS. However, because of the matter described in the Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting section, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Material Weakness⁴

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. If one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective. The following material weakness has been included in the accompanying [title of management's report].

[Identify the material weakness described in management's report and include a description of the material weakness, including its nature and actual and potential effect on the presentation of the entity's financial statements issued during the existence of the material weakness.]

⁴ Paragraph .76 does not specify the placement of this information. The sample in the illustrative auditor's report includes the information in a separate section with the title "Material Weakness;" however, auditors have discretion to present this information in the part of the report they consider appropriate. [Footnote added, effective for audits of financial statements for periods ending on or after December 15, 2021.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 4 — Unmodified Opinion on ICFR Making Reference to a Component Auditor

The following is an illustrative report expressing an unmodified opinion on ICFR when the engagement partner decides to make reference to the report of a component auditor.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² In our opinion, based on our audit and the report of the other auditors, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].

We did not audit the effectiveness of internal control over financial reporting of B Company, a wholly owned subsidiary, whose financial statements reflect total assets and revenues constituting 20 percent and 30 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 20XX. The effectiveness of B Company's internal control over financial reporting was audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the effectiveness of B Company's internal control over financial reporting, is based solely on the report of the other auditors.

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion], based on our audit and the report of the other auditors.

Basis for Opinion

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Audit of Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting included in the accompanying [title of management's report].

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

The following is an illustrative combined report expressing an unmodified opinion on ICFR and an unmodified opinion on the financial statements. The circumstances include the following:

- An audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210A, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements and Internal Control¹

Opinions on the Financial Statements and Internal Control Over Financial Reporting

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20XX, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

¹ The subtitle "Report on the Financial Statements and Internal Control" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We also have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on *[identify criteria]*.² In our opinion, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on *[identify criteria]*.

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audits of the Financial Statements and Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying *[title of management's report]*.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audits of the Financial Statements and Internal Control Over Financial Reporting

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

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

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

In performing an audit of financial statements and an audit of internal control over financial reporting in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audits
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the statement audit in order to design audit procedures that are appropriate in the circumstances.
- Obtain an understanding of internal control over financial reporting relevant to the audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the financial statement audit.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

.A156

Exhibit B — Illustrative Written Communication of Significant Deficiencies and Material Weaknesses

The following is an illustrative written communication of significant deficiencies and material weaknesses.

To Management and *[identify the body or individuals charged with governance, such as the entity's board of directors]* of ABC Company:

In connection with our audit of ABC Company's (the Company) financial statements as of December 31, 20XX, and for the year then ended, and our audit of the Company's internal control over financial reporting as of December 31, 20XX (integrated audit), auditing standards generally accepted in the United States of America require that we advise you of the following matters relating to internal control over financial reporting (internal control) identified during our integrated audit.

Our responsibility is to plan and perform our integrated audit to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to fraud or error, and whether effective internal control was maintained in all material respects (that is, whether material weaknesses exist as of the date specified in management's assessment). The integrated audit is not designed to detect deficiencies that, individually or in combination, are less severe than a material weakness.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. *[We consider the following deficiencies in the Company's internal control to be material weaknesses:*

[Describe the material weaknesses that were identified during the integrated audit and provide an explanation of their potential effects. The auditor may separately identify those material weaknesses that exist as of the date specified in management's assessment about ICFR by referring to the auditor's report.]

[A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Company's internal control over financial reporting to be significant deficiencies:]

[Describe the significant deficiencies that were identified during the integrated audit and provide an explanation of their potential effects.]

This communication is intended solely for the information and use of management, *[identify the body or individuals charged with governance]*, others within the organization, and *[identify any governmental authorities to which the*

auditor is required to report] and is not intended to be and should not be used by anyone other than these specified parties.¹

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date*]

[Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

¹ When the engagement is also performed in accordance with *Government Auditing Standards*, see paragraph .11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, for alternative reporting requirements.

.A157

Exhibit C — Illustrative Management Report

The following is an illustrative management report containing the reporting elements described in paragraph .55 of this section with no material weaknesses reported.

Management's Report on Internal Control Over Financial Reporting

ABC Company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management of ABC Company is responsible for designing, implementing, and maintaining effective internal control over financial reporting. Management assessed the effectiveness of ABC Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].¹ Based on that assessment, management concluded that, as of December 31, 20XX, ABC Company's internal control over financial reporting is effective, based on [*identify criteria*].

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

ABC Company
Report signers, if applicable
Date

[Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

¹ For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

.A158

Exhibit D — Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act

1. The Federal Deposit Insurance Corporation (FDIC) has provided guidance on the meaning of the term *financial reporting* for purposes of compliance by insured depository institutions (IDIs) with Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (Section 36 of the Federal Deposit Insurance Act [FDI Act], 12.U.S.C. 1831m), and its implementing regulation, 12 CFR Part 363. The FDIC's guidance indicates that financial reporting, at a minimum, includes both financial statements prepared in accordance with generally accepted accounting principles (GAAP) for the IDI (or its holding company) and financial statements prepared for regulatory reporting purposes. Financial statements prepared for regulatory reporting purposes include the schedules equivalent to the GAAP-based financial statements that are included in an IDI's (or its holding company's) appropriate regulatory report (for example, Schedules RC, RI, and RI-A in the Consolidated Reports of Condition and Income [Call Report]). Accordingly, to comply with the FDICIA and Part 363, management of the IDI (or its holding company) and the auditor are required to identify and test controls over the preparation of GAAP-based financial statements as well as the schedules equivalent to the GAAP-based financial statements that are included in the IDI's (or its holding company's) appropriate regulatory report. Further, both management and the auditor are required to include in their report on the IDI's (or its holding company's) internal control over financial reporting (ICFR) a specific description indicating that the scope of ICFR included controls over the preparation of the IDI's (or its holding company's) GAAP-based financial statements as well as the schedules equivalent to the GAAP-based financial statements that are included in the IDI's (or its holding company's) appropriate regulatory report.¹

Definition of ICFR for FDICIA Purposes

2. In accordance with paragraph .64g of this section, the auditor's report is required to include a definition of ICFR that uses the same description of ICFR that management uses in its report. The following is an illustrative definition paragraph that may be used when an IDI that is an insured bank (which is not subject to Section 404 of the Sarbanes-Oxley Act of 2002) elects to report on controls for FDICIA purposes at the bank holding company level:

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of [Holding Company's] internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding

¹ Refer to Section 36 of the Federal Deposit Insurance Act (FDI Act), Section 363.1: Scope and Definitions, for the requirements pertaining to compliance by subsidiaries of holding companies.

Companies (Form FR Y-9C).² An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Requirements When the IDI Is Required to Report on ICFR at the IDI Level

3. This paragraph and the following paragraphs are applicable and provide guidance when an IDI is required by 12 CFR Part 363 to report on ICFR at the IDI level. An IDI that is a subsidiary of a holding company may use the consolidated holding company's financial statements (group financial statements) to satisfy the audited financial statements requirement of 12 CFR Part 363, provided certain criteria are met.³ For some IDIs, however, an audit of ICFR is required at the IDI level. An audit of ICFR is required to be integrated with an audit of financial statements. Accordingly, to comply with the integrated audit requirements in this section, when the IDI elects to use the holding company's group financial statements to satisfy the audited financial statements requirement of 12 CFR Part 363 and the audit of ICFR is required to be performed at the IDI level, the auditor would be required to perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion on the IDI's financial statements and on its ICFR. When the IDI does not prepare financial statements at the IDI level for external distribution, "financial statements" for this purpose may consist of the IDI's financial information in a reporting package or equivalent schedules and analyses that include the IDI information necessary for the preparation of the holding company's group financial statements, including disclosures. The measurement of materiality is determined based on the IDI's financial information rather than the holding company's group financial statements.⁴ If the auditor is unable to apply the procedures necessary to obtain sufficient appropriate audit evidence with respect to the IDI's financial information, the auditor is required by paragraph .73 of this section to withdraw from the engagement or disclaim an opinion on the effectiveness of ICFR at the IDI level.

Evaluation of IDI Financial Reporting Process

4. As previously described, the FDIC indicated that financial reporting, at a minimum, includes both financial statements prepared in accordance with generally accepted accounting principles (GAAP) for the IDI (or its holding company) and financial statements prepared for regulatory purposes. Financial statements prepared for regulatory reporting purposes include the schedules equivalent to the GAAP-based financial statements that are included in

² This sentence would be modified if the insured depository institution (IDI) reports at the institution level rather than at the bank holding company level to refer to the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income instead of to the Form FR Y-9C. This sentence would also be modified if the IDI reports at a holding company level and employs another approach to reporting on controls over the preparation of regulatory reports as permitted by Section 36 of the FDI Act.

³ See footnote 1.

⁴ See paragraph .10 of section 320, *Materiality in Planning and Performing an Audit*.

an IDI's (or its holding company's) appropriate regulatory report. When the IDI does not prepare financial statements for external distribution, the auditor is, nevertheless, required by paragraph .24 of this section to evaluate the IDI's period-end financial reporting process. This process includes, among other things, the IDI's procedures for preparing financial information for purposes of the holding company's group financial statements, which are prepared in accordance with GAAP, and the schedules equivalent to the GAAP-based financial statements that are included in the IDI's appropriate regulatory report.

Organization Structure

5. The period-end financial reporting process may occur either at the IDI or the holding company, or both. The organizational structure, including where the controls relevant to the IDI's financial information operate, may affect how the auditor evaluates this process. For example

- a. when the period-end financial reporting process occurs at the holding company and the IDI comprises substantially all of the consolidated total assets, there may be no distinguishable difference between the IDI's and its holding company's process for purposes of the integrated audit. This is because the auditor's risk assessment, including the determination of significant classes of transactions, account balances, and disclosures, and their relevant assertions, the selection of controls to test, and the determination of the evidence necessary to conclude on the effectiveness of a given control, would likely be the same for the IDI and the holding company.⁵ In this circumstance, the period-end financial reporting process of the holding company would be, in effect, the period-end financial reporting process of the IDI and, therefore, would be included in the scope of the integrated audit of the IDI.
- b. when the period-end financial reporting process occurs at the holding company and the IDI does not comprise substantially all of the consolidated total assets, the IDI's financial reporting process may be sufficient for the auditor to meet the requirement in paragraph .24 of this section, if the necessary GAAP information is prepared by the IDI or the holding company, and the process can be evaluated by the auditor. The auditor may determine that the IDI's preparation of the IDI's appropriate regulatory report, together with other financial information at the IDI level that is incorporated into the holding company's group financial statements, is sufficient for this purpose. In this circumstance, both the period-end financial reporting process of the holding company, as it relates to the financial information of the IDI, and the period-end financial reporting process of the IDI, with respect to the preparation of the schedules equivalent to the basic financial statements that are included in the IDI's appropriate regulatory report, would be included in the scope of the integrated audit of the IDI.

IDI Not Subject to Section 404 of Sarbanes-Oxley Act of 2002

6. The illustrative reports in exhibit A, "Illustrative Reports," of this section may be used to report on the effectiveness of the IDI's ICFR. Because 12 CFR Part 363 does not require the auditor to issue a separate auditor's report on the IDI's financial statements, the requirement in paragraph .65 of this section to add a paragraph to the ICFR report that references the financial statement

⁵ See paragraph .A22 of this section.

audit will not apply when the auditor does not issue a separate auditor's report on the IDI's financial statements. In accordance with paragraph .64 of this section, the auditor's report on ICFR is required to include a definition of ICFR that uses the same description of ICFR as management uses in its report. The following is an illustrative definition paragraph that may be used when an IDI that is not subject to Section 404 of the Sarbanes-Oxley Act of 2002 is required to report on controls for FDICIA purposes at the IDI level, and the IDI uses the holding company's group financial statements to satisfy the audited financial statements requirement of 12 CFR Part 363:

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of [IDI's] internal control over financial reporting included controls over the preparation of financial information for purposes of [consolidated holding company's] financial statements in accordance with accounting principles generally accepted in the United States of America and controls over the preparation of schedules equivalent to basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (Call Report Instructions). An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Use of the *Internal Control — Integrated Framework* (2013) (COSO)

7. Management may evaluate and report on the effectiveness of the IDI's ICFR based on the report *Internal Control—Integrated Framework* (2013), issued by Committee of Sponsoring Organizations of the Treadway Commission's (COSO). For purposes of reporting under Section 112 of FDICIA, the COSO criteria relevant to internal reporting objectives are appropriate only for the IDI and its regulatory agencies that are presumed to have an adequate understanding of the level of the auditor's service on historical financial information, considering the IDI does not prepare external GAAP-based financial statements. Accordingly, the report is required to include an other-matter paragraph, under an appropriate heading, that restricts its use.⁶ An example of such a restriction is as follows:

***Restriction on Use*⁷**

This report is intended solely for the information and use of management, [identify the body or individuals charged with governance], others within the organization, the Federal Deposit Insurance Corporation and [other federal bank

⁶ See paragraphs .06a and .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. Although reports on internal control issued in accordance with the guidance in this appendix are required to be restricted as to use, Section 36 of the FDI Act and Title 12 U.S. Code of Federal Regulations Part 363 require that these reports be available for public inspection.

⁷ Another appropriate heading may be used.

regulatory agency] and is not intended to be and should not be used by anyone other than these specified parties.

8. Likewise, the auditor's report and management's assessment about ICFR refer to the COSO criteria relevant to internal reporting objectives. For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) relevant to internal reporting objectives for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA)."

[Paragraph renumbered and amended, effective for audits of financial statements for periods ending on or after December 15, 2021, by SAS No. 140.]

AU-C Section 945

Auditor Involvement With Exempt Offering Documents

Source: SAS No. 133; SAS No. 137.

Effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibilities when both of the following conditions exist:

- a. The auditor's report on financial statements or the auditor's review report on interim financial information of an entity is included or incorporated by reference in an offering document relating to either of the following:
 - i. Securities, when either the transaction or the securities themselves are exempt from registration under the Securities Act of 1933, as amended (Securities Act of 1933)
 - ii. Franchise offerings regulated by the Federal Trade Commission (FTC) or applicable state franchise laws

Hereafter, such security and franchise offerings are referred to as "exempt offerings" for purposes of this section.

- b. The auditor performs one or more of the activities in paragraph .08b with respect to the exempt offering document.

In such situations, the auditor is deemed to be involved with the exempt offering document. (Ref: par. .A1–.A3)

.02 Exempt offerings are made pursuant to federal or state securities laws and regulations or pursuant to federal or state franchise laws and regulations, including, in each case, the antifraud provisions thereof.¹ Exempt offerings include, but are not limited to, the following:

- Securities transactions that are exempt from the registration requirements of Section 5 of the Securities Act of 1933, such as private placement offerings, exempt public offerings, and municipal securities offerings
- Offerings of securities issued or backed by governmental, municipal, banking, tax-exempt, or other entities that are exempt from registration under the Securities Act of 1933
- Franchise offerings

¹ Exhibit A, "Examples of Exempt Offerings," provides examples of types of offerings within the scope of this section.

Effective Date

.03 This section is effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018. (Ref: par. .A4)

Objectives

.04 The objectives of the auditor when involved with an exempt offering document are to perform procedures specified in this section and respond appropriately as follows:

- a. When the auditor determines that information included or incorporated by reference in the exempt offering document could undermine the credibility of the financial statements and the auditor's report thereon
- b. To facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report

Definitions

.05 For purposes of this section, the following terms have the meanings attributed as follows:

Exempt offering document. The disclosure document that provides financial and nonfinancial information related to the entity issuing the exempt offering (or in the case of a franchise offering, the franchisor) and the offering itself. (Ref: par. .A5)

Security. *Security* has the meaning as defined in Section 2(a)(1) of the Securities Act of 1933, as amended.

.06 References in this section to an auditor's report are to be read to encompass an auditor's report on financial statements² or an auditor's review report on interim financial information in accordance with section 930, *Interim Financial Information*.

.07 References in this section to an auditor's report that is included in an exempt offering document are to be read to also encompass an auditor's report that is incorporated by reference in an exempt offering document.

Requirements

Involvement

.08 The auditor is involved with an exempt offering document and should apply the requirements of this section in connection with an exempt offering document when both of the following conditions exist:

- a. The auditor's report is included in the exempt offering document.

² An auditor's report in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, or section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*.

- b. The auditor performs one or more of the following activities with respect to the exempt offering document: (Ref: par. .A6)
 - i. Assisting the entity in preparing information included in the exempt offering document (Ref: par. .A7–.A10)
 - ii. Reading a draft of the exempt offering document at the entity's request (Ref: par. .A11)
 - iii. Issuing a comfort or similar letter in accordance with section 920, *Letters for Underwriters and Certain Other Requesting Parties*, or an agreed-upon procedures report in accordance with AT-C section 215, *Agreed-Upon Procedures Engagements*, in lieu of a comfort or similar letter on information included in the exempt offering document (Ref: par. .A12–.A14)
 - iv. Participating in due diligence discussions with underwriters, placement agents, broker-dealers, or other financial intermediaries in connection with the exempt offering (Ref: par. .A15)
 - v. Issuing a practitioner's attestation report on information relating to the exempt offering (Ref: par. .A16–.A17)
 - vi. Providing written agreement for the use of the auditor's report in the exempt offering document (Ref: par. .A18–.A23)
 - vii. Updating an auditor's report for inclusion in the exempt offering document (Ref: par. .A24–.A25)

When the auditor is involved with an exempt offering document, the auditor should perform the procedures in paragraphs .09–.15 at or shortly before the date of distribution, circulation, or submission of the exempt offering document, and as appropriate upon any subsequent distribution, circulation, or submission of the exempt offering document. (Ref: par. .A26)

Other Information Included in the Exempt Offering Document

.09 When the auditor is involved with an exempt offering document, the auditor should perform the procedures described in paragraphs .15–.23 of section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, adapted as necessary, on the exempt offering document. When performing those procedures, the auditor should determine that the auditor's role is not described in the exempt offering document in a way that indicates that the auditor's responsibility is greater than the auditor intends. (Ref: par. .A27–.A31) [As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after December 15, 2021, by SAS No. 137.]

Subsequent Events and Subsequently Discovered Facts

.10 When the auditor is involved with an exempt offering document, the auditor should do the following:

- a. Perform procedures designed to identify events occurring between the date of the auditor's report and the date of the distribution, circulation, or submission of the exempt offering document that, had they been known to the auditor as of the date of the auditor's report, may have caused the auditor to revise the auditor's report (hereafter referred to as "subsequent events" for purposes of this section). Such procedures should include the following: (Ref: par. .A32–.A35)
 - i. Obtaining an understanding of any procedures that management may have performed to identify such events
 - ii. Inquiring of management and, when appropriate, those charged with governance about whether any such events have occurred that might affect the financial statements
 - iii. Reading minutes, if any, of the meetings of the entity's management and those charged with governance that have been held since the date of the auditor's report and inquiring about matters discussed at any such meetings for which minutes are not yet available
 - iv. Reading the entity's most recent subsequent interim financial statements, if any
- b. Obtain updated written representations from management about the following:
 - i. Whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified
 - ii. Whether any events have occurred subsequent to the date of the auditor's report that would require adjustment to, or disclosure in, the financial statements
 - iii. That management provided complete minutes of the meetings of the entity's management and those charged with governance, or summaries of actions of recent meetings for which minutes have not yet been prepared since previous representations were provided
 - iv. That management provided communications received from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices since previous representations were provided

.11 If a predecessor auditor's report on a prior period is included in the exempt offering document but the predecessor auditor did not audit the entity's separate financial statements for the most recent audited period for which the entity's audited financial statements are included in the exempt offering document, and the predecessor auditor is involved with the exempt offering then the predecessor auditor should perform the following procedures:

- a. Read the financial statements of the subsequent period to be presented on a comparative basis.
- b. Compare the prior period financial statements that the predecessor auditor reported on with the financial statements of the subsequent period to be presented on a comparative basis.
- c. Inquire of and request written representations from management of the former client, at or near the date of distribution, circulation, or submission of the exempt offering document about the following:

- i. Whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified
 - ii. Whether any events have occurred subsequent to the date of the latest prior period financial statements reported on by the predecessor auditor that, had they been known to the auditor as of the date of the auditor's report, may have caused the auditor to revise the auditor's report
- d. Obtain a representation letter from the successor auditor stating whether the successor auditor's audit revealed any matters that, in the successor auditor's opinion, might have a material effect on, or require disclosure in, the financial statements reported on by the predecessor auditor.

.12 When a predecessor auditor of an acquired entity is involved with an exempt offering document and the acquirer's audited financial statements included in the exempt offering document reflect a time period that includes the date of acquisition, the predecessor auditor may be unable to perform all of the procedures in paragraph .11 of this section. In such circumstances, the predecessor auditor should obtain written representations from management of the former client, and a representation letter from the successor auditor as described in paragraph .11c–d of this section.

.13 If the auditor identifies subsequent events that may require adjustment of, or disclosure in, the audited financial statements or reviewed interim financial information, the auditor should not agree to the inclusion of the auditor's report in the exempt offering document until the auditor's consideration of the subsequent events, including the effect on the auditor's report, has been satisfactorily evaluated in accordance with section 560, *Subsequent Events and Subsequently Discovered Facts*.³

.14 If the auditor becomes aware of subsequently discovered facts, the auditor should not agree to the inclusion of the auditor's report in the exempt offering document until the auditor's consideration of the subsequently discovered facts, including the effect on the auditor's report, has been satisfactorily evaluated in accordance with section 560.⁴

.15 If management does not revise the financial statements in circumstances in which the auditor believes they need to be revised, in addition to following the requirements in section 560, the auditor should not agree to the inclusion of the auditor's report in the exempt offering document.⁵

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 Securities offerings and franchise offerings may be offered by means other than a registered offering through exemptions to registration afforded under federal or state laws and regulations based on the size and nature of the offering or the issuing entity or franchisor, as applicable. Securities offered through means other than a registration statement under the Securities Act of 1933 and franchise offerings are within the scope of this section. Exhibit A,

³ Paragraph .11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

⁴ Paragraphs .15–.18 of section 560.

⁵ Paragraphs .17–.18 of section 560.

"Examples of Exempt Offerings," provides examples of types of offerings within the scope of this section. Section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, addresses the auditor's responsibilities when financial statements of a nonissuer are included or incorporated by reference in a registration statement under the Securities Act of 1933.

.A2 Auditors may include a provision in the terms of the engagement requiring the entity to obtain permission from the auditor before using the auditor's report in connection with an exempt offering document. The existence of such a provision in an engagement letter does not establish involvement unless the auditor performs one or more of the activities in paragraph .08b with respect to the exempt offering document. An example provision for an engagement letter may read as follows:

The Entity may wish to include our report on these financial statements in an exempt offering document. The Entity agrees that the aforementioned auditor's report, or reference to our Firm, will not be included in any such offering document without our prior permission or consent. Any agreement to perform work in connection with an exempt offering document, including an agreement to provide permission or consent, will be a separate engagement.

.A3 The auditor may include in the terms of the engagement a provision that any exempt offering document issued by the entity with which the auditor is not involved, other than as determined by paragraph .08, will clearly indicate the auditor is not involved with the contents of such offering document. An example disclosure related to an exempt offering document may read as follows:

[Name of Firm], our independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. [Name of Firm] also has not performed any procedures relating to this offering document.

Effective Date (Ref: par. .03)

.A4 Some exempt offerings have multiple stages, for example distribution of a preliminary offering document and a final offering document. For such exempt offerings, the effective date relates to the distribution, circulation, or submission of the initial exempt offering document on or after June 15, 2018. Other exempt offerings, such as franchise offerings, may be updated annually. For such exempt offerings, the effective date relates to the initial or updated exempt offering document distributed, circulated, or submitted on or after June 15, 2018.

Definitions (Ref: par. .05)

.A5 An exempt offering document may also be referred to as an offering statement, offering memorandum, offering circular, or a franchise disclosure document.

Involvement

Performance of Activities (Ref: par. .08b)

.A6 Auditors may become aware of an offering through a communication from an entity or through the receipt of a draft exempt offering document from an underwriter, placement agent, broker-dealer, or the entity. Awareness of an exempt offering by the auditor does not, by itself, constitute involvement.

Assisting in Preparing Information (Ref: par. .08bi)

.A7 Assistance in preparing information as described in paragraph .08bi is predicated upon the auditor being reasonably aware that the information will be included in a specific exempt offering document. For example, an auditor assisting the entity with the preparation of a schedule for the entity's internal purposes that the entity later includes in an exempt offering document would not be considered assisting the entity in preparing information as described in paragraph .08bi.

.A8 Information does not include the audited financial statements or interim financial information covered by the auditor's report. Further, information does not include required supplementary information, or other information that accompanied those financial statements that the auditor already considered during the audit of the financial statements or review of interim financial information.

.A9 Self-review, management participation, and advocacy threats to a covered member's compliance with the AICPA Code of Professional Conduct may exist when a member provides corporate finance consulting services to an entity.⁶ A member may assist the entity in drafting its exempt offering document or memorandum without impairing independence⁷ if the member complies with the AICPA Code of Professional Conduct.^{8, 9}

.A10 Providing written or oral comments to the entity on the exempt offering document is considered assisting the entity in preparing information included in the exempt offering document, regardless of whether the entity requested the auditor to read the document or the auditor did so voluntarily.

Reading a Draft of the Exempt Offering Document (Ref: par. .08bii)

.A11 Reading a draft of the exempt offering document encompasses situations in which the auditor reads the exempt offering document at the request of the entity even if the auditor does not ultimately provide written or oral comments.

Issuing a Comfort or Similar Letter or an Agreed-Upon Procedures Report in Accordance With AT-C Section 215 (Ref: par. .08biii)

.A12 Underwriting agreements between an entity and its underwriters may include a request for the entity's auditor to prepare and issue a comfort letter that will assist the underwriters with their due diligence in connection with the exempt offering. Comfort letters may also be requested by parties other than the underwriters. Section 920 addresses the auditor's responsibilities related to the issuance of comfort letters.

.A13 An auditor may issue a comfort letter that provides negative assurance to a requesting party (as defined in section 920) only if the requesting party provides the written opinion from external legal counsel or the required

⁶ The "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct.

⁷ The "Corporate Finance Consulting" interpretation (ET sec. 1.295.130.02f) of the "Nonattest Services" subtopic (ET sec. 1.295) under the "Independence Rule" of the AICPA Code of Professional Conduct.

⁸ The "General Requirements for Performing Nonattest Services" interpretation (ET sec. 1.295.040) of the "Nonattest Services" subtopic under the "Independence Rule."

⁹ The "Corporate Finance Consulting" interpretation (ET sec. 1.295.130.03) of the "Nonattest Services" subtopic under the "Independence Rule" also lists examples of types of corporate finance consulting services that would impair a member's independence in connection with an offering.

representation letter described in section 920.¹⁰ If the requesting party does not provide the required written opinion from external legal counsel or a representation letter, the auditor may issue a similar letter that does not provide negative assurance, but that instead includes certain statements required by section 920.¹¹

.A14 When a comfort letter is requested by a party other than a requesting party as defined in section 920, the auditor should not provide that party with a comfort letter or similar letter described in section 920.¹² Instead, the auditor may accept an engagement to perform agreed-upon procedures requested by that party in accordance with the attestation standards and may issue a practitioner's report.¹³

Participating in Due Diligence Discussions (Ref: par. .08biv)

.A15 As part of their due diligence process, underwriters and their counsel may ask to meet with the entity's auditors and discuss the specific exempt offering, either formally or informally.¹⁴ Such meetings are often referred to as oral due diligence meetings; however, other communication methods may be used. The discussion typically focuses on the audit engagement, the entity's financial statements, and the entity's system of internal control over financial reporting. Auditors use professional judgment in determining whether to participate in due diligence discussions if the underwriter has not provided the written opinion from external legal counsel or representation letter as described in section 920.¹⁵ If the auditor agrees to participate, auditors use professional judgment in determining which questions in an oral due diligence meeting can be addressed.

Issuing a Practitioner's Attestation Report on Information Relating to the Exempt Offering (Ref: par. .08bv)

.A16 During the offering process, management or other parties to the offering may engage a practitioner to perform an attestation engagement on information related to the offering. For example, in an exempt debt offering, management or its legal advisers may engage a practitioner to perform agreed-upon procedures on the entity's compliance with the revenue coverage requirements on outstanding debt securities or to recompute the calculation of escrow account requirements for an advance refunding of debt securities. If the practitioner engaged to perform the attestation engagement is the auditor whose report accompanies the financial statements included in the exempt offering document, the auditor is deemed to be involved with the exempt offering document. A practitioner's attestation report relating to an exempt offering need not be referred to or included in the exempt offering document to involve the auditor of the financial statements with the offering.

.A17 If the practitioner engaged to perform the attestation engagement is not the financial statement auditor, the practitioner engaged to perform the

¹⁰ Paragraphs .07, .11, and .A92 of section 920, *Letters for Underwriters and Certain Other Requesting Parties*.

¹¹ Paragraph .12 and example Q, "Letter to a Requesting Party That Has Not Provided the Legal Opinion or the Representation Letter Required by Paragraph .11," of exhibit B, "Examples of Comfort Letters," of section 920.

¹² Paragraph .13 of section 920.

¹³ AT-C section 215, *Agreed-Upon Procedures Engagements*.

¹⁴ The "Confidential Client Information Rule" (ET sec 1.700.001) of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client.

¹⁵ Paragraphs .07, .11, and .A92 of section 920.

attestation engagement is not deemed to be involved with the exempt offering document in the manner described in this section.

Providing Written Agreement for the Use of the Auditor's Report in the Exempt Offering Document (Ref: par. .08bvi)

.A18 For securities exempt from registration under the Securities Act of 1933, it may not be necessary for the auditor to provide any type of written agreement. If the auditor is asked to provide written agreement, the auditor may provide an inclusion letter indicating that the auditor agrees to the inclusion of the auditor's report in the exempt offering document.

.A19 An inclusion letter is a letter requested by and addressed to the entity that is signed and dated by the auditor indicating that the auditor agrees to the inclusion or incorporation by reference of the auditor's report in the exempt offering document.

.A20 For securities exempt from registration under the Securities Act of 1933, an inclusion letter may also be referred to as an *agree-to-include letter*, an *acknowledgement letter*, or an *awareness letter*. Note that *awareness letter* is defined in section 925 with a different meaning in that context.

.A21 The following example language may be used to indicate that the auditor agrees to inclusion of the auditor's report on financial statements in an exempt offering document:

Independent Auditor's Inclusion Letter

We agree to the inclusion [or incorporation by reference] in the [name of Offering Document] dated [insert issuance date of Offering Document] of our report, dated [insert date of auditor's report on the financial statements], on our audit of the financial statements of [name of Entity] as of December 31, 20X2 [and 20X1], and for the year[s] then ended.

.A22 For franchise offerings regulated by the FTC, certain states may require a *consent of accountant* which may also be referred to as an *acknowledgement letter*.

.A23 The following example language may be used to indicate the auditor's agreement to the inclusion of the auditor's report on financial statements in a franchise offering document:

Independent Auditor's Acknowledgment

We agree to the inclusion in the [name of Offering Document, for example the Franchise Disclosure Document] dated [issuance date of Offering Document] issued by [name of Franchisor] ("the Franchisor") of our report, dated [insert date of auditor's report on the financial statements], relating to the financial statements of the Franchisor as of December 31, 20X2 [and 20X1], and for the year[s] then ended.

Updating an Auditor's Report for Inclusion in the Exempt Offering Document (Ref: par. .08bvii)

.A24 Updating an auditor's report involves, for example, signing an updated auditor's report when the previously issued financial statements are corrected for an accounting error or reflect a retrospective application of a change in accounting principle.

.A25 The following examples would not constitute updating an auditor's report for purposes of paragraph .08bvii:

- Providing a copy of or re-signing a previously issued auditor's report
- Revising an originally issued auditor's report to eliminate references made by the auditor in the original report required by *Government Auditing Standards*
- Revising an originally issued report to eliminate references made by the auditor in the original report to supplementary information that the auditor reported on in relation to the basic financial statements

Distribution, Circulation, or Submission (Ref: par. .08)

.A26 As discussed in paragraph .A4, exempt offerings may have multiple stages. Thus, a single offering could involve multiple applications of this section. Requesting management to keep the auditor advised of the progress of the preparation of the exempt offering document proceedings through the final distribution, circulation, or submission of the final exempt offering document is important so that the auditor's consideration of events occurring after the date of the auditor's report up to the distribution, circulation, or submission of the final exempt offering document can be completed.

Other Information Included in the Exempt Offering Document (Ref: par. .09)

.A27 When revision of the other information in the exempt offering document is necessary due to a material misstatement that management refuses to correct, section 720 requires the auditor to communicate the matter with those charged with governance and request that the correction be made. If the other information is not corrected after communicating with those charged with governance, the auditor is required to take appropriate action in accordance with paragraph .21 of section 720. With regard to exempt offerings, actions may also include determining whether to withhold the auditor's agreement to include the auditor's report. In such cases, the auditor may consider it appropriate to obtain legal advice. [As amended, effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after December 15, 2021, by SAS No. 137.]

References to the Auditor as an "Expert"

.A28 The term *expert* has a specific statutory meaning under the Securities Act of 1933. Outside the Securities Act of 1933 context, the term *expert* is typically undefined. Accordingly, except as described in paragraph .A31 of this section, when an entity wishes to make reference to the auditor's role in connection with an exempt offering, the caption to that section of the document would generally be titled "Independent Auditors" (or something similar) rather than "Experts," with no reference to the auditor as an expert anywhere in the exempt offering document.

.A29 The following is an example of a typical description of the auditor's role when an entity wishes to make reference to the auditor in an exempt offering document:

Independent Auditors

The financial statements of [name of Entity] as of December 31, 20X2 [and 20X1], and for the year[s] then ended, included in this offering document, have

been audited by [name of Firm], independent auditors, as stated in their report appearing herein.

.A30 If the entity refuses to delete references to the auditor as an "expert," the auditor may consider whether to withhold permission to include the auditor's report in the exempt offering document, based on the auditor's professional judgment. In such circumstances, the auditor may consider it appropriate to obtain legal advice.

.A31 In situations in which the term *expert* is sufficiently defined the auditor may agree to be referred to as an expert outside the context of a registration statement filed under the Securities Act of 1933, as amended. For example, if the term *expert* is defined under applicable state law, the auditor may agree to be named as an expert in an exempt offering document in an intrastate offering. An understanding of any auditor liability provisions that may be included in the applicable federal or state statutes is an important consideration. In such circumstances, the auditor may consider it appropriate to obtain legal advice.

Subsequent Events and Subsequently Discovered Facts (Ref: par. .10–.15)

.A32 The general objective of the subsequent event procedures described in this section is to identify subsequent events or act upon any subsequently discovered facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report. After financial statements have been issued or are available to be issued, the accounting framework pursuant to which they were prepared may not require accounting for or disclosure of events occurring after that date. Financial statements included in an exempt offering document may have previously been issued; accordingly, the auditor's subsequent event procedures are performed to update the auditor's awareness of the existence of any events or facts that may cause revision to the financial statements, including disclosures, or the auditor's report thereon through the date of distribution, circulation, or submission of the exempt offering document.

.A33 When applying the procedures described in paragraphs .11–.15 of this section, the auditor may consider the application and other explanatory material in section 560.

.A34 An illustrative updating management representation letter is included in section 580, *Written Representations*.¹⁶

Considerations Specific to Governmental Entities

.A35 In determining the extent of subsequent event procedures to perform in connection with a governmental debt offering, and the related management representations to request as addressed in paragraph .10b of this section, the auditor may consider the structure of the government and which component units relate to the debt offering. A component unit not guaranteeing the repayment is ordinarily not a relevant entity to the users of the debt offering. Alternatively, if the debt is offered solely by a particular component unit, the scope of subsequent event procedures would likely be limited to the applicable

¹⁶ Exhibit C, "Illustrative Updating Management Representation Letter," of section 580, *Written Representations*.

component unit responsible for the repayment of the debt. However, if the full set of financial statements for the reporting entity were included in the exempt offering document, the scope of subsequent event procedures would likely also encompass the primary government.

.A36

Exhibit A—Examples of Exempt Offerings (Ref: par. .A1)

1. The Securities Act of 1933 provides for two broad types of exemptions to the requirement that securities be registered with the SEC under Section 5 of the 1933 Act: exempt securities (under Section 3 of the 1933 Act) and exempt transactions (generally under Sections 4 and 4A of the 1933 Act). With Section 3 exempt securities, the exemption lies with the nature of the security, and thus each transaction involving that security will itself be exempt. With Section 4 exempt transactions, however, the exemption is applicable only to a single transaction, and does not necessarily carry over to subsequent transactions. Each transaction involving that security must be analyzed to determine if it too is exempt from Section 5 registration requirements. The following list is not intended to be comprehensive. The exemptions listed are frequently subject to conditions and definitional limitations that are not summarized here.

Exempt Securities

2. Examples of exempt securities (subject to conditions and, in some cases, restrictive definitions) include the following:

- Securities issued or guaranteed by federal, state, and local governments, including most industrial development bonds (Section 3(a)(2))
- Any security issued or guaranteed by banks or employee benefit plans (Section 3(a)(2))
- Short-term commercial paper with a maturity of nine months or less (Section 3(a)(3))
- Securities issued by non-profit religious, educational or charitable organizations (Section 3(a)(4))
- Securities issued by savings and loans and farmer's cooperatives (Section 3(a)(5))
- Railroad equipment trusts (Section 3(a)(6))
- Certificates of receivers and trustees issued with court approval (Section 3(a)(7))
- Insurance policies and annuity contracts (Section 3(a)(8))
- Equity securities issued in connection with the acquisition by a bank holding company of a bank or savings association (Section 3(a)(12))
- Securities issued by certain church employee plans (Section 3(a)(13))
- Security futures products and standardized options (Section 3(a)(14))

Exempt Transactions

3. Examples of exempt transactions include the following:

- Transactions by any person other than an issuer, underwriter, or dealer (Section 4(a)(1))

- Transaction by an entity not involving any public offering (the "private placement" exemption), including offerings under Regulation D Rule 506 and Rule 144A (Section 4(a)(2))
- Transactions by a dealer, with certain exceptions (Section 4(a)(3))
- Brokers' transactions executed on customer orders (Section 4(a)(4))
- Offers or sales by an entity to accredited investors (under certain conditions) (Section 4(a)(5))
- Regulation CF transactions (crowdfunding) (Section 4(a)(6))
- Private resales of securities (Section 4(a)(7))
- Small issues of securities, including Regulation A offerings and offerings under Rules 504 and 505 of Regulation D (Section 3(b) and Section 3(c))
- Voluntary exchanges between an entity and security holders (Section 3a)(9))
- Judicially or administratively approved exchanges (Section 3a)(10))
- Intrastate offerings (Section 3(a)(11))

Other Common Exemptions

4. Examples of other common exemptions include these:

- Rule 701 exemptions for compensatory arrangements
- Regulation S (offshore offers and sales)

Franchise Offerings

5. Franchise offerings are regulated at the federal and state level. Federal regulation occurs through the FTC under the *Disclosure Requirements and Prohibitions Concerning Franchising* (the FTC rule). The FTC rule requires franchisors to provide a franchise disclosure document to each prospective buyer, but does not require franchise disclosure documents to be filed or registered with the FTC. At the state level, regulations vary widely. Some states have franchise statutes and regulations that are more stringent than the FTC requirements, and which may require a franchisor to file or register its offering with state franchise authorities.

AU-C Appendixes

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AU-C Appendix A

Historical Background

In 1917, the American Institute of Certified Public Accountants, then known as the American Institute of Accountants, at the request of the Federal Trade Commission, prepared "a memorandum on balance-sheet audits," which the Federal Trade Commission approved and transmitted to the Federal Reserve Board.

The Federal Reserve Board, after giving the memorandum its provisional endorsement, published it in the *Federal Reserve Bulletin* of April 1917; reprints were widely disseminated for the consideration of "banks, bankers, banking associations; merchants, manufacturers, and associations of manufacturers; auditors, accountants, and associations of accountants" in pamphlet form with the title of "Uniform Accounting: a Tentative Proposal Submitted by the Federal Reserve Board."

In 1918, it was reissued under the same sponsorship, with a new title "Approved Methods for the Preparation of Balance-Sheet Statements." There was practically no change from 1917 except that, as indicated by the respective titles and corresponding change in the preface, instead of the objective of "a uniform system of accounting to be adopted by manufacturing and merchandising concerns," the new objective was "the preparation of balance-sheet statements" for the same businesses.

In 1929, a special committee of the Institute undertook revision of the earlier pamphlet in the light of the experience of the past decade; again under the auspices of the Federal Reserve Board, the revised pamphlet was issued in 1929 as "Verification of Financial Statements."

The preface of the 1929 pamphlet spoke of its predecessors as having been criticized, on the one hand, by some accountants for being "more comprehensive than their conception of the so-called balance-sheet audit," and, on the other hand, by other accountants because "the procedure would not bring out all the desired information." This recognition of opposing views evidenced the growing realization of the impracticability of uniform procedures to fit the variety of situations encountered in practice. Of significance is the appearance in the opening paragraph of "General Instructions" in the 1929 publication of the statement:

The extent of the verification will be determined by the conditions in each concern. In some cases, the auditor may find it necessary to verify a substantial portion or all of the transactions recorded upon the books. In others, where the system of internal check is good, tests only may suffice. The responsibility for the extent of the work required must be assumed by the auditor.

Between 1932 and 1934, there was correspondence, dealing with both accounting and auditing matters, between the Institute's special committee on cooperation with stock exchanges and the committee on stock list of the New York Stock Exchange. The views expressed were an important development in the recognition of the position of accountancy in finance and business. The series of letters was published in 1934 under the title *Audits of Corporate Accounts*.

In 1936, a committee of the Institute prepared and published a further revision of the earlier pamphlets under the title of "Examination of Financial Statements by Independent Public Accountants." The Institute availed itself of the views of persons outside the ranks of the profession whose opinions would be helpful, but the authority behind and responsibility for the publication of the pamphlet rested wholly with the Institute as the authoritative representative of a profession that had by that time become well established in the business community.

In the 1936 revision, aside from the very briefly noted "Modifications of Program for Larger or Smaller Companies," the detailed procedures were restrictively stated to be an "outline of examination of financial statements of a small or moderate size company." Moreover, the nature and extent of such examinations were based on the purpose of the examination, the required detail to be reported on, the type of business, and, most important of all, the system of internal control; variations in the extent of the examination were specifically related to "the size of the organization and the personnel employed" and were said to be "essentially a matter of judgment which must be exercised by the accountant."

It is possible from the foregoing narrative to trace the development of the profession's view of an audit based on the experience of three decades. The succession of titles is illustrative. The earliest ambition for "uniform accounting" was quickly realized to be unattainable, and the same listed procedures were related instead to "balance-sheet statements." Then, with the gradually greater emphasis on periodic earnings, the earlier restrictive consideration of the balance sheet was superseded in the 1929 title, "Verification of Financial Statements," by according the income statement at least equal status. When in turn the 1936 revision was undertaken, there was a growing realization that, with the complexity of modern business and the need of the independent auditor to rely on testing, such a word as "verification" was not an accurate portrayal of the independent auditor's function. Accordingly, the bulletin of that year was stated to cover an "examination" of financial statements.

Statements on Auditing Procedure

The Committee on Auditing Procedure had its beginning on January 30, 1939, when the executive committee of the Institute authorized the appointment of a small committee "to examine into auditing procedure and other related questions in the light of recent public discussion."

On May 9 of that year, the report "Extensions of Auditing Procedure" of this special committee was adopted by the Council of the Institute and authority given for its publication and distribution, and in the same year the bylaws were amended to create a standing Committee on Auditing Procedure.

In 1941, the executive committee authorized the issuance to Institute members, in pamphlet form, of the Statements on Auditing Procedure, prepared by the Committee on Auditing Procedure, previously published only in *The Journal of Accountancy*.

The Statements on Auditing Procedure were designed to guide the independent auditor in the exercise of his judgment in the application of auditing procedures. In no sense were they intended to take the place of auditing textbooks; by their very nature textbooks must deal in a general way with the description of procedures and refinement of detail rather than the variety of circumstances encountered in practice that require the independent auditor to exercise his judgment.

Largely to meet this need, the Institute began the series of Statements on Auditing Procedure. The first of these presented the report of the original special committee, as modified and approved, at the Institute's annual meeting on September 19, 1939, and issued under the title of "Extensions of Auditing Procedure."

Statement No. 1 presented conclusions drawn from the experience and tradition of the profession which largely furnished the foundation for the Committee's present structural outline of auditing standards; the other Statements on Auditing Procedure appropriately fit into that structural outline.

The "Codification of Statements on Auditing Procedure" was issued by the Committee on Auditing Procedure in 1951 to consolidate the features of the first 24 pronouncements, which were of continuing usefulness.

When the SEC adopted the requirement that a representation on compliance with generally accepted auditing standards be included in the independent auditor's report on financial statements filed with the SEC, it became apparent that a pronouncement was needed to define these standards. Accordingly, the Committee on Auditing Procedure undertook a special study of auditing standards (as distinguished from auditing procedures) and submitted a report that was published in October 1947 under the title "Tentative Statement of Auditing Standards—Their Generally Accepted Significance and Scope." The recommendations of this brochure ceased to be tentative when, at the September 1948 meeting, the membership of the Institute approved the summarized statement of auditing standards.

In 1954 the tentative brochure was replaced by the booklet *Generally Accepted Auditing Standards—Their Significance and Scope*, which was issued as a special report of the Committee on Auditing Procedure. This pronouncement also gave recognition to the approval of Statement on Auditing Procedure No. 23 (Revised), *Clarification of Accountant's Report When Opinion Is Omitted* (1949) and the issuance of the codification (1951).

Statement on Auditing Procedure No. 33 was issued in 1963 as a consolidation of, and a replacement for, the following pronouncements of the Committee on Auditing Procedure: *Internal Control* (1949), *Generally Accepted Auditing Standards* (1954), *Codification of Statements on Auditing Procedure* (1951), and Statements on Auditing Procedure Nos. 25–32, which were issued between 1951 and 1963. Statement No. 33 was a codification of earlier committee pronouncements that the committee believed to be of continuing interest to the independent auditor.

Statements on Auditing Standards

After issuance of Statement on Auditing Procedure No. 33, 21 additional Statements on Auditing Procedure, Nos. 34–54, were issued by the Committee on Auditing Procedure. In November 1972, these pronouncements were codified in Statement on Auditing Standards (SAS) No. 1, *Codification of Auditing Standards and Procedures*. Also, in 1972, the name of the committee was changed to the Auditing Standards Executive Committee to recognize its role as the AICPA's senior technical committee charged with interpreting generally accepted auditing standards.

The Auditing Standards Executive Committee issued 22 additional statements through No. 23. These statements were incorporated in this publication, which provides a continuous codification of SASs.

Creation of the Auditing Standards Board

As a result of the recommendations of the Commission on Auditors' Responsibilities, an independent study group appointed by the AICPA, a special committee was formed to study the structure of the AICPA's auditing standard-setting activity. In May 1978, the AICPA Council adopted the recommendations of that committee to restructure the Committee. Accordingly, in October 1978 the Auditing Standards Board (ASB) was formed as the successor to prior senior technical committees on auditing matters. The ASB was given the following charge:

The AICPA Auditing Standards Board shall be responsible for the promulgation of auditing standards and procedures to be observed by members of the AICPA in accordance with the Institute's rules of conduct.

The board shall be alert to new opportunities for auditors to serve the public, both by the assumption of new responsibilities and by improved ways of meeting old ones, and shall as expeditiously as possible develop standards and procedures that will enable the auditor to assume those responsibilities.

Auditing standards and procedures promulgated by the board shall—

- a. Define the nature and extent of the auditor's responsibilities.
- b. Provide guidance to the auditor in carrying out his duties, enabling him to express an opinion on the reliability of the representations on which he is reporting.
- c. Make special provision, where appropriate, to meet the needs of small enterprises.
- d. Have regard to the costs which they impose on society in relation to the benefits reasonably expected to be derived from the audit function.

The Auditing Standards Board shall provide auditors with all possible guidance in the implementation of its pronouncements, by means of interpretations of its statements, by the issuance of guidelines, and by any other means available to it.

Changes Created by Sarbanes-Oxley Act of 2002

AICPA members who perform auditing and other related professional services have been required to comply with SASs promulgated by the AICPA ASB. These standards constitute what is known as generally accepted auditing standards (GAAS). Prior to Sarbanes-Oxley, the ASB's auditing standards have applied to audits of all entities.

However, as a result of the passage of the Sarbanes-Oxley Act of 2002 (the Act), the PCAOB was designated as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act. Public accounting firms auditing those entities are required to be registered with the PCAOB and to adhere to all PCAOB rules and standards in those audits. In 2003, the PCAOB adopted the then-existing Audit and Attest Standards as its interim auditing standards.

The preparation and issuance of audit reports for those entities not subject to the Act, as amended, (that is, those audits that are not within the PCAOB's jurisdiction) continue to be governed by GAAS promulgated by the ASB.

The Reconstituted ASB

In February 2004, the AICPA's Board of Directors unanimously recommended that the AICPA's Governing Council take the following action at its meeting in May 2004:

- Designate the PCAOB as a body with the authority to promulgate auditing and related attestation standards, quality control, ethics, independence, and other standards relating to the preparation and issuance of audit reports for entities as defined by the Act, as amended.
- Amend the ASB's current designation to recognize the ASB as a body with the authority to promulgate auditing, attestation, and quality control standards relating to the preparation and issuance of audit reports for entities not within the PCAOB's jurisdiction.

As a result of this action, the ASB was reconstituted and its jurisdiction amended by AICPA Council to recognize the ASB as a body with the authority to promulgate auditing, attestation and quality control standards relating to the preparation and issuance of audit and attestation reports for entities not within the PCAOB's jurisdiction.

U.S. Auditing Standards—AICPA (Clarified)

In October 2011, the ASB issued SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which was the culmination of a multi-year Clarity Project to clarify the SASs and converge them with the International Standards on Auditing. Beginning with SAS No. 122, all new SASs are now included in the section *U.S. Auditing Standards—AICPA (Clarified)*. SAS No. 122 is effective for audits of financial statements for periods ending on or after December 15, 2012. Refer to individual AU-C sections for specific effective date language.

AU-C Appendix B***Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards*****200–299 GENERAL PRINCIPLES AND RESPONSIBILITIES**

ISA 200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
ISA 210	Agreeing the Terms of Audit Engagements
ISA 220	Quality Control for an Audit of Financial Statements
ISA 230	Audit Documentation
ISA 240	The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements
ISA 250 (Revised)	Consideration of Laws and Regulations in an Audit of Financial Statements
ISA 260 (Revised)	Communication with Those Charged with Governance
ISA 265	Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

300–499 RISK ASSESSMENT AND RESPONSE TO ASSESSED RISKS

ISA 300	Planning an Audit of Financial Statements
ISA 315 (Revised)	Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment
ISA 320	Materiality in Planning and Performing an Audit
ISA 330	The Auditor's Responses to Assessed Risks
ISA 402	Audit Considerations Relating to an Entity Using a Service Organization
ISA 450	Evaluation of Misstatements Identified during the Audit

500–599 AUDIT EVIDENCE

ISA 500	Audit Evidence
ISA 501	Audit Evidence — Specific Considerations for Selected Items
ISA 505	External Confirmations
ISA 510	Initial Audit Engagements — Opening Balances
ISA 520	Analytical Procedures
ISA 530	Audit Sampling

(continued)

ISA 540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
ISA 550	Related Parties
ISA 560	Subsequent Events
ISA 570 (Revised)	Going Concern
ISA 580	Written Representations

600–699 USING THE WORK OF OTHERS

ISA 600	Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)
ISA 610 (Revised 2013)	Using the Work of Internal Auditors (Revised 2013)
ISA 620	Using the Work of an Auditor's Expert

700–799 AUDIT CONCLUSIONS AND REPORTING

ISA 700 (Revised)	Forming an Opinion and Reporting on Financial Statements
ISA 701	Communicating Key Audit Matters in the Independent Auditor's Report
ISA 705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report
ISA 706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
ISA 710	Comparative Information — Corresponding Figures and Comparative Financial Statements
ISA 720 (Revised)	The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements

800–899 SPECIALIZED AREAS

ISA 800 (Revised)	Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
ISA 805 (Revised)	Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
ISA 810 (Revised)	Engagements to Report on Summary Financial Statements

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between the Statements on Auditing Standards and International Standards on Auditing, and the rationales therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on, or reviewed by, the Auditing Standards Board.

Statements on Auditing Standards (SASs) are issued by the Auditing Standards Board (ASB), the senior committee of the AICPA designated to issue

pronouncements on auditing matters for nonissuers.¹ The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an audit of a nonissuer to comply with standards promulgated by the ASB.

The ASB has a strategic objective to converge its standards with those developed by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). Each SAS differs from its corresponding ISA only where the ASB believes compelling reasons exist for the differences. As described in this appendix, nearly all ISA requirements are also requirements of auditing standards generally accepted in the United States of America (GAAS). The ASB also has a strategic objective of minimizing unnecessary differences with the auditing standards of the PCAOB. Accordingly, GAAS contain additional requirements that address issues specific to the United States of America or that have been retained from previous SASs.

An AICPA member practicing in the United States of America may be engaged to audit the financial statements of a nonissuer in accordance with the ISAs. In those circumstances where the auditor's report states that the audit was conducted in accordance with the ISAs, the U.S. auditor should comply with both the ISAs and, as required by the AICPA Code of Professional Conduct, GAAS. An engagement of this nature is normally conducted by performing an audit in accordance with GAAS plus performing any additional procedures required by the ISAs.

The purpose of this appendix is to assist the U.S. auditor in planning and performing an engagement in accordance with the ISAs. This document provides a brief description of how each ISA differs from the comparable U.S. standard. However, to fully understand how the ISA might affect the nature, timing, and extent of the procedures performed in an engagement in accordance with GAAS, the auditor should consider the ISAs in their entirety by considering the standards together with the related guidance included in the ISAs. In performing an audit in accordance with the ISAs, the auditor also needs to comply with the International Ethics Standards Board for Accountants' (IESBA) *International Code of Ethics for Professional Accountants*.

This analysis compares the ISAs included in the 2018 edition of the *Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*, to the AICPA's *Professional Standards*, as of January 2020. References to GAAS are made to the relevant AU-C sections. This analysis describes the differences in terms of

- a. differences in wording,
- b. requirements in the ISAs not in GAAS,
- c. requirements in GAAS not in the ISAs,
- d. differences between requirements, and
- e. the placement of certain requirements within GAAS

General

In converging with the ISAs, the ASB has made various changes to the wording of the ISAs throughout the SASs. Such changes have been made to use terms

¹ See the definition of the term *nonissuer* in the AU-C Glossary. [Footnote revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

applicable in the United States and to make the SASs easier to read and apply in the United States. The ASB believes that such changes do not create differences between the application of the ISAs and the application of GAAS. Selected changes are described in the analysis that follows.

ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, Compared to Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards

Requirements in the ISAs Not in GAAS

The ISAs provide for reporting on financial statements that are prepared in accordance with fair presentation financial reporting frameworks and compliance financial reporting frameworks. In the ISAs, compliance frameworks do not necessarily require fair presentation. GAAS address reporting on financial statements that are prepared in accordance with fair presentation frameworks only, because the ASB believes that in the United States, users of financial statements expect all fair presentation frameworks to be fair presentation financial reporting frameworks.

Requirements in GAAS Not in the ISAs

GAAS, as described in paragraph .25 of section 200, contain two categories of professional requirements: unconditional requirements and presumptively mandatory requirements. Paragraph .25 of section 200 describes the auditor's obligation to comply with (1) an unconditional requirement in all cases where such requirement is relevant, and (2) a presumptively mandatory requirement in all cases where such a requirement is relevant except in rare circumstances. The ISAs contain only one category of professional requirements, with which paragraphs 22–23 of ISA 200 require the auditor to comply when such requirements are relevant except in rare circumstances. The ASB retained two categories of professional requirements so as not to create unnecessary differences with the application of the auditing standards promulgated by the PCAOB, which contain the same two categories of professional requirements as described in section 200.

Paragraphs .27–.28 of section 200 contain requirements relating to interpretive publications and other auditing publications. The ISAs do not address interpretive publications or other auditing publications.

ISA 210, Agreeing the Terms of Audit Engagements, Compared to Section 210A, Terms of Engagement

Requirements in the ISAs Not in GAAS

Paragraphs 11–12 of ISA 210 contain requirements relating to situations when law or regulation prescribes management's responsibilities. Paragraph 18 of

ISA 210 contains requirements relating to situations when law or regulation supplements financial reporting standards established by an authorized or recognized standards-setting organization. The ASB believes that these situations are not applicable to nonissuers in the United States and, accordingly, such requirements are not included in GAAS.

Requirements in GAAS Not in the ISAs

Paragraphs .11–.12 of section 210A address the auditor's communications with predecessor auditors in initial audit or reaudit engagements. ISA 210 does not contain these requirements. The ASB believes these requirements and related application material are appropriate for inclusion in GAAS.

Paragraph 13 of ISA 210 requires that for recurring audits, the auditor should assess whether there is a need to remind the entity of the existing terms of the engagement. Paragraph .13 of section 210A requires the auditor to remind the entity of the existing terms of the engagement and to document the reminder. The ASB believes that it is important to review the terms of the engagement with the entity each year.

Placement of Certain Requirements Within GAAS

Paragraphs 19–20 of ISA 210 contain requirements relating to situations when the financial reporting framework is prescribed by law or regulation. These requirements are addressed in section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. The different placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 220, *Quality Control for an Audit of Financial Statements*, Compared to Section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*

Requirements in the ISAs Not in GAAS

Paragraph 21 of ISA 220 contains requirements relating to audits of listed entities. Such requirements are not applicable to audits of nonissuers in the United States and, accordingly, such requirements are not included in GAAS.

Differences Between Requirements

Paragraph .21 of section 220A requires that when an engagement quality control review is performed, the engagement quality control review be completed before the engagement partner releases the auditor's report. Paragraph 19 of ISA 220 requires that the quality control review be completed before the engagement partner dates the auditor's report. The ASB believes that an engagement quality control review is an independent review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to section 220A, when the engagement quality control review results in additional procedures being performed, the date of the report would be changed.

ISA 230, *Audit Documentation*, Compared to Section 230, *Audit Documentation*

Requirements in GAAS Not in the ISAs

Paragraph .10 of section 230 requires the auditor to include abstracts or copies of significant contracts or agreements in documentation of auditing procedures related to inspection of those significant contracts or agreements. ISA 230 does not require the auditor to include abstracts or copies of the entity's records. Paragraph A3 of ISA 230 (which is application material relating to the requirement in paragraph 8 of ISA 230, which corresponds to paragraph .08 in section 230) states, "the auditor may include abstracts or copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation."

When performing auditing procedures related to inspection of significant contracts or agreements, the ASB believes that, in the context of the preparation of audit documentation that is sufficient to enable an experienced auditor to understand the audit evidence obtained, it is important to include abstracts or copies of such contracts or agreements. Further, the PCAOB standards include a requirement that documentation of auditing procedures related to the inspection of significant contracts or agreements should include abstracts or copies of the documents.² The ASB does not want to create a difference with PCAOB standards in this regard.

Differences Between Requirements

Paragraph 14 of ISA 230 requires the auditor to assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report, and the related application and other explanatory material indicates that an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. Paragraph .16 of section 230 requires the auditor to assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis, no later than 60 days following the report release date. The auditor is required by paragraph .15 of section 230 to document the report release date in the audit documentation.

Paragraph 15 of ISA 230 requires that after the assembly of the final audit file has been completed, the auditor not delete or discard audit documentation of any nature before the end of its retention period. Paragraph A23 of ISA 230 states, "the retention period for audit engagements is ordinarily no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report." Paragraph .17 of section 230 requires that after the documentation completion date, the auditor not delete or discard audit documentation before the end of the specified retention period, and goes on to state that "such retention period, however, should not be shorter than five years from the report release date."

The ASB believes that it is appropriate to be consistent with the standards of the PCAOB in relation to the date from which the documentation completion

² Paragraph 10 of PCAOB Auditing Standard No. 3, *Audit Documentation*.
All AS sections can be found in AICPA *PCAOB Standards and Related Rules*.

and retention periods are measured.³ Notwithstanding that the documentation completion period is measured from the same date in GAAS and in the PCAOB standard, the ASB continues to believe that a 60-day period is appropriate for GAAS as opposed to the 45-day period in the PCAOB standard.

ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, Compared to Section 240, *Consideration of Fraud in a Financial Statement Audit*

Differences in Wording

Paragraph 12 of ISA 240 and paragraph .11 of section 240 define *fraud*. However, the definition of fraud in paragraph .11 of section 240 was revised by changing the words "to obtain illegal or unjust advantage" to "results in a misstatement in financial statements that are the subject of an audit." The ASB believes that (a) the definition in ISA 240 is too broad and could inappropriately expose auditors to additional liability in the United States, and (b) the meaning of *unjust* could be interpreted very broadly and subjectively in its application and could imply a scope well beyond the intent of the standard.

In addition, paragraph .11 of section 240 includes the definition of the term *significant unusual transaction* as *significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature*. This concept is in the ISAs but not as a defined term. The term *significant unusual transactions* has been used throughout GAAS instead of the phrases *nonroutine transactions* or *significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature*. This change was made to be more consistent with terminology used in the auditing standards of the PCAOB.

The ASB believes that these differences in wording do not create significant differences between the application of the ISAs and the application of GAAS.

Requirements in GAAS Not in the ISAs

Section 240 contains requirements, consistent with requirements of SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*, as amended, that have been expanded from the requirements of ISA 240, or elevated from application material in ISA 240, as follows:

- The requirement in paragraph 15 of ISA 240 for the auditor to investigate inconsistent responses to auditor inquiries of management or those charged with governance has been expanded in paragraph .14 of section 240 to also include responses that are otherwise unsatisfactory (for example, vague or implausible responses).
- The requirement in paragraph 16 of ISA 240 that requires members of the engagement team to discuss the susceptibility of the entity's financial statements to material misstatements has been

³ Paragraphs 14–15 of PCAOB Auditing Standard No. 3.

expanded in paragraph .15 of section 240 to include additional discussion items from application and other explanatory material in ISA 240 to requirements in section 240. These include a required brainstorming session focused very specifically on, among other things, internal and external fraud factors and the possibility of management override of controls. In addition, section 240 further clarifies the requirement for participation of key engagement team members and the engagement partner in the discussion and brainstorming sessions. Lastly, section 240 requires appropriate communication throughout the audit among the engagement team members. Several of these discussion items have been elevated from paragraphs A10–A11 of ISA 240.

- The requirement in paragraph 45 of ISA 240 to document the significant decisions reached during the discussion among the engagement team regarding fraud-related matters has been expanded in paragraph .43 of section 240 to also require documenting how and when the discussion occurred and the audit team members who participated.
- Procedures elevated from paragraph A19 of ISA 240 to requirements in paragraph .19 of section 240, related to making inquiries of internal audit as part of performing risk assessment procedures, include determining (a) whether internal audit has performed any procedures to identify or detect fraud during the year, and (b) whether management has satisfactorily responded to any findings resulting from these inquiries.
- The requirement in paragraph 35 of ISA 240 to evaluate whether the results of analytical procedures at or near the end of the reporting period indicate a previously unrecognized risk of material misstatement due to fraud has been expanded in paragraph .34 of section 240 to include the accumulated results of auditing procedures, including analytical procedures performed as substantive tests or when forming an overall conclusion. Section 240 also specifically requires performance of analytical procedures relating to revenue accounts through the end of the reporting period, in light of the generally higher risk of financial statement fraud involving revenue.
- The requirements in paragraph 33(a) of ISA 240 address designing and performing auditing procedures to test the appropriateness of journal entries. In addition to essential guidance about addressing the risk of possible management override of controls, included in paragraph .32a of section 240 are requirements to
 - obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, and determine whether such controls are suitably designed and have been implemented.
 - consider fraud risk factors, the nature and complexity of accounts, and entries processed outside the normal course of business, elevated from the application and other explanatory material contained in paragraph A44 of ISA 240 in order to emphasize the importance of these considerations.
 - include identification and testing of specific journal entries regardless of controls.

- The requirement for the auditor to design and perform auditing procedures to review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud, in paragraph 33(b) of ISA 240, has been expanded in paragraph .32*b* of section 240 to include those estimates that are based on highly sensitive assumptions.

In addition, the following requirements in section 240 were expanded from the requirements of ISA 240 to be consistent with requirements in PCAOB AS 2410, *Related Parties*,⁴ that the ASB believes will enhance audit quality for audits of financial statements of nonissuers.

- The requirement in paragraphs 17–19 of ISA 240 relating to required inquiries has been expanded. Paragraph .17 of section 240 has been expanded to require inquiries of management about the existence, and if so, the nature, terms, and business purpose of, and involvement of related parties in, any significant unusual transactions. Similarly, the requirements in paragraphs .19 and .21 of section 240 have been expanded to include inquiry about whether the entity entered into any significant unusual transactions.
- The requirement in paragraph 32(c) of ISA 240 for the evaluation of significant transactions that are outside the normal course of business (that is, significant unusual transactions) has been expanded to include the following procedures:
 - Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction
 - Determining whether the transaction has been authorized and approved in accordance with the entity's established policies and procedures
 - Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, Compared to Section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

Differences in Wording

Changes to the wording of section 250 include:

- In paragraphs .10*a* and .13, changing the phrase "compliance with the provisions of those laws and regulations generally recognized to have a direct and material effect on the determination of material amounts and disclosures in the financial statements" to the

⁴ All AS sections can be found in AICPA PCAOB Standards and Related Rules.

phrase "material amounts and disclosures in the financial statements that are determined by the provisions of those laws and regulations generally recognized to have a direct effect on their determination." This change was made to address the ASB's concerns that the requirement in ISA 250 (Revised) expanded the auditor's responsibility to encompass all aspects of those laws and regulations described in paragraph .06a of section 250, as opposed to focusing on the amounts and disclosures included in the financial statements. The ASB has discussed this issue with the IAASB, and the wording in section 250 reflects the intent of ISA 250 (Revised). The IAASB made subsequent changes to the application material in ISA 250 (Revised) to make this clear.

- In paragraphs .10b and .14, changing "to help identify" to "that may identify." The ASB believes that the wording of section 250 better conveys the intent of ISA 250 (Revised).
- In paragraph .18, adding the phrase "(at a level above those involved with the suspected noncompliance, if possible)."

Such changes have been made to make section 250 easier to read and apply. The ASB believes that such changes do not create differences between the application of ISA 250 (Revised) and the application of section 250.

Placement of Certain Requirements Within GAAS

Paragraph 16 of ISA 250 (Revised) requires the auditor to request management and, when appropriate, those charged with governance to provide written representations regarding identified or suspected instances of noncompliance with relevant laws and regulations. The ASB believes this requirement is more appropriately placed in section 580, *Written Representations*. The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 260 (Revised), *Communication with Those Charged with Governance*, Compared to Section 260, *The Auditor's Communication With Those Charged With Governance*

Differences in Wording

Changes to the wording of section 260 from ISA 260 (Revised) include

- in paragraph .12, requiring that the auditor communicate with those charged with governance "the auditor's views about qualitative aspects of the entity's significant accounting practices" compared with the requirement in paragraph 16 of ISA 260 (Revised) that the auditor communicate with those charged with governance "the auditor's views about significant qualitative aspects of the entity's accounting practices." The ASB believes that the wording of section 260 better conveys the intent of ISA 260 (Revised).

- in paragraph .16, changing the wording in ISA 260 (Revised) from "Written communications need not include all matters that arose during the course of the audit" to "This communication need not include matters that arose during the course of the audit that were communicated with those charged with governance and satisfactorily resolved."

Such changes have been made to make section 260 easier to read and apply. The ASB believes that such changes do not create differences between the application of ISA 260 (Revised) and the application of section 260.

Requirements in the ISAs Not in GAAS

Paragraphs 17 and 20 of ISA 260 (Revised) require the auditor to communicate certain matters regarding independence in the case of listed entities. These requirements are not applicable to the audits of nonissuers in the United States and, therefore, are not included in section 260.

Requirements in GAAS Not in the ISAs

Paragraph .12a of section 260 requires the auditor, when applicable, to determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates and about the basis for the auditor's conclusions regarding the reasonableness of those estimates. Additional matters required by paragraphs .12–.13 of section 260 for the auditor to communicate to those charged with governance, that are not required by ISA 260 (Revised), are

- significant unusual transactions.
- matters that are difficult or contentious for which the auditor consulted outside the engagement team and that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.

The fact that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit. Paragraph .14a and c of section 260 require, when not all of those charged with governance are involved in managing the entity, the auditor to communicate (a) material, corrected misstatements that were brought to the attention of management as a result of audit procedures, and (b) the auditor's views about significant matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultation has occurred. Paragraph .12c of section 260 requires the auditor to communicate disagreements with management, if any. ISA 260 (Revised) does not require communication of these matters. The ASB believes that it is important for these matters to be communicated to those charged with governance of non issuers in the United States.

Paragraph .17 of section 260 requires that if, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, the auditor should communicate any omitted or inadequately described matters to those charged with governance, and paragraph .21 includes a related documentation requirement.

Paragraph .18 of section 260 requires the auditor, when communicating matters in accordance with section 260 in writing, to indicate in the communication that it is intended solely for the information and use of those charged with governance and, if appropriate, management and is not intended to be, and should not be, used by anyone other than these specified parties. ISA 260 (Revised) does not require this indication, nor does it prohibit it. The ASB believes that this communication meets the criteria for a by-product report under section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.

Placement of Certain Requirements Within GAAS

Consistent with requirements in paragraphs 12–13 of ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph .13 of section 260 contains a requirement for the auditor to communicate certain matters regarding uncorrected misstatements. The ASB believes that this communication with those charged with governance is more appropriately placed in section 260.

ISA 265, Communicating Deficiencies in Internal Control to Those Charged with Governance and Management, Compared to Section 265, Communicating Internal Control Related Matters Identified in an Audit

Differences in Wording

Section 265 includes and defines the term *material weakness*, whereas ISA 265 does not.

The definitions of *material weakness*, *deficiency in internal control*, and *significant deficiency in internal control* have been modified to align with the definitions of these terms used in the standards of the PCAOB. The ASB believes that consistency between its standards and those of the PCAOB in the use and definition of these terms is essential in the United States due to legal and regulatory requirements, including those pertaining to the evaluation of the effectiveness of an entity's internal control over financial reporting.

Requirements in GAAS Not in the ISAs

Section 265 requires the auditor to evaluate each deficiency to determine, on the basis of the audit work performed, whether, individually or in combination, the deficiencies constitute significant deficiencies or material weaknesses. ISA 265 does not explicitly refer to the auditor's evaluation of each deficiency in making this determination. The ASB believes that the requirement in section 265 is consistent with the intent of ISA 265.

Section 265 requires the auditor to communicate significant deficiencies and material weaknesses to management and those charged with governance. Because ISA 265 does not include or define the term *material weakness*, ISA 265 does not contain a requirement to separately identify or communicate material weaknesses.

Section 265 includes an additional requirement for the auditor to consider, if the auditor determines that a deficiency, or a combination of deficiencies, in internal control is not a material weakness, whether prudent officials, having

knowledge of the same facts and circumstances, would likely reach the same conclusion (paragraph .10).

Section 265 explicitly requires the auditor to document the communication of other deficiencies in internal control that are communicated orally to management (paragraph .12b).

Paragraphs 9–10 of ISA 265 require the auditor to communicate to those charged with governance and management on a timely basis. Paragraph .13 of section 265 requires the communication to be made no later than 60 days following the report release date. ISA 265 recognizes in paragraph A13 that the written communication of significant deficiencies forms part of the final audit file and is subject to the overriding requirement for the auditor to complete the assembly of the final audit file on a timely basis. ISA 230 states that an appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

In addition to the required elements of the written communication identified in paragraph 11 of ISA 265, paragraph .14 of section 265 requires that the following additional items/elements be included in the written communication:

- The definition of *material weakness* and, when relevant, the definition of *significant deficiency*
- An explanation that the auditor is not expressing an opinion on the effectiveness of internal control
- An explanation that the auditor's consideration of internal control was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies
- A statement restricting the use of the communication to management, those charged with governance, others within the organization, and any governmental authority to which the auditor is required to report

Paragraph .15 of section 265 includes reporting requirements when the auditor issues a written communication stating that no material weaknesses were identified during the audit of the financial statements. Paragraph .16 of section 265 prohibits the issuance of a written communication stating that no significant deficiencies were identified during the audit. ISA 265 does not address the issuance of communications indicating no material weaknesses or no significant deficiencies.

ISA 300, *Planning an Audit of Financial Statements*, Compared to Section 300, *Planning an Audit*

Requirements in GAAS Not in the ISAs

Paragraph .12 of section 300 contains requirements regarding the auditor's obligations for determining the extent of involvement of professionals possessing specialized skills. ISA 300 does not contain these requirements. The ASB believes these requirements, and the related application material, are necessary for the auditor's consideration of the need for specialized skills and knowledge in the audit.

ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment, Compared to Section 315A, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

Differences in Wording

Paragraph .10 of section 315A uses different wording than paragraph 9 of ISA 315 (Revised) to describe the auditor's requirement regarding the relevance of information obtained. Paragraphs .19 and .25 of section 315A include additional modifiers to conform to the comparable auditing standard issued by the Public Company Accounting Oversight Board.

Both ISA 240 and section 240 contain requirements for the auditor to consider the risks of material misstatement due to fraud. Paragraph .09 of section 315A contains a specific requirement for the auditor to consider the results of the assessment of the risk of material misstatement due to fraud during planning, whereas ISA 315 (Revised) does not. In addition, certain requirements in paragraphs .21 and .33 of section 315A contain more specificity than do the equivalent requirements in ISA 315.

These differences do not create differences between the application of ISA 315 (Revised) and the application of section 315A.

ISA 320, Materiality in Planning and Performing an Audit, Compared to Section 320, Materiality in Planning and Performing an Audit

Differences in Wording

Paragraphs .02, .04, and .10 use different words to describe the concept of materiality, in order to be consistent with the description of materiality used by the U.S. judicial system, the auditing standards of the Public Company Accounting Oversight Board, the U.S. Securities and Exchange Commission, and the Financial Accounting Standards Board (FASB). The ASB believes that such consistency in the United States is in the public interest.

The ASB believes that these differences do not create differences between the application of ISA 320 and the application of section 320.

ISA 330, The Auditor's Responses to Assessed Risks, Compared to Section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained

Requirements in GAAS Not in the ISAs

Paragraph .20 of section 330 includes a requirement to confirm accounts receivable unless certain conditions exist. This requirement is not in the ISAs. The

ASB believes it is appropriate to retain the requirement in paragraph .34 of SAS No. 67, *The Confirmation Process*.

Differences Between Requirements

To be consistent with the wording of the comparable requirements in the comparable auditing standard issued by the PCAOB, the requirement in paragraph .07 of section 330 has been modified with the words "relevant" and "material," and the requirement in paragraph .10 of section 330 has been expanded to specifically include addressing, when applicable, whether the person performing the control possesses the necessary authority and competence to perform the control effectively. The ASB believes these differences do not create differences between the application of ISA 330 and the application of section 330.

Paragraph 18 of ISA 330 requires the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material class of transactions, account balance, and disclosure. Paragraph .18 of section 330 specifies that the substantive procedures should be designed and performed for all relevant assertions related to each material class of transactions, account balance, and disclosure. The ASB believes that this wording clarifies that procedures need not be performed for irrelevant assertions and does not create a difference between the application of ISA 330 and the application of section 330.

Placement of Certain Requirements Within GAAS

Paragraph .25 of section 330 includes a requirement for the auditor addressing the means of selecting items for testing. This requirement is in the ISAs in ISA 500, *Audit Evidence*. The ASB believes this requirement is more appropriately placed in section 330. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, Compared to Section 402, *Audit Considerations Relating to an Entity Using a Service Organization*

Differences in Wording

The definitions of *Report on a description of a service organization's system and the suitability of the design of controls (type 1 report)* and *Report on a description of a service organization's system and the suitability of the design and operating effectiveness of controls (type 2 report)*, in paragraph .08 of section 402, indicate that management's written assertion is an element of these reports. This is consistent with the definitions of these terms in International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*. The definitions of these terms in paragraph 8 of ISA 402 do not include management's written assertion as an element of the reports. The ASB believes that the definitions are consistent with the intent of ISA 402 and that the modifications do not create differences between the application of ISA 402 and the application of section 402.

ISA 450, Evaluation of Misstatements Identified during the Audit, Compared to Section 450, Evaluation of Misstatements Identified During the Audit

Placement of Certain Requirements Within GAAS

Paragraphs 12–13 of ISA 450 require the auditor to communicate certain matters regarding uncorrected misstatements to those charged with governance. The ASB believes that the requirements for this communication are more appropriately placed in section 260.

Paragraph 14 of ISA 450 requires the auditor to request written representations from management and, where appropriate, those charged with governance regarding uncorrected misstatements. The ASB believes this requirement is more appropriately placed in section 580.

The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 500, Audit Evidence, Compared to Section 500, Audit Evidence

Placement of Certain Requirements Within GAAS

Paragraph 10 of ISA 500 includes a requirement for the auditor addressing the means of selecting items for testing. The ASB believes this requirement is more appropriately placed in section 330. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 501, Audit Evidence — Specific Considerations for Selected Items, Compared to Section 501, Audit Evidence — Specific Considerations for Selected Items

Requirements in GAAS Not in the ISAs

Section 501 contains specific requirements relating to auditing investments in securities and derivative instruments that are not in ISA 501. The ASB concluded that it was appropriate to retain these specific requirements of SAS No. 92, *Auditing Derivatives Instruments, Hedging Activities, and Investments in Securities*.

SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, is based on the premise that the applicable financial reporting framework complies with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*. In addition, the audit inquiry letters required under SAS No. 12 have been subjected to the provisions of the 1975 agreement between the AICPA and the American Bar Association (ABA

treaty). Consequently, section 501 contains specific requirements relating to litigation, claims and assessments consistent with the requirements of SAS No. 12 that are not contained in ISA 501. The ASB decided to retain such content in section 501 because it is particular to the U.S. environment and continues to be relevant in practice.

Placement of Certain Requirements Within GAAS

Paragraph 12 of ISA 501 requires the auditor to request written representations from management and, where appropriate, those charged with governance regarding litigation and claims. The ASB believes this requirement is more appropriately placed in section 580. The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 505, *External Confirmations*, Compared to Section 505, *External Confirmations*

Differences in Wording

The definition of *external confirmation* has been expanded to include an example of a medium through which a response may be obtained. The example — direct access by the auditor to information held by a third party — addresses a situation that is increasingly common. The ASB believes that the inclusion of this concept clarifies the definition and is consistent with the intent of the definition in ISA 505.

ISA 510, *Initial Audit Engagements — Opening Balances*, Compared to Section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*

Requirements in GAAS Not in the ISAs

Paragraph .07 of section 510 states that the auditor, when the prior period financial statements were audited by a predecessor auditor, should request management to authorize the predecessor auditor to allow a review of the predecessor auditor's audit documentation and to respond fully to inquiries by the auditor. Other requirements related to reviewing the predecessor auditor's audit documentation do not differ between ISA 510 and section 510.

Paragraph .13 of section 510 requires the auditor to respond when management refuses to inform the predecessor auditor that the prior period financial statements may need revision or if the auditor is not satisfied with the resolution of the matter. The ASB believes it is important to address this situation.

Paragraph .14 of section 510 states that the auditor should not make reference to the report or work of the predecessor auditor as the basis, in part, for the successor auditor's own opinion. The ASB believes this requirement is necessary in the United States to clearly distinguish this situation from the circumstances

in section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, in which the auditor determines to make reference to the audit of a component auditor in the auditor's report on the group financial statements.

Differences Between Requirements

Paragraph 6(c) of ISA 510 requires the auditor to perform one or more of three identified procedures, in addition to the procedures required in paragraph 6(a–b) of ISA 510, to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. Two of the three procedures are (a) reviewing the predecessor auditor's audit documentation to obtain evidence regarding opening balances, and (b) evaluating whether audit procedures performed in the current audit provide evidence relevant to the opening balances. The ASB does not believe that either of these procedures, on its own, provides sufficient evidence regarding opening balances, and accordingly, the ASB has redrafted paragraph .08c of section 510 to require the auditor to evaluate whether audit procedures performed in the current period provide evidence relevant to the opening balances and also to perform one or both of the other procedures identified in paragraph .08c(i–ii) of section 510.

ISA 520, *Analytical Procedures*, Compared to Section 520, *Analytical Procedures*

Differences in Wording

The ASB has made various changes to the wording throughout section 520 in comparison with ISA 520. The changes to section 520 include the following:

- In paragraph .05c, adding the parenthetical "(taking into account whether substantive analytical procedures are to be performed alone or in combination with tests of details)" to clarify that the auditor can use as audit evidence a substantive analytical procedure that is less precise than performance materiality when such analytical procedure is combined with other substantive audit procedures.
- In paragraph .05d, adding "compare the recorded amounts, or ratios developed from recorded amounts, with the expectations." The ASB is of the understanding that such procedure is presumed in ISA 520.

Such changes have been made to make section 520 easier to read and apply. The ASB believes that the changes made do not create differences between the application of ISA 520 and the application of section 520.

Requirements in GAAS Not in the ISAs

Section 520 includes specific documentation requirements, in paragraph .08, which ISA 520 does not. The ASB believes that the requirements are appropriate and should be retained from SAS No. 56, *Analytical Procedures*.

ISA 530, *Audit Sampling*, Compared to Section 530, *Audit Sampling*

Differences in Wording

The definition of *audit sampling* in paragraph 5 of ISA 530 was revised in section 530 because the ASB believes that the ISA 530 wording defining audit sampling to require the auditor to select items such that "each item has a chance of selection" is too imprecise to be meaningful. The definition was revised to (a) focus on conclusions about the population, and (b) include the fundamental concept of representativeness. Paragraph .08 of section 530, which establishes a requirement with respect to the selection of items in a population, reflects the revised definition of *audit sampling*.

Requirements in the ISAs Not in GAAS

The requirement in paragraph 13 of ISA 530 that addresses the issue of anomalies is not included in section 530. The ASB expressed concerns about terms used in paragraph 13 of ISA 530, such as "in the extremely rare circumstances" and "a high degree of certainty." These terms are not used in GAAS and the ASB believes these terms would not be consistently interpreted in practice. The ASB also believes that the deletion from section 530 of the option to consider a misstatement an anomaly will enhance audit quality because misstatements identified by the auditor during audit sampling will be treated in the same manner as any other misstatement identified by the auditor and, thus, will prevent the misuse of anomalies.

Paragraph 14 of ISA 530 requires, for tests of details, the projection of misstatements found in a sample to the population. The ASB believes that projection of misstatements is also relevant to tests of controls and tests of compliance, and accordingly, has broadened the requirement in paragraph .14 of section 530 to project the results of audit sampling to also include tests of controls and tests of compliance.

Other

The appendixes of ISA 530 were not been included in section 530 because the guidance contained therein is covered by the AICPA Audit Guide *Audit Sampling*.

ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, Compared to Section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Placement of Certain Requirements Within GAAS

Paragraph 22 of ISA 540 requires the auditor to obtain written representations from management and, when appropriate, those charged with governance

about whether management and, when appropriate, those charged with governance believe significant assumptions used in making accounting estimates are reasonable. The ASB believes this requirement is more appropriately placed in section 580. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 550, *Related Parties*, Compared to Section 550, *Related Parties*

Requirements in GAAS Not in the ISAs

ISA 550 distinguishes between fair presentation and compliance frameworks and between financial reporting frameworks that contain related party requirements and financial reporting frameworks that have minimal or no related party requirements. However, the ASB believes that in the United States, users of financial statements expect all financial reporting frameworks to be fair presentation frameworks. Further, to achieve fair presentation, disclosures related to related parties, such as those required by generally accepted accounting principles (GAAP), are necessary and, accordingly, section 550 defines *related party* as "a party as defined in GAAP." Thus, section 550 does not refer to applicable financial reporting frameworks; the applicability, objectives, and requirements of section 550 are the same regardless of the applicable financial reporting framework.

In addition, the following requirements in section 550 were expanded from the requirements of ISA 550 to minimize differences with requirements in PCAOB AS 2410, *Related Parties* that the ASB believes will enhance audit quality for audits of financial statements of nonissuers.

- Paragraphs .14–.15 of section 550 expand the inquiries required by ISA 550 to include inquiries of management and others within the entity regarding (1) the business purpose of entering into a transaction with a related party versus an unrelated party; (2) whether the entity modified or terminated any transactions with related parties during the period; and (3) related party transactions that were not authorized or approved in accordance with the entity's policies or procedures or for which exceptions were granted, and the reasons for granting those exceptions.
- Paragraph .16 of section 550 requires that, unless all of those charged with governance are involved in managing the entity, the auditor should inquire of those charged with governance (or the audit committee or, at least, its chair) regarding
 - their understanding of the entity's relationships and transactions with related parties that are significant to the entity and
 - whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.
- Paragraph .17 of section 550 expands the documents the auditor is required to inspect for indications of the existence of unidentified related party transactions to include summaries of actions of recent meetings for which minutes have not yet been prepared.

- Paragraph .22 of section 550 requires the auditor to evaluate whether the entity has properly identified its related party relationships and transactions, including the performance of procedures to test the accuracy and completeness of the related party relationships and transactions identified by the entity.
- Paragraph .23 of section 550 requires the auditor to perform procedures that address the related risks of material misstatement on balances with affiliated entities as of concurrent dates.

Differences Between Requirements

Paragraph 23 of ISA 550 requires the auditor to perform specified procedures for identified significant related party transactions outside the entity's normal course of business. Paragraph .26 of section 550 requires the auditor to perform the same specified procedures for identified related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk.

Placement of Certain Requirements Within GAAS

Paragraph 26 of ISA 550 requires the auditor to request that management and, when appropriate, those charged with governance, provide written representations regarding related party transactions. The ASB believes this requirement is more appropriately placed in section 580. The placement of this requirement does not create a difference between the ISAs as a whole and GAAS as a whole.

ISA 560, *Subsequent Events*, Compared to Section 560, *Subsequent Events and Subsequently Discovered Facts*

Differences in Wording

Paragraph 5 of ISA 560 defines *subsequent events* to include both events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report. Section 560 includes separate definitions for *subsequent events* and *subsequently discovered facts* to clearly distinguish the auditor's responsibilities for each. The definition of *subsequently discovered facts* was also expanded to use language that is consistent with language in the objectives and requirements of ISA 560 (paragraphs 4(b) and 14) but that is not specifically included in the definition in ISA 560.

Paragraph 5 of ISA 560 further defines *the date the financial statements are issued*, which is the date the auditor's report and audited financial statements are made available to third parties. This term was deleted from section 560 because the applicable financial reporting framework may define the financial statement issuance date. In addition, because GAAS define the report release date, the ASB believes the definition could cause confusion with respect to the release versus the issuance of the auditor's report. Although the definition was deleted, the requirements in section 560 were modified to use terms that are well understood in the United States and to be consistent with the intent of the requirements in ISA 560.

Paragraph 12 of ISA 560 permits the auditor to dual date the auditor's report when law or regulation does not prohibit management from restricting the revision of the financial statements to the effects of the subsequent event or events causing that revision and those responsible for approving the financial statements are not prohibited from restricting their approval to that revision. In the United States, no such prohibition by law or regulation exists. Accordingly, paragraph .13 of section 560 omits the reference to law or regulation.

Because the date of the auditor's report and the report release date are within the auditor's control, the requirements in paragraphs .12–.18 of section 560 were restructured with reference to the report release date in lieu of reference to the date that the financial statements were issued. Similar changes were made to the related application and other explanatory material.

Paragraph 15(b) of ISA 560 requires the auditor to review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements, together with the auditor's report thereon, is informed of the situation. Paragraphs .16*b* and .17*b* of section 560 require the auditor to determine whether management's steps are timely and appropriate. The ASB believes this is consistent with the intent of the requirements of ISA 560.

The ASB believes these changes do not create differences between the application of ISA 560 and the application of section 560.

Requirements in the ISAs Not in GAAS

Certain requirements in ISA 560 also require the auditor to provide the auditor's report or a new or revised auditor's report. These references were eliminated from the requirements in section 560 because the ASB believes that it is not necessary to require the auditor to provide the auditor's report.

Paragraph 12(b) of ISA 560, which is an optional form of dual dating, was not included in section 560 because it is uncommon in the United States to provide a new or revised auditor's report that includes a statement in an emphasis-of-matter paragraph that conveys that the auditor's procedures on subsequent events are restricted solely to the revision of the financial statements, as described in the relevant note to the financial statements.

Requirements in GAAS Not in the ISAs

Section 560 includes an additional objective in paragraph .06, requirements in paragraphs .19–.20, and application and other explanatory material in paragraphs .A27–.A30 related to a predecessor auditor's responsibilities when reissuing the auditor's report on previously issued financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period. ISA 560 does not include such requirements.

Paragraph 9 of ISA 560 requires the auditor to request that management and, when appropriate, those charged with governance provide written representations regarding subsequent events. This requirement is included in paragraph .18 of section 580. However, if the financial statements are subsequently revised, paragraph .13*a–b* of section 560 include additional requirements for the auditor to request management to provide certain representations when the auditor either dates the auditor's report as of a later date or includes an additional date limited to the revision (that is, dual dates the auditor's report for that revision). These representations are not included in ISA 560.

Placement of Certain Requirements Within GAAS

Paragraph 5 of ISA 560 defines *the date of approval of the financial statements*. This definition was deleted from the definitions of section 560 because the ASB did not believe it was necessary to its application and because the term is described in paragraph .A57 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

Paragraphs 11(b)(ii) and 15(c)(i) of ISA 560 require that the new auditor's report not be dated earlier than the date of approval of the revised financial statements. This requirement is not included in section 560 because the requirements for dating the report are addressed in section 700.

As noted in the preceding section, the requirement in paragraph 9 of ISA 560 regarding written representations has been moved to section 580.

Paragraph 16 of ISA 560 requires the auditor to include in the new or revised auditor's report an emphasis-of-matter paragraph or other-matter paragraph in situations when the financial statements are revised after the financial statements have been issued. Paragraph 16 of ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*, includes a similar requirement related to comparative financial statements and the auditor's opinion on prior period financial statements, when reporting on prior period financial statements in connection with the current period's audit, differs from the opinion previously expressed. Requirements have been placed in paragraph .16c of section 560 and paragraphs .13–.14 of section 708, *Consistency of Financial Statements*, that when considered together, achieve the intent of the requirements in paragraph 16 of ISA 560 and paragraph 16 of ISA 710.

The ASB believes such placements do not create differences between the ISAs as a whole and GAAS as a whole.

ISA 570 (Revised), *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, Compared to Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

Differences in Wording

Section 570 is intended to be applicable to audits of financial statements prepared under various financial accounting frameworks and accordingly was written to be framework-neutral. In discussing certain concepts, reference to accounting terms is necessary. To better explain and illustrate those concepts, section 570 uses terminology that is more commonly used in the United States, such as terminology from the FASB standards and GASB statements, for example "substantial doubt."

Requirements GAAS Not in the ISAs

Section 570 includes a definition of reasonable period of time that includes the period of time required by the applicable financial reporting section, in paragraph .11, and also includes application material in paragraph .A6 with examples of the periods contained in various financial reporting frameworks. ISA 570 (Revised) does not include this definition or the related application material.

Paragraph .10 of section 570 contains an objective of the auditor to evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern. The ASB believes that the inclusion of this objective is important to address disclosures, particularly for accounting frameworks that contain explicit disclosure requirements. ISA 570 (Revised) does not include this objective.

Paragraph .17 contains a requirement to obtain sufficient appropriate evidence when management's plans include financial support by third parties or the entity's owner-manager and such support is necessary in supporting management's assertions about the entity's ability to continue as a going concern. The ASB believes that this requirement is important to address this situation.

Paragraph .18 of section 570 contains a requirement of the auditor to request written representations from management about management's plans to mitigate the adverse effects of conditions or events that indicate there is substantial doubt about the entity's ability to continue as a going concern and the completeness of the financial statement disclosures that management is aware that are relevant to the entity's ability to continue as a going concern. Paragraphs .29–.30 include requirements that address comparative presentations and eliminating a going-concern emphasis-of-matter paragraph from a reissued report. Paragraph .32 of section 570 contains a requirement of the auditor to document specific matters related to the auditor's evaluation and conclusions about conditions or events that are identified, when considered in the aggregate, raise substantial doubt about the entity's ability to continue as a going concern before consideration of management's plans. The ASB believes it is important to retain these requirements from SAS No. 126, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

ISA 580, Written Representations, Compared to Section 580, Written Representations

Differences in Wording

Paragraph 8 of ISA 580 describes management's responsibility in the case of a fair presentation framework. The ASB believes that in the United States, users of financial statements expect all financial reporting frameworks to be fair presentation frameworks, and, thus, the requirements of section 580 reflect this perspective.

Requirements in the ISAs Not in GAAS

Paragraph 15 of ISA 580 contains a requirement related to situations in which law or regulation requires management to make written public statements about its responsibilities. The ASB believes that these situations are not applicable to nonissuers in the United States and, accordingly, such requirements are not included in section 580.

Differences Between Requirements

Paragraph 14 of ISA 580 requires that the date of the written representations be as near as practicable to, but not after, the date of the auditor's report on

the financial statements. Paragraph .20 of section 580 requires that the date of the written representations be as of the date of the auditor's report. Paragraph .A27 of section 580 states that, occasionally, circumstances may prevent management from signing the representation letter and returning it to the auditor on the date of the auditor's report. In these circumstances, the auditor may accept management's oral confirmation, on or before the date of the representations, that management has reviewed the final representation letter and will sign the representation letter without exception as providing sufficient appropriate audit evidence for the auditor to date the report. However, possession of the signed management representation letter prior to releasing the auditor's report is necessary because paragraph .21 of section 580 requires that the representations be in the form of a written letter from management.

Paragraph .17 of section 580 requires the auditor to request management to provide written representations that it has disclosed to the auditor the identify of all the entity's related parties. The corresponding requirement in paragraph 26 of ISA 550, *Related Parties*, does not include the word *all* with regard to the entity's related parties.

Placement of Certain Requirements Within GAAS

The following ISAs contain requirements for requesting written representations:

- Paragraph 39 of ISA 240
- Paragraph 16 of ISA 250
- Paragraph 14 of ISA 450
- Paragraph 12 of ISA 501
- Paragraph 22 of ISA 540
- Paragraph 26 of ISA 550
- Paragraph 9 of ISA 560

Such requirements have been included in paragraphs .12–.19 of section 580. The ASB believes these requirements, which relate to representations that would be obtained for every audit engagement, are more appropriately placed in section 580. The placement of these requirements does not create differences between the ISAs as a whole and GAAS as a whole.

ISA 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors), Compared to Section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)

Differences in Wording

All the requirements in ISA 600 are addressed to either the group engagement partner or the group engagement team. In section 600, requirements that, in the circumstances, may be appropriately fulfilled by the firm are addressed

to the auditor of the group financial statements. These requirements, in paragraphs .16 and .29, relate to engagement acceptance and modification of the auditor's opinion on the group financial statements. The ASB believes that this does not create a substantive difference between the requirements of ISA 600 and the requirements of section 600.

Requirements in the ISAs Not in GAAS

ISA 600 does not permit the auditor's report on the group financial statements to make reference to a component auditor unless required by law or regulation to include such reference. Section 600 permits the auditor, in the auditor's report on the group financial statements, to make reference to the audit of a component auditor.

The ASB believes that the ability to make reference to the report of another auditor is appropriate in the United States for several reasons. No compelling practice issues suggest a need to change an approach that has always been permitted by GAAS in the United States. The size, complexity, and diversity of some audits, in particular the audit of the federal government in which withdrawing from the engagement or disclaiming an opinion are not viable options, make eliminating the option to make reference to a component auditor problematic. In addition, the ASB believes that there will be considerable practical problems with access issues, particularly with equity investments, under the approach in ISA 600. The ASB believes that there is no difference in the effectiveness of the audit in either approach when the audits are conducted in accordance with GAAS. Accordingly, section 600 contains requirements and application and other explanatory material relating to making reference to the report of another auditor that are not in ISA 600, which results in substantive differences in the wording of the objectives, requirements, and application material between ISA 600 and section 600. A group audit conducted in accordance with GAAS when the group engagement partner determines to make reference to the audit performed by a component auditor would not comply with the ISAs. As such, in an audit conducted under both GAAS and the ISAs, the auditor of the group financial statements would need to assume responsibility for the work of all component auditors and, therefore, plan the audit accordingly to comply with both sets of standards.

When no reference is made to a component auditor in the auditor's report on the group financial statements, no substantive differences exist between the requirements ISA 600 and the requirements of section 600.

Differences Between Requirements

Paragraph .41c of section 600 expands the requirement in paragraph 40(e) of ISA 600 to clarify that the communication of a list of related parties prepared by group management and any other related parties of which the group engagement team is aware includes the nature of the entity's relationships and transaction with those related parties. This clarification is not in ISA 600.

ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, Compared to Section 610, *Using the Work of Internal Auditors*

Requirements in the ISAs Not in GAAS

Using Internal Auditors to Provide Direct Assistance

Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance

Section 610 does not include paragraph 26 of ISA 610 (Revised 2013) because obtaining direct assistance from internal auditors is not prohibited in the United States.

Paragraph 27 of ISA 610 (Revised 2013) contains a requirement that the external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity include inquiry of the internal auditors regarding interests and relationships that may create a threat to their objectivity. This requirement is not included in section 610 because the ASB believes it is implicit in the overall requirement to evaluate the internal auditor's objectivity.

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance

GAAS do not include paragraph 30 of ISA 610 (Revised 2013) in section 610 because the paragraph precludes the external auditor's use of internal auditors to provide direct assistance in specified circumstances. The ASB believes that the requirements in paragraphs 30a and 30b were not necessary in the context of audits of nonissuers in the United States. These requirements are partly redundant with the requirement in paragraph .27 of section 610 regarding the need for the auditor to consider the amount of judgment involved in determining the nature and extent of work to assign to internal auditors and the nature, timing, and extent of the review thereof. Additional material was added to paragraph .A42 section 610 to further emphasize that as materiality of the financial statement amounts increases, and either the assessed risks of material misstatement or the amount of judgment involved increases, the need for the external auditor to perform procedures directly increases. The ASB further concluded that the requirements in paragraphs 30c and 30d were not necessary because an appropriate assessment of the objectivity of the internal auditors in accordance with section 610 would result in a conclusion that it would not be appropriate for internal auditors' work to be used in the situations addressed by those paragraphs.

Using Internal Auditors to Provide Direct Assistance

Paragraph 33b of ISA 610 (Revised 2013) requires that, prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity. Given the established practice and historical experience of using internal auditors to provide direct assistance, the ASB did not believe that it was necessary to include this requirement for the audits of nonissuers in the United States. However, the ASB added application material to indicate that the auditor may determine it necessary to instruct the internal auditors to keep specific matters confidential and, in some

situations, may determine it to be necessary to request written acknowledgement from the internal auditors of having understood such instruction (paragraph .A41 of section 610).

Differences Between Requirements

Using Internal Auditors to Provide Direct Assistance

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance

Paragraph 31 of ISA 610 (Revised 2013) establishes a requirement that, in communicating with those charged with governance, an overview of the planned scope and timing of the audit in accordance with ISA 260, *Communication with Those Charged with Governance*, the external auditor should communicate the nature and extent of the planned use of internal auditors to provide direct assistance *so as to reach a mutual understanding that such use is not excessive in the circumstances of the engagement*. The ASB decided to revise this paragraph to improve the clarity of the requirement and eliminate the requirement to explicitly obtain a mutual understanding with those charged with governance that the proposed nature and extent of the use of internal auditors to provide direct assistance is not excessive because it was not considered necessary in the context of audits of nonissuers in the United States. The ASB believes that the external auditor's communication required by paragraph .28 of section 610 provides those charged with governance the opportunity to voice any concerns.

Using Internal Auditors to Provide Direct Assistance

Paragraph 34a of ISA 610 (Revised 2013) requires the external auditor to direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220. It further states that the "nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29 of this ISA." The ASB omitted the phrase *recognize that the internal auditors are not independent of the entity* from the comparable requirement in paragraph .31a because the ASB did not believe there was any incremental effect of the phrase on the nature, timing, and extent of the external auditor's required actions. The ASB also believes that the fact that internal auditors are not independent of the entity is already implicit in, and encompassed by, the external auditor's evaluation of the factors in paragraph .27 of section 610.

In paragraph .31c of section 610, the ASB revised paragraph 34b of ISA 610 (Revised 2013) to express the requirement in terms more commonly understood in the United States and that are more consistent with the terminology in section 610.

Requirements in GAAS Not in the ISAs

Using Internal Auditors to Provide Direct Assistance

The ASB added paragraph 31b, which represents a requirement to instruct internal auditors to bring accounting and auditing issues to the attention of the external auditors. The ASB believes that it is important to retain this requirement from SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*.

The ASB believes these differences do not create a difference between the application of ISA 610 (Revised 2013) and the application of section 610.

ISA 620, Using the Work of an Auditor's Expert, Compared to Section 620, Using the Work of an Auditor's Specialist

Differences in Wording

Paragraph 12(b) of ISA 620 requires the auditor to evaluate the significant assumptions and methods of the auditor's specialist. The ASB expanded the wording of this requirement to more clearly articulate the auditor's responsibility in this regard. The ASB believes this does not create a difference between the application of ISA 620 and the application of section 620.

Requirements in the ISAs Not in GAAS

Paragraph 14 of ISA 620 contains a conditional requirement regarding the auditor's reference to the auditor's specialist in the auditor's report when such reference is required by law or regulation. Because such reference is not required by law or regulation in the United States, such requirement is not included in section 620.

ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements, Compared to Section 700, Forming an Opinion and Reporting on Financial Statements

Differences in Wording

Paragraph 13(d) of ISA 700 (Revised) requires the auditor to evaluate, among other things, whether, in view of the requirements of the applicable financial reporting framework, the information that should have been included has been included, and whether such information is appropriately classified, aggregated or disaggregated, and characterized. Paragraph .15d of section 700 uses the term "presented" instead of "characterized" in the otherwise identical requirement. The ASB believes replacing "characterized" with "presented" addresses the presentation in paragraph 13(d)(ii) of ISA 700 (Revised) and therefore this does not create a difference between the application of ISA 700 (Revised) and section 700.

Paragraph 34(a) of ISA 700 (Revised) requires the auditor's report to describe management's responsibility for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Paragraph .32a of section 700 requires the auditor's report to describe management's responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements. The ASB believes section 700 better conveys management's responsibility in the United States.

Paragraph 38(b) of ISA 700 (Revised) requires the auditor's report to state that reasonable assurance is a high level of assurance, but not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Paragraph .35b of section 700 states that reasonable assurance is a high level of assurance but not absolute assurance and therefore is not a guarantee. The ASB believes this does not create a difference in the application of ISAs and the application of GAAS.

Paragraph 39(b)(iv) of ISA 700 requires the auditor's report to describe an audit by stating what the auditor's responsibilities are in ISA 570 (Revised). As noted previously in the ISA 570 (Revised) section of this appendix, section 570 is intended to be applicable to audits of financial statements prepared under various financial accounting frameworks and accordingly was written to be framework-neutral. In discussing certain concepts, reference to accounting terms is necessary. To better explain and illustrate those concepts, section 570 uses terminology that is more commonly used in the United States, such as terminology from the FASB standards and GASB statements, for example "substantial doubt." Accordingly, the language in the auditor's report aligns with the requirements in section 570.

Requirements in the ISAs Not in GAAS

Compliance Framework

Paragraphs 7(b), 19, and 26 of ISA 700 (Revised) discuss financial statements prepared in accordance with a compliance framework. GAAS do not include any references to compliance frameworks because the ASB believes that in the United States, users of financial statements expect all financial reporting frameworks to be fair presentation frameworks. Accordingly, section 700 is written in the context of a complete set of general purpose financial statements prepared in accordance with a fair presentation framework.

Definitions

Paragraph 7(b) of ISA 700 (Revised) defines *fair presentation framework*. Section 700 does not include this definition because fair presentation framework is already defined in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. As noted previously, section 700 does not include any references to compliance frameworks; therefore, there is no need to emphasize the differences between a fair presentation framework and a compliance framework in section 700.

Use of True and Fair View

Paragraphs 25(b) and 36 of ISA 700 (Revised) indicate that the description in the auditor's report can refer either to the preparation and fair presentation of the financial statements or the preparation of financial statements that give a true and fair view. GAAS do not include any references to "true and fair view" because such wording has not historically been used in the United States; GAAS continues to require the use of "present fairly, in all material respects" in the auditor's opinion.

Requirements for Listed Entities

Paragraphs 30, 40(b), and 46 of ISA 700 (Revised) contain requirements relating to audits of listed entities. Such requirements are not applicable to audits

of nonissuers in the United States and, accordingly, such requirements are not included in GAAS.

Opinion Section

Paragraph 24(d) of ISA 700 (Revised) requires the opinion section of the auditor's report to refer to the summary of significant accounting policies. Section 700 does not include this requirement because the ASB believes the notes to the financial statements are an integral part of the financial statements, and specific notes need not be identified in the opinion section. The ASB believes this does not create a difference between the application of ISA 700 (Revised) and the application of section 700.

Responsibilities of Management for the Financial Statements

Paragraph 33 of ISA 700 (Revised) requires the report to use a term that is appropriate in the context of the legal framework in the particular jurisdiction and need not refer specifically to "management" when the auditor's report discusses management's responsibilities. Section 700 does not include this requirement because the ASB believes this paragraph relates to jurisdictions in which the structure of the boards and corporate law are different than in the United States. In the United States, the ASB believes reference to management is sufficient. The ASB believes this does not create a difference between the application of ISA 700 (Revised) and the application of section 700.

Paragraph 35 of ISA 700 (Revised) requires the auditor's report to identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from those who fulfill the responsibilities described in paragraph 34 of ISA 700 (Revised). Section 700 does not include this requirement because the ASB believes that distinction may cause confusion in a nonissuer environment. The ASB believes this does not create a difference in the application of the ISA 700 (Revised) and the application of section 700.

Auditor's Responsibilities for the Audit of the Financial Statements

Paragraph 38(c)(ii) of ISA 700 (Revised) requires the auditor's report to state that misstatements can arise from fraud or error and either (i) describe that they are considered material, if individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or (ii) provide a definition or description of materiality in accordance with the applicable financial reporting framework. Section 700 requires the auditor to include the description in (i) and does not include the option in (ii) to provide a definition or description of materiality in accordance with the applicable financial reporting framework. The ASB believes this will create more consistency in reporting and was mindful to minimize differences between the PCAOB form of auditor's report and section 700. The ASB believes this does not create a difference in the application of ISA 700 (Revised) and the application of section 700.

Paragraph 39(c) of ISA 700 (Revised) requires the auditor's report to further describe the auditor's responsibilities in a group audit engagement. Section 700 does not include this requirement because GAAS permits for the auditor to have divided responsibility in group audit situations and therefore the reporting language in section 600 provides transparency as to the responsibilities of the auditor in such situations. The ASB believes this does not create a difference in the application of the ISA 700 (Revised) and the application of section 700.

Information Presented in the Financial Statements

Paragraph 54 of ISA 700 (Revised) contains requirements when supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, ISA 700 (Revised) requires the auditor to ask management to change how the unaudited supplementary information is presented and if management refuses to do so, the auditor should explain in the auditor's report that such supplementary information has not been audited. In the United States, section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, addresses the auditor's responsibility when engaged to report on supplementary information. At the present time, no ISAs exist that correspond to section 725. GAAS do not include the requirement for the auditor to ask management to change how the unaudited supplementary information is presented when the supplementary information is not clearly differentiated from the audited financial statements.

Requirements in GAAS Not in the ISAs***Responsibilities of Management for the Financial Statements***

Paragraph .33 of section 700 adds a requirement that the description about management's responsibilities for the financial statements in the auditor's report should not be referenced to a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report.

ISA 700 (Revised) does not contain this requirement, which the ASB believes is appropriate for inclusion in GAAS.

Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB

Paragraph .46 of section 700 adds a requirement on how to report when conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB. ISA 700 (Revised) does not contain this requirement which is specific to the United States.

Differences Between Requirements***Basis for Opinion — Auditor Independence***

Paragraph 28(c) of ISA 700 (Revised) requires the "Basis for Opinion" section to include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement should identify the jurisdiction of origin of the relevant ethical requirements or refer to the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code). Paragraph .28c of section 700 requires the "Basis for Opinion" section to include a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant

ethical requirements relating to the audit and does not require identification of the jurisdiction of origin of the relevant ethical requirements. The ASB believes section 700 better conveys the auditor's independence and ethical responsibilities in the United States while minimizing differences between the PCAOB form of the auditor's report and section 700. The ASB believes having different statements about the auditor's responsibilities for independence in the GAAS report and in the PCAOB report would cause confusion in the United States and that such difference between the two reports is not necessary.

Key Audit Matters

Paragraph 31 of ISA 700 (Revised) requires that when the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor should do so in accordance with ISA 701. Paragraph .30 of section 700 requires that when the auditor is engaged to communicate key audit matters the auditor should do so in accordance with section 701. The ASB is not aware of law or regulation in the United States that requires communication of key audit matters for nonissuers and believes this does not create a difference in the application of the ISAs and the application of GAAS.

Auditor's Responsibilities for the Audit of the Financial Statements

Paragraph 39(b)(v) requires the report to describe an audit by stating that the auditor's responsibilities are to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. Paragraph .36d of section 700 requires the auditor to include in the auditor's report the auditor's responsibility to evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements. The ASB believes this does not create a difference in the application of the ISAs and the application of GAAS.

Auditor's Report for Audits Conducted in Accordance With Both Auditing Standards of a Specific Jurisdiction and ISAs

Paragraphs 51–52 of ISA 700 (Revised) contain requirements when an auditor is required to conduct an audit in accordance with the auditing standards of a specific jurisdiction but may additionally have complied with the ISAs in the conduct of the audit. Paragraphs .44–.45 of section 700 have been revised to reflect reporting conventions in the United States.

The ASB believes these differences do not create a difference between the application of ISA 700 (Revised) and the application of section 700.

Placement of Certain Requirements Within GAAS

Comparative Financial Statements

Section 700 addresses comparative financial statements and comparative information, which are not addressed in ISA 700 (Revised), but are addressed in ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*. See the section "ISA 710, *Comparative Information — Corresponding Figures and Comparative Financial Statements*, Compared to Section 700, *Forming an Opinion and Reporting on Financial Statements*," following for a comparison of the requirements of section 700 and the requirements of ISA 710. ISA 710 addresses reporting in other jurisdictions that are

not common to the United States, including corresponding figures that are not covered by the auditor's report. For simplicity, the ASB decided to include those requirements and application material that apply in the United States in section 700 rather than have a separate AU-C section.

Key Audit Matters

Paragraph 40(c) of ISA 700 (Revised) requires the report to describe key audit matters in the auditor's responsibilities section of the auditor's report. For simplicity, and because GAAS does not require the communication of KAM in the auditor's report, section 701 requires a description of key audit matters, when the auditor is engaged to include key audit matters in the auditor's report, to be placed in a separate key audit matters section.

Auditor's Report Prescribed by Law or Regulation

Paragraph 50 of ISA 700 (Revised) discusses the auditor's report prescribed by law or regulation. Section 700 does not contain this section because it does not pertain to general purpose financial statements in the United States. Auditor's reports prescribed by law or regulation are addressed in section 800.

The ASB believes that the placement of these requirements does not create differences between the application of the ISAs as a whole and the application of GAAS as a whole.

ISA 701, Communicating Key Audit Matters in the Independent Auditor's Report, Compared to Section 701, Communicating Key Audit Matters in the Independent Auditor's Report

Differences in Wording

Going Concern

Paragraph 15 of ISA 701 describes the interaction between descriptions of key audit matters and other elements required to be included in the auditor's report. Section 700 contains the same section; however, section 700 aligns with the terminology used in section 570.

Requirements in ISAs Not in GAAS

Required Communication of Key Audit Matters

ISA 701 addresses the auditor's responsibilities to communicate key audit matters in the auditor's report and applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. Section 701 does not require the communication of key audit matters. This is not inconsistent with ISA 701 because ISA 701 only requires listed entities to communicate key audit matters. In the United States, audits of listed entities are within the jurisdiction of the PCAOB and therefore GAAS does not contain a similar requirement. The ASB believes this does not create a difference in the application of the ISAs and the application GAAS.

ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report, Compared to Section 705, Modifications to the Opinion in the Independent Auditor's Report

Requirements in the ISAs Not in GAAS

Compliance Framework

GAAS do not include any references to compliance frameworks because the ASB believes that in the United States, users of financial statements expect all financial reporting frameworks to be fair presentation frameworks. Accordingly, the reference to compliance frameworks in paragraphs 17(b) and 18(b) of ISA 705 (Revised) are included in paragraphs .18–.19 of section 705.

Use of True and Fair View

GAAS do not include any references to "true and fair view" because such wording has not historically been used in the United States; GAAS continue to require the use of "present fairly, in all material respects" in the auditor's opinion. Accordingly, the references to "true and fair view" in paragraphs 17(a)–18(a) of ISA 705 (Revised) are not included in paragraphs .18–.19 of section 705. The ASB believes this does not result in a difference in the application of the ISAs and the application of GAAS.

Multiple Uncertainties

Paragraph 10 of ISA 705 (Revised) requires the auditor to disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements. Section 705 does not include this requirement because the ASB believes that a disclaimer of opinion is appropriate only when the auditor is not able to obtain sufficient appropriate audit evidence.

Differences Between Requirements

Management-Imposed Scope Limitation

Paragraph 13(b)(i) of ISA 705 (Revised) requires the auditor to withdraw from the audit when the auditor is unable to obtain sufficient appropriate audit evidence, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation. Paragraph .13b of section 705 changes this requirement so that the auditor should either disclaim an opinion on the financial statements or withdraw from the engagement, when practical, under such circumstances. The ASB believes that in the United States, the auditor should not be required to withdraw from an engagement but, rather, should be able to decide whether to withdraw or disclaim an opinion on the financial statements

based upon the pervasiveness of the effects on the financial statements. The ASB believes this does not create differences between the application of ISA 705 (Revised) and the application of section 705.

Description of Auditor's Responsibilities When the Auditor Disclaims an Opinion

Paragraph 28(c) of ISA 705 (Revised) requires the auditor, when the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, to amend the description of the auditor's responsibilities section of the auditor's report to include the statement about auditor independence and other ethical responsibilities required by paragraph 28(c) of ISA 700 (Revised). Paragraph .29c of section 705 requires a statement that the auditor is required to be independent and to meet other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit, required by paragraph .28c of section 700 or paragraph .67c or .107c of section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. The ASB believes that the requirement in section 700 better conveys the auditor's independence and ethical responsibilities in the United States while being mindful to minimize differences between the PCAOB form of the auditor's report and section 700. The wording in section 705 aligns with section 700 requirements.

Considerations When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements

Paragraph 29 of ISA 705 (Revised) precludes the auditor from including a Key Audit Matters section in accordance with ISA 701 when the auditor disclaims an opinion. Paragraph .30 of section 705 precludes the auditor from including a Key Audit Matters section when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements. The ASB believes this incremental requirement to be appropriate for inclusion in GAAS.

ISA 706 (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report, Compared to Section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report

Differences Between Requirements

Emphasis-of-Matter Paragraphs in the Auditor's Report

Paragraph 9(a) of ISA 706 (Revised) requires the auditor, when the auditor includes an emphasis-of-matter paragraph in the auditor's report, to use an appropriate heading that includes the term "Emphasis of Matter." In the same situation, paragraph .09a of section 706 requires the auditor to use an appropriate heading and only requires the use of the term "Emphasis of Matter" to be included in the heading when key audit matters are communicated in the auditor's report. Because key audit matters are not required under GAAS, the ASB believes it is only necessary to require the use of the term "emphasis-of-matter"

when the term is needed to help differentiate between an emphasis-of-matter section and a key audit matters section.

ISA 710, Comparative Information — Corresponding Figures and Comparative Financial Statements, Compared to Section 700, Forming an Opinion and Reporting on Financial Statements

Differences in Wording

The definitions of *comparative information* and *comparative financial statements* in paragraph 6(a) and (c) of ISA 710 have been revised to reflect U.S. conventions.

Requirements in the ISAs Not in GAAS

ISA 710 addresses reporting in other jurisdictions that are not common in the United States, including corresponding figures that are not covered by the auditor's report. GAAS do not include any references to corresponding figures because these are not common in the United States.

Requirements in GAAS Not in the ISAs

Comparative Information

Paragraph .48 of section 700 requires that when expressing an opinion on all periods presented, a continuing auditor should update the report on the financial statements of one or more prior periods presented on a comparative basis with those of the current period. The auditor's report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit.

Paragraph .50 of section 700 contains a requirement that if comparative information is presented, and the entity requests the auditor to express an opinion on all periods presented, the auditor should consider whether the information included for the prior periods contains sufficient detail to constitute a fair presentation in accordance with the applicable financial reporting framework.

Audit Procedures

Paragraph .51 of section 700 contains a requirement that the audit procedures in paragraphs .51–.53 of section 700 should apply regardless of whether comparative financial statements or comparative information is presented for the prior period.

Prior Period Financial Statements

Paragraph .56 of section 700 includes requirements on what to disclose in an emphasis-of-matter paragraph or other-matter paragraph when reporting on prior period financial statements in connection with the current period's audit, and the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed.

Paragraph .57 of section 700 adds "and the predecessor auditor's report on the prior period's financial statements is not reissued" to the requirement. This was added to clarify that if the report was reissued, section 560 would apply. In addition, a requirement was added to include in the other-matter paragraph the nature of an emphasis-of-matter paragraph or other-matter paragraph included in the predecessor auditor's report, if any.

Prior Period Financial Statements Not Audited

Paragraphs .59–.60 of section 700 include requirements on how to report when prior period financial statements were not audited, reviewed, or compiled, to better clarify what is covered in section 700 related to comparative financial statements and comparative information.

ISA 710 does not contain these requirements. The ASB believes these requirements and related application material are appropriate for inclusion in GAAS.

Placement of Certain Requirements Within GAAS

ISA 710 addresses reporting in other jurisdictions that are not common to the United States, including corresponding figures that are not covered by the auditor's report. For simplicity, the ASB decided to include certain requirements and application material for comparative financial statements and comparative information in section 700 rather than having a separate AU-C section. The ASB believes that the requirements in section 700 related to comparative financial statements and comparative information are consistent with the intent of ISA 710 and that the placement of these requirements does not create differences between the application of the ISAs as a whole and the application of GAAS as a whole.

ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements, Compared to Section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports

Differences in Wording

The ASB has made various changes to the wording throughout section 720, in comparison with ISA 720. The changes to section 720 include the following:

- Adding paragraph .02, which clarifies that section 720 "may be applied, and adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention."
- In paragraph .05, deleting the phrase "either by law, regulation or custom" from the definition of *other information* to avoid confusion with required supplementary information.
- Adding paragraph .09, which clarifies that the section does not apply to supplementary information addressed by section 725, *Supplementary Information in Relation to the Financial Statements*

as a Whole, or required supplementary information addressed by section 730, *Required Supplementary Information*. There are no equivalent ISAs to sections 725 and 730.

- In paragraph .12, adding the phrase "other-matter" to clarify the report modification.
- In paragraph .17, adding the wording "by the entity in determining whether such matter is a material misstatement of fact" to clarify that the advice is received by the entity.

Such changes have been made to make section 720 easier to read and apply. The ASB believes that such changes do not create differences between the application of ISA 720 (Revised) and the application of section 720.

Requirements in GAAS not in the ISAs

Paragraph .13a of section 720 includes a requirement that the auditor obtain management's written acknowledgment regarding which document or documents comprise the annual report and the entity's planned manner and timing of the issuance of such documents.

Paragraph .14 of section 720 includes a requirement for the auditor to take appropriate action if the auditor becomes aware that the entity did not provide the auditor with the final version of documents determined in accordance with paragraph .13a to be part of the annual report prior to the issuance of those documents to third parties.

The ASB believes that these incremental requirements are appropriate for inclusion in GAAS.

Requirements in the ISAs not in GAAS

Section 720 does not include reporting requirements when the auditor is required by law or regulation of a specific jurisdiction to refer to the other information in the auditor's report using a specific layout or wording. The ASB believes that such requirements are not necessary in the U.S. environment.

Differences Between Requirements

Paragraph .21 of section 720 provides the option for the auditor to withhold the auditor's report if the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance. The ASB believes it important to retain this option from the previous SAS.

Paragraph .24 of section 720 requires that the auditor report on the other information only when the auditor has obtained all of the other information at the date of the auditor's report. ISA 720 (Revised) requires that the auditor report on the other information when the auditor "has obtained some or all of the other information" at the date of the auditor's report. The ASB believes that, because a framework for annual reports rarely exists in the nonissuer environment in the United States, a requirement to report when "some" of the other information is obtained at the date of the auditor's report could confuse users of the auditor's report and therefore is not in the public interest.

ISA 800 (Revised), *Special Considerations — Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, Compared to Section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

Differences in Wording

Definitions

Paragraph 6 of ISA 800 defines a *special purpose framework* as a financial reporting framework (a fair presentation framework or a compliance framework) designed to meet the financial information needs of specific users. Section 800 defines a special purpose framework as one of the following bases of accounting: cash, tax, regulatory, contractual, or other basis of accounting, all of which are fair presentation frameworks in the United States. An other basis of accounting is a basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

Considerations When Planning and Performing the Audit

Paragraph 9 of ISA 800 requires the auditor to determine whether application of the ISAs requires special consideration in the circumstances of the engagement. However, paragraph .12 of section 800 requires the auditor to adapt all AU-C sections relevant to the audit as necessary in the circumstances of the engagement. The ASB believes that the requirement in section 800 is consistent with the intent of ISA 800 and that such changes do not create differences between the application of ISA 800 and the application of section 800.

Requirements in GAAS Not in the ISAs

Considerations When Accepting the Engagement

Paragraph .11 of section 800 includes a requirement for the auditor, when accepting the engagement, to obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures, including specified disclosures, that are appropriate for the special purpose framework used to prepare the entity's financial statements.

Description of the Applicable Financial Reporting Framework

Paragraph .15 of section 800 includes a requirement for the auditor to evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP.

Fair Presentation

If the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP,

paragraph .18 of section 800 includes a requirement for the auditor to evaluate whether the financial statements include informative disclosures similar to those required by GAAP. Paragraph .18 of section 800 also requires the auditor to evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures may be necessary for the financial statements to achieve fair presentation.

Restricting the Use of the Auditor's Report

Paragraph .21 of section 800 requires the auditor's report to include an other-matter paragraph that restricts the use of the auditor's report when the special purpose financial statements are prepared in accordance with a contractual basis of accounting, a regulatory basis of accounting, or an other basis of accounting when required pursuant to paragraphs .06a–b of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*, except for the circumstances described in paragraph .22 of section 800. In accordance with paragraph .22 of section 800, the other-matter paragraph is not required when the special purpose financial statements are prepared in accordance with a regulatory basis of accounting and the special purpose financial statements together with the auditor's report are intended for general use. In this circumstance, the auditor is required to express an opinion on whether the financial statements are prepared in accordance with GAAP and, in a separate paragraph, an opinion on whether the financial statements are prepared in accordance with the special purpose framework.

Auditor's Report Prescribed by Law or Regulation

Paragraph .22 of section 800 identifies the required minimum elements to be included in the auditor's report when the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report. Paragraph .24 requires the auditor to reword the prescribed form of report or attach an appropriately worded separate report if the prescribed specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that the auditor has no basis to make.

These requirements are not included in ISA 800.

Differences Between Requirements

Auditor's Report

Paragraph 13 of ISA 800 requires the auditor's report to describe the purpose for which the financial statements are prepared and, if necessary, the intended users, or refer to a note in the special purpose financial statements that contains that information. Section 800 does not require this description when the special purpose financial statements are prepared in accordance with the cash or tax basis of accounting.

Alerting Readers That the Financial Statements Are Prepared in Accordance With a Special Purpose Framework

Paragraph 14 of ISA 800 requires the auditor's report to include an emphasis-of-matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. Paragraph .20c of section 800 requires the emphasis-of-matter paragraph

to state that the special purpose framework is a basis of accounting other than GAAP and only requires the auditor's report to state that the "financial statements may not be suitable for another purpose" when a description of the purpose for which the financial statements are prepared or a reference to a note in the special purpose financial statements that contains that information is required by paragraph .19a. In accordance with paragraph .22 of section 800, the emphasis-of-matter paragraph is not required when the special purpose financial statements are prepared in accordance with a regulatory basis of accounting and the special purpose financial statements together with the auditor's report are intended for general use.

Placement of Certain Requirements Within GAAS

Paragraph .14 of section 800 indicates that the following requirements in section 570 apply irrespective of whether the going concern basis of accounting is relevant to the preparation of the financial statements:

- To conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- When such substantial doubt exists, to evaluate the adequacy of the financial statement disclosures

The ASB believes this is essential guidance for section 800 that does not create a difference in the application of the requirements of the ISAs and the requirements of GAAS.

ISA 805 (Revised), Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement, Compared to Section 805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement

Requirements in the ISAs Not in GAAS

Form of Opinion

Paragraph 9 of ISA 805 requires the auditor to consider whether the expected form of opinion is appropriate in the circumstances. This requirement was not included in section 805 because the circumstances to which it relates are not applicable in the United States.

Requirements in GAAS Not in the ISAs

Considerations When Accepting the Engagement and Planning and Performing the Audit

Paragraph .10 of section 805 requires the auditor to obtain an understanding of (a) the purpose for which the single financial statement or specific element of a financial statement is prepared, (b) the intended users, and (c) the steps

taken by management to determine that the application of the financial reporting framework is acceptable in the circumstances. The ASB believes this requirement is necessary in determining the acceptability of the financial reporting framework that is applicable to a single financial statement or a specific element of a financial statement.

Paragraph .09 of section 805 requires the auditor to determine whether the auditor will be able to perform procedures on interrelated items as a consideration when accepting the engagement. Paragraph .13 of section 805 includes a requirement for the auditor to perform procedures on interrelated items as necessary to meet the objective of the audit. In the case of an audit of a specific element that is, or is based upon, the entity's stockholders' equity or net income (or the equivalents thereto), paragraph .13 of section 805 further requires the auditor to perform procedures necessary to obtain sufficient appropriate audit evidence about financial position, or financial position and results of operations, respectively, because of the interrelationship between the element and the balance sheet accounts and the income statement accounts.

Materiality

Paragraph .14 of section 805 requires the auditor to determine materiality for the single financial statement being reported on, and in the case of an audit of one or more specific elements of a financial statement, materiality for each individual element reported on.

Reporting on an Incomplete Presentation but One That Is Otherwise in Accordance With GAAP

When the auditor reports on an incomplete presentation but one that is otherwise in accordance with GAAP, paragraph .24 of section 805 requires the auditor to include an emphasis-of-matter paragraph in the auditor's report, alerting users as to the purpose of the presentation and that the presentation is incomplete. ISA 805 does not address reporting on incomplete presentations that are otherwise in accordance with the applicable financial reporting framework.

ISA 805 does not contain these requirements.

Differences Between Requirements

Reporting on the Entity's Complete Set of Financial Statements and a Single Financial Statement or a Specific Element of Those Financial Statements

Paragraph 12 of ISA 805 requires the auditor to express a separate opinion for each engagement when undertaking an engagement to report on a single financial statement or a specific element of a financial statement in conjunction with an engagement to audit the entity's complete set of financial statements. Paragraph .16 of section 805 requires that the separate opinions be in separate auditor's reports and that the report on a specific element include certain information about the auditor's report on the entity's complete set of financial statements.

Paragraph .20 of section 805 address the case of an audit of a specific element of a financial statement when the opinion in the auditor's report on an entity's complete set of financial statements is modified and the modification of the auditor's opinion is relevant to the audit of the specific element. In such cases, the auditor is required to express either an adverse opinion or disclaim an opinion on the specific element, depending on the reasons for the modification of the auditor's opinion on the complete set of financial statements. ISA 805 does not

specifically require an adverse opinion or disclaimer of opinion in such circumstances.

Paragraph 16 of ISA 805 addresses situations when the auditor concludes that it is necessary to express an adverse opinion or disclaim an opinion on the entity's complete set of financial statements as a whole, but in the context of a separate audit of a specific element that is included in those financial statements, the auditor nevertheless considers it appropriate to express an unmodified opinion on that element. In addition to the matters in ISA 805, paragraph .21 of section 805 precludes such reporting when the specific element is, or is based upon, the entity's stockholders' equity or net income (or the equivalent thereto).

ISA 810 (Revised), *Engagements to Report on Summary Financial Statements*, Compared to Section 810, *Engagements to Report on Summary Financial Statements*

Differences in Wording

Paragraph .05 of section 810 includes more specificity than is in paragraph 3 of ISA 810, including an objective to perform the procedures necessary as the basis for the auditor's opinion on the summary financial statements, and a description of the opinion. The ASB believes that these changes do not create differences between the intent of ISA 810 and the intent of section 810.

Paragraph 6(b)(ii) of ISA 810 requires that management make the audited financial statements available to the intended users of the summary financial statements without undue difficulty. Section 810 requires in paragraph .09b(ii) that management make the audited financial statements readily available. This is not a substantive difference between ISA 810 and the section 810. The terminology in section 810 aligns with section 930, *Interim Financial Information*.

If the summary financial statements contain comparatives that were reported on by another auditor, both ISA 810 and section 810 require the auditor's report on the summary financial statements to contain certain matters. Such matters are included directly in paragraph .23 of section 810 and incorporated in paragraph 22 of ISA 810 by reference to ISA 710.

Requirements in the ISAs Not in GAAS

Paragraphs 6–7 of ISA 810 include requirements pertaining to (a) criteria established by law or regulation, (b) situations in which law or regulation does not require the audited financial statements to be made available, and (c) accepting the engagement when required by law or regulation to do so. These requirements were not included in section 810 because they are not applicable to the United States.

Paragraph 9 of ISA 810 permits the use of two different phrases when opining on summary financial statements. Paragraph .14 of section 810 only includes one of these phrases, which is consistent with practice.

Paragraphs 10–11 of ISA 810 address situations when regulation prescribes the wording of the opinion on the summary financial statements in terms that

are different from those described in ISA 810. These requirements were not included in section 810 as they are not applicable in the United States.

Paragraph 15 of ISA 810 requires the auditor to evaluate the appropriateness of using a different addressee, if the addressee of the summary financial statements is not the same as the addressee of the auditor's report on the audited financial statements. Section 810 does not include this requirement because the ASB believes having different addressees is never appropriate.

Requirements in GAAS Not in the ISAs

Paragraph 6(a) of ISA 810 requires the auditor to determine whether the applied criteria are acceptable. The requirement in paragraph .09a of section 810 was expanded to clarify what constitutes acceptable criteria.

Paragraph .09b(iii) of section 810 requires the auditor to obtain the agreement of management that it acknowledges and understands its responsibility to provide the auditor with written representations, as described in paragraph .12 of section 810. ISA 810 does not include such a requirement.

Paragraphs .12–.13 of section 810 include requirements for the auditor to request management to provide written representations related to the summary financial statements. Such representations are necessary in the United States, particularly in situations when the auditor's report on the summary financial statements is dated later than the auditor's report on the audited financial statements. ISA 810 does not include any requirements for written representations.

Paragraph .19 of section 810 was expanded to require the auditor to withdraw from the engagement to report on the summary financial statements when withdrawal is possible under applicable law or regulation and when the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion. Paragraph .19d of section 810 further clarifies the reporting elements when the auditor issues a report on the summary financial statements in those situations when it is not possible to withdraw from the engagement.

Paragraph .15e(i–ii) of section 810 includes additional elements for the auditor's report on the summary financial statements with regard to the nature of the procedures that were performed by the auditor on the summary financial statements, including that the auditor did not perform audit procedures regarding the audited financial statements after the date of the report on those financial statements if the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements.

Paragraph .24 of section 810 includes an additional reporting requirement if the summary financial statements contain comparatives that were not reported on by the auditor or another auditor.

Paragraph .27 of section 810 includes additional requirements related to other information, which require the auditor to discuss the matter with management if the auditor identifies a material inconsistency and to consider appropriate further action in the circumstances if the auditor identifies a material inconsistency or becomes aware of an apparent material misstatement of fact.

Differences Between Requirements

Paragraph 19 of ISA 810 addresses the reporting elements when the auditor expresses an unmodified opinion on the summary financial statements and the

auditor's report on the audited financial statements contains certain specified elements, including a statement that describes an uncorrected material misstatement of other information. In ISA 810, the requirement in this paragraph only applies when the auditor expresses an unmodified opinion on the summary financial statements. The comparable requirement in paragraph .18 of section 810 applies when the auditor expresses either an unmodified opinion or an adverse opinion on the summary financial statements and does not address situations in which the auditor's report on the audited financial statements includes a statement that describes an uncorrected material misstatement of other information.

Section 810, in paragraph .21, eliminated the reference to the restriction on distribution of the auditor's report in paragraph 20 of ISA 810. In the United States, use of an auditor's report is restricted, not its distribution. An auditor is not responsible for controlling management's distribution of restricted-use reports.

AU-C Appendix C

[Reserved.]

AU-C Appendix D

AICPA Audit and Accounting Guides and Statements of Position

Audit and Accounting Guides

Airlines

Analytical Procedures

Assessing and Responding to Audit Risk in a Financial Statement Audit

Assets Acquired to Be Used in Research and Development Activities

Audit Sampling

Brokers and Dealers in Securities

Construction Contractors

Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies

Employee Benefit Plans

Entities With Oil and Gas Producing Activities

Gaming

Government Auditing Standards and Single Audits

Health Care Entities

Investment Companies

Life and Health Insurance Entities

Not-for-Profit Entities

Property and Liability Insurance Entities

Revenue Recognition

Special Considerations in Auditing Financial Instruments

State and Local Governments

Testing Goodwill for Impairment

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Statements of Position—Auditing

<i>Auditing Property/Casualty Insurance Entities' Statutory Financial Statements—Applying Certain Requirements of the NAIC Annual Statement Instructions</i>	<i>10/92</i>
<i>Auditing the Statement of Social Insurance</i>	<i>11/04</i>

AU-C Appendix E

*Schedule of Changes in Statements on Auditing Standards**

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
200	.03	Added by SAS No. 123.	October 2011
200	.07	Amended by SAS No. 138.	December 2019
200	.14	Amended by SAS No. 134.	May 2019
200	.15	Added by SAS No. 123.	October 2011
200	.A17	Amended by SAS No. 123.	October 2011
200	.A18	Added by SAS No. 123.	October 2011
200	.A50	Amended by SAS No. 136.	July 2019
200	.A77	Amended by SAS No. 128.	January 2015
210A	.06	Amended by SAS No. 137.	July 2019
210	.11	Amended by SAS No. 147.	June 2022
210	.12-.13	Added by SAS No. 147.	June 2022
210	.15	Added by SAS No. 147.	June 2022
210A	.A9	Amended by SAS No. 134.	May 2019
210A	.A17	Added by SAS No. 137.	July 2019
210A	.A23	Amended by SAS No. 134.	May 2019
210A	.A24	Added by SAS No. 134.	May 2019
210	.A30	Amended by SAS No. 147.	June 2022
210	.A31	Added by SAS No. 147.	June 2022
210A	.A32	Amended by SAS No. 135.	May 2019
210	.A32	Deleted by SAS No. 147.	June 2022
210	.A33	Amended by SAS No. 147.	June 2022
210	.A34	Added by SAS No. 147.	June 2022
210	.A35	Amended by SAS No. 147.	June 2022
210A	.A43	Amended by SAS No. 134.	May 2019
210A	.A44	Amended by SAS No. 137.	July 2019
210A	.A44	Amended by SAS No. 138	December 2019
220		Superseded by SAS No. 146.	June 2022
220A	.09	Amended by SAS No. 128.	January 2015
220A	.A25	Amended by SAS No. 136.	July 2019
220A	.A28	Added by SAS No. 134.	May 2019
230	.19	Added by SAS No. 123.	October 2011
230	.A12	Amended by SAS No. 134.	May 2019

(continued)

* This table lists changes resulting from Statements on Auditing Standards (SASs) issued subsequent to SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, which was issued in October 2011.

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
230	.A22	Amended by SAS No. 128.	January 2015
230	.A30	Amended by SAS No. 134.	May 2019
230	.A30	Amended by SAS No. 137.	July 2019
240	.11	Amended by SAS No. 135.	May 2019
240	.15	Amended by SAS No. 134.	May 2019
240	.17	Amended by SAS No. 135.	May 2019
240	.19	Amended by SAS No. 128.	January 2015
240	.19	Amended by SAS No. 135.	May 2019
240	.21	Amended by SAS No. 135.	May 2019
240	.32	Amended by SAS No. 135.	May 2019
240	.A6	Amended by SAS No. 134.	May 2019
240	.A13	Amended by SAS No. 134.	May 2019
240	.A19	Amended by SAS No. 135.	May 2019
240	.A54	Amended by SAS No. 135.	May 2019
240	.A55	Added by SAS No. 135.	May 2019
240	.A62	Amended by SAS No. 136.	July 2019
240	.A72	Amended by SAS No. 135.	May 2019
240	.A75	Amended by SAS No. 128.	January 2015
240	.A76	Amended by SAS No. 135.	May 2019
260	.03	Amended by SAS No. 134.	May 2019
260	.11	Amended by SAS No. 134.	May 2019
260	.12	Amended by SAS No. 123.	October 2011
260	.12	Amended by SAS No. 134.	May 2019
260	.12	Amended by SAS No. 135.	May 2019
260	.13	Amended by SAS No. 135.	May 2019
260	.14	Amended by SAS No. 134.	May 2019
260	.17	Amended by SAS No. 125.	December 2011
260	.17	Added by SAS No. 135.	May 2019
260	.21	Amended by SAS No. 135.	May 2019
260	.A13	Amended by SAS No. 134.	May 2019
260	.A17	Added by SAS No. 134.	May 2019
260	.A20	Amended by SAS No. 128.	January 2015
260	.A20	Added by SAS No. 134.	May 2019
260	.A21–.A22	Amended by SAS No. 134.	May 2019
260	.A22	Amended by SAS No. 137.	July 2019
260	.A24	Amended by SAS No. 134.	May 2019
260	.A26	Added by SAS No. 134.	May 2019
260	.A27	Added by SAS No. 123.	October 2011
260	.A27	Amended by SAS No. 134.	May 2019
260	.A28	Added by SAS No. 134.	May 2019
260	.A30	Amended by SAS No. 134.	May 2019
260	.A30	Added by SAS No. 135.	May 2019
260	.A32–.A33	Added by SAS No. 134.	May 2019

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
260	.A34	Amended by SAS No. 134.	May 2019
260	.A35–.A36	Added by SAS No. 134.	May 2019
260	.A38	Amended by SAS No. 128.	January 2015
260	.A40	Amended by SAS No. 134.	May 2019
260	.A45	Amended by SAS No. 128.	January 2015
260	.A48	Amended by SAS No. 134.	May 2019
260	.A50	Amended by SAS No. 134.	May 2019
260	.A57	Amended by SAS No. 134.	May 2019
260	.A58	Amended by SAS No. 137.	July 2019
265	.14	Amended by SAS No. 125.	December 2011
265	.A8	Amended by SAS No. 135.	May 2019
265	.A26	Amended by SAS No. 128.	January 2015
265	.A32	Amended by SAS No. 125.	December 2011
265	.A38–.A39	Amended by SAS No. 125.	December 2011
300	.A15–.A16	Added by SAS No. 134.	May 2019
300	.A25	Amended by SAS No. 128.	January 2015
300	.A27	Amended by SAS No. 134.	May 2019
315	.06	Amended by SAS No. 128.	January 2015
315	.19	Amended by SAS No. 134.	May 2019
315	.24	Amended by SAS No. 128.	January 2015
315	.27	Amended by SAS No. 134.	May 2019
315	.29	Amended by SAS No. 135.	May 2019
315	.A1	Amended by SAS No. 128.	January 2015
315	.A1	Amended by SAS No. 134.	May 2019
315	.A7	Added by SAS No. 128.	January 2015
315	.A8	Added by SAS No. 128.	January 2015
315	.A9	Added by SAS No. 128.	January 2015
315	.A10	Added by SAS No. 128.	January 2015
315	.A11	Added by SAS No. 128.	January 2015
315	.A12	Added by SAS No. 128.	January 2015
315	.A13	Added by SAS No. 128.	January 2015
315	.A19	Amended by SAS No. 134.	May 2019
315	.A20	Added by SAS No. 134.	May 2019
315	.A28	Amended by SAS No. 134.	May 2019
315	.A31–.A32	Amended by SAS No. 134.	May 2019
315	.A36	Amended by SAS No. 135.	May 2019
315	.A81	Added by SAS No. 128.	January 2015
315	.A83	Amended by SAS No. 134.	May 2019
315	.A94–.A95	Added by SAS No. 134.	May 2019
315	.A99	Amended by SAS No. 134.	May 2019
315	.A106	Added by SAS No. 134.	May 2019
315	.A112	Added by SAS No. 128.	January 2015
315	.A113	Amended by SAS No. 128.	January 2015

(continued)

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
315	.A114	Amended by SAS No. 128.	January 2015
315	.A115	Added by SAS No. 128.	January 2015
315	.A116	Added by SAS No. 128.	January 2015
315	.A117	Amended by SAS No. 128.	January 2015
315	.A118	Added by SAS No. 128.	January 2015
315	.A119	Added by SAS No. 128.	January 2015
315	.A120	Added by SAS No. 128.	January 2015
315	.A127	Amended by SAS No. 134.	May 2019
315	.A131–.A133	Amended by SAS No. 134.	May 2019
315	.A134	Added by SAS No. 134.	May 2019
315	.A139–.A140	Amended by SAS No. 134.	May 2019
315	.A141–.A143	Added by SAS No. 134.	May 2019
315	.A147	Added by SAS No. 134.	May 2019
315	.A148–.A149	Amended by SAS No. 135.	May 2019
315	.A153	Amended by SAS No. 135.	May 2019
315	.A167	Amended by SAS No. 134.	May 2019
315		Superseded by SAS No. 145.	October 2021
320	.02	Amended by SAS No. 138.	December 2019
320	.04	Amended by SAS No. 138.	December 2019
320	.06	Amended by SAS No. 134.	May 2019
320	.10	Amended by SAS No. 138.	December 2019
320	.A1	Added by SAS No. 134.	May 2019
320	.A12	Amended by SAS No. 138.	December 2019
320	.A13	Amended by SAS No. 134.	May 2019
330	.01	Amended by SAS No. 136.	July 2019
330	.21	Amended by SAS No. 134.	May 2019
330	.26	Amended by SAS No. 134.	May 2019
330	.33	Amended by SAS No. 134.	May 2019
330	.A14–.A15	Amended by SAS No. 134.	May 2019
330	.A57	Amended by SAS No. 134.	May 2019
330	.A58	Added by SAS No. 135.	May 2019
330	.A59	Amended by SAS No. 135.	May 2019
330	.A72	Amended by SAS No. 134.	May 2019
402	.A1	Amended by SAS No. 128.	January 2015
450	.01	Amended by SAS No. 136.	July 2019
450	.04	Amended by SAS No. 134.	May 2019
450	.09	Amended by SAS No. 136.	July 2019
450	.A1–.A2	Amended by SAS No. 134.	May 2019
450	.A3–.A5	Added by SAS No. 134.	May 2019
450	.A6	Amended by SAS No. 134.	May 2019
450	.A9	Amended by SAS No. 134.	May 2019
450	.A15	Amended by SAS No. 136.	July 2019
450	.A22	Amended by SAS No. 134.	May 2019
450	.A23	Amended by SAS No. 138.	December 2019

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
450	.A23–.A24	Added by SAS No. 134.	May 2019
450	.A28	Amended by SAS No. 137.	July 2019
450	.A29	Amended by SAS No. 134.	May 2019
500	.A52	Amended by SAS No. 128.	January 2015
500		Superseded by SAS No. 142.	July 2020
501	.01	Amended by SAS No. 142.	July 2020
501	.01	Amended by SAS No. 143.	July 2020
501	.03	Amended by SAS No. 142.	July 2020
501	.03	Amended by SAS No. 144.	June 2021
501	.04	Added by SAS No. 142.	July 2020
501	.05	Amended by SAS No. 143.	July 2020
501	.07–.11	Deleted by SAS No. 143.	July 2020
501	.27	Added by SAS No. 142.	July 2020
501	.27	Amended by SAS No. 144.	June 2021
501	.A1	Added by SAS No. 143.	July 2020
501	.A2	Amended by SAS No. 143.	July 2020
501	.A3	Deleted by SAS No. 143.	July 2020
501	.A6–.A7	Amended by SAS No. 143.	July 2020
501	.A9	Amended by SAS No. 143.	July 2020
501	.A12–.A20	Deleted by SAS No. 143.	July 2020
501	.A29–.A31	Amended by SAS No. 144.	June 2021
501	.A53	Amended by SAS No. 136.	July 2019
501	.A65	Amended by SAS No. 136.	July 2019
501	.A69–.A70	Added by SAS No. 142.	July 2020
501	.A71	Added by SAS No. 142.	July 2020
501	.A71	Amended by SAS No. 144.	June 2021
501	.A72	Added by SAS No. 142.	July 2020
501	.A72	Amended by SAS No. 144.	June 2021
501	.A73–.A78	Added by SAS No. 142.	July 2020
501	.A79	Added by SAS No. 142.	July 2020
501	.A79	Amended by SAS No. 144.	June 2021
501	.A80	Added by SAS No. 142.	July 2020
501	.A81	Added by SAS No. 142.	July 2020
501	.A81	Amended by SAS No. 144.	June 2021
501	.A82–.A83	Added by SAS No. 142.	July 2020
501	.A84	Amended by SAS No. 144.	June 2021
501	.A85–.A88	Added by SAS No. 144.	June 2021
510	.01	Amended by SAS No. 136.	July 2019
510	.A5	Amended by SAS No. 135.	May 2019
510	.A15	Amended by SAS No. 136.	July 2019
510	.A18	Added by SAS No. 134.	May 2019
510	.A20	Amended by SAS No. 134.	May 2019
510	.A20	Amended by SAS No. 138.	December 2019

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540	.A107	Amended by SAS No. 144.	June 2021
540	.A127–.A128	Amended by SAS No. 144.	June 2021
540	.A154	Added by SAS No. 144.	June 2021
540A	.A18	Amended by SAS No. 134.	May 2019
540A	.A120	Amended by SAS No. 134.	May 2019
540A	.A133	Amended by SAS No. 136.	July 2019
550	.01	Amended by SAS No. 135.	May 2019
550	.02	Amended by SAS No. 136.	July 2019
550	.14	Amended by SAS No. 135.	May 2019
550	.15	Amended by SAS No. 135.	May 2019
550	.16	Added by SAS No. 135.	May 2019
550	.17	Amended by SAS No. 135.	May 2019
550	.18	Amended by SAS No. 135.	May 2019
550	.20	Amended by SAS No. 135.	May 2019
550	.22	Amended by SAS No. 135.	May 2019
550	.23	Added by SAS No. 135.	May 2019
550	.26	Amended by SAS No. 135.	May 2019
550	.28	Amended by SAS No. 136.	July 2019
550	.29	Amended by SAS No. 135.	May 2019
550	.A3	Amended by SAS No. 135.	May 2019
550	.A11	Amended by SAS No. 135.	May 2019
550	.A14	Added by SAS No. 135.	May 2019
550	.A15	Amended by SAS No. 128.	January 2015
550	.A16	Amended by SAS No. 135.	May 2019
550	.A17	Amended by SAS No. 128.	January 2015
550	.A17	Amended by SAS No. 135.	May 2019
550	.A18	Amended by SAS No. 135.	May 2019
550	.A20	Amended by SAS No. 135.	May 2019
550	.A22	Amended by SAS No. 128.	January 2015
550	.A22	Amended by SAS No. 135.	May 2019
550	.A26	Amended by SAS No. 135.	May 2019
550	.A27	Amended by SAS No. 135.	May 2019
550	.A28	Amended by SAS No. 135.	May 2019
550	.A29	Amended by SAS No. 135.	May 2019
550	.A36	Amended by SAS No. 135.	May 2019
550	.A42	Amended by SAS No. 135.	May 2019
550	.A43	Amended by SAS No. 135.	May 2019
550	.A44	Amended by SAS No. 135.	May 2019
550	.A45	Amended by SAS No. 135.	May 2019
550	.A52	Amended by SAS No. 135.	May 2019
550	.A53	Amended by SAS No. 135.	May 2019
560	.03	Amended by SAS No. 136.	July 2019
560	.07	Amended by SAS No. 136.	July 2019

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560	.A10	Amended by SAS No. 136.	July 2019
560	.A14	Amended by SAS No. 136.	July 2019
560	.A30	Amended by SAS No. 136.	July 2019
570		Superseded by SAS No. 132.	February 2017
570	.24–.26	Amended by SAS No. 134.	May 2019
570	.29–.30	Amended by SAS No. 134.	May 2019
570	.A37	Amended by SAS No. 136.	July 2019
570	.A51–.A52	Added by SAS No. 134.	May 2019
570	.A54–.A55	Amended by SAS No. 134.	May 2019
570	.A56	Added by SAS No. 134.	May 2019
570	.A57	Amended by SAS No. 134.	May 2019
570	.A60	Amended by SAS No. 136.	July 2019
570	.A62	Amended by SAS No. 134.	May 2019
570	.A65	Added by SAS No. 134.	May 2019
580	.17	Amended by SAS No. 135.	May 2019
580	.A16	Amended by SAS No. 135.	May 2019
580	.A18	Amended by SAS No. 135.	May 2019
580	.A38	Amended by SAS No. 136.	July 2019
600	.25	Amended by SAS No. 127.	January 2013
600	.26	Added by SAS No. 127.	January 2013
600	.28	Amended by SAS No. 127.	January 2013
600	.32	Amended by SAS No. 127.	January 2013
600	.32	Amended by SAS No. 138.	December 2019
600	.41	Amended by SAS No. 135.	May 2019
600	.50	Amended by SAS No. 127.	January 2013
600	.A35	Amended by SAS No. 128.	January 2015
600	.A53	Amended by SAS No. 127.	January 2013
600	.A54–.A56	Added by SAS No. 127.	January 2013
600	.A57	Amended by SAS No. 127.	January 2013
600	.A60	Amended by SAS No. 127.	January 2013
600	.A63	Amended by SAS No. 138.	December 2019
600	.A83	Amended by SAS No. 128.	January 2015
600	.A94	Amended by SAS No. 128.	January 2015
600	.A94	Amended by SAS No. 135.	May 2019
600	.A96	Amended by SAS No. 128.	January 2015
600	.A97	Amended by SAS No. 127.	January 2013
600	.A97	Amended by SAS No. 134.	May 2019
600	.A97	Amended by SAS No. 137.	July 2019
600	.A97	Amended by SAS No. 138.	December 2019
610		Superseded by SAS No. 128.	February 2014
620	.A10	Amended by SAS No. 144.	June 2021
620	.A20–.A22	Amended by SAS No. 144.	June 2021

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620	.A43	Added by SAS No. 144.	June 2021
620	.A45	Added by SAS No. 144.	June 2021
700		Superseded by SAS No. 134.	May 2019
700	.08	Amended by SAS No. 141.	May 2020
700	.35	Amended by SAS No. 138.	December 2019
700	.38	Added by SAS No. 137.	July 2019
700	.A2	Amended by SAS No. 137.	July 2019
700	.A14	Amended by SAS No. 138.	December 2019
700	.A81	Amended by SAS No. 137.	July 2019
701		Added by SAS No. 134.	May 2019
701	.05	Amended by SAS No. 141.	May 2020
703		Added by SAS No. 136	July 2019
703	.13	Amended by SAS No. 141.	May 2020
703	.74	Amended by SAS No. 138.	December 2019
703	.114	Amended by SAS No. 138.	December 2019
703	.127	Amended by SAS No. 140.	April 2020
703	.A69	Amended by SAS No. 138.	December 2019
703	.A148	Amended by SAS No. 140.	April 2020
703	.A154	Amended by SAS No. 140.	April 2020
705		Superseded by SAS No. 134.	May 2019
705	.04	Amended by SAS No. 141.	May 2020
705	.30	Amended by SAS No. 137.	July 2019
705	.A36	Amended by SAS No. 137.	July 2019
705	.A38	Amended by SAS No. 137.	July 2019
706		Superseded by SAS No. 134.	May 2019
706	.03	Amended by SAS No. 137.	July 2019
706	.05	Amended by SAS No. 141.	May 2020
706	.A17	Amended by SAS No. 137.	July 2019
706	.A19	Amended by SAS No. 140.	April 2020
708	.A9	Amended by SAS No. 136.	July 2019
720		Superseded by SAS No. 137.	July 2019
720	.10	Amended by SAS No. 141.	May 2020
725	.01	Amended by SAS No. 136.	July 2019
725	.09	Amended by SAS No. 140.	April 2020
725	.A2	Amended by SAS No. 137.	July 2019
725	.A16	Amended by SAS No. 125.	December 2011
725	.A17	Amended by SAS No. 140.	April 2020
730	.07–.09	Amended by SAS No. 140.	April 2020
730	.A1	Amended by SAS No. 137.	July 2019
730	.A3	Amended by SAS No. 140.	April 2020
800	.01	Amended by SAS No. 127.	January 2013

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800	.18	Amended by SAS No. 127.	January 2013
800	.14	Added by SAS No. 139	March 2020
800	.15	Amended by SAS No. 139	March 2020
800	.18	Amended by SAS No. 139	March 2020
800	.19	Amended by SAS No. 139	March 2020
800	.20	Amended by SAS No. 125.	December 2011
800	.20	Amended by SAS No. 127.	January 2013
800	.20	Amended by SAS No. 139	March 2020
800	.21	Amended by SAS No. 139	March 2020
800	.23	Amended by SAS No. 139	March 2020
800	.A4–.A5	Amended by SAS No. 127.	January 2013
800	.A5	Added by SAS No. 139	March 2020
800	.A6	Amended by SAS No. 139	March 2020
800	.A8	Amended by SAS No. 127.	January 2013
800	.A11	Amended by SAS No. 139	March 2020
800	.A12	Amended by SAS No. 139	March 2020
800	.A15	Deleted by SAS No. 139	March 2020
800	.A18	Added by SAS No. 139	March 2020
800	.A20	Added by SAS No. 139	March 2020
800	.A21	Added by SAS No. 139	March 2020
800	.A22	Added by SAS No. 139	March 2020
800	.A24	Amended by SAS No. 127.	January 2013
800	.A25	Amended by SAS No. 139	March 2020
800	.A26–.A27	Amended by SAS No. 125.	December 2011
800	.A28	Amended by SAS No. 139	March 2020
800	.A33	Amended by SAS No. 125.	December 2011
800	.A33	Amended by SAS No. 127.	January 2013
800	.A34	Amended by SAS No. 139	March 2020
800	.A39	Amended by SAS No. 139	March 2020
800	.A40	Amended by SAS No. 139	March 2020
800	.A41	Amended by SAS No. 139	March 2020
805	.A1	Amended by SAS No. 139	March 2020
805	.A2	Added by SAS No. 139	March 2020
805	.A3	Amended by SAS No. 139	March 2020
805	.A4	Amended by SAS No. 139	March 2020
805	.A8	Amended by SAS No. 139	March 2020
805	.A11	Added by SAS No. 139	March 2020
805	.A13	Amended by SAS No. 139	March 2020
805	.A14	Amended by SAS No. 139	March 2020
805	.A15	Added by SAS No. 139	March 2020
805	.A17	Amended by SAS No. 139	March 2020

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805	.A21	Added by SAS No. 139	March 2020
805	.A23	Added by SAS No. 139	March 2020
805	.A24	Added by SAS No. 139	March 2020
805	.A25	Added by SAS No. 139	March 2020
805	.A26	Added by SAS No. 139	March 2020
805	.A28	Added by SAS No. 139	March 2020
805	.A29	Amended by SAS No. 139	March 2020
805	.A32	Amended by SAS No. 139	March 2020
805	.A33	Amended by SAS No. 139	March 2020
805	.A34	Amended by SAS No. 139	March 2020
806	.12–.13	Amended by SAS No. 125.	December 2011
806	.A6–.A8	Amended by SAS No. 125.	December 2011
810	.15	Amended by SAS No. 139	March 2020
810	.18	Amended by SAS No. 139	March 2020
810	.19	Amended by SAS No. 139	March 2020
810	.20	Amended by SAS No. 139	March 2020
810	.26	Amended by SAS No. 139	March 2020
810	.27	Amended by SAS No. 137.	July 2019
810	.A1	Amended by SAS No. 139	March 2020
810	.A15	Added by SAS No. 139	March 2020
810	.A16	Added by SAS No. 139	March 2020
810	.A20	Amended by SAS No. 137.	July 2019
810	.A24	Amended by SAS No. 139	March 2020
905		Superseded by SAS No. 125.	December 2011
910		Superseded by SAS No. 124.	October 2011
910	.A11	Amended by SAS No. 134.	May 2019
910	.A11	Amended by SAS No. 138.	December 2019
910	.A11	Amended by SAS No. 140.	April 2020
915	.09	Amended by SAS No. 123.	October 2011
915	.14	Amended by SAS No. 123.	October 2011
915	.14	Amended by SAS No. 125.	December 2011
915	.A6	Amended by SAS No. 125.	December 2011
920	.29	Amended by SAS No. 140.	April 2020
920	.32	Deleted by SAS No. 125.	December 2011
920	.33	Amended by SAS No. 125.	December 2011
920	.A29	Amended by SAS No. 140.	April 2020
920	.A34	Amended by SAS No. 125.	December 2011
920		Amended by SAS No. 129.	July 2014
930	.22	Amended by SAS No. 135.	May 2019
930	.31	Amended by SAS No. 140.	April 2020
930	.38	Amended by SAS No. 140.	April 2020
930	.39	Added by SAS No. 140.	April 2020

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930	.A41	Added by SAS No. 140.	April 2020
930	.A45–.A60	Added by SAS No. 140.	April 2020
930	.A59	Amended by SAS No. 135.	May 2019
930	.A68–.A69	Amended by SAS No. 140.	April 2020
930	.A70	Added by SAS No. 140.	April 2020
930	.A79–.A81	Amended by SAS No. 140.	April 2020
935	.04	Amended by SAS No. 140.	April 2020
935	.08	Amended by SAS No. 140.	April 2020
935	.10–.11	Amended by SAS No. 140.	April 2020
935	.16–.17	Amended by SAS No. 140.	April 2020
935	.23	Amended by SAS No. 140.	April 2020
935	.30–.31	Amended by SAS No. 123.	October 2011
935	.30–.31	Amended by SAS No. 140.	April 2020
935	.32	Deleted by SAS No. 140.	April 2020
935	.30–.31	Amended by SAS No. 125.	December 2011
935	.34	Amended by SAS No. 140.	April 2020
935	.35	Added by SAS No. 140.	April 2020
935	.36	Deleted by SAS No. 140.	April 2020
935	.38	Amended by SAS No. 140.	April 2020
935	.A1–.A2	Amended by SAS No. 140.	April 2020
935	.A7	Amended by SAS No. 140.	April 2020
935	.A9–.A11	Amended by SAS No. 140.	April 2020
935	.A16–.A17	Amended by SAS No. 140.	April 2020
935	.A21	Amended by SAS No. 140.	April 2020
935	.A24–.A26	Amended by SAS No. 140.	April 2020
935	.A33	Deleted by SAS No. 125.	December 2011
935	.A34–.A35	Added by SAS No. 140.	April 2020
935	.A37–.A38	Amended by SAS No. 140.	April 2020
935	.A41	Amended by SAS No. 123.	October 2011
935	.A42–.A44	Amended by SAS No. 140.	April 2020
940	.01–.A158	Added by SAS No. 130.	October 2015
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940	.69–.70	Amended by SAS No. 140.	April 2020
940	.75–.76	Amended by SAS No. 140.	April 2020
940	.80	Amended by SAS No. 140.	April 2020
940	.86	Amended by SAS No. 140.	April 2020
940	.A25	Amended by SAS No. 135.	May 2019
940	.A91	Amended by SAS No. 135.	May 2019
940	.A113	Amended by SAS No. 140.	April 2020
940	.A114	Deleted by SAS No. 140.	April 2020
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940	.A158	Amended by SAS No. 140.	April 2020
945	.01–.A38	Added by SAS No. 133.	July 2017
945	.09	Amended by SAS No. 137.	July 2019
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Other Auditing Publications

This listing identifies *other auditing publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate as defined in section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Products may be obtained through <https://www.aicpa.org/cpe-learning>.

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AT-C Cross-References to SSAEs

Part I—Statements on Standards for Attestation Engagements and Sources of Sections in Current Text

Statements on Standards for Attestation Engagements*

No.	Date Issued	Title	AT-C Section
18	April 2016	<i>Attestation Standards: Clarification and Recodification</i> ¹	
19	December 2019	<i>Agreed-Upon Procedures Engagements</i> ²	215
20	December 2019	<i>Amendments to the Description of the Concept of Materiality</i> ³	
21	October 2020	<i>Direct Examination Engagements</i> ⁴	205, 206
22	December 2020	<i>Review Engagements</i>	210

Sources of Sections in Current Text

AT-C Section	Contents	Source
100	Common Concepts	
105	<i>Concepts Common to All Attestation Engagements</i> ⁵	SSAE No. 18
105A	<i>Concepts Common to All Attestation Engagements</i>	SSAE No. 18
200	Level of Service	
205	<i>Assertion-Based Examination Engagements</i>	SSAE No. 21

(continued)

* This table lists Statements on Standards for Attestation Engagements (SSAEs) issued subsequent to SSAE No. 18, *Attestation Standards: Clarification and Recodification*, which was issued in April 2016. Refer to part II, "List of Statement on Standards for Attestation Engagements Nos. 1–17," of this section for SSAEs issued prior to SSAE No. 18.

¹ SSAE No. 18 created various sections throughout *U.S. Attestation Standards—AICPA (Clarified)*. See the following section, "Sources of Sections in Current Text," for a full list.

² SSAE No. 19 has been integrated within paragraphs 105.02–.03, .09–.10, .25, .A2–.A3, .A28, .A35, .A37, .A39, .A41, and .A56.

SSAE No. 19 is effective for agreed-upon procedures reports dated on or after July 15, 2021.

³ SSAE No. 20 has been integrated within sections 205.A17 and 210.A16.

⁴ SSAE No. 21 has been integrated within paragraphs 105.01–.04, .11–.14, .18, .21, .26–.30, .34, .36, .45–.46, .A1, .A7, .A9–.A11, .A13, .A15–.A16, .A20, .A24, .A27–.A32, .A34, .A36–.A45, .A51–.A53, .A56–.A57, .A59, .A61–.A63, .A66, .A72, and .A76.

SSAE No. 21 is effective for practitioners' reports dated on or after June 15, 2022.

⁵ Statement on Auditing Standards (SAS) No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, has been integrated within section 105.06–.07.

The amendments in SAS No. 146 are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of AU-C section 220 until the effective date, when they will be applied to this section.

<i>AT-C Section</i>	<i>Contents</i>	<i>Source</i>
205A	<i>Examination Engagements</i>	SSAE No. 18
206	<i>Direct Examination Engagements</i>	SSAE No. 21
210	<i>Review Engagements</i>	SSAE No. 22
210A	<i>Review Engagements</i>	SSAE No. 18
215	<i>Agreed-Upon Procedures Engagements</i>	SSAE No. 19
300	Subject Matter	
305	<i>Prospective Financial Information</i>	SSAE No. 18
310	<i>Reporting on Pro Forma Financial Information</i>	SSAE No. 18
315	<i>Compliance Attestation</i>	SSAE No. 18
320	<i>Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting</i>	SSAE No. 18
395	<i>Designated for AT Section 701, Management's Discussion and Analysis</i>	SSAE No. 10 ⁶

⁶ SSAE No. 18 does not supersede chapter 7, "Management's Discussion and Analysis," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, which is currently codified as AT section 701. The Auditing Standards Board (ASB) has not clarified AT section 701 because practitioners rarely perform attest engagements to report on management's discussion and analysis prepared pursuant to the rules and regulations adopted by the SEC. Therefore, the ASB decided that it would retain AT section 701 in its current unclarified format as AT-C section 395 until further notice.

Part II—List of Statement on Standards for Attestation Engagements Nos. 1–17

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>
1	Mar. 1986	<i>Attestation Standards</i>
1	Dec. 1987	<i>Attest Services Related to MAS Engagements</i>
1	Oct. 1985	<i>Financial Forecasts and Projections</i>
1	Sept. 1988	<i>Reporting on Pro Forma Financial Information</i>
2	May 1993	<i>Reporting on an Entity's Internal Control Over Financial Reporting</i>
3	Dec. 1993	<i>Compliance Attestation</i>
4	Sept. 1995	<i>Agreed-Upon Procedures Engagements</i>
5	Nov. 1995	<i>Amendment to Statement on Standards for Attestation Engagements No. 1, Attestation Standards</i>
6	Dec. 1995	<i>Reporting on an Entity's Internal Control Over Financial Reporting: An Amendment to Statement on Standards for Attestation Engagements No. 2</i>
7	Oct. 1997	<i>Establishing an Understanding With the Client</i>
8	Mar. 1998	<i>Management's Discussion and Analysis</i>
9	Jan. 1999	<i>Amendments to Statement on Standards for Attestation Engagements Nos. 1, 2, and 3</i>
10	Jan. 2001	<i>Attestation Standards: Revision and Recodification</i>
11	Jan. 2002	<i>Attest Documentation</i>
12	Sept. 2002	<i>Amendment to Statement on Standards for Attestation Engagements No. 10, Attestation Standards: Revision and Recodification</i>
13	Dec. 2005	<i>Defining Professional Requirements in Statements on Standards for Attestation Engagements</i>
14	Nov. 2006	<i>SSAE Hierarchy</i>
15	Sept. 2008	<i>An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements</i>
16	April 2010	<i>Reporting on Controls at a Service Organization</i>
17	Dec. 2010	<i>Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired</i>

AT-C Introduction

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AT-C Introduction

Foreword

Authority of the SSAEs

Statements on Standards for Attestation Engagements (SSAEs) are issued by senior committees of the AICPA designated to issue pronouncements on attestation matters. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member (a practitioner) performing an attestation engagement for a nonissuer¹ to comply with AICPA Statements on Standards for Attestation Engagements. A practitioner must comply with an unconditional requirement in all cases in which such requirement is relevant. A practitioner also must comply with a presumptively mandatory requirement in all cases in which such requirement is relevant. However, if, in rare circumstances, a practitioner judges it necessary to depart from a relevant presumptively mandatory requirement, the practitioner should perform alternative procedures to achieve the intent of that requirement and must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Exhibits and interpretations to SSAEs are *interpretive publications*, as defined in section 105. Section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement. Interpretive publications are not attestation standards. Interpretive publications are recommendations on the application of the SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the relevant senior committee after all members of the applicable committee have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. Attestation interpretations are included in AT-C sections. AICPA Guides and Attestation Statements of Position are listed in AT-C appendix A, *AICPA Guides and Statements of Position*.

AUDITING STANDARDS BOARD
Sara Lord, *Chair*
Jennifer Burns, Chief Auditor — AICPA

¹ See the definition of the term *nonissuer* in the AU-C Glossary.

AT-C Preface

Preface to the Attestation Standards

.01 The Statements on Standards for Attestation Engagements (SSAEs or attestation standards) establish requirements and provide application guidance for performing and reporting on examination, review, and agreed-upon procedures engagements (attestation engagements). Examples of subject matter for attestation engagements are a schedule of investment returns, the effectiveness of an entity's controls over the security of a system, or a statement of greenhouse gas emissions.

.02 The attestation standards are issued through a due process that includes deliberation in meetings open to the public, public exposure of proposed attestation standards, and a formal vote by an authorized standard-setting body.

.03 The attestation standards are developed and issued in the form of SSAEs and are codified into sections.

Structure of the Attestation Standards

.04 The attestation standards apply to three levels of service—examination, review, and agreed-upon procedures—and can be applied to innumerable types of subject matter. The applicability of specific AT-C sections to an engagement depends on both the level of service provided and the subject matter on which the practitioner is engaged to report.

.05 Section 105, *Concepts Common to All Attestation Engagements*, contains concepts that are relevant to any attestation engagement. The level of service sections are the examination level sections, which include section 205, *Assertion-Based Examination Engagements* and section 206, *Direct Examination Engagements*; section 210, *Review Engagements*; and section 215, *Agreed-Upon Procedures Engagements*. Each of these sections contain additional requirements and application guidance specific to examination, review, or agreed-upon procedures engagements, respectively. Under the attestation standards, the applicable requirements and application guidance for any attestation engagement are contained in at least two sections: section 105 and section 205, 206, 210, or 215, depending on the specific service being provided. In addition, incremental performance and reporting requirements and application guidance unique to specific subject matters, such as prospective financial information or compliance with laws and regulations, are contained in the subject-matter sections. The applicable requirements and application guidance for a subject-matter-specific engagement is contained in three sections: section 105; section 205, 210, or 215, as applicable; and the applicable subject-matter section. Section 206 is not mentioned because section 206 does not permit the performance of a direct examination engagement of the subject matters currently covered by the subject-matter sections.

Purpose of the Engagement and Premise on Which an Attestation Engagement Is Conducted

.06 The purpose of an examination or review engagement is to provide users of information with an opinion or conclusion regarding the underlying

subject matter, as measured or evaluated against suitable and available criteria. (An examination engagement results in an opinion and a review engagement results in a conclusion. The purpose of an agreed-upon procedures report is to enhance users' confidence in the subject matter by providing findings from procedures performed by the practitioner on underlying subject matter or subject matter information.)

Premise Upon Which an Attestation Engagement is Conducted

.07 An engagement in accordance with the attestation standards is conducted on the premise that the responsible party is responsible for certain matters, including:

- the underlying subject matter (and, if applicable, the preparation and presentation of the subject matter) in accordance with (or based on) the criteria
- in an assertion-based examination engagement and in a review engagement, the subject matter and its assertion about the subject matter;
- in an assertion-based examination engagement and in a review engagement, the subject matter being in accordance with the criteria.

.08 Practitioners are responsible for complying with the relevant performance and reporting requirements established in the attestation standards when they are engaged to issue, or do issue, an examination, review, or agreed-upon procedures report on subject matter or an assertion about subject matter that is the responsibility of another party (the responsible party). Although a practitioner may assist the responsible party in developing or presenting the subject matter, the responsible party remains responsible for the subject matter. The term *subject matter* includes both underlying subject matter and subject matter information. The terms *underlying subject matter* and *subject matter information* are defined in the glossary.

Responsibilities

.09 In all services provided under the attestation standards, practitioners are responsible for

- having the appropriate competence and capabilities to perform the engagement,
- complying with relevant ethical requirements,
- maintaining professional skepticism, and
- exercising professional judgment throughout the planning and performance of the engagement.

Performance

.10 To express an opinion in an assertion-based examination, the practitioner obtains reasonable assurance about whether the subject matter, or an assertion about the subject matter, is free from material misstatement, whether due to fraud or error. In a direct examination, the practitioner obtains reasonable assurance by measuring or evaluating the underlying subject matter

against the criteria and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of that measurement or evaluation. To obtain reasonable assurance, which is a high but not absolute level of assurance, the practitioner

- plans the work and properly supervises other members of the engagement team.
- identifies and assesses the risks of material misstatement, whether due to fraud or error, based on an understanding of the subject matter, its measurement or evaluation, the criteria, and other engagement circumstances.
- obtains sufficient appropriate evidence about whether material misstatements exist by designing and implementing appropriate responses to the assessed risks. Examination procedures may involve inspection, observation, analysis, inquiry, reperformance, recalculation, or confirmation with outside parties.

.11 To express a conclusion in a review, the practitioner obtains limited assurance about whether any material modification should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the assertion in order for it to be fairly stated. In a review, the nature and extent of the procedures are substantially less than in an examination. To obtain limited assurance in a review, the practitioner

- plans the work and properly supervises other members of the engagement team.
- focuses procedures in those areas in which the practitioner believes increased risks of misstatements exist, whether due to fraud or error, based on the practitioner's understanding of the subject matter, its measurement or evaluation, the criteria, and other engagement circumstances.
- obtains sufficient appropriate review evidence to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria.

.12 To report on the application of agreed-upon procedures, the practitioner performs specific procedures on underlying subject matter or subject matter information and reports the findings without providing an opinion or a conclusion. In an agreed-upon procedures engagement, the practitioner

- plans the work and properly supervises other members of the engagement team.
- performs the specific procedures agreed to and acknowledged by the engaging party to meet the intended purpose of the engagement established with the engaging party and reports on the results of the procedures.

Reporting

.13 Based on evidence obtained, the practitioner expresses an opinion in an examination, expresses a conclusion in a review, or reports findings in an agreed-upon procedures engagement. In the case of an assertion-based examination, the practitioner's report provides an opinion about whether the subject matter, as measured against the criteria, is in accordance with (or based on) the criteria (or whether the assertion about the subject matter is fairly stated),

in all material respects. In a direct examination engagement, the practitioner's report expresses an opinion that conveys the results of the practitioner's measurement or evaluation of the underlying subject matter against the criteria. In a review, the report expresses a conclusion about whether, based on the procedures performed, the practitioner is aware of any material modification that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or to the assertion in order for it to be fairly stated. In an agreed-upon procedures report, the practitioner describes the specified procedures that were applied to the subject matter and the results of those procedures.

AT-C Glossary

*Glossary of Terms*¹

Appropriate party. Reference to this term should be read as the *responsible party* or the *engaging party*, as appropriate. Also see **engaging party** and **responsible party**.

Appropriateness of evidence (in the context of section 205, *Examination Engagements*). The measure of the quality of evidence, that is, its relevancy and reliability in providing support for the practitioner's opinion. Also see **evidence**.

Appropriateness of review evidence (in the context of section 210, *Review Engagements*). The measure of the quality of review evidence, that is, its relevancy and reliability in providing support for the practitioner's conclusion. Also see **review evidence**.

Assertion. Any declaration or set of declarations about whether the underlying subject matter or subject matter information is in accordance with (or based on) the criteria. An assertion is subject matter information.

Attestation engagement. An engagement performed under the attestation standards. The following are the four types of attestation engagements:

- a. *Assertion-based examination engagement.* An attestation engagement in which the practitioner obtains reasonable assurance by obtaining sufficient appropriate evidence about the responsible party's measurement or evaluation of the underlying subject matter against criteria in order to be able to draw reasonable conclusions on which to base the practitioner's opinion about whether the subject matter is in accordance with (or based on) the criteria or the responsible party's assertion is fairly stated, in all material respects.
- b. *Direct examination engagement.* An attestation engagement in which the practitioner obtains reasonable assurance by measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of that measurement or evaluation. In a direct examination engagement, the responsible party does not provide an assertion.
- c. *Review engagement.* An attestation engagement in which the practitioner obtains limited assurance by obtaining sufficient appropriate review evidence about the responsible party's measurement or evaluation of the underlying subject matter against criteria in order to express a conclusion about whether any material modification should be made to the subject matter information in order for it to be in accordance with (or based on) the criteria or to the responsible party's assertion in order for it to be fairly stated.

¹ This glossary lists terms defined in the "Definitions" sections of the attestation standards as well as certain terms defined or explained in other sections of the attestation standards. Terms defined for purposes of a specific section are denoted as such. Terms may appear in more than one section.

- d. *Agreed-upon procedures engagement.* An attestation engagement in which a practitioner performs specific procedures on underlying subject matter or subject matter information and reports the findings without providing an opinion or a conclusion.

Also see **specified party** and **attestation standards**.

Attestation risk. In an examination or review engagement, the risk that the practitioner expresses an inappropriate opinion or conclusion, as applicable, when the subject matter information (or assertion) is materially misstated.

Attestation standards. The Statements on Standards for Attestation Engagements (SSAEs), which are also known as the *attestation standards*, establish requirements and provide guidance for performing and reporting on examination, review, and agreed-upon procedures engagements (attestation engagements). Examples of subject matter for attestation engagements are a schedule of investment returns, the effectiveness of an entity's controls over the security of a system, or a statement of greenhouse gas emissions. The SSAEs apply only to attestation engagements performed under the SSAEs. They are issued under the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct, which requires an AICPA member who performs an attestation engagement to comply with standards promulgated by bodies designated by AICPA Council. AICPA Council has granted the Auditing Standards Board authority to promulgate the attestation standards, which are issued through a due process that includes deliberation in meetings open to the public, public exposure of proposed attestation standards, and a formal vote by an authorized standard-setting body. Also see **attestation engagement**.

Carve-out method (in the context of section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*). Method of addressing the services provided by a subservice organization, whereby management's description of the service organization's system identifies the nature of the services performed by the subservice organization and excludes from the description and from the scope of the service auditor's engagement the subservice organization's relevant control objectives and related controls.

Complementary subservice organization controls (in the context of section 320). Controls that management of the service organization assumes, in the design of the service organization's system, will be implemented by the subservice organizations and are necessary to achieve the control objectives stated in management's description of the service organization's system.

Complementary user entity controls (in the context of section 320). Controls that management of the service organization assumes, in the design of the service organization's system, will be implemented by user entities and are necessary to achieve the control objectives stated in management's description of the service organization's system.

Compliance with specified requirements (in the context of section 315, *Compliance Attestation*). An entity's compliance with specified laws, regulations, rules, contracts, or grants.

Control objectives (in the context of section 320). The aim or purpose of specified controls at the service organization. Control objectives address the risks that controls are intended to mitigate.

Controls at a service organization (in the context of section 320). The policies and procedures at a service organization likely to be relevant to user entities' internal control over financial reporting. These policies and procedures are designed, implemented, and documented by the service organization to provide reasonable assurance about the achievement of the control objectives relevant to the services covered by the service auditor's report.

In the context of section 320, the policies and procedures include aspects of the information and communications component of user entities' internal control maintained by the service organization and control activities related to the information and communications component and may also include aspects of one or more of the other components of internal control at a service organization. For example, the definition of *controls at a service organization* may include aspects of the service organization's control environment, risk assessment, monitoring activities, and control activities when they relate to the services provided. Such definition does not, however, include controls at a service organization that are not related to the achievement of the control objectives stated in management's description of the service organization's system, for example, controls related to the preparation of the service organization's own financial statements.

Criteria. The benchmarks used to measure or evaluate the underlying subject matter.

Criteria for the preparation of pro forma financial information (in the context of section 310, *Reporting on Pro Forma Financial Information*). The basis disclosed in the pro forma financial information that management used to develop the pro forma financial information, including the assumptions underlying the pro forma financial information. Paragraph .11 of section 310 contains the attributes of suitable criteria for an examination or review of pro forma financial information.

Documentation completion date. The date on which the practitioner has assembled for retention a complete and final set of documentation in the engagement file.

Engagement circumstances. The broad context defining the particular engagement, which includes the terms of the engagement; whether it is an examination, review, or agreed-upon procedures engagement; the characteristics of the underlying subject matter; the criteria; the information needs of the intended users; relevant characteristics of the responsible party and, if different, the engaging party and their environment; and other matters, for example, events, transactions, conditions and practices, and relevant laws and regulations, that may have a significant effect on the engagement.

Engagement documentation. The record of procedures performed, relevant evidence obtained, and, in an examination or review engagement, conclusions reached by the practitioner, or in an agreed-upon procedures engagement, findings of the practitioner. (Terms such as *working papers* or *workpapers* are also sometimes used).

Engagement partner. The partner or other person in the firm who is responsible for the attestation engagement and its performance and for the practitioner's report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body. *Engagement partner*, *partner*, and *firm* refer to their governmental equivalents when relevant. Also see **firm** and **practitioner**.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform attestation procedures on the engagement. This excludes a practitioner's external specialist and engagement quality control reviewer engaged by the firm or a network firm. The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance.

Engaging party. The party(ies) that engages the practitioner to perform the attestation engagement. Also see **appropriate party** and **responsible party**.

Entity (in the context of section 305, *Prospective Financial Information*). Any unit, existing or to be formed for which financial statements could be prepared in accordance with generally accepted accounting principles or special purpose frameworks. For example, an entity can be an individual, partnership, corporation, trust, estate, association, or governmental unit.

Evidence. Information used by the practitioner in arriving at the opinion, conclusion, or findings on which the practitioner's report is based. Also see **appropriateness of evidence** and **sufficiency of evidence**.

Financial forecast (in the context of section 305). Prospective financial statements that present, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and cash flows. A financial forecast is based on the responsible party's assumptions reflecting conditions it expects to exist and the course of action it expects to take. A financial forecast may be expressed in specific monetary amounts as a single-point estimate of forecasted results or as a range, when the responsible party selects key assumptions to form a range within which it reasonably expects, to the best of its knowledge and belief, the item or items subject to the assumptions to actually fall. If a forecast contains a range, the range is not selected in a biased or misleading manner (for example, a range in which one end is significantly less expected than the other).

Financial projection (in the context of section 305). Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows. A financial projection is sometimes prepared to present one or more hypothetical courses of action for evaluation, as in response to a question such as, "What would happen if...?" A financial projection is based on the responsible party's assumptions reflecting conditions it expects would exist and the course of action it expects would be taken, given one or more hypothetical assumptions. A projection, like a forecast, may contain a range.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting. Also see **engagement partner** and **practitioner**.

Forecast (in the context of section 305). Used alone, this term means forecasted information, which can be either a full presentation (a financial forecast) or a partial presentation. Also see **financial forecast**.

Fraud. An intentional act involving the use of deception that results in a misstatement in the subject matter or the assertion.

General use. Use of a practitioner's report that is not restricted to specified parties.

General use of prospective financial statements (in the context of section 305). Refers to the use of the statements by persons with whom the responsible party is not negotiating directly, for example, in an offering statement of an entity's debt or equity interests. Also see **limited use of prospective financial statements** and **prospective financial statements**.

Guide (in the context of section 305). The AICPA Guide *Prospective Financial Information*.

Hypothetical assumption (in the context of section 305). An assumption used in a financial projection or in a partial presentation of projected information to present a condition or course of action that is not necessarily expected to occur but is consistent with the purpose of the projection.

Inclusive method (in the context of section 320). Method of addressing the services provided by a subservice organization whereby management's description of the service organization's system includes a description of the nature of the services provided by the subservice organization as well as the subservice organization's relevant control objectives and related controls.

Internal audit function. A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes.

Internal control over compliance (in the context of section 315). An entity's internal control over compliance with specified requirements. The internal control addressed in section 315 may include part of, but is not the same as, internal control over financial reporting.

Interpretive publications. Interpretations of the Statements on Standards for Attestation Engagements (SSAEs), exhibits to SSAEs, guidance on attestation engagements included in AICPA Audit and Accounting Guides and AICPA Attestation Statements of Position to the extent that those statements are applicable to such engagements. Also see **other attestation publications**.

Key factors (in the context of section 305). The significant matters on which an entity's future results are expected to depend. Such factors are basic to the entity's operations and, thus, encompass matters that affect, among other things, the entity's sales, production, service, and financing activities. Key factors serve as a foundation for prospective financial information and are the bases for the assumptions.

Limited use of prospective financial statements (in the context of section 305). Refers to the use of prospective financial statements by the responsible party alone or by the responsible party and third parties with whom the responsible party is negotiating directly. Examples include use in negotiations for a bank loan, submission to a regulatory agency, and use solely within the entity. Also see **general use of prospective financial statements** and **prospective financial statements**.

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls (referred to in the context of section 320 as a type 1 report). A service auditor's report that comprises the following:

- i. Management's description of the service organization's system
- ii. A written assertion by management of the service organization about whether, based on the criteria
 - (1) management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date
 - (2) the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date
- iii. A service auditor's report that expresses an opinion on the matters in (ii)(1)–(ii)(2)

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls (referred to in the context of section 320 as a *type 2 report*). A service auditor's report that comprises the following:

- i. Management's description of the service organization's system
- ii. A written assertion by management of the service organization about whether, based on the criteria
 - (1) management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period
 - (2) the controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period to achieve those control objectives
 - (3) the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period to achieve those control objectives
- iii. A service auditor's report that
 - (1) expresses an opinion on the matters in (ii)(1)–(ii)(3)
 - (2) includes a description of the tests of controls and the results thereof

Material noncompliance (in the context of section 315). A failure to follow compliance requirements or a violation of prohibitions included in the specified requirements that results in noncompliance that is quantitatively or qualitatively material, either individually or when aggregated with other noncompliance.

Misstatement. A difference between the measurement or evaluation of the underlying subject matter and the appropriate measurement or evaluation of the underlying subject matter in accordance with (or based on) the criteria. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions. In certain engagements, a misstatement may be referred to as a *deviation*, *exception*, or *instance of noncompliance*. Also see **risk of material misstatement**.

Modified opinion (in the context of section 205). A qualified opinion, an adverse opinion, or a disclaimer of opinion.

Monitoring of controls (in the context of section 320). A process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the service organization, and taking necessary corrective actions.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400, *Definitions*.

Noncompliance with laws or regulations. Acts of omission or commission by the entity, either intentional or unintentional, that are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the subject matter or subject matter information) by those charged with governance, management, or employees of the entity.

Nonparticipant party (in the context of section 215, *Agreed-Upon Procedures Engagements*). An additional specified party the practitioner is requested to add as a user of the report subsequent to the completion of the agreed-upon procedures engagement. Also see **specified party**.

Other attestation publications. Publications other than interpretive publications. These include AICPA attestation publications not defined as interpretive publications; attestation articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instructional materials, textbooks, guidebooks, attestation programs, and checklists; and other attestation publications from state CPA societies, other organizations, and individuals. The practitioner is not expected to be aware of the full body of other attestation publications. Also see **interpretive publications**.

Other practitioner. An independent practitioner who is not a member of the engagement team who performs work on information that will be used as evidence by the practitioner performing the attestation engagement. An other practitioner may be part of the practitioner's firm, a network firm, or another firm.

Partial presentation (in the context of section 305). A presentation of prospective financial information that excludes one or more of the applicable items required for prospective financial statements as described in chapter 8, "Presentation Guidelines," of the AICPA Guide *Prospective Financial Information*.

Pervasive (in the context of section 205). Describes the effects on the subject matter of misstatements or the possible effects on the subject matter of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate evidence. Pervasive effects on the subject matter are those that, in the practitioner's professional judgment

- a. are not confined to specific aspects of the subject matter;
- b. if so confined, represent or could represent a substantial proportion of the subject matter; or
- c. in relation to disclosures, are fundamental to the intended users' understanding of the subject matter.

Practitioner. The person or persons conducting the attestation engagement, usually the engagement partner or other members of the engagement

team, or, as applicable, the firm. When a section of the attestation standards expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner*, rather than *practitioner*, is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant. Also see **engagement partner** and **firm**.

Practitioner's specialist. An individual or organization possessing expertise in a field other than accounting or attestation, whose work in that field is used by the practitioner to assist the practitioner in obtaining evidence for the service being provided. A practitioner's specialist may be either a practitioner's internal specialist (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm) or a practitioner's external specialist. *Partner* and *firm* refer to their governmental equivalents when relevant.

Presentation guidelines (in the context of section 305). The criteria for the presentation and disclosure of prospective financial information.

Presumptively mandatory requirements. The category of professional requirements with which the practitioner must comply in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .20 of section 105, *Concepts Common to All Attestation Engagements*. The attestation standards use the word *should* to indicate a presumptively mandatory requirement. Also see **attestation standards** and **unconditional requirements**.

Pro forma financial information (in the context of section 310). A presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date.

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by attestation and ethical standards in making informed decisions about the courses of action that are appropriate in the circumstances of the attestation engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of evidence.

Projection (in the context of section 305). This term can refer to either a financial projection or a partial presentation of projected information. Also see **financial projection**.

Prospective financial information (in the context of section 305). Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Prospective financial statements (in the context of section 305). Either financial forecasts or financial projections, including the summaries of significant assumptions and accounting policies. Although prospective financial statements may cover a period that has partially expired, statements for periods that have completely expired are not considered to be prospective financial statements. Pro forma financial statements and partial presentations are not considered to be prospective financial statements. Also see **general use of prospective financial statements** and **limited use prospective financial statements**.

Reasonable assurance. A high but not absolute level of assurance.

Report release date. The date on which the practitioner grants the engaging party permission to use the practitioner's report.

Responsible party. The party responsible for the underlying subject matter, which is a party other than the practitioner. In an assertion-based examination or review engagement, if the nature of the underlying subject matter is such that no such party exists, a party who has a reasonable basis for making a written assertion about the underlying subject matter may be deemed to be the responsible party. Also see **appropriate party** and **engaging party**.

Review evidence (in the context of section 210). Information used by the practitioner in obtaining limited assurance on which the practitioner's review report is based. Also see **appropriateness of review evidence** and **sufficiency of review evidence**.

Risk of material misstatement (in the context of section 205). The risk that the subject matter is not in accordance with (or based on) the criteria in all material respects or that the assertion is not fairly stated, in all material respects. Also see **misstatement**.

Service auditor (in the context of section 320). A practitioner who reports on controls at a service organization.

Service organization (in the context of section 320). An organization or segment of an organization that provides services to user entities, which are likely to be relevant to those user entities' internal control over financial reporting.

Service organization's assertion (in the context of section 320). A written assertion about the matters referred to in item ii of the definition of *Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls*, for a type 2 report, and, for a type 1 report, the matters referred to in part (b) of the definition of *Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls*.

Service organization's system (in the context of section 320). The policies and procedures designed, implemented, and documented by management of the service organization to provide user entities with the services covered by the service auditor's report. Management's description of the service organization's system identifies the services covered, the period to which the description relates (or in the case of a type 1 report, the date to which the description relates), the control objectives specified by management or an outside party, the party specifying the control objectives (if not specified by management), and the related controls.

In the context of section 320, the policies and procedures refer to the guidelines and activities for providing transaction processing and other services to user entities and include the infrastructure, software, people, and data that support the policies and procedures.

Specified party. The intended user(s) to whom use of the practitioner's written report is limited. Also see **nonparticipant party**.

Statements on Standards for Attestation Engagements (SSAEs). See **attestation standards**.

Subject matter. For purposes of applying sections 205, 206, and 210, the term *subject matter* encompasses the terms *underlying subject matter* and *subject matter information*, as defined in section 105. If only one of these terms is applicable, that term is used.

Subject matter information. The outcome of the measurement or evaluation of the underlying subject matter against criteria. An assertion about whether the underlying subject matter is in accordance with the criteria is a form of subject matter information

Underlying subject matter. In an examination or review engagement, the phenomenon that is measured or evaluated by applying criteria. In an agreed-upon procedures engagement, the phenomenon upon which procedures are performed.

Subservice organization (in the context of section 320). A service organization used by another service organization to perform some of the services provided to user entities that are likely to be relevant to those user entities' internal control over financial reporting.

Sufficiency of evidence (in the context of section 205). The measure of the quantity of evidence. The quantity of the evidence needed is affected by the risks of material misstatement and also by the quality of such evidence. Also see **evidence**.

Sufficiency of review evidence (in the context of section 210). The measure of the quantity of review evidence. The quantity of the review evidence needed is affected by the risks of material misstatement and also by the quality of such evidence. Also see **review evidence**.

Suitable criteria. Criteria that exhibit all the following characteristics:

- *Relevance.* Criteria are relevant to the subject matter.
- *Objectivity.* Criteria are free from bias.
- *Measurability.* Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness.* Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter.

Test of controls (in the context of section 205). A procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements in the subject matter.

Test of controls (in the context of section 320). A procedure designed to evaluate the operating effectiveness of controls in achieving the control objectives stated in management's description of the service organization's system.

Type 1 report. See **management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls**.

Type 2 report. See **management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls**.

Unconditional requirements. The category of professional requirements with which the practitioner must comply in all cases in which such requirement is relevant. The attestation standards use the word *must* to indicate an unconditional requirement. Also see **attestation standards** and **presumptively mandatory requirements**.

User auditor (in the context of section 320). An auditor who audits and reports on the financial statements of a user entity.

User entity (in the context of section 320). An entity that uses a service organization for which controls at the service organization are likely to be relevant to that entity's internal control over financial reporting.

Working papers or workpapers. See **engagement documentation**.

AT-C Section 100
COMMON CONCEPTS

The following is a Codification of Statements on Standards for Attestation Engagements (SSAEs) resulting from the Auditing Standards Board's (ASB) project to clarify the SSAEs and related attestation interpretations. SSAEs are issued by senior committees of the AICPA designated to issue pronouncements on attestation matters applicable to the preparation and issuance of attestation reports for entities that are nonissuers.¹ The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member performing an attestation engagement for a nonissuer (a practitioner) to comply with standards promulgated by the ASB. A practitioner must comply with an unconditional requirement in all cases in which such requirement is relevant. A practitioner also must comply with a presumptively mandatory requirement in all cases in which such requirement is relevant; however, if, in rare circumstances, a practitioner judges it necessary to depart from a relevant presumptively mandatory requirement, the practitioner must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Attestation interpretations are interpretive publications, as defined in section 105, *Concepts Common to All Attestation Engagements*. Section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement. Interpretive publications are not attestation standards. Interpretive publications are recommendations on the application of the SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the relevant senior technical committee after all members of the committee have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. Attestation interpretations are included in AT-C sections. AICPA Guides and Attestation Statements of Position are listed in AT-C appendix A, "AICPA Guides and Statements of Position."

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¹ See the definition of the term *nonissuer* in the AU-C Glossary. [Footnote added, February 2017, to better reflect the AICPA Council Resolution designating the Public Company Accounting Oversight Board to promulgate technical standards.]

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AT-C Section 105

Concepts Common to All Attestation Engagements

Source: SSAE No. 18; SSAE No. 19; SSAE No. 21.

See section 9105 for interpretations of this section.

Effective for practitioners' reports dated on or after May 1, 2017, unless otherwise indicated.

NOTE

In June 2022, the Auditing Standards Board issued Statement on Auditing Standards No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, which contains amendments to this section.

The amendments are effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025, and can be viewed in the appendix of AU-C section 220 until the effective date, when they will be applied to this section.

Introduction

.01 This section applies to engagements in which a CPA in the practice of public accounting is engaged to issue, or does issue, a practitioner's

- assertion-based examination report in accordance with section 205, *Assertion-Based Examination Engagements*,
- direct examination report in accordance with section 206, *Direct Examination Engagements*,
- review report in accordance with section 210, *Review Engagements*, or
- agreed-upon procedures report in accordance with section 215, *Agreed-Upon Procedures Engagements*.

In this section, when the term *examination* is used, it is inclusive of both assertion-based and direct examination engagements.

In all attestation engagements, the underlying subject matter is the responsibility of a party other than the practitioner. (Ref: par. .A1) [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Examination and Review Engagements

.02 Examination and review engagements include the following:

- a. Assertion-based examination engagements, in which a party other than the practitioner measures or evaluates the underlying subject matter against the criteria and provides an assertion about the outcome of the measurement or evaluation, and

the practitioner expresses an opinion in a written report about whether the underlying subject matter is in accordance with (or based on) the criteria, in all material respects, or the responsible party's assertion is fairly stated, in all material respects.

- b. Direct examination engagements, in which the practitioner measures or evaluates the underlying subject matter against the criteria and performs other procedures to obtain sufficient appropriate evidence to express an opinion in a written report that conveys the results of that measurement or evaluation. The responsible party does not provide an assertion about the results of the measurement or evaluation of the underlying subject matter against the criteria.
- c. Review engagements, in which a party other than the practitioner measures or evaluates the underlying subject matter against the criteria and provides an assertion about the outcome of the measurement or evaluation, and the practitioner expresses a conclusion in a written report about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the responsible party's assertion in order for it to be fairly stated.

[Paragraph added, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.03 The practitioner's objective in both an assertion-based examination engagement and a direct examination engagement is to obtain reasonable assurance. Section 205 contains requirements and application material for assertion-based examination engagements. Section 206 contains requirements and application material for direct examination engagements. [Paragraph added, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.04 An assertion-based examination engagement and a review engagement are predicated on the concept that a party other than the practitioner makes an assertion about whether the underlying subject matter is measured or evaluated in accordance with suitable criteria. Section 205 and section 210 require the practitioner to request such an assertion in writing when performing an assertion-based examination engagement or a review engagement.¹ In assertion-based examination engagements and review engagements, when the engaging party is the responsible party, the responsible party's refusal to provide a written assertion requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable laws and regulations.² In assertion-based examination engagements and review engagements, when the engaging party is not the responsible party and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement but is required to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party.^{3, [4]} The purpose of an examination or review engagement is to provide users of information with

¹ Paragraph .10 of section 205, *Assertion-Based Examination Engagements*, and paragraph .11 of section 210, *Review Engagements*. [As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

² Paragraph .84 of section 205 and paragraph .59 of section 210.

³ Paragraph .86 of section 205 and paragraph .60 of section 210.

^[4] [Footnote deleted by the issuance of SSAE No. 19, December 2019.]

an opinion or conclusion regarding the underlying subject matter, as measured or evaluated against suitable and available criteria. An examination engagement results in an opinion, and a review engagement results in a conclusion. The purpose of an agreed-upon procedures engagement is to provide users of information with the results of procedures performed by the practitioner on underlying subject matter or subject matter information. An agreed-upon procedures engagement results in findings. [As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.05 This section is not applicable to professional services for which the AICPA has established other professional standards, for example, services performed in accordance with (Ref: par. .A2)

- a. Statements on Auditing Standards,
- b. Statements on Standards for Accounting and Review Services
- c. Statements on Standards for Tax Services, or
- d. Statements on Standards for Consulting Services, including litigation services that involve pending or potential legal or regulatory proceedings before a trier of fact. (Ref: par. .A3)

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.06 An attestation engagement may be part of a larger engagement, for example, a feasibility study or business acquisition study that also includes an examination of prospective financial information. In such circumstances, the attestation standards apply only to the attestation portion of the engagement. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Compliance With the Attestation Standards

.07 The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires members who perform professional services to comply with standards promulgated by bodies designated by the Council of the AICPA. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Relationship of Attestation Standards to Quality Control Standards

.08 Quality control systems, policies, and procedures are the responsibility of the firm in conducting its attestation practice. Under QM section 10A, *A Firm's System of Quality Control*, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that⁵ (Ref: par. .A4–.A6)

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. practitioners' reports issued by the firm are appropriate in the circumstances.

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

⁵ Paragraph .12 of QM section 10A, *A Firm's System of Quality Control*.

.09 Attestation standards relate to the conduct of individual attestation engagements; quality control standards relate to the conduct of a firm's attestation practice as a whole. Thus, attestation standards and quality control standards are related, and the quality control policies and procedures that a firm adopts may affect both the conduct of individual attestation engagements and the conduct of a firm's attestation practice as a whole. However, deficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular engagement was not performed in accordance with the attestation standards. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Effective Date

.10 This section is effective for practitioners' reports dated on or after May 1, 2017. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Objectives

.11 In conducting an attestation engagement, the overall objectives of the practitioner are as follows:

- a. Apply the requirements relevant to the attestation engagement
- b. Report on the underlying subject matter or subject matter information (or assertion) and communicate as required by the applicable AT-C section, in accordance with the results of the practitioner's procedures
- c. Implement quality control procedures at the engagement level that provide the practitioner with reasonable assurance that the attestation engagement complies with professional standards and applicable legal and regulatory requirements

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Definitions

.12 For purposes of the attestation standards, the following terms have the meanings attributed as follows:

Assertion. Any declaration or set of declarations about whether the underlying subject matter or subject matter information is in accordance with (or based on) the criteria. An assertion is subject matter information.

Attestation engagement. An engagement performed under the attestation standards. The following are the four types of attestation engagements:

- a. **Assertion-based examination engagement.** An attestation engagement in which the practitioner obtains reasonable assurance by obtaining sufficient appropriate evidence about the responsible party's measurement or evaluation of the underlying subject matter against criteria in order to be able to draw reasonable conclusions on which to base the practitioner's opinion about whether the

subject matter is in accordance with (or based on) the criteria or the responsible party's assertion is fairly stated, in all material respects. (Ref: par. .A7)

- b. **Direct examination engagement.** An attestation engagement in which the practitioner obtains reasonable assurance by measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of that measurement or evaluation. In a direct examination engagement, the responsible party does not provide an assertion. (Ref: par. .A7)
- c. **Review engagement.** An attestation engagement in which the practitioner obtains limited assurance by obtaining sufficient appropriate review evidence about the responsible party's measurement or evaluation of underlying subject matter against criteria in order to express a conclusion about whether any material modification should be made to the subject matter information in order for it be in accordance with (or based on) the criteria or to the responsible party's assertion in order for it to be fairly stated. (Ref: par. .A8)
- d. **Agreed-upon procedures engagement.** An attestation engagement in which a practitioner performs specific procedures on underlying subject matter or subject matter information or an assertion and reports the findings without providing an opinion or a conclusion.

Attestation risk. In an examination or review engagement, the risk that the practitioner expresses an inappropriate opinion or conclusion, as applicable, when the subject matter information (or assertion) is materially misstated. (Ref: par. .A9–.A15)

Criteria. The benchmarks used to measure or evaluate the underlying subject matter. (Ref: par. .A16)

Documentation completion date. The date on which the practitioner has assembled for retention a complete and final set of documentation in the engagement file.

Engagement circumstances. The broad context defining the particular engagement, which includes the terms of the engagement; whether it is an examination, review, or agreed-upon procedures engagement; the characteristics of the underlying subject matter; the criteria; the information needs of the intended users; relevant characteristics of the responsible party and, if different, the engaging party and their environment; and other matters, for example, events, transactions, conditions and practices, and relevant laws and regulations, that may have a significant effect on the engagement.

Engagement documentation. The record of procedures performed, relevant evidence obtained, and, in an examination or review engagement, conclusions reached by the practitioner, or in an agreed-upon procedures engagement, findings of the practitioner. (Terms such as *working papers* or *workpapers* are also sometimes used).

Engagement partner. The partner or other person in the firm who is responsible for the attestation engagement and its performance and for the practitioner's report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body. *Engagement partner, partner, and firm* refer to their governmental equivalents when relevant.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform attestation procedures on the engagement. This excludes a practitioner's external specialist and engagement quality control reviewer engaged by the firm or a network firm. The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance.

Engaging party. The party that engages the practitioner to perform the attestation engagement. (Ref: par. .A17)

Evidence. Information used by the practitioner in arriving at the opinion, conclusion, or findings on which the practitioner's report is based.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

Fraud. An intentional act involving the use of deception that results in a misstatement in the subject matter or the assertion.

General use. Use of a practitioner's report that is not restricted to specified parties.

Internal audit function. A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management, and internal control processes.

Interpretative publications. Interpretations of the Statements on Standards for Attestation Engagements (SSAEs), exhibits to SSAEs, guidance on attestation engagements included in AICPA Audit and Accounting Guides, and AICPA attestation Statements of Position, to the extent that those statements are applicable to such engagements.

Misstatement. A difference between the measurement or evaluation of the underlying subject matter and the appropriate measurement or evaluation of the underlying subject matter in accordance with (or based on) the criteria. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions. In certain engagements, a misstatement may be referred to as a *deviation, exception, or instance of noncompliance*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400, *Definitions*.

Noncompliance with laws or regulations. Acts of omission or commission by the entity, either intentional or unintentional, that are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the underlying subject matter or subject matter

information) by those charged with governance, management, or employees of the entity.

Other attestation publications. Publications other than interpretive publications. These include AICPA attestation publications not defined as interpretive publications; attestation articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instructional materials, textbooks, guidebooks, attestation programs, and checklists; and other attestation publications from state CPA societies, other organizations, and individuals.

Other practitioner. An independent practitioner who is not a member of the engagement team who performs work on information that will be used as evidence by the practitioner performing the attestation engagement. An other practitioner may be part of the practitioner's firm, a network firm, or another firm.

Practitioner. The person or persons conducting the attestation engagement, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. When an AT-C section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner*, rather than *practitioner*, is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant.

Practitioner's specialist. An individual or organization possessing expertise in a field other than accounting or attestation, whose work in that field is used by the practitioner to assist the practitioner in obtaining evidence for the service being provided. A practitioner's specialist may be either a practitioner's internal specialist (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm) or a practitioner's external specialist. *Partner* and *firm* refer to their governmental equivalents when relevant.

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by attestation and ethical standards in making informed decisions about the courses of action that are appropriate in the circumstances of the attestation engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of evidence.

Reasonable assurance. A high, but not absolute, level of assurance.

Report release date. The date on which the practitioner grants the engaging party permission to use the practitioner's report.

Responsible party. The party responsible for the underlying subject matter, which is a party other than the practitioner. In an assertion-based examination or review engagement, if the nature of the underlying subject matter is such that no such party exists, a party who has a reasonable basis for making a written assertion about the underlying subject matter may be deemed to be the responsible party.

Specified party. The intended user(s) to whom use of the written practitioner's report is limited.

Subject matter information. The outcome of the measurement or evaluation of the underlying subject matter against criteria. An assertion about whether the underlying subject matter is in accordance with the criteria is a form of subject matter information.

Underlying subject matter.* In an examination or review engagement, the phenomenon that is measured or evaluated by applying criteria. In an agreed-upon procedures engagement, the phenomenon upon which procedures are performed.

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.13 For the purposes of the attestation standards, references to appropriate party should be read hereafter as the responsible party or the engaging party, as appropriate. (Ref: par. .A18) [Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Requirements

Conduct of an Attestation Engagement in Accordance With the Attestation Standards

Complying With AT-C Sections That Are Relevant to the Engagement

.14 When performing an attestation engagement, the practitioner should comply with

- this section;
- sections 205, 206, 210, or 215, as applicable; and
- any subject-matter AT-C section relevant to the engagement when the AT-C section is in effect and the circumstances addressed by the AT-C section exist.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.15 The practitioner should not represent compliance with this or any other AT-C section unless the practitioner has complied with the requirements of this section and all other AT-C sections relevant to the engagement. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.16 Reports issued by a practitioner in connection with services performed under other professional standards should be written to be clearly distinguishable from and not confused with reports issued under the attestation standards. (Ref: par. .A19–.A20) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Text of an AT-C Section

.17 The practitioner should have an understanding of the entire text of each AT-C section that is relevant to the engagement being performed, including its application and other explanatory material, to understand its objectives

* Prior to the issuance of SSAE No. 21, "the phenomenon that is measured or evaluated by applying criteria" was the definition of *subject matter*. [Footnote added, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

and apply its requirements properly. (Ref: par. .A21–.A26) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Complying With Relevant Requirements

.18 Subject to paragraph .22, the practitioner should comply with each requirement of the AT-C sections that is relevant to the engagement being performed, including any relevant subject-matter AT-C section, unless, in the circumstances of the engagement,

- a. the entire AT-C section is not relevant, or
- b. the requirement is not relevant because it is conditional, and the condition does not exist.

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.19 When a practitioner undertakes an attestation engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides, procedures, statutes, rules, and regulations, the practitioner should comply with those governmental requirements as well as the applicable AT-C sections. (Ref: par. .A27) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Practitioner's Report Prescribed by Law or Regulation

.20 If the practitioner is required by law or regulation to use a specific layout, form, or wording of the practitioner's report and the prescribed form of report is not acceptable or would cause a practitioner to make a statement that the practitioner has no basis to make, the practitioner should reword the prescribed form of report or attach an appropriately worded separate practitioner's report. (Ref: par. .A28) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Defining Professional Requirements in the Attestation Standards

.21 The attestation standards use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility it imposes on practitioners:

- *Unconditional requirements.* The practitioner must comply with an unconditional requirement in all cases in which such requirement is relevant. The attestation standards use the word *must* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The practitioner must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .22. The attestation standards use the word *should* to indicate a presumptively mandatory requirement.

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Departure From a Relevant Requirement

.22 In rare circumstances, the practitioner may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the practitioner should perform alternative procedures to achieve the intent of that requirement. The need for the practitioner to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving

the intent of the requirement. (Ref: par. .A29) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Interpretive Publications

.23 The practitioner should consider applicable interpretive publications in planning and performing the attestation engagement. (Ref: par. .A30) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Other Attestation Publications

.24 In applying the attestation guidance included in an other attestation publication, the practitioner should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the attestation engagement. (Ref: par. .A31–.A33) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Acceptance and Continuance

.25 The engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and attestation engagements have been followed and should determine that conclusions reached in this regard are appropriate. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Preconditions for an Attestation Engagement

.26 The practitioner must be independent when performing an attestation engagement in accordance with the attestation standards unless the practitioner is required by law or regulation to accept the engagement. (Ref: par. .A34) [Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.27 In order to establish that the preconditions for an attestation engagement are present, the practitioner should, on the basis of a preliminary knowledge of the engagement circumstances and discussion with the appropriate party, determine the following:

- a. Whether the responsible party is a party other than the practitioner and takes responsibility for the underlying subject matter. (Ref: par. .A35–.A37)
- b. Whether the engagement exhibits all of the following characteristics:
 - i. The subject matter is appropriate. (Ref: par. .A38–.A43)
 - ii. In an examination or review engagement, the criteria to be applied in the preparation and evaluation of the underlying subject matter are suitable and will be available to the intended users. (Ref: par. .A44–.A54)
 - iii. The practitioner expects to be able to obtain the evidence needed to arrive at the practitioner's opinion, conclusion, or findings, including (Ref: par. .A55–.A56)
 - (1) access to all information of which the appropriate party is aware that is relevant to the engagement;
 - (2) access to additional information that the practitioner may request from the appropriate party for the purpose of the engagement; and

- (3) unrestricted access to persons within the appropriate party from whom the practitioner determines it necessary to obtain evidence.
- iv. The practitioner's opinion, conclusion, or findings, in the form appropriate to the engagement, is to be contained in a written practitioner's report.

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.28 If the preconditions in paragraphs .26–.27 are not present, the practitioner should discuss the matter with the engaging party to attempt to resolve the issue. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.29 The practitioner should accept an attestation engagement only when the practitioner

- a. has no reason to believe that relevant ethical requirements, including independence, will not be satisfied;
- b. is satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities (see also paragraph .34);
- c. has determined that the engagement to be performed meets all the preconditions for an attestation engagement (see also paragraphs .26–.27); and
- d. has reached a common understanding with the engaging party of the terms of the engagement, including the practitioner's reporting responsibilities.

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.30 If it is discovered after the engagement has been accepted that one or more of the preconditions for an attestation engagement is not present, the practitioner should discuss the matter with the appropriate party and should determine

- a. whether the matter can be resolved;
- b. whether it is appropriate to continue with the engagement; and
- c. if the matter cannot be resolved but it is still appropriate to continue with the engagement, whether to communicate the matter in the practitioner's report, and if the matter is to be communicated in the practitioner's report, how to do so.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Acceptance of a Change in the Terms of the Engagement

.31 The practitioner should not agree to a change in the terms of the engagement when no reasonable justification for doing so exists. If a change in the terms of the engagement is made, the practitioner should not disregard evidence that was obtained prior to the change. (Ref: par. .A57–.A58) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.32 If the practitioner concludes, based on the practitioner's professional judgment, that there is reasonable justification to change the terms of the engagement from the original level of service that the practitioner was engaged to

perform to a lower level of service, for example, from an examination to a review, and if the practitioner complies with the AT-C sections applicable to the lower level of service, the practitioner should issue an appropriate practitioner's report on the lower level of service. The report should not include reference to (a) the original engagement, (b) any procedures that may have been performed, or (c) scope limitations that resulted in the changed engagement. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Using the Work of an Other Practitioner

.33 When the practitioner expects to use the work of an other practitioner, the practitioner should (Ref: par. .A59–.A60)

- a. obtain an understanding of whether the other practitioner understands and will comply with the ethical requirements that are relevant to the engagement and, in particular, is independent.
- b. obtain an understanding of the other practitioner's professional competence.
- c. communicate clearly with the other practitioner about the scope and timing of the other practitioner's work and findings.
- d. if assuming responsibility for the work of the other practitioner, be involved in the work of the other practitioner.
- e. evaluate whether the other practitioner's work is adequate for the practitioner's purposes.
- f. determine whether to make reference to the other practitioner in the practitioner's report.

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Quality Control

Assignment of the Engagement Team and the Practitioner's Specialists

.34 The engagement partner should be satisfied that

- a. the engagement team, and any practitioner's external specialists, collectively, have the appropriate competence, including knowledge of the underlying subject matter and criteria, and capabilities to (Ref: par. .A61–.A62)
 - i. perform the engagement in accordance with professional standards and applicable legal and regulatory requirements and
 - ii. enable the issuance of a practitioner's report that is appropriate in the circumstances.
- b. to an extent that is sufficient to accept responsibility for the opinion, conclusion, or findings on the underlying subject matter or subject matter information (or assertion), the engagement team will be able to be involved in the work of
 - i. a practitioner's external specialist when the work of that specialist is to be used and (Ref: par. .A63)
 - ii. an other practitioner, when the work of that practitioner is to be used.
- c. those involved in the engagement have been informed of their responsibilities, including the objectives of the procedures they are

to perform and matters that may affect the nature, timing, and extent of such procedures.

- d. engagement team members have been directed to bring to the engagement partner's attention significant questions raised during the engagement so that their significance may be assessed.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Leadership Responsibilities for Quality in Attestation Engagements

.35 The engagement partner should take responsibility for the overall quality on each attestation engagement. This includes responsibility for the following:

- a. Appropriate procedures being performed regarding the acceptance and continuance of client relationships and engagements
- b. The engagement being planned and performed (including appropriate direction and supervision) to comply with professional standards and applicable legal and regulatory requirements
- c. Reviews being performed in accordance with the firm's review policies and procedures and reviewing the engagement documentation on or before the date of the practitioner's report (Ref: par. .A64)
- d. Appropriate engagement documentation being maintained to provide evidence of achievement of the practitioner's objectives and that the engagement was performed in accordance with the attestation standards and relevant legal and regulatory requirements
- e. Appropriate consultation being undertaken by the engagement team on difficult or contentious matters

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.36 Throughout the engagement, the engagement partner should remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine the appropriate action. [Paragraph added, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Engagement Documentation

.37 The practitioner should prepare engagement documentation on a timely basis. (Ref: par. .A65) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.38 The practitioner should assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file no later than 60 days following the practitioner's report release date. (Ref: par. .A66) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.39 After the documentation completion date, the practitioner should not delete or discard documentation of any nature before the end of its retention period. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.40 If the practitioner finds it necessary to amend existing engagement documentation or add new engagement documentation after the documentation completion date, the practitioner should, regardless of the nature of the amendments or additions, document

- a. the specific reasons for making the amendments or additions and
- b. when, and by whom, they were made and reviewed.

[Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.41 Engagement documentation is the property of the practitioner, and some jurisdictions recognize this right of ownership in their statutes. The practitioner should adopt reasonable procedures to retain engagement documentation for a period of time sufficient to meet the needs of the practitioner and to satisfy any applicable legal or regulatory requirements for records retention. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.42 Because engagement documentation often contains confidential information, the practitioner should adopt reasonable procedures to maintain the confidentiality of that information. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.43 The practitioner also should adopt reasonable procedures to prevent unauthorized access to engagement documentation. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

.44 If, in rare circumstances, the practitioner judges it necessary to depart from a relevant, presumptively mandatory requirement, the practitioner must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. (See paragraph .20.) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Engagement Quality Control Review

.45 For those engagements, if any, for which the firm has determined that an engagement quality control review is required (Ref: par. .A67)

- a. the engagement partner should take responsibility for discussing with the engagement quality control reviewer significant findings or issues arising during the engagement, including those identified during the engagement quality control review, and should not release the practitioner's report until completion of the engagement quality control review and
- b. the engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. This evaluation should include the following:
 - i. Discussion of significant findings or issues with the engagement partner
 - ii. Reading the written subject matter information (or assertion) and the proposed report
 - iii. Reading selected engagement documentation relating to the significant judgments the engagement team made and the related conclusions it reached
 - iv. Evaluation of the decisions reached in formulating the report and consideration of whether the proposed report is appropriate

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Professional Skepticism and Professional Judgment

Professional Skepticism

.46 The practitioner should maintain professional skepticism while planning and performing an attestation engagement. (Ref: par. .A68–.A70) [Paragraph renumbered and amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.47 Unless the practitioner has reason to believe the contrary, the practitioner may accept records and documents as genuine. If conditions identified during the attestation engagement cause the practitioner to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the practitioner, the practitioner should investigate further. [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Professional Judgment

.48 The practitioner should exercise professional judgment in planning and performing an attestation engagement. (Ref: par. .A71–.A76) [Paragraph renumbered by the issuance of SSAE No. 21, October 2020.]

Application and Other Explanatory Material

Introduction (Ref: par. .01 and .05)

.A1 An attestation engagement may address a variety of conditions or events, including the following:

- a. Historical or prospective performance or condition, for example, historical or prospective financial information, performance measurements, and backlog data
- b. Physical characteristics, for example, narrative descriptions or square footage of facilities
- c. Historical events, for example, the price of a market basket of goods on a certain date
- d. Analyses, for example, break-even analyses
- e. Systems and processes, for example, internal control
- f. Behavior, for example, corporate governance, compliance with laws and regulations, and human resource practices
- g. Environmental, social, and governance information, for example, greenhouse gas emissions or diversity in employment

The measurement or evaluation of such conditions or events may be as of a point in time or for a period of time. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A2 Because performance audits performed pursuant to *Government Auditing Standards* do not require a practitioner's examination, review, or agreed-upon procedures report as described in this section, this section does not apply to performance audits unless the practitioner engaged to conduct a performance audit is also engaged to conduct an AICPA attestation engagement or

issues such an examination, review, or agreed-upon procedures report. [Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.A3 Examples of litigation services include the following circumstances:

- a. The service comprises being an expert witness.
- b. The service comprises being a trier of fact or acting on behalf of one.
- c. The practitioner's work under the rules of the proceedings is subject to detailed analysis and challenge by each party to the dispute.
- d. The practitioner is engaged by an attorney to do work that will be protected by the attorney's work product or attorney-client privilege, and such work is not intended to be used for other purposes.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

Relationship of Attestation Standards to Quality Control Standards (Ref: par. .06)

.A4 The nature and extent of a firm's quality control policies and procedures depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

.A5 Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the attestation engagement and provide the firm with relevant information to enable the functioning of that part of the firm's quality control relating to independence.

.A6 Engagement teams are entitled to rely on the firm's system of quality control, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.

Definitions

Assertion-Based and Direct Examination Engagements (Ref: par. .12)

.A7 The practitioner obtains the same level of assurance in an assertion-based and direct examination engagement as the practitioner does in a financial statement audit. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Review Engagement (Ref: par. .12)

.A8 The practitioner obtains the same level of assurance in a review engagement as the practitioner does in a review of financial statements.

Attestation Risk (Ref: par. .12)

.A9 Attestation risk does not refer to the practitioner's business risks, such as loss from litigation, adverse publicity, or other events arising in connection with the underlying subject matter or subject matter information (or assertion) reported on. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A10 In general, attestation risk can be represented by the following components, although not all of these components will necessarily be present or significant for all engagements:

- a. Risks that the practitioner does not directly influence, which consist of
 - i. the susceptibility of the subject matter information to a material misstatement before consideration of any related controls (inherent risk) and
 - ii. the risk that a material misstatement that could occur in the subject matter information will not be prevented, or detected and corrected, on a timely basis by the appropriate party's internal control (control risk)
- b. Risk that the practitioner does directly influence, which consists of the risk that the procedures to be performed by the practitioner will not detect a material misstatement (detection risk)

[As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A11 The degree to which each of these components of attestation risk is relevant to the engagement is affected by the engagement circumstances, in particular

- the nature of the underlying subject matter or subject matter information. (For example, the concept of control risk may be more useful when the underlying subject matter or subject matter information relates to the preparation of information about an entity's performance than when it relates to information about the existence of a physical condition.)
- the type of engagement being performed. (For example, in a review engagement, the practitioner may often decide to obtain evidence by means other than tests of controls, in which case, consideration of control risk may be less relevant than in an examination engagement on the same subject matter information [or assertion].)

[As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A12 The consideration of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

.A13 In an examination engagement, the practitioner reduces attestation risk to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's opinion. Reducing attestation risk to zero is not contemplated in an examination engagement and, therefore, reasonable assurance is less than absolute assurance as a result of factors such as the following:

- The use of selective testing
- The inherent limitations of internal control
- The fact that much of the evidence available to the practitioner is persuasive, rather than conclusive
- The exercise of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence
- In some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria

[As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A14 In a review engagement, attestation risk is greater than it is in an examination engagement. Because the practitioner obtains limited assurance in a review engagement, the types of procedures performed are less extensive than they are in an examination engagement and generally are limited to inquiries and analytical procedures.

.A15 Attestation risk is not applicable to an agreed-upon procedures engagement because in such engagements, the practitioner performs specific procedures on underlying subject matter or subject matter information and reports the findings without providing an opinion or conclusion. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Criteria (Ref: par. .12)

.A16 Suitable criteria are required for reasonably consistent measurement or evaluation of underlying subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. The suitability of criteria is context-sensitive, that is, it is determined in the context of the engagement circumstances. Even for the same underlying subject matter, there can be different criteria, which will yield a different measurement or evaluation. For example, one responsible party might select the number of customer complaints resolved to the acknowledged satisfaction of the customer for the underlying subject matter of customer satisfaction; another responsible party might select the number of repeat purchases in the three months following the initial purchase. The suitability of criteria is not affected by the level of assurance, that is, if criteria are unsuitable for an examination engagement, they are also unsuitable for a review engagement and vice versa. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Engaging Party (Ref: par. .12)

.A17 The engaging party, depending on the circumstances, may be management or those charged with governance of the responsible party, a governmental body or agency, the intended users, or another third party.

Appropriate Party(ies) (Ref: par. .13)

.A18 Management and governance structures vary by entity, reflecting influences such as size and ownership characteristics. Such diversity means that it is not possible for the attestation standards to specify for all engagements the person(s) with whom the practitioner is to interact regarding particular matters. For example, an entity may be a segment of an organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance with whom to communicate may require the exercise of professional judgment.

Conduct of an Attestation Engagement in Accordance With the Attestation Standards

Complying With AT-C Sections That Are Relevant to the Engagement (Ref: par. .16)

.A19 A practitioner's report that merely excludes the phrase "was conducted in accordance with attestation standards established by the American

Institute of Certified Public Accountants" but is otherwise similar to a practitioner's examination, review, or agreed-upon procedures attestation report is an example of a practitioner's report that is not clearly distinguishable from, and could be confused with, a report issued under the attestation standards.

.A20 Paragraph .16 does not prohibit combining reports issued by a practitioner under the attestation standards with reports issued under other professional standards.

Text of an AT-C Section (Ref: par. .17)

.A21 The AT-C sections contain the objectives of the practitioner and requirements designed to enable the practitioner to meet those objectives. In addition, they contain related guidance in the form of application and other explanatory material, introductory material that provides context relevant to a proper understanding of the section, and definitions.

.A22 Introductory material may include, as needed, such matters as an explanation of the following:

- The purpose and scope of the AT-C section, including how the AT-C section relates to other AT-C sections
- The subject matter of the AT-C section
- The respective responsibilities of the practitioner and others regarding the subject matter of the AT-C section
- The context in which the AT-C section is set

.A23 The application and other explanatory material provides further explanation of the requirements of an AT-C section and guidance for carrying them out. In particular, it may

- a. explain more precisely what a requirement means or is intended to cover and
- b. include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not, in itself, impose a requirement, it may explain the proper application of the requirements of an AT-C section. The application and other explanatory material may also provide background information on matters addressed in an AT-C section. They do not, however, limit or reduce the responsibility of the practitioner to apply and comply with the requirements in applicable AT-C sections.

.A24 The practitioner is required by paragraph .17 to understand the application and other explanatory material. How the practitioner applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the section. The words *may*, *might*, and *could* are used to describe these actions and procedures.

.A25 An AT-C section may include, in a separate section under the heading "Definition(s)," a description of the meanings attributed to certain terms for purposes of the AT-C section. These are provided to assist in the consistent application and interpretation of the AT-C section and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings in all AT-C sections.

.A26 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body

of the related AT-C section or within the title and introduction of the appendix itself.

Complying With Relevant Requirements (Ref: par. .19)

.A27 In certain attestation engagements, the practitioner may also be required to comply with other requirements, such as in law or regulation, in addition to the attestation standards. The attestation standards do not override law or regulation that governs the attestation engagement. In the event that such law or regulation differs from attestation standards, an attestation engagement conducted only in accordance with law or regulation will not necessarily comply with the attestation standards. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Practitioner's Report Prescribed by Law or Regulation (Ref: par. .20)

.A28 Some report forms can be made acceptable by inserting additional wording to include the elements required by sections 205, 206, 210, and 215.⁶ Some report forms required by law or regulation can be made acceptable only by complete revision because the prescribed language of the practitioner's report calls for statements by the practitioner that are not consistent with the practitioner's function or responsibility, for example, a report form that requests the practitioner to "certify" the subject matter information. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Departure From a Relevant Requirement (Ref: par. .22)

.A29 Paragraph .44 prescribes documentation requirements when the circumstances described in paragraph .22 occur.

Interpretive Publications (Ref: par. .23)

.A30 *Interpretive publications* are not attestation standards. Interpretive publications are recommendations on the application of the attestation standards in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the relevant senior technical committee after all members of the committee have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the attestation standards. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Other Attestation Publications (Ref: par. .24)

.A31 Other attestation publications have no authoritative status; however, they may help the practitioner understand and apply the attestation standards. The practitioner is not expected to be aware of the full body of other attestation publications. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A32 Although the practitioner determines the relevance of these publications in accordance with paragraph .24, the practitioner may presume that other attestation publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other

⁶ Paragraphs .63–.66 of section 205, paragraphs .46–.49 of section 210, and paragraph .32–.33 of section 215, *Agreed-Upon Procedures Engagements*. [As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

attestation publications are listed in AT-C appendix B, "Other Attestation Publications."

.A33 In determining whether an other attestation publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the attestation engagement, the practitioner may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying the attestation standards and the degree to which the publisher or author is recognized as an authority in attestation matters. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the Public Company Accounting Oversight Board to promulgate technical standards.]

Preconditions for an Attestation Engagement (Ref: par. .26)

.A34 The "Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation (ET sec. 1.297) establishes special requirements for independence for services provided under the attestation standards. In addition, the "Conceptual Framework Approach" interpretation (ET sec. 1.210.010) discusses threats to independence not specifically detailed elsewhere, for example, when the practitioner has an interest in the underlying subject matter. [As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Roles and Responsibilities (Ref: par. .27a)

.A35 All attestation engagements have an engaging party, a responsible party, the practitioner, and intended users. In some attestation engagements, the engaging party is different from the responsible party. In other attestation engagements, the engaging party, the responsible party, and the intended users may all be the same. [Paragraph added, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.A36 The responsible party may acknowledge its responsibility for the underlying subject matter as it relates to the objective of the engagement in a number of ways, for example, in an engagement letter, a representation letter, or the presentation of the subject matter information, including the notes thereto, or the written assertion. Examples of other evidence of the responsible party's responsibility for the underlying subject matter include reference to legislation, a regulation, or a contract. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A37 Evidence that the appropriate relationship exists with respect to responsibility for the underlying subject matter may be obtained through an acknowledgment provided by the responsible party. Such an acknowledgment also establishes a basis for a common understanding of the responsibilities of the responsible party and the practitioner. A written acknowledgment is the most appropriate form of documenting the responsible party's understanding. In the absence of a written acknowledgment of responsibility, it may still be appropriate for the practitioner to accept the engagement if, for example, other sources, such as legislation or a contract, indicate responsibility. In other cases, it may be appropriate to decline the engagement depending on the circumstances or disclose the circumstances in the attestation report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Appropriateness of Underlying Subject Matter (Ref: par. .27b(i))

.A38 An element of the appropriateness of underlying subject matter is the existence of a reasonable basis for measuring or evaluating the underlying subject matter against criteria. The responsible party in an assertion-based examination engagement or review engagement is responsible for having a reasonable basis for measuring or evaluating the underlying subject matter against the criteria. What constitutes a reasonable basis will depend on the nature of the underlying subject matter and other engagement circumstances. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A39 An appropriate underlying subject matter

- a. is identifiable and capable of consistent measurement or evaluation against the criteria and
- b. can be subjected to procedures for obtaining sufficient appropriate evidence to support an opinion, conclusion, or findings, as appropriate.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A40 If the underlying subject matter is not appropriate for an examination engagement, it also is not appropriate for a review engagement. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A41 Different underlying subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective, and relates to a point in time or covers a period. Such characteristics affect the following:

- a. In an examination or review engagement, the precision with which the underlying subject matter can be measured or evaluated against criteria
- b. The persuasiveness of available evidence

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A42 Identifying such characteristics and considering their effects assists the practitioner when assessing the appropriateness of the underlying subject matter and also in determining the content of the practitioner's report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A43 In some cases, the attestation engagement may relate to only one part of a broader underlying subject matter. For example, the practitioner may be engaged to examine one aspect of an entity's contribution to sustainable development, such as the programs run by the entity that have positive environmental outcomes, and may be aware that the practitioner has not been engaged to examine more significant programs with less favorable outcomes. In such cases,

in determining whether the engagement exhibits the characteristic of having an appropriate underlying subject matter, it may be appropriate for the practitioner to consider whether information about the aspect that the practitioner is asked to examine is likely to meet the information needs of intended users. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Suitable and Available Criteria (Ref: par. .27b(ii))

.A44 Suitable criteria exhibit all of the following characteristics:

- *Relevance.* Criteria are relevant to the underlying subject matter.
- *Objectivity.* Criteria are free from bias.
- *Measurability.* Criteria permit reasonably consistent measurements, qualitative or quantitative, of underlying subject matter.
- *Completeness.* Criteria are complete when subject matter information prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter information.

The relative importance of each characteristic to a particular engagement is a matter of professional judgment. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A45 Criteria can be developed in a variety of ways, for example, they may be

- embodied in laws or regulations.
- issued by authorized or recognized bodies of experts that follow a transparent due process.
- developed collectively by a group that does not follow a transparent due process.
- published in scholarly journals or books.
- developed for sale on a proprietary basis.
- specifically designed for the purpose of measuring, evaluating, or disclosing information about the underlying subject matter in the particular circumstances of the engagement.

How criteria are developed may affect the work that the practitioner carries out to assess their suitability. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A46 Criteria that are established or developed by groups composed of experts that follow due process procedures, including exposure of the proposed criteria for public comment, are ordinarily considered suitable. Criteria promulgated by a body designated by the Council of the AICPA under the AICPA Code of Professional Conduct are, by definition, considered to be suitable. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A47 In some cases, laws or regulations prescribe the criteria to be used for the engagement. In the absence of indications to the contrary, such criteria are presumed to be suitable. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A48 Criteria may be established or developed by the engaging party, the responsible party, industry associations, or other groups that do not follow due process procedures or do not as clearly represent the public interest. The practitioner's determination of whether such criteria are suitable is based on the characteristics described in paragraph .A42. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A49 Regardless of who establishes or develops the criteria, the responsible party or the engaging party is responsible for selecting the criteria, and the engaging party is responsible for determining that such criteria are appropriate for its purposes. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A50 Some criteria may be suitable for only a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria. For example, criteria set forth in a lease agreement for override payments may be suitable only for reporting to the parties to the agreement because of the likelihood that such criteria would be misunderstood or misinterpreted by parties other than those who have specifically agreed to the criteria. Such criteria can be agreed upon directly by the parties or through a designated representative. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A51 Even when established criteria exist for an underlying subject matter, specific users may agree to other criteria for their specific purposes. For example, various frameworks can be used as established criteria for evaluating the effectiveness of internal control. Specific users may, however, develop a more detailed set of criteria that meet their specific information needs. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A52 If criteria are specifically designed for the purpose of measuring, evaluating, or disclosing information about the underlying subject matter in the particular circumstances of the engagement, they are not suitable if they result in subject matter information or a practitioner's report that is misleading to the intended users. It is desirable for the intended users or the engaging party to acknowledge that specifically developed criteria are suitable for the intended users' purposes. The absence of such an acknowledgement may affect what is to be done to assess the suitability of the criteria and the information provided about the criteria in the report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A53 Criteria need to be available to the intended users to allow them to understand how the underlying subject matter has been measured or evaluated. Criteria are made available to the intended users in one or more of the following ways:

- a. Publicly
- b. Through inclusion in a clear manner in the presentation of the subject matter information
- c. Through inclusion in a clear manner in the practitioner's report
- d. By general understanding, for example, the criterion for measuring time in hours and minutes
- e. Available only to specified parties, for example, terms of a contract or criteria issued by an industry association that are available only to those in the industry

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A54 When criteria are available only to specified parties, sections 205 and 210 require a statement restricting the use of the practitioner's report.⁷ [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Access to Evidence (Ref: par. .27b[iii])

.A55 The nature of the relationship between the responsible party and, if different, the engaging party, may affect the practitioner's ability to access records, documentation, and other information the practitioner may require as evidence to arrive at the practitioner's opinion, conclusion, or findings. Therefore, the nature of that relationship may be a relevant consideration when determining whether or not to accept the engagement. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A56 The quantity or quality of available evidence is affected by both of the following:

- a. The characteristics of the underlying subject matter or the subject matter information, for example, less objective evidence might be expected when the subject matter information is future-oriented, rather than historical
- b. Other circumstances, such as when evidence that could reasonably be expected to exist is not available, for example, because of the timing of the practitioner's appointment, an entity's document retention policy, inadequate information systems, or a restriction imposed by the responsible or engaging party

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

**Acceptance of a Change in the Terms of the Engagement
(Ref: par. .31)**

.A57 A change in circumstances that affects the requirements of the responsible party or, if different, the engaging party, or a misunderstanding concerning the nature of the engagement originally requested, may be considered reasonable justification for requesting a change in the engagement, for example, from an attestation engagement to a consulting engagement or from an examination engagement to a review engagement. A change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete, or otherwise unsatisfactory. An example of such a circumstance is a request to change the engagement from an examination to a review to avoid a modified opinion or a disclaimer of opinion in a situation in which the practitioner is unable to obtain sufficient appropriate evidence regarding the underlying subject matter or subject matter information. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A58 If the practitioner and the engaging party are unable to agree to a change in the terms of the engagement and the practitioner is not permitted

⁷ Paragraph .64b of section 205 and paragraph .47b of section 210.

to continue the original engagement, the practitioner may withdraw from the engagement when possible under applicable laws and regulations. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Using the Work of an Other Practitioner (Ref: par. .33)

.A59 The practitioner is responsible for (a) the direction, supervision, and performance of the engagement in compliance with professional standards; applicable regulatory and legal requirements; and the firm's policies and procedures and (b) determining whether the practitioner's report that is issued is appropriate in the circumstances. The practitioner may, however, use the work of other practitioners to obtain sufficient appropriate evidence to express an opinion, conclusion, or findings on the subject matter information (or assertion). [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A60 The engagement partner may decide to assume responsibility for the work of the other practitioner or to make reference to the other practitioner in the practitioner's report. Regardless of whether the engagement partner decides to assume responsibility or make reference, the practitioner is required to communicate clearly with the other practitioner and evaluate whether the other practitioner's work is adequate for the purposes of the engagement. The nature, timing, and extent of this involvement are affected by the practitioner's understanding of the other practitioner, such as previous experience with, or knowledge of, the other practitioner and the degree to which the engagement team and the other practitioner are subject to common quality control policies and procedures. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Quality Control

Assignment of the Engagement Team and the Practitioner's Specialists (Ref: par. .34a–b[i])

.A61 The practitioner may obtain knowledge about the specific underlying subject matter to which the procedures are to be applied and the criteria through formal or continuing education, practical experience, or consultation with others. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A62 When considering the appropriate competence and capabilities expected of those involved in the engagement, the engagement partner may take into consideration such matters as their

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant IT and specialized areas relevant to the underlying subject matter.
- knowledge of relevant industries in which the entity operates.
- ability to apply professional judgment.

- understanding of the firm's quality control policies and procedures.

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A63 Some of the attestation work may be performed by a multidisciplinary team that includes one or more practitioner's specialists. For example, in an examination engagement, a practitioner's specialist may be needed to assist the practitioner in obtaining an understanding of the underlying subject matter, criteria, and other engagement circumstances or in assessing or responding to the risk of material misstatement. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Leadership Responsibilities for Quality in Attestation Engagements **(Ref: par. .36c)**

.A64 Under QM section 10A, the firm's review responsibility policies and procedures are determined on the basis that suitably experienced team members review the work of other team members. The engagement partner may delegate part of the review responsibility to other members of the engagement team, in accordance with the firm's system of quality control. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Engagement Documentation (Ref: par. .37–.38)

.A65 Documentation prepared at the time work is performed or shortly thereafter is likely to be more accurate than documentation prepared at a much later time. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A66 The completion of the assembly of the final engagement file is an administrative process that does not involve the performance of new procedures or the drawing of new conclusions. Changes may, however, be made to the documentation during the final assembly process if they are administrative in nature. Examples of such changes include the following:

- Deleting or discarding superseded documentation
- Sorting, collating, and cross-referencing working papers
- Signing off on completion checklists relating to the file assembly process
- Documenting evidence that the practitioner has obtained, discussed, and agreed with the relevant members of the engagement team before the date of the practitioner's report
- Adding information received after the date of the report, for example, an original confirmation that was previously communicated electronically

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

Engagement Quality Control Review (Ref: par. .45)

.A67 Other matters that may be considered in an engagement quality control review include the following:

- a. The engagement team's evaluation of the firm's independence in relation to the engagement
- b. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
- c. Whether engagement documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Professional Skepticism and Professional Judgment

Professional Skepticism (Ref: par. .46)

.A68 Professional skepticism includes being alert to matters such as the following:

- Evidence that contradicts other evidence obtained
- Information that brings into question the reliability of documents and responses to inquiries to be used as evidence
- Circumstances that may indicate fraud
- Circumstances that suggest the need for procedures in addition to those required by relevant AT-C sections

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A69 Professional skepticism is necessary to the critical assessment of evidence. This includes questioning contradictory evidence and the reliability of documents and responses to inquiries and other information obtained from the appropriate party. It also includes consideration of the sufficiency and appropriateness of evidence obtained in light of the circumstances. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A70 The practitioner neither assumes that the appropriate party is dishonest nor assumes unquestioned honesty. The practitioner cannot be expected to disregard past experience of the honesty and integrity of those who provide evidence. Nevertheless, a belief that those who provide evidence are honest and have integrity does not relieve the practitioner of the need to maintain professional skepticism or allow the practitioner to be satisfied with less than sufficient appropriate evidence for the service being provided. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Professional Judgment (Ref: par. .48)

.A71 Professional judgment is essential to the proper conduct of an attestation engagement. This is because interpretation of relevant ethical requirements and relevant AT-C sections and the informed decisions required throughout the engagement cannot be made without the application of relevant knowledge and experience to the facts and circumstances. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A72 For examination and review engagements, professional judgment is necessary regarding decisions about the following matters:

- Materiality and attestation risk
- The nature, timing, and extent of procedures used to meet the requirements of relevant AT-C sections and gather evidence

- Evaluating whether sufficient appropriate evidence for the service being provided has been obtained and whether more needs to be done to achieve the objectives of this section, section 205, section 206, or section 210, and any relevant subject-matter-specific AT-C sections and thereby the overall objectives of the practitioner
- In assertion-based examination engagements and review engagements, the evaluation of the responsible party's judgments in applying the criteria
- The drawing of conclusions based on the evidence obtained, for example, assessing the reasonableness of the evaluation or measurement of underlying subject matter

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

.A73 The distinguishing feature of professional judgment expected of a practitioner is that such judgment is exercised based on competencies necessary to achieve reasonable judgments developed by the practitioner through relevant training, knowledge, and experience. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A74 The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the practitioner. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, assist the practitioner in making informed and reasonable judgments. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A75 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of the attestation standards and measurement or evaluation principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the practitioner up to the date of the practitioner's report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A76 The requirement to exercise professional judgment applies throughout the engagement. Professional judgment also needs to be appropriately documented as required by sections 205, 206, and 210. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019. As amended, effective for practitioners' reports dated on or after June 15, 2022, by SSAE No. 21.]

AT-C Section 9105

Concepts Common to All Attestation Engagements: Attestation Interpretations of Section 105

1. Responding to Requests for Reports on Matters Relating to Solvency

.01 Question — Lenders, as a requisite to the closing of certain secured financings in connection with leveraged buyouts, recapitalizations, and certain other financial transactions, have sometimes requested written assurance from an accountant regarding the prospective borrower's solvency and related matters.¹ The lender is concerned that such financings not be considered to include a fraudulent conveyance or transfer under the United States Bankruptcy Code² or the relevant state fraudulent conveyance or transfer statute.³ If the financing is subsequently determined to have included a fraudulent conveyance or transfer, repayment obligations and security interests may be set aside or subordinated to the claims of other creditors.

.02 May a practitioner provide assurance concerning *matters relating to solvency*, as hereinafter defined?

.03 Interpretation — No. For reasons set forth subsequently, a practitioner should not provide any form of assurance, through an examination, review, or agreed-upon procedures engagement, that an entity

¹ Although this interpretation describes requests from secured lenders and summarizes the potential effects of fraudulent conveyance or transfer laws upon such lenders, the interpretation is not limited to requests from lenders. All requests for assurance on matters relating to solvency are governed by this interpretation.

² Chapter 5 of the United States Bankruptcy Code addresses *fraudulent transfers and obligations* and states the following:

(a)(1) The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor, that was made or incurred on or within two years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer occurred or such obligation was incurred, indebted; or

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

³ State fraudulent conveyance or transfer statutes such as the Uniform Fraudulent Conveyance Act and the Uniform Fraudulent Transfer Act reflect substantially similar provisions. These state laws may be employed absent a declaration of bankruptcy or by a bankruptcy trustee under Section 544(1) of the United States Bankruptcy Code. Although the statute of limitations varies from state to state, in some states, financing transactions may be vulnerable to challenge for up to six years from closing.

- is not insolvent at the time the debt is incurred or would not be rendered insolvent thereby.
- does not have unreasonably small capital.
- has the ability to pay its debts as they mature.

In the context of particular transactions, other terms are sometimes used or defined by the parties as equivalents of or substitutes for the preceding terms (for example, *fair salable value of assets exceeds liabilities*). These terms, and those matters listed previously, are hereinafter referred to as *matters relating to solvency*. The prohibition extends to providing assurance concerning all such terms.

.04 Section 105, *Concepts Common to All Attestation Engagements*, indicates that one of the preconditions for performing an attestation engagement is that the criteria to be applied in the preparation and evaluation of the underlying subject matter are suitable and will be available to the intended users.⁴ Section 105 also indicates that suitable criteria exhibit all the following characteristics:⁵

- *Relevance*. Criteria are relevant to the underlying subject matter.
- *Objectivity*. Criteria are free from bias.
- *Measurability*. Criteria permit reasonably consistent measurements, qualitative or quantitative, of underlying subject matter.
- *Completeness*. Criteria are complete when subject matter information prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of the subject matter information.

.05 The matters relating to solvency mentioned in paragraph .03 of this interpretation are subject to legal interpretation under, and varying legal definition in, the United States Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense and, therefore, are subject to varying interpretations, they do not provide the practitioner with suitable criteria required to evaluate the underlying subject matter or an assertion. In addition, lenders are concerned with legal issues on matters relating to solvency, and the practitioner is generally unable to evaluate or provide assurance on these matters of legal interpretation. Therefore, practitioners are precluded from giving any form of assurance on matters relating to solvency or any financial presentation of matters relating to solvency.

.06 Under existing AICPA standards, the practitioner may provide a client with various professional services that may be useful to the client in connection with a financing. These services include the following:

- Audit of historical financial statements
- Review of historical financial information (a review in accordance with AU-C section 930, *Interim Financial Information*, of interim financial information or in accordance with AR-C section 90, *Review of Financial Statements*)
- Examination or review of pro forma financial information (section 310, *Reporting on Pro Forma Financial Information*).
- Examination of prospective financial information in accordance with section 305, *Prospective Financial Information*,

⁴ Paragraph .27b(ii) of section 105, *Concepts Common to All Attestation Engagements*.

⁵ Paragraph .A44 of section 105.

or compilation of prospective financial information in accordance with AR-C section 80A, *Compilation Engagements*.⁶

.07 Although a practitioner may not provide an agreed-upon procedures report under section 215, *Agreed-Upon Procedures Engagements*, that addresses matters related to solvency, a practitioner may provide an agreed-upon procedures report that addresses other subject matter that can be useful to a client or lender in connection with a financing. For example, the practitioner may perform an agreed-upon procedures engagement in which the client and lender specify the procedures to be applied to various financial presentations, such as historical financial information, pro forma financial information, and prospective financial information, which can be useful to a client or lender in connection with a financing.

.08 The practitioner should be aware that certain of the services described in paragraph .06 require that the practitioner have an appropriate level of knowledge of the entity's accounting and financial reporting practices and its internal control. This has ordinarily been obtained by the practitioner auditing historical financial statements of the entity for the most recent annual period or by otherwise obtaining an equivalent knowledge base. When considering acceptance of an engagement relating to a financing, the practitioner should consider whether he or she can perform these services without an equivalent knowledge base.

.09 Section 215 states that the practitioner should not express an opinion or conclusion on the subject matter or about whether the subject matter is in accordance with (or based on) the criteria.⁷ Accordingly, a report on agreed-upon procedures should not express an opinion or conclusion on matters relating to solvency or any financial presentation of matters relating to solvency (for example, fair salable value of assets less liabilities or fair salable value of assets less liabilities, contingent liabilities, and other commitments). A practitioner's report on the results of applying agreed-upon procedures should contain the report elements set forth in section 215 (or section 305 if applying agreed-upon procedures to prospective financial information).⁸ To clarify the purpose of the engagement and the practitioner's findings, the practitioner's report on the results of applying agreed-upon procedures may state that

- the service has been requested in connection with a financing (no reference should be made to any solvency provisions in the financing agreement).
- no representations are provided regarding questions of legal interpretation.
- no assurance is provided concerning the borrower's
 - solvency,
 - adequacy of capital, or
 - ability to pay its debts.

⁶ Paragraph .01 of AR-C section 80A, *Compilation Engagements*. Section 305, *Prospective Financial Information*, does not address compilations of prospective financial information — a service that is included in AT section 301, *Financial Forecasts and Projections*. Paragraph .01 of AR-C section 80A states that AR-C section 80A (which is applicable to compilations of historical financial statements) also may be applied, adapted as necessary in the circumstances, to other historical or prospective financial information.

All AT sections can be found in *PCAOB Standards and Related Rules*.

All AR-C sections can be found in *AICPA Professional Standards*.

⁷ Paragraph .26c of section 215, *Agreed-Upon Procedures Engagements*.

⁸ Paragraph .34 of section 215 and paragraph .39 of section 305.

- the procedures should not be taken to supplant any additional inquiries and procedures that the lender should undertake in its consideration of the proposed financing.
- where applicable, an audit of recent historical financial statements has previously been performed and that no audit of any historical financial statements for a subsequent period has been performed. In addition, if any services have been performed pursuant to paragraph .06, they may be referred to.

.10 The financing agreement ordinarily specifies the date, often referred to as the *cut-off date*, to which the report is to relate (for example, a date three business days before the date of the report). To clarify the purpose of the engagement and the practitioner's findings, the report may state that the inquiries and other procedures carried out in connection with the report did not cover the period from the cut-off date to the date of the report.

.11 The practitioner might consider furnishing the client with a draft of the agreed-upon procedures report. In order to avoid giving the impression that the procedures described therein have been performed, the draft report may be identified as a draft. This practice of furnishing a draft report at an early point permits the practitioner to make clear to the client and lender what they may expect the accountant to furnish and gives them an opportunity to change the financing agreement or the agreed-upon procedures if they so desire. [Issue Date: May 1988. Amended, February 1993. Revised, January 2001. Revised, November 2006. Revised, December 2012. Revised, April 2016, effective for practitioners' reports dated on or after May 1, 2017. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE Nos. 19 and 21.]

2. Applicability of Attestation Standards to Litigation Services

.12 Question — Does Interpretation No. 1, "Responding to Requests for Reports on Matters Relating to Solvency," of section 105 prohibit a practitioner from providing expert testimony, as described in section 105, before a trier of fact on matters relating to solvency?⁹

.13 Interpretation — No. Matters relating to solvency mentioned in paragraph .03 of Interpretation No. 1 are subject to legal interpretation under, and varying legal definition in, the United States Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense and, therefore, subject to varying interpretations, they do not provide the practitioner with the suitable criteria required to evaluate the assertion. Thus, Interpretation No. 1 prohibits a practitioner from providing any form of assurance in reporting upon examination, review, or agreed-upon procedures engagements about matters relating to solvency (as defined in paragraph .03 of Interpretation No. 1).

.14 However, a practitioner who is involved with pending or potential formal legal or regulatory proceedings before a trier of fact in connection with the resolution of a dispute between two or more parties may provide an expert opinion or consulting advice about matters relating to solvency. The prohibition in Interpretation No. 1 does not apply in such engagements because as part of the legal or regulatory proceedings, each party to the dispute has the opportunity to analyze and challenge the legal definition and interpretation of the matters

⁹ Paragraph .A2 of section 105.

relating to solvency and the criteria the practitioner uses to evaluate matters related to solvency. Such services are not intended to be used by others who do not have the opportunity to analyze and challenge such definitions and interpretations. [Issue Date: July 1990. Revised: January 2001. Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

3. Providing Access to or Copies of Engagement Documentation to a Regulator^{10, 11}

.15 Question — Section 105 states that "Because engagement documentation often contains confidential information, the practitioner should adopt reasonable procedures to maintain the confidentiality of that information."¹² However, practitioners are sometimes required by law, regulation, or contract¹³ to provide a regulator, or a duly appointed representative, access to engagement documentation. For example, a regulator may request access to the engagement documentation to fulfill a quality review requirement or to assist in establishing the scope of a regulatory examination. Furthermore, as part of the regulator's review of the engagement documentation, the regulator may request copies of all or selected portions of the engagement documentation during or after the review. The regulator may intend, or decide, to make copies (or information derived from the engagement documentation) available to others, including other governmental agencies, for their particular purposes, with or without the knowledge of the practitioner or the client. When a regulator requests the practitioner to provide access to (and possibly copies of) engagement documentation pursuant to law, regulation, or contract, what actions might the practitioner consider?

.16 Interpretation — When a regulator requests access to engagement documentation pursuant to law, regulation, or contract, the practitioner may take the following steps:

- a. Consider advising the client that the regulator has requested access to (and possibly copies of) the engagement documentation and that the practitioner intends to comply with such request.¹⁴

¹⁰ The term *regulator(s)* includes federal, state, and local government officials with legal oversight authority over the entity. Examples of regulators who may request access to engagement documentation include, but are not limited to, state insurance and utility regulators, various health care authorities, and federal agencies such as the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, the Department of Labor, and the Rural Electrification Administration.

¹¹ The guidance in this interpretation does not apply to requests from the IRS; firm practice-monitoring programs, to comply with AICPA or state professional requirements such as peer or quality reviews; proceedings relating to alleged ethics violations; or subpoenas.

¹² Paragraph .42 of section 105.

¹³ Paragraphs .26–.30 of this interpretation address situations in which the practitioner is not required by law, regulation, or contract to provide a regulator access to the engagement documentation.

¹⁴ The practitioner may wish (and, in some cases, may be required by law, regulation, or contract) to confirm in writing with the client that the practitioner may be required to provide a regulator access to the engagement documentation. Sample language that may be used follows:

The engagement documentation for this engagement is the property of [name of firm] and constitutes confidential information. However, we may be requested to make certain engagement documentation available to [name of regulator] pursuant to authority given to it by law or regulation. If requested, access to such engagement documentation will be provided under the supervision of [name of firm] personnel. Furthermore, upon request, we may provide copies of selected engagement documentation to [name of regulator]. The [name of regulator] may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

- b. Make appropriate arrangements with the regulator for the review.
- c. Maintain control over the engagement documentation, and
- d. Consider submitting the letter described in paragraph .19 of this interpretation to the regulator.

.17 Making appropriate arrangements with the regulator may include establishing the specific details, such as the date, time, and location of the review. The engagement documentation may be made available to a regulator at the offices of the client, the practitioner, or a mutually agreed-upon location. However, maintaining control of engagement documentation is necessary in order for the practitioner to maintain the integrity of the engagement documentation and the confidentiality of client information. For example, the practitioner (or the practitioner's representative) may be present when the engagement documentation is reviewed by the regulator.

.18 Ordinarily, the practitioner may not agree to transfer ownership of the engagement documentation to a regulator. Furthermore, the practitioner may not agree, without client authorization, that the information contained therein about the client may be communicated to or made available to any other party. In this regard, the action of a practitioner providing access to, or copies of, the engagement documentation shall not constitute transfer of ownership or authorization to make them available to any other party.

.19 An engagement performed in accordance with the attestation standards is not intended to, and does not, satisfy a regulator's oversight responsibilities. To avoid any misunderstanding, prior to allowing a regulator access to the engagement documentation, the practitioner may submit a letter to the regulator that

- a. sets forth the practitioner's understanding of the purpose for which access is being requested;
- b. describes the examination, review, or agreed-upon procedures process, as applicable, and the limitations inherent in the applicable attestation engagement;
- c. explains the purpose for which the engagement documentation was prepared, and that any individual conclusions or findings must be read in the context of the practitioner's report on the subject matter (or assertion);
- d. states, except when not applicable, that the engagement was not planned or conducted in contemplation of the purpose for which access is being granted or to assess the entity's compliance with laws and regulations;
- e. states that the examination, review, or agreed-upon procedures engagement, as applicable, and the engagement documentation should not supplant other inquiries and procedures that should be undertaken by the regulator for its purposes;
- f. requests confidential treatment under the Freedom of Information Act or similar laws and regulations,¹⁵ when a request for the engagement documentation is made, and that written notice be given to the practitioner before transmitting any information contained in the engagement documentation to others, including

¹⁵ The practitioner may need to consult the regulations of individual agencies and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

other governmental agencies, except when such transfer is required by law or regulation; and

- g. states that if any copies are to be provided, they will be identified as "Confidential Treatment Requested by [name of firm, address, telephone number]."

The practitioner may obtain a signed acknowledgment copy of the letter as evidence of the regulator's receipt of the letter. Illustrative letters for an examination engagement performed in accordance with section 315, *Compliance Attestation*, and an agreed-upon procedures engagement performed in accordance with section 215 follow.

.20 Illustrative letter for an examination engagement:

Illustrative Letter to Regulator¹⁶

[Date]

[Name and Address of Regulatory Agency]

Your representatives have requested access to our engagement documentation in connection with our engagement to examine XYZ Company's compliance with [identify the specified requirements] during the period [date] to [date] [or management's assertion about its compliance with (identify the specified requirements) during the period (date) to (date)]. It is our understanding that the purpose of your request is [state purpose: for example, "to facilitate your regulatory examination"]¹⁷

Our examination was conducted in accordance with attestation standards¹⁸ established by the AICPA, the objective of which is to obtain reasonable assurance about whether XYZ Company complied with [identify the specified requirements] during the period [date] to [date], in all material respects, and to express an opinion in a written report about whether XYZ Company complied with [identify the specified requirements] during the period [date] to [date] [or whether management's assertion about its compliance with (identify the specified requirements) during the period (date) to (date) is fairly stated], in all material respects, based on our examination. Under these standards, we have the responsibility to plan and perform our examination to provide a reasonable basis for our opinion and to exercise due professional care in the performance of our examination. Our examination is subject to the inherent risk that material noncompliance, if it exists, would not be detected. In addition, our examination does not address the possibility that material noncompliance may occur in the future. Also, our use of professional judgment and the assessments of attestation risk and materiality for the purpose of our examination means that matters may have existed that would have been assessed differently by you.

¹⁶ The letter may be modified appropriately when the engagement has been conducted in accordance with Statements on Standards for Attestation Engagements (SSAEs) and also in accordance with additional attestation requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

¹⁷ See footnote 13. Also, if the practitioner is not required by law, regulation, or contract to provide a regulator access to the engagement documentation but otherwise intends to provide such access, the letter should include a statement that "Management of [name of entity] has authorized us to provide you access to our attest documentation for [state purpose]." [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

¹⁸ See footnote 16.

Our examination does not provide a legal determination on *[name of entity]*'s compliance with specified requirements.

The engagement documentation was prepared for the purpose of providing a sufficient and appropriate record of the basis of our opinion on *[name of entity]*'s compliance and to aid in the performance and supervision of our examination. The engagement documentation is the principal record of attestation procedures performed, relevant evidence obtained, and conclusions reached by us in the examination. The procedures that we performed were limited to those we considered necessary under attestation standards¹⁹ established by the AICPA to provide us with reasonable basis for our opinion. Accordingly, we make no representation as to the sufficiency or appropriateness, for your purposes, of either the procedures or information in our engagement documentation. In addition, any notations, comments, and individual conclusions appearing on any of the engagement documentation do not stand alone and should not be read as an opinion on any part of management's assertion or the related subject matter.

Our examination was conducted for the purpose stated above and was not planned or performed in contemplation of your *[state purpose]*: for example, "regulatory examination". Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our examination, and the engagement documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the *[name of regulatory agency]* for the purpose of monitoring and regulating *[name of entity]*. In addition, we have not performed any procedures since the date of our report with respect to the subject matter *[or management's assertion related thereto]*, and significant events or circumstances may have occurred since that date.

The engagement documentation constitutes and reflects work performed or information obtained by us in the course of our examination. The documents contain trade secrets and confidential commercial and financial information of our firm and *[name of entity]* that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations²⁰ when requests are made for the engagement documentation or information contained therein or any documents created by the *[name of regulatory agency]* containing information derived there from. We further request that written notice be given to our firm before distribution of the information in the engagement documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.

[If it is expected that copies will be requested, add the following:]

Any copies of our engagement documentation we agree to provide you will contain a legend "Confidential Treatment Requested by *(name of firm, address, telephone number)*."

[Firm signature]

¹⁹ See footnote 16.

²⁰ This illustrative paragraph may not, in and of itself, be sufficient to gain confidential treatment under the rules and regulations of certain regulatory agencies. The practitioner should consider tailoring this paragraph to the circumstances after consulting the regulations of each applicable regulatory agency and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

.21 The following is an illustrative letter for an agreed-upon procedures engagement:

Illustrative Letter to Regulator²¹

[Date]

[Name and Address of Regulatory Agency]

Your representatives have requested access to our engagement documentation in connection with our engagement to perform agreed-upon procedures on [identify the subject matter or management's assertion]. It is our understanding that the purpose of your request is [state purpose: for example, "to facilitate your regulatory examinations."]²²

Our agreed-upon procedures engagement was conducted in accordance with attestation standards²³ established by the AICPA. Under these standards, we have the responsibility to perform the agreed-upon procedures to provide a reasonable basis for the findings expressed in our report. We were not engaged to, and did not, perform an examination, the objective of which would be to form an opinion on [identify the subject matter or management's assertion]. Our engagement is subject to the inherent risk that material misstatement of [identify the subject matter or management's assertion], if it exists, would not be detected. [The practitioner may add the following: "In addition, our engagement does not address the possibility that material misstatement of (identify the subject matter or management's assertion) may occur in the future."] The procedures that we performed were limited to those agreed to and acknowledged by [name of entity] to be appropriate to meet the intended purpose of [the intended purpose of the agreed-upon procedures engagement]. Further, our engagement does not provide a legal determination on [name of entity]'s compliance with specified requirements.

The engagement documentation was prepared to document agreed-upon procedures applied, information obtained, and related findings in the engagement. Accordingly, we make no representation, for your purposes, as to the sufficiency or appropriateness of the information in our engagement documentation. In addition, any notations, comments, and individual findings appearing on any of the engagement documentation should not be read as an opinion on [identify the subject matter or management's assertion], or any part thereof.

Our engagement was performed for the purpose stated above and was not performed in contemplation of your [state purpose: for example, "regulatory examination"]. Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our engagement, and the engagement documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the [name of regulatory agency] for the purpose of monitoring and regulating [name of client]. In addition, we have not performed any procedures since the date of our report with respect to the subject matter or management's assertion related thereto, and significant events or circumstances may have occurred since that date.

The engagement documentation constitutes and reflects procedures performed or information obtained by us in the course of our engagement. The documents

²¹ See footnote 16.

²² See footnotes 13 and 17. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Revised, April 2016.]

²³ See footnote 16.

contain trade secrets and confidential commercial and financial information of our firm and *[name of client]* that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations when requests are made for the engagement documentation or information contained therein or any documents created by the *[name of regulatory agency]* containing information derived therefrom. We further request that written notice be given to our firm before distribution of the information in the engagement documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.²⁴

[If it is expected that copies will be requested, add the following:]

Any copies of our engagement documentation we agree to provide you will contain a legend "Confidential Treatment Requested by *(name of firm, address, telephone number)*."

[Firm signature]

[Issue Date: May 1996; Revised: January 2001. January 2002. Revised: December 2012. Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE Nos. 19 and 21.]

.22 Question — A regulator may request access to the engagement documentation before the attestation engagement has been completed and the report released. May the practitioner allow access in such circumstances?

.23 Interpretation — When the engagement has not been completed, the engagement documentation is necessarily incomplete because (a) additional information may be added as a result of further tests and review by supervisory personnel, and (b) any results of the engagement and conclusions reflected in the incomplete engagement documentation may change. Accordingly, it is preferable that access be delayed until all attestation procedures have been completed and all internal reviews have been performed. If access is provided prior to completion of the engagement, the practitioner may issue the letter referred to in paragraph .19 of this interpretation, modified appropriately. The following is an example of additional language that may be included in the letter:

We have been engaged to examine, in accordance with attestation standards established by the AICPA, XYZ Company's compliance with *[identify the specified requirements]* during the period *[date]* to *[date]* (or management's assertion about its compliance during the period *[date]* to *[date]*), but have not yet completed our examination. Accordingly, at this time, we do not express any opinion on XYZ Company's compliance with *[identify the specified requirements]* during the period *[date]* to *[date]* (or management's assertion about its compliance during the period *[date]* to *[date]*). Furthermore, the contents of the engagement documentation may change as a result of additional attestation procedures and review of the engagement documentation by supervisory personnel of our firm. Accordingly, our engagement documentation is incomplete.

Because the engagement documentation may change prior to completion of the engagement, it is preferable that the practitioner not provide copies of the engagement documentation until the engagement has been completed.

²⁴ See footnote 20.

.24 Question — Some regulators may engage an independent party, such as another independent public accountant, to perform the engagement documentation review on behalf of the regulatory agency. Are there any special precautions the practitioner may observe in these circumstances?

.25 Interpretation — The practitioner may obtain acknowledgment, preferably in writing, from the regulator stating that the third party is acting on behalf of the regulator and agreement from the third party that he or she is subject to the same restrictions on disclosure and use of engagement documentation and the information contained therein as the regulator.

.26 Question — When a regulator requests the practitioner to provide access to (and possibly copies of) engagement documentation and the practitioner is not otherwise required by law, regulation, or contract to provide such access, what steps may the practitioner take?

.27 Interpretation — The practitioner may obtain an understanding of the reasons for the regulator's request for access to the engagement documentation and may consider consulting with legal counsel regarding the request. If the practitioner decides to provide such access, reasonable procedures to maintain the confidentiality of client information include obtaining the client's consent, preferably in writing, to provide the regulator access to the engagement documentation.

.28 Following is an example of language that may be used in the written communication to the client:

The engagement documentation for this engagement is the property of [name of firm] and constitutes confidential information. However, we have been requested to make certain engagement documentation available to [name of regulator] for [describe the regulator's basis for its request]. Access to such engagement documentation will be provided under the supervision of [name of firm] personnel. Furthermore, upon request, we may provide copies of selected engagement documentation to [name of regulator].

You have authorized [name of firm] to allow [name of regulator] access to the engagement documentation in the manner discussed above. Please confirm your agreement to the above by signing below and returning to [name of firm, address].

[Firm signature]

Agreed and acknowledged:

[Name and title]

[Date]

.29 If the client requests to review the engagement documentation before allowing the regulator access, the practitioner may provide the client with the opportunity to obtain an understanding of the nature of the information about the subject matter contained in the engagement documentation that is being made available to the regulator. When a client reviews the engagement documentation, the need to maintain control of the engagement documentation is as discussed in paragraph .17 of this interpretation.

.30 The guidance in paragraphs .17–.25 of this interpretation, which provide guidance on making arrangements with the regulator for access to the engagement documentation, maintaining control over the engagement documentation, and submitting a letter describing various matters to the regulator, is also applicable.

[Issue Date: July, 1994. Revised: June, 1996. Revised: October, 2000. Revised: January, 2002. Revised: December, 2005. Revised: October, 2011, effective for audits of financial statements for periods ending on or after December 15, 2012. Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

4. Performing and Reporting on an Attestation Engagement Under Two Sets of Attestation Standards

.31 Question — Do the AICPA attestation standards permit the performance of, and reporting on, an attestation engagement in which the practitioner follows both the AICPA attestation standards and another set of attestation standards, such as those issued by the International Auditing and Assurance Standards Board or the PCAOB?

.32 Interpretation — Yes, a practitioner may perform and report on an attestation engagement in accordance with AICPA attestation standards in addition to another set of attestation standards, as long as both sets of attestation standards are followed in their entirety.

.33 Question — If a practitioner performs an attestation engagement in accordance with the AICPA attestation standards and the PCAOB interim attestation standards, how would the practitioner reference both sets of attestation standards if the practitioner chooses to do so in the attestation report?

.34 Interpretation — If the practitioner performs an attestation engagement in accordance with both AICPA attestation standards and the PCAOB interim attestation standards, and the report references both sets of attestation standards, the statement that the attestation engagement was conducted in accordance with attestation standards established by the AICPA would be amended to add that the engagement was also conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)."²⁵ A reference to "the standards" of the PCAOB indicates that the practitioner has complied not only with the PCAOB interim attestation standards, but also with the related professional practice standards of the PCAOB, which include the relevant independence rules. If the practitioner is required to comply only with the PCAOB interim attestation standards rather than all the PCAOB standards, the practitioner may include the word "attestation" in the reference to the standards of the PCAOB.²⁶ A practitioner performing an attestation engagement in these circumstances may, nevertheless, be responsible for complying with certain or all of the independence and other related professional practice standards of the PCAOB, for example, when the attestation engagement is subject to regulatory oversight that requires compliance with those rules. Whether the practitioner conducts an attestation engagement in accordance with the standards of the PCAOB or in accordance with the attestation standards of the PCAOB depends on the circumstances of the engagement.

²⁵ PCAOB Release No. 2015-002, *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, states, in part, "...whenever the practitioner is required to make reference in a report to attestation standards established by the American Institute of Certified Public Accountants, the practitioner must instead refer to 'the standards of the Public Company Accounting Oversight Board (United States).'"

²⁶ By analogy to Staff Question and Answer No. 2, *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board* (PCAOB Staff Guidance, sec. 100.01), dated June 30, 2004.

.35 Following are illustrative reports with examples of additional language (in ***bold italics***) that a practitioner may include in attestation reports to indicate that the engagement was conducted in accordance with the AICPA attestation standards and the PCAOB interim attestation standards:

Examination Engagement

Independent Accountant's Report

[Same first paragraph as the standard report]

Our examination was conducted in accordance with attestation standards established by the AICPA ***and in accordance with the standards of the Public Company Accounting Oversight Board (United States)***. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

[Same subsequent paragraphs as the standard report]

Review Engagement

Independent Accountant's Report

[Same first paragraph as the standard report]

Our review was conducted in accordance with attestation standards established by the AICPA ***and in accordance with the standards of the Public Company Accounting Oversight Board (United States)***. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to *[identify the subject matter, for example, the schedule of investment returns]* in order for it to be in accordance with (or based on) the criteria. The procedures performed in a review vary in nature and timing from and are substantially less in extent than an examination, the objective of which is to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

[Same subsequent paragraphs as the standard report]

Agreed-Upon Procedures Engagement

Independent Accountant's Report

[Appropriate Addressee]

We have performed the procedures enumerated below on *[identify the subject matter, for example, the accompanying Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]*. *[The responsible party, for example, XYZ Fund]* is responsible for *[the subject matter]*.

*[The engaging party, for example, the audit committee and management of XYZ Fund] has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of [identify the intended purpose of the engagement, for example, assisting users in understanding the Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]. Additionally, [identify the specified parties, for example, the audit committee and management of ABC Inc.]²⁷ has agreed to the procedures performed.²⁸ This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes. **The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.**²⁹*

[Include paragraphs to enumerate procedures and findings]

We were engaged by *[the engaging party, for example, the audit committee and management of XYZ Fund]* to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA **and in accordance with the standards of the Public Company Accounting Oversight Board (United States)**. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on *[identify the subject matter, for example, the accompanying Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]*. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Fund and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of the audit committees and managements of ABC Inc. and XYZ Fund and is not intended to be and should not be used by anyone other than these specified parties.³⁰

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

.36 A practitioner performing an attestation engagement for a nonissuer may be required by law or regulation, or may otherwise determine it is more

²⁷ Paragraph .31b of PCAOB AT section 201 requires that the practitioner's report include an identification of the specified parties.

²⁸ Paragraph .31f of PCAOB AT section 201 requires that the practitioner's report include a statement that the procedures performed were agreed to by the specified parties identified in the report.

²⁹ Paragraph .31h of PCAOB AT section 201 requires that the practitioner's report include a statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures.

³⁰ Paragraph .31i of PCAOB AT section 201 requires that the practitioner's report include a statement of restrictions on the use of the report because it is intended to be used solely by the specified parties.

appropriate to use the form of attestation report included in the PCAOB Interim Attestation Standards adjusted to reflect that the engagement was also performed in accordance with AICPA attestation standards. In these circumstances a practitioner may use the reports illustrated in paragraph .37.

.37 Following are illustrative attestation reports based on the illustrative reports in the PCAOB interim attestation standards.³¹ The reports are marked to conform with the incremental reporting requirements in section 205, *Assertion-Based Examination Engagements*, section 210, *Review Engagements*, and section 215, *Agreed-Upon Procedures Engagements*, respectively. Additions to the reports are shown in ***bold italics*** and deletions are shown in ~~strike through~~. Such edits are intended to illustrate an attestation report that complies with the reporting requirements of both AICPA attestation standards and the PCAOB interim attestation standards.

Examination Engagement

Independent Accountant's Report³²

[Appropriate Addressee]

We have examined the *[identify the subject matter — for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for the schedule of investment returns ***in accordance with (or based on) [identify criteria — for example, the ABC criteria set forth in Note 1]***. Our responsibility is to express an opinion ***on [identify the subject matter; for example, the schedule of investment returns]*** based on our examination.

Our examination was conducted in accordance with ***the standards of the Public Company Accounting Oversight Board (United States) and in accordance with*** attestation standards established by the AICPA. ***Those standards require that we plan and perform the examination to obtain reasonable assurance about whether [identify the subject matter; for example, the schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of [identify the subject matter; for example, the schedule of investment returns], whether due to fraud or error. The procedures*** and, accordingly, included examining, on a test basis, evidence supporting *[identify the subject matter — for example, XYZ Company's schedule of investment returns]* and performing such other procedures as we considered necessary in the circumstances. We believe that the evidence we obtained in our examination ***is sufficient and appropriate to provide*** a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

³¹ The illustrative attestation reports include the examination report in example 1 of appendix A, "Examination Reports," of AT section 101, *Attest Engagements*, the review report in example 1 of appendix B, "Review Reports," of AT section 101, and the agreed-upon procedures report in paragraph .32 of AT section 201, *Agreed-Upon Procedures Engagements*. [Footnote renumbered, November 2020, effective for agreed-upon procedures reports dated on or after July 15, 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

³² A firm registered with the PCAOB may use the title "Report of Independent Registered Public Accounting Firm," or another appropriate title that includes the word "independent."

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter; for example, the schedule of investment returns]* **is presented** presents, in all material respects, *[identify the subject matter — for example, the investment returns of XYZ Company for the year ended December 31, 20XX]* **in accordance with (or based on)** *[identify criteria — for example, the ABC criteria set forth in Note 1]*, **in all material respects.**

[Practitioner's signature]

[City and state where the practitioner's report is issued] *Practitioner's city and state*

[Date of practitioner's report]

Review Engagement

Independent Accountant's Report³³

[Appropriate Addressee]

We have reviewed the *[identify the subject matter — for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for the *[identify the subject matter — for example, the schedule of investment returns]* **in accordance with (or based on)** *[identify criteria — for example, the ABC criteria set forth in Note 1]*. **Our responsibility is to express a conclusion on the schedule of investment returns based on our review.**

Our review was conducted in accordance with ***the standards of the Public Company Accounting Oversight Board (United States) and in accordance with*** attestation standards established by the AICPA. ***Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to [identify the subject matter — for example, the schedule of investment returns] in order for it to be in accordance with (or based on) the criteria. The procedures performed in*** ~~A~~ ***a review vary in nature and timing from and are*** is substantially less in scope ***extent*** than an examination, the objective of which is ***to obtain reasonable assurance about whether [identify the subject matter — for example, XYZ Company's schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects and*** the expression of an opinion on *[identify the subject matter — for example, XYZ Company's schedule of investment returns]* **and** to obtain reasonable assurance about whether *[identify the subject matter — for example, XYZ Company's schedule of investment returns]* is in accordance with ~~(or based on)~~ the criteria, in all material respects. Accordingly, we do not express such an opinion. ***Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.***

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

³³ See footnote 32.

[Include a description of the work performed as a basis for the practitioner's conclusion.]

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Based on our review, ~~nothing came to our attention that caused us to believe that the~~ ***we are not aware of any material modifications that should be made to*** *[identify the subject matter — for example, schedule of investment returns of XYZ Company for the year ended December 31, 20XX]* ***is in order for it to be in accordance with (or based on)*** ~~not presented, in all material respects, in conformity with~~ *[identify the criteria — for example, the ABC criteria set forth in Note 1].*

[Practitioner's signature]

[City and state where the practitioner's report is issued *Practitioner's city and state]*

[Date of practitioner's report]

Agreed-Up Upon Procedures Engagement

Independent Accountant's Report on Applying Agreed-Up Upon Procedures³⁴

[Appropriate Addressee]:

We have performed the procedures enumerated below, which were agreed to by the audit committees and managements of ABC Inc. and XYZ Fund, solely to assist you in evaluating the accompanying Statement of Investment Performance Statistics of XYZ Fund (prepared in accordance with the criteria specified therein) for the year ended December 31, 20X1. ***These parties have also acknowledged that the procedures performed are appropriate to meet the intended purpose of assisting users in evaluating the accompanying Statement of Investment Performance Statistics of XYZ Fund.***³⁵ ***This report may not be suitable for any other purpose.***³⁶ ***The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.***³⁷ XYZ Fund's management is responsible for the statement of investment performance statistics. ***We were engaged by XYZ Fund to perform this agreed-upon procedures engagement.***³⁸ This agreed-upon procedures engagement was conducted in accordance with ***the standards of the Public Company Accounting Oversight Board (United States) and in accordance with*** attestation standards established by the

³⁴ See footnote 32.

³⁵ Paragraph .34f of section 215 requires that the practitioner's agreed-upon procedures report include a statement that the engaging party acknowledged that the procedures performed are appropriate to meet the intended purpose of the engagement.

³⁶ Paragraph .34h of section 215 requires that the practitioner's agreed-upon procedures report include a statement that the practitioner's report may not be suitable for any other purpose.

³⁷ Paragraph .34i of section 215 requires that the practitioner's agreed-upon procedures report include a statement that the procedures performed may not address all items of interest to a user of the report and may not meet the needs of all users of the report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

³⁸ Paragraph .34c of section 215 requires that the practitioner's agreed-upon procedures report include an identification of the engaging party.

AICPA. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[Include paragraphs to enumerate procedures and findings.]

We were not engaged to and did not conduct an examination **or a review engagement**, the objective of which would be the expression of an opinion **or conclusion, respectively**, on the accompanying Statement of Investment Performance Statistics of XYZ Fund **for the year ended December 31, 20XX**. Accordingly, we do not express such an opinion **or conclusion**. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Fund and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.³⁹

This report is intended solely for the information and use of the audit committees and managements of ABC Inc. and XYZ Fund, and is not intended to be and should not be used by anyone other than these specified parties.

[Practitioner's signature]

[City and state where the practitioner's report is issued Practitioner's city and state]

[Date of practitioner's report]

[Issue Date: May 2017. Revised: February 2018. Revised, November 2020, effective for agreed-upon procedures reports dated on or after July 15, 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE Nos. 21 and 22.]

³⁹ Paragraph .34r of section 215 requires that the practitioner's agreed-upon procedures report include a statement that the practitioner is required to be independent of the responsible party and to meet the practitioner's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the agreed-upon procedures engagement.

AT-C Section 105A***Concepts Common to All Attestation Engagements**

Source: SSAE No. 18; SSAE No. 19.

See section 9105 for interpretations of this section.

Effective for practitioners' reports dated on or after May 1, 2017, unless otherwise indicated.

Introduction

.01 This section applies to engagements in which a CPA in the practice of public accounting is engaged to issue, or does issue, a practitioner's examination, review, or agreed-upon procedures report on subject matter or an assertion about subject matter (hereinafter referred to as an *assertion*) that is the responsibility of another party. (Ref: par. .A1)

.02 An examination or review engagement is predicated on the concept that a party other than the practitioner makes an assertion about whether the subject matter is measured or evaluated in accordance with suitable criteria. Section 205, *Examination Engagements*, and section 210, *Review Engagements*, require the practitioner to request such an assertion in writing when performing an examination or review engagement.¹ In examination and review engagements, when the engaging party is the responsible party, the responsible party's refusal to provide a written assertion requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable laws and regulations.² In examination and review engagements, when the engaging party is not the responsible party and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement but is required to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party.^{3, [4]} The purpose of an examination or review attestation engagement is to provide users of information with an opinion or conclusion regarding subject matter or an assertion about the subject matter, as measured against suitable and available criteria. An examination engagement results in an opinion, and a review engagement results in a conclusion. The purpose of an agreed-upon procedures engagement is to provide users of information with the results of procedures performed by the practitioner on subject matter. An agreed-upon procedures engagement results in findings. [As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

* This section contains an "AT-C" identifier, instead of an "AT" identifier, to avoid confusion with references to existing "AT" sections, which remain effective through April 2017.

¹ Paragraph .10 of section 205, *Examination Engagements*, and paragraph .11 of section 210, *Review Engagements*. [As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

² Paragraph .82 of section 205 and paragraph .59 of section 210.

³ Paragraph .84 of section 205 and paragraph .60 of section 210.

[⁴] [Footnote deleted by the issuance of SSAE No. 19, December 2019.]

.03 This section is not applicable to professional services for which the AICPA has established other professional standards, for example, services performed in accordance with (Ref: par. .A2)

- a. Statements on Auditing Standards,
- b. Statements on Standards for Accounting and Review Services
- c. Statements on Standards for Tax Services, or
- d. Statements on Standards for Consulting Services, including litigation services that involve pending or potential legal or regulatory proceedings before a trier of fact. (Ref: par. .A3)

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.04 An attestation engagement may be part of a larger engagement, for example, a feasibility study or business acquisition study that also includes an examination of prospective financial information. In such circumstances, the attestation standards apply only to the attestation portion of the engagement.

Compliance With the Attestation Standards

.05 The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires members who perform professional services to comply with standards promulgated by bodies designated by the Council of the AICPA.

Relationship of Attestation Standards to Quality Control Standards

.06 Quality control systems, policies, and procedures are the responsibility of the firm in conducting its attestation practice. Under QM section 10A, *A Firm's System of Quality Control*, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that⁵ (Ref: par. .A4–.A6)

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. practitioners' reports issued by the firm are appropriate in the circumstances.

.07 Attestation standards relate to the conduct of individual attestation engagements; quality control standards relate to the conduct of a firm's attestation practice as a whole. Thus, attestation standards and quality control standards are related, and the quality control policies and procedures that a firm adopts may affect both the conduct of individual attestation engagements and the conduct of a firm's attestation practice as a whole. However, deficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular engagement was not performed in accordance with the attestation standards.

Effective Date

.08 This section is effective for practitioners' reports dated on or after May 1, 2017.

⁵ Paragraph .12 of QM section 10A, *A Firm's System of Quality Control*.

Objectives

.09 In conducting an attestation engagement, the overall objectives of the practitioner are as follows:

- a. Apply the requirements relevant to the attestation engagement;
- b. In an examination or review engagement, report on the subject matter or assertion, and in an agreed-upon procedures engagement, report on the procedures performed and related findings without providing an opinion or conclusion on the subject matter.
- c. Communicate as required by the applicable AT-C section, in accordance with the results of the practitioner's procedures.
- d. Implement quality control procedures at the engagement level that provide the practitioner with reasonable assurance that the attestation engagement complies with professional standards and applicable legal and regulatory requirements.

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

Definitions

.10 For purposes of the attestation standards, the following terms have the meanings attributed as follows:

Assertion. Any declaration or set of declarations about whether the subject matter is in accordance with (or based on) the criteria.

Attestation engagement. An examination, review, or agreed-upon procedures engagement performed under the attestation standards related to subject matter or an assertion that is the responsibility of another party. The following are the three types of attestation engagements:

- a. **Examination engagement.** An attestation engagement in which the practitioner obtains reasonable assurance by obtaining sufficient appropriate evidence about the measurement or evaluation of subject matter against criteria in order to be able to draw reasonable conclusions on which to base the practitioner's opinion about whether the subject matter is in accordance with (or based on) the criteria or the assertion is fairly stated, in all material respects. (Ref: par. .A7)
- b. **Review engagement.** An attestation engagement in which the practitioner obtains limited assurance by obtaining sufficient appropriate review evidence about the measurement or evaluation of subject matter against criteria in order to express a conclusion about whether any material modification should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or to the assertion in order for it to be fairly stated. (Ref: par. .A8)
- c. **Agreed-upon procedures engagement.** An attestation engagement in which a practitioner performs specific procedures on subject matter or an assertion and reports the findings without providing an opinion or a conclusion.

Attestation risk. In an examination or review engagement, the risk that the practitioner expresses an inappropriate opinion or conclusion, as applicable, when the subject matter or assertion is materially misstated. (Ref: par. .A9–.A15)

Criteria. The benchmarks used to measure or evaluate the subject matter. (Ref: par. .A16)

Documentation completion date. The date on which the practitioner has assembled for retention a complete and final set of documentation in the engagement file.

Engagement circumstances. The broad context defining the particular engagement, which includes the terms of the engagement; whether it is an examination, review, or agreed-upon procedures engagement; the characteristics of the subject matter; the criteria; the information needs of the intended users; relevant characteristics of the responsible party and, if different, the engaging party and their environment; and other matters, for example, events, transactions, conditions and practices, and relevant laws and regulations, that may have a significant effect on the engagement.

Engagement documentation. The record of procedures performed, relevant evidence obtained, and, in an examination or review engagement, conclusions reached by the practitioner, or in an agreed-upon procedures engagement, findings of the practitioner. (Terms such as *working papers* or *workpapers* are also sometimes used).

Engagement partner. The partner or other person in the firm who is responsible for the attestation engagement and its performance and for the practitioner's report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body. *Engagement partner*, *partner*, and *firm* refer to their governmental equivalents when relevant.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform attestation procedures on the engagement. This excludes a practitioner's external specialist and engagement quality control reviewer engaged by the firm or a network firm. The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance.

Engaging party. The party(ies) that engages the practitioner to perform the attestation engagement. (Ref: par. .A17)

Evidence. Information used by the practitioner in arriving at the opinion, conclusion, or findings on which the practitioner's report is based.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

Fraud. An intentional act involving the use of deception that results in a misstatement in the subject matter or the assertion.

General use. Use of a practitioner's report that is not restricted to specified parties.

Internal audit function. A function of an entity that performs assurance and consulting activities designed to evaluate and

improve the effectiveness of the entity's governance, risk management, and internal control processes.

Misstatement. A difference between the measurement or evaluation of the subject matter by the responsible party and the proper measurement or evaluation of the subject matter based on the criteria. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions. In certain engagements, a misstatement may be referred to as a *deviation*, *exception*, or *instance of noncompliance*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400, *Definitions*.

Noncompliance with laws or regulations. Acts of omission or commission by the entity, either intentional or unintentional, that are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the subject matter) by those charged with governance, management, or employees of the entity.

Other practitioner. An independent practitioner who is not a member of the engagement team who performs work on information that will be used as evidence by the practitioner performing the attestation engagement. An other practitioner may be part of the practitioner's firm, a network firm, or another firm.

Practitioner. The person or persons conducting the attestation engagement, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. When an AT-C section expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term *engagement partner*, rather than *practitioner*, is used. *Engagement partner* and *firm* are to be read as referring to their governmental equivalents when relevant.

Practitioner's specialist. An individual or organization possessing expertise in a field other than accounting or attestation, whose work in that field is used by the practitioner to assist the practitioner in obtaining evidence for the service being provided. A practitioner's specialist may be either a practitioner's internal specialist (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm) or a practitioner's external specialist. *Partner* and *firm* refer to their governmental equivalents when relevant.

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by attestation and ethical standards in making informed decisions about the courses of action that are appropriate in the circumstances of the attestation engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of evidence.

Reasonable assurance. A high, but not absolute, level of assurance.

Report release date. The date on which the practitioner grants the engaging party permission to use the practitioner's report.

Responsible party. The party(ies) responsible for the subject matter. If the nature of the subject matter is such that no such party exists, a party who has a reasonable basis for making a written assertion about the subject matter may be deemed to be the responsible party.

Specified party. The intended user(s) to whom use of the written practitioner's report is limited.

Subject matter. In an examination or review engagement, the phenomenon that is measured or evaluated by applying criteria. In an agreed-upon procedures engagement, the phenomenon upon which procedures are performed.

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.11 For the purposes of the attestation standards, references to appropriate party(ies) should be read hereafter as the responsible party or the engaging party, as appropriate. (Ref: par. .A18)

Requirements

Conduct of an Attestation Engagement in Accordance With the Attestation Standards

Complying With AT-C Sections That Are Relevant to the Engagement

.12 When performing an attestation engagement, the practitioner should comply with

- this section;
- sections 205, 210, or 215, as applicable; and
- any subject-matter AT-C section relevant to the engagement when the AT-C section is in effect and the circumstances addressed by the AT-C section exist.

.13 The practitioner should not represent compliance with this or any other AT-C section unless the practitioner has complied with the requirements of this section and all other AT-C sections relevant to the engagement.

.14 Reports issued by a practitioner in connection with services performed under other professional standards should be written to be clearly distinguishable from and not confused with reports issued under the attestation standards. (Ref: par. .A19–.A20)

Text of an AT-C Section

.15 The practitioner should have an understanding of the entire text of each AT-C section that is relevant to the engagement being performed, including its application and other explanatory material, to understand its objectives and apply its requirements properly. (Ref: par. .A21–.A26)

Complying With Relevant Requirements

.16 Subject to paragraph .20, the practitioner should comply with each requirement of the AT-C sections that is relevant to the engagement being performed, including any relevant subject-matter AT-C section, unless, in the circumstances of the engagement,

- a. the entire AT-C section is not relevant, or
- b. the requirement is not relevant because it is conditional, and the condition does not exist.

.17 When a practitioner undertakes an attestation engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides, procedures, statutes, rules, and regulations, the practitioner should comply with those governmental requirements as well as the applicable AT-C sections. (Ref: par. .A27)

Practitioner's Report Prescribed by Law or Regulation

.18 If the practitioner is required by law or regulation to use a specific layout, form, or wording of the practitioner's report and the prescribed form of report is not acceptable or would cause a practitioner to make a statement that the practitioner has no basis to make, the practitioner should reword the prescribed form of report or attach an appropriately worded separate practitioner's report. (Ref: par. .A28)

Defining Professional Requirements in the Attestation Standards

.19 The attestation standards use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility it imposes on practitioners:

- *Unconditional requirements.* The practitioner must comply with an unconditional requirement in all cases in which such requirement is relevant. The attestation standards use the word *must* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The practitioner must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .20. The attestation standards use the word *should* to indicate a presumptively mandatory requirement.

Departure From a Relevant Requirement

.20 In rare circumstances, the practitioner may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the practitioner should perform alternative procedures to achieve the intent of that requirement. The need for the practitioner to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the intent of the requirement. (Ref: par. .A29)

Interpretive Publications

.21 The practitioner should consider applicable interpretive publications in planning and performing the attestation engagement. (Ref: par. .A30)

Other Attestation Publications

.22 In applying the attestation guidance included in an other attestation publication, the practitioner should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the attestation engagement. (Ref: par. .A31–.A33)

Acceptance and Continuance

.23 The engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and attestation engagements have been followed and should determine that conclusions reached in this regard are appropriate.

Preconditions for an Attestation Engagement

.24 The practitioner must be independent when performing an attestation engagement in accordance with the attestation standards unless the practitioner is required by law or regulation to accept the engagement and report on the subject matter or assertion. (Ref: par. .A34)

.25 In order to establish that the preconditions for an attestation engagement are present, the practitioner should determine both of the following:

- a. Whether the responsible party is a party other than the practitioner and takes responsibility for the subject matter. (Ref: par. .A35–.A37)
- b. Whether the engagement exhibits all of the following characteristics:
 - i. The subject matter is appropriate. (Ref: par. .A38–.A43)
 - ii. In an examination or review engagement, the criteria to be applied in the preparation and evaluation of the subject matter are suitable and will be available to the intended users. (Ref: par. .A44–.A54)
 - iii. The practitioner expects to be able to obtain the evidence needed to arrive at the practitioner's opinion, conclusion, or findings, including (Ref: par. .A55–.A56)
 - (1) access to all information of which the appropriate party is aware that is relevant to the measurement, evaluation, or disclosure of the subject matter;
 - (2) access to additional information that the practitioner may request from the appropriate party for the purpose of the engagement; and
 - (3) unrestricted access to persons within the appropriate party from whom the practitioner determines it necessary to obtain evidence.
 - iv. The practitioner's opinion, conclusion, or findings, in the form appropriate to the engagement, is to be contained in a written practitioner's report.

[As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.26 If the preconditions in paragraphs .24–.25 are not present, the practitioner should discuss the matter with the engaging party to attempt to resolve the issue.

.27 The practitioner should accept an attestation engagement only when the practitioner

- a. has no reason to believe that relevant ethical requirements, including independence, will not be satisfied;

- b.* is satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities (see also paragraph .32);
- c.* has determined that the engagement to be performed meets all the preconditions for an attestation engagement (see also paragraphs .24–.25); and
- d.* has reached a common understanding with the engaging party of the terms of the engagement, including the practitioner's reporting responsibilities.

.28 If it is discovered after the engagement has been accepted that one or more of the preconditions for an attestation engagement is not present, the practitioner should discuss the matter with the appropriate party(ies) and should determine

- a.* whether the matter can be resolved;
- b.* whether it is appropriate to continue with the engagement; and
- c.* if the matter cannot be resolved but it is still appropriate to continue with the engagement, whether, and if so how, to communicate the matter in the practitioner's report.

Acceptance of a Change in the Terms of the Engagement

.29 The practitioner should not agree to a change in the terms of the engagement when no reasonable justification for doing so exists. If a change in the terms of the engagement is made, the practitioner should not disregard evidence that was obtained prior to the change. (Ref: par. .A55–.A56)

.30 If the practitioner concludes, based on the practitioner's professional judgment, that there is reasonable justification to change the terms of the engagement from the original level of service that the practitioner was engaged to perform to a lower level of service, for example, from an examination to a review, and if the practitioner complies with the AT-C sections applicable to the lower level of service, the practitioner should issue an appropriate practitioner's report on the lower level of service. The report should not include reference to (a) the original engagement, (b) any procedures that may have been performed, or (c) scope limitations that resulted in the changed engagement.

Using the Work of an Other Practitioner

.31 When the practitioner expects to use the work of an other practitioner, the practitioner should (Ref: par. .A57–.A58)

- a.* obtain an understanding of whether the other practitioner understands and will comply with the ethical requirements that are relevant to the engagement and, in particular, is independent.
- b.* obtain an understanding of the other practitioner's professional competence.
- c.* communicate clearly with the other practitioner about the scope and timing of the other practitioner's work and findings.
- d.* if assuming responsibility for the work of the other practitioner, be involved in the work of the other practitioner.
- e.* evaluate whether the other practitioner's work is adequate for the practitioner's purposes.
- f.* determine whether to make reference to the other practitioner in the practitioner's report.

Quality Control

Assignment of the Engagement Team and the Practitioner's Specialists

.32 The engagement partner should be satisfied that

- a. the engagement team, and any practitioner's external specialists, collectively, have the appropriate competence, including knowledge of the subject matter, and capabilities to (Ref: par. .A59–.A60)
 - i. perform the engagement in accordance with professional standards and applicable legal and regulatory requirements and
 - ii. enable the issuance of a practitioner's report that is appropriate in the circumstances.
- b. to an extent that is sufficient to accept responsibility for the opinion, conclusion, or findings on the subject matter or assertion, the engagement team will be able to be involved in the work of
 - i. a practitioner's external specialist when the work of that specialist is to be used and (Ref: par. .A61)
 - ii. an other practitioner, when the work of that practitioner is to be used.
- c. those involved in the engagement have been informed of their responsibilities, including the objectives of the procedures they are to perform and matters that may affect the nature, timing, and extent of such procedures.
- d. engagement team members have been directed to bring to the engagement partner's attention significant questions raised during the engagement so that their significance may be assessed.

Leadership Responsibilities for Quality in Attestation Engagements

.33 The engagement partner should take responsibility for the overall quality on each attestation engagement. This includes responsibility for the following:

- a. Appropriate procedures being performed regarding the acceptance and continuance of client relationships and engagements
- b. The engagement being planned and performed (including appropriate direction and supervision) to comply with professional standards and applicable legal and regulatory requirements
- c. Reviews being performed in accordance with the firm's review policies and procedures and reviewing the engagement documentation on or before the date of the practitioner's report (Ref: par. .A62)
- d. Appropriate engagement documentation being maintained to provide evidence of achievement of the practitioner's objectives and that the engagement was performed in accordance with the attestation standards and relevant legal and regulatory requirements
- e. Appropriate consultation being undertaken by the engagement team on difficult or contentious matters

Engagement Documentation

.34 The practitioner should prepare engagement documentation on a timely basis. (Ref: par. .A63)

.35 The practitioner should assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file no later than 60 days following the practitioner's report release date. (Ref: par. .A64)

.36 After the documentation completion date, the practitioner should not delete or discard documentation of any nature before the end of its retention period.

.37 If the practitioner finds it necessary to amend existing engagement documentation or add new engagement documentation after the documentation completion date, the practitioner should, regardless of the nature of the amendments or additions, document

- a. the specific reasons for making the amendments or additions and
- b. when, and by whom, they were made and reviewed.

.38 Engagement documentation is the property of the practitioner, and some jurisdictions recognize this right of ownership in their statutes. The practitioner should adopt reasonable procedures to retain engagement documentation for a period of time sufficient to meet the needs of the practitioner and to satisfy any applicable legal or regulatory requirements for records retention.

.39 Because engagement documentation often contains confidential information, the practitioner should adopt reasonable procedures to maintain the confidentiality of that information.

.40 The practitioner also should adopt reasonable procedures to prevent unauthorized access to engagement documentation.

.41 If, in rare circumstances, the practitioner judges it necessary to depart from a relevant, presumptively mandatory requirement, the practitioner must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. (See paragraph .20.)

Engagement Quality Control Review

.42 For those engagements, if any, for which the firm has determined that an engagement quality control review is required (Ref: par. .A65)

- a. the engagement partner should take responsibility for discussing with the engagement quality control reviewer significant findings or issues arising during the engagement, including those identified during the engagement quality control review, and not release the practitioner's report until completion of the engagement quality control review and
- b. the engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report. This evaluation should include the following:
 - i. Discussion of significant findings or issues with the engagement partner
 - ii. Reading the written subject matter or assertion and the proposed report
 - iii. Reading selected engagement documentation relating to the significant judgments the engagement team made and the related conclusions it reached

- iv. Evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate

Professional Skepticism and Professional Judgment

Professional Skepticism

.43 The practitioner should plan and perform an attestation engagement with professional skepticism. (Ref: par. .A66–.A68)

.44 Unless the practitioner has reason to believe the contrary, the practitioner may accept records and documents as genuine. If conditions identified during the attestation engagement cause the practitioner to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the practitioner, the practitioner should investigate further.

Professional Judgment

.45 The practitioner should exercise professional judgment in planning and performing an attestation engagement. (Ref: par. .A69–.A74)

Application and Other Explanatory Material

Introduction (Ref: par. .01 and .03)

.A1 The subject matter of an attestation engagement may take many forms, including the following:

- a. Historical or prospective performance or condition, for example, historical or prospective financial information, performance measurements, and backlog data
- b. Physical characteristics, for example, narrative descriptions or square footage of facilities
- c. Historical events, for example, the price of a market basket of goods on a certain date
- d. Analyses, for example, break-even analyses
- e. Systems and processes, for example, internal control
- f. Behavior, for example, corporate governance, compliance with laws and regulations, and human resource practices

The subject matter may be as of a point in time or for a period of time.

.A2 Because performance audits performed pursuant to *Government Auditing Standards* do not require a practitioner's examination, review, or agreed-upon procedures report as described in this section, this section does not apply to performance audits unless the practitioner engaged to conduct a performance audit is also engaged to conduct an AICPA attestation engagement or issues such an examination, review, or agreed-upon procedures report. [Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.A3 Examples of litigation services include the following circumstances:

- a. The service comprises being an expert witness.
- b. The service comprises being a trier of fact or acting on behalf of one.

- c. The practitioner's work under the rules of the proceedings is subject to detailed analysis and challenge by each party to the dispute.
- d. The practitioner is engaged by an attorney to do work that will be protected by the attorney's work product or attorney-client privilege, and such work is not intended to be used for other purposes.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

Relationship of Attestation Standards to Quality Control Standards (Ref: par. .06)

.A4 The nature and extent of a firm's quality control policies and procedures depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

.A5 Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the attestation engagement and provide the firm with relevant information to enable the functioning of that part of the firm's quality control relating to independence.

.A6 Engagement teams are entitled to rely on the firm's system of quality control, unless the engagement partner determines that it is inappropriate to do so based on information provided by the firm or other parties.

Definitions

Examination Engagement (Ref: par. .10)

.A7 The practitioner obtains the same level of assurance in an examination engagement as the practitioner does in a financial statement audit.

Review Engagement (Ref: par. .10)

.A8 The practitioner obtains the same level of assurance in a review engagement as the practitioner does in a review of financial statements.

Attestation Risk (Ref: par. .10)

.A9 Attestation risk does not refer to the practitioner's business risks, such as loss from litigation, adverse publicity, or other events arising in connection with the subject matter or assertion reported on.

.A10 In general, attestation risk can be represented by the following components, although not all of these components will necessarily be present or significant for all engagements:

- a. Risks that the practitioner does not directly influence, which consist of
 - i. the susceptibility of the subject matter to a material misstatement before consideration of any related controls (inherent risk) and
 - ii. the risk that a material misstatement that could occur in the subject matter will not be prevented, or detected and corrected, on a timely basis by the appropriate party(ies)'s internal control (control risk)

- b. Risk that the practitioner does directly influence, which consists of the risk that the procedures to be performed by the practitioner will not detect a material misstatement (detection risk)

.A11 The degree to which each of these components of attestation risk is relevant to the engagement is affected by the engagement circumstances, in particular

- the nature of the subject matter or assertion. (For example, the concept of control risk may be more useful when the subject matter or assertion relates to the preparation of information about an entity's performance than when it relates to information about the existence of a physical condition.)
- the type of engagement being performed. (For example, in a review engagement, the practitioner may often decide to obtain evidence by means other than tests of controls, in which case, consideration of control risk may be less relevant than in an examination engagement on the same subject matter or assertion.)

.A12 The consideration of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

.A13 In an examination engagement, the practitioner reduces attestation risk to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's opinion. Reducing attestation risk to zero is not contemplated in an examination engagement and, therefore, reasonable assurance is less than absolute assurance as a result of factors such as the following:

- The use of selective testing
- The inherent limitations of internal control
- The fact that much of the evidence available to the practitioner is persuasive, rather than conclusive
- The use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence
- In some cases, the characteristics of the subject matter when evaluated or measured against the criteria

.A14 In a review engagement, attestation risk is greater than it is in an examination engagement. Because the practitioner obtains limited assurance in a review engagement, the types of procedures performed are less extensive than they are in an examination engagement and generally are limited to inquiries and analytical procedures.

.A15 Attestation risk is not applicable to an agreed-upon procedures engagement because in such engagements, the practitioner performs specific procedures (the design of which is the responsibility of the specified parties) on subject matter or an assertion and reports the findings without providing an opinion or conclusion.

Criteria (Ref: par. .10)

.A16 Suitable criteria are required for reasonably consistent measurement or evaluation of subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. The suitability of criteria is context-sensitive, that is, it is determined in the context of the engagement circumstances. Even for the same subject matter, there can be different criteria, which will yield a different measurement or evaluation. For example, one responsible party might select the number of customer complaints

resolved to the acknowledged satisfaction of the customer for the subject matter of customer satisfaction; another responsible party might select the number of repeat purchases in the three months following the initial purchase. The suitability of criteria is not affected by the level of assurance, that is, if criteria are unsuitable for an examination engagement, they are also unsuitable for a review engagement and vice versa.

Engaging Party (Ref: par. .10)

.A17 The engaging party, depending on the circumstances, may be management or those charged with governance of the responsible party, a governmental body or agency, the intended users, or another third party.

Appropriate Party(ies) (Ref: par. .11)

.A18 Management and governance structures vary by entity, reflecting influences such as size and ownership characteristics. Such diversity means that it is not possible for the attestation standards to specify for all engagements the person(s) with whom the practitioner is to interact regarding particular matters. For example, an entity may be a segment of an organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance with whom to communicate may require the exercise of professional judgment.

Conduct of an Attestation Engagement in Accordance With the Attestation Standards

Complying With AT-C Sections That Are Relevant to the Engagement (Ref: par. .14)

.A19 A practitioner's report that merely excludes the phrase "was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants" but is otherwise similar to a practitioner's examination, review, or agreed-upon procedures attestation report is an example of a practitioner's report that is not clearly distinguishable from, and could be confused with, a report issued under the attestation standards.

.A20 Paragraph .14 does not prohibit combining reports issued by a practitioner under the attestation standards with reports issued under other professional standards.

Text of an AT-C Section (Ref: par. .15)

.A21 The AT-C sections contain the objectives of the practitioner and requirements designed to enable the practitioner to meet those objectives. In addition, they contain related guidance in the form of application and other explanatory material, introductory material that provides context relevant to a proper understanding of the section, and definitions.

.A22 Introductory material may include, as needed, such matters as an explanation of the following:

- The purpose and scope of the AT-C section, including how the AT-C section relates to other AT-C sections
- The subject matter of the AT-C section
- The respective responsibilities of the practitioner and others regarding the subject matter of the AT-C section
- The context in which the AT-C section is set

.A23 The application and other explanatory material provides further explanation of the requirements of an AT-C section and guidance for carrying them out. In particular, it may

- a. explain more precisely what a requirement means or is intended to cover and
- b. include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not, in itself, impose a requirement, it may explain the proper application of the requirements of an AT-C section. The application and other explanatory material may also provide background information on matters addressed in an AT-C section. They do not, however, limit or reduce the responsibility of the practitioner to apply and comply with the requirements in applicable AT-C sections.

.A24 The practitioner is required by paragraph .15 to understand the application and other explanatory material. How the practitioner applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the section. The words *may*, *might*, and *could* are used to describe these actions and procedures.

.A25 An AT-C section may include, in a separate section under the heading "Definition(s)," a description of the meanings attributed to certain terms for purposes of the AT-C section. These are provided to assist in the consistent application and interpretation of the AT-C section and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings in all AT-C sections.

.A26 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AT-C section or within the title and introduction of the appendix itself.

Complying With Relevant Requirements (Ref: par. .17)

.A27 In certain attestation engagements, the practitioner also may be required to comply with other requirements in addition to the attestation standards. The attestation standards do not override law or regulation that governs the attestation engagement. In the event that such law or regulation differs from attestation standards, an attestation engagement conducted only in accordance with law or regulation will not necessarily comply with the attestation standards.

Practitioner's Report Prescribed by Law or Regulation (Ref: par. .18)

.A28 Some report forms can be made acceptable by inserting additional wording to include the elements required by sections 205, 210, and 215.⁶ Some report forms required by law or regulation can be made acceptable only by complete revision because the prescribed language of the practitioner's report calls for statements by the practitioner that are not consistent with the practitioner's function or responsibility, for example, a report form that requests the practitioner to "certify" the subject matter.

⁶ Paragraphs .63–.66 of section 205, paragraphs .46–.49 of section 210, and paragraph .32–.33 of section 215. [As amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

Departure From a Relevant Requirement (Ref: par. .20)

.A29 Paragraph .41 prescribes documentation requirements when the circumstances described in paragraph .20 occur.

Interpretive Publications (Ref: par. .21)

.A30 *Interpretive publications* are not attestation standards. Interpretive publications are recommendations on the application of the attestation standards in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the relevant senior technical committee after all members of the committee have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the attestation standards. Examples of interpretive publications are interpretations of the attestation standards, exhibits to the AT-C sections, and attestation guidance included in AICPA guides and attestation Statements of Position (SOPs). Interpretations of the AT-C sections and exhibits are included within the AT-C sections. AICPA guides and attestation SOPs are listed in AT-C appendix A, "AICPA Guides and Statements of Position."

Other Attestation Publications (Ref: par. .22)

.A31 *Other attestation publications* are publications other than interpretive publications. These include AICPA attestation publications not defined as interpretive publications; attestation articles in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instruction materials, textbooks, guidebooks, attestation programs, and checklists; and other attestation publications from state CPA societies, other organizations, and individuals. Other attestation publications have no authoritative status; however, they may help the practitioner understand and apply the attestation standards. The practitioner is not expected to be aware of the full body of other attestation publications.

.A32 Although the practitioner determines the relevance of these publications in accordance with paragraph .22, the practitioner may presume that other attestation publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other attestation publications are listed in AT-C appendix B, "Other Attestation Publications."

.A33 In determining whether an other attestation publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the attestation engagement, the practitioner may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying the attestation standards and the degree to which the publisher or author is recognized as an authority in attestation matters. [Revised, February 2017, to better reflect the AICPA Council Resolution designating the Public Company Accounting Oversight Board to promulgate technical standards.]

**Preconditions for an Attestation Engagement
(Ref: par. .24–.25b(ii))**

.A34 The "Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation (ET sec. 1.297) establishes special requirements for independence for services provided under the attestation standards. In addition, the "Conceptual

Framework Approach" interpretation (ET sec. 1.210.010) discusses threats to independence not specifically detailed elsewhere, for example, when the practitioner has an interest in the subject matter.

Roles and Responsibilities (Ref: par. .25)

.A35 All attestation engagements have an engaging party, a responsible party, the practitioner, and intended users. In some attestation engagements, the engaging party is different from the responsible party. In other attestation engagements, the engaging party, the responsible party, and the intended users may all be the same. [Paragraph added, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.A36 The responsible party may acknowledge its responsibility for the subject matter or for the written assertion as it relates to the objective of the engagement in a number of ways, for example, in an engagement letter, a representation letter, or the presentation of the subject matter, including the notes thereto, or the written assertion. Examples of other evidence of the responsible party's responsibility for the subject matter include reference to legislation, a regulation, or a contract. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Appropriateness of Subject Matter (Ref: par. .25b[i])

.A37 Evidence that the appropriate relationship exists with respect to responsibility for the subject matter may be obtained through an acknowledgment provided by the responsible party. Such an acknowledgment also establishes a basis for a common understanding of the responsibilities of the responsible party and the practitioner. A written acknowledgment is the most appropriate form of documenting the responsible party's understanding. In the absence of a written acknowledgment of responsibility, it may still be appropriate for the practitioner to accept the engagement if, for example, other sources, such as legislation or a contract, indicate responsibility. In other cases, it may be appropriate to decline the engagement depending on the circumstances or disclose the circumstances in the attestation report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A38 An element of the appropriateness of subject matter is the existence of a reasonable basis for measuring or evaluating the subject matter. The responsible party in an attestation engagement is responsible for having a reasonable basis for measuring or evaluating the subject matter. What constitutes a reasonable basis will depend on the nature of the subject matter and other engagement circumstances. In some cases, a formal process with extensive internal control may be needed to provide the responsible party with a reasonable basis for concluding that the measurement or evaluation of the subject matter is free from material misstatement. The fact that the practitioner will report on the subject matter or assertion is not a substitute for the responsible party's own processes to have a reasonable basis for measuring or evaluating the subject matter or assertion. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A39 An appropriate subject matter

- a. is identifiable and, in an examination or review engagement, is capable of consistent measurement or evaluation against the criteria and
- b. can be subjected to procedures for obtaining sufficient appropriate evidence to support an opinion, conclusion, or findings, as appropriate.

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.A40 If the subject matter is not appropriate for an examination engagement, it also is not appropriate for a review engagement. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A41 Different subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective, and relates to a point in time or covers a period. Such characteristics affect the following:

- a. In an examination or review engagement, the precision with which the subject matter can be measured or evaluated against criteria
- b. The persuasiveness of available evidence

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

.A42 Identifying such characteristics and considering their effects assists the practitioner when assessing the appropriateness of the subject matter and also in determining the content of the practitioner's report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A43 In some cases, the attestation engagement may relate to only one part of a broader subject matter. For example, the practitioner may be engaged to examine one aspect of an entity's contribution to sustainable development, such as the programs run by the entity that have positive environmental outcomes, and may be aware that the practitioner has not been engaged to examine more significant programs with less favorable outcomes. In such cases, in determining whether the engagement exhibits the characteristic of having an appropriate subject matter, it may be appropriate for the practitioner to consider whether information about the aspect that the practitioner is asked to examine is likely to meet the information needs of intended users. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Suitable and Available Criteria (Ref: par. .25b[ii])

.A44 Suitable criteria exhibit all of the following characteristics:

- *Relevance.* Criteria are relevant to the subject matter.
- *Objectivity.* Criteria are free from bias.
- *Measurability.* Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness.* Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter.

The relative importance of each characteristic to a particular engagement is a matter of professional judgment. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A45 Criteria can be developed in a variety of ways, for example, they may be

- embodied in laws or regulations.
- issued by authorized or recognized bodies of experts that follow a transparent due process.

- developed collectively by a group that does not follow a transparent due process.
- published in scholarly journals or books.
- developed for sale on a proprietary basis.
- specifically designed for the purpose of measuring, evaluating, or disclosing the subject matter or assertion in the particular circumstances of the engagement.

How criteria are developed may affect the work that the practitioner carries out to assess their suitability. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A46 Criteria that are established or developed by groups composed of experts that follow due process procedures, including exposure of the proposed criteria for public comment, are ordinarily considered suitable. Criteria promulgated by a body designated by the Council of the AICPA under the AICPA Code of Professional Conduct are, by definition, considered to be suitable. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A47 In some cases, laws or regulations prescribe the criteria to be used for the engagement. In the absence of indications to the contrary, such criteria are presumed to be suitable. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A48 Criteria may be established or developed by the engaging party, the responsible party, industry associations, or other groups that do not follow due process procedures or do not as clearly represent the public interest. The practitioner's determination of whether such criteria are suitable is based on the characteristics described in paragraph .A42. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A49 Regardless of who establishes or develops the criteria, the responsible party or the engaging party is responsible for selecting the criteria, and the engaging party is responsible for determining that such criteria are appropriate for its purposes. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A50 Some criteria may be suitable for only a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria. For example, criteria set forth in a lease agreement for override payments may be suitable only for reporting to the parties to the agreement because of the likelihood that such criteria would be misunderstood or misinterpreted by parties other than those who have specifically agreed to the criteria. Such criteria can be agreed upon directly by the parties or through a designated representative. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A51 Even when established criteria exist for a subject matter, specific users may agree to other criteria for their specific purposes. For example, various frameworks can be used as established criteria for evaluating the effectiveness of internal control. Specific users may, however, develop a more detailed set of criteria that meet their specific information needs. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A52 If criteria are specifically designed for the purpose of measuring, evaluating, or disclosing the subject matter or assertion in the particular circumstances of the engagement, they are not suitable if they result in subject matter, an assertion, or a practitioner's report that is misleading to the intended users. It is desirable for the intended users or the engaging party to acknowledge that

specifically developed criteria are suitable for the intended users' purposes. The absence of such an acknowledgement may affect what is to be done to assess the suitability of the criteria and the information provided about the criteria in the report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A53 Criteria need to be available to the intended users to allow them to understand how the subject matter has been measured or evaluated. Criteria are made available to the intended users in one or more of the following ways:

- a. Publicly
- b. Through inclusion in a clear manner in the presentation of the subject matter
- c. Through inclusion in a clear manner in the practitioner's report
- d. By general understanding, for example, the criterion for measuring time in hours and minutes
- e. Available only to specified parties, for example, terms of a contract or criteria issued by an industry association that are available only to those in the industry

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A54 When criteria are available only to specified parties, sections 205 and 210 require a statement restricting the use of the practitioner's report.⁷ [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Access to Evidence (Ref: par. .25b[iii])

.A55 The nature of the relationship between the responsible party and, if different, the engaging party, may affect the practitioner's ability to access records, documentation, and other information the practitioner may require as evidence to arrive at the practitioner's opinion, conclusion, or findings. Therefore, the nature of that relationship may be a relevant consideration when determining whether or not to accept the engagement. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A56 The quantity or quality of available evidence is affected by both of the following:

- a. The characteristics of the subject matter, for example, less objective evidence might be expected when the subject matter is future-oriented, rather than historical
- b. Other circumstances, such as when evidence that could reasonably be expected to exist is not available, for example, because of the timing of the practitioner's appointment, an entity's document retention policy, inadequate information systems, or a restriction imposed by the responsible or engaging party

[Paragraph renumbered and amended, effective for practitioners' reports dated on or after July 15, 2021, by SSAE No. 19. Early implementation is permitted.]

Acceptance of a Change in the Terms of the Engagement (Ref: par. .29)

.A57 A change in circumstances that affects the requirements of the responsible party or, if different, the engaging party, or a misunderstanding concerning the nature of the engagement originally requested, may be considered

⁷ Paragraph .64b of section 205 and paragraph .47b of section 210.

reasonable justification for requesting a change in the engagement, for example, from an attestation engagement to a consulting engagement or from an examination engagement to a review engagement. A change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete, or otherwise unsatisfactory. An example of such a circumstance is a request to change the engagement from an examination to a review to avoid a modified opinion or a disclaimer of opinion in a situation in which the practitioner is unable to obtain sufficient appropriate evidence regarding the subject matter. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A58 If the practitioner and the engaging party are unable to agree to a change in the terms of the engagement and the practitioner is not permitted to continue the original engagement, the practitioner may withdraw from the engagement when possible under applicable laws and regulations. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Using the Work of an Other Practitioner (Ref: par. .31)

.A59 The practitioner is responsible for (a) the direction, supervision, and performance of the engagement in compliance with professional standards; applicable regulatory and legal requirements; and the firm's policies and procedures and (b) determining whether the practitioner's report that is issued is appropriate in the circumstances. The practitioner may, however, use the work of other practitioners to obtain sufficient appropriate evidence to express an opinion, conclusion, or findings on the subject matter or assertion. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A60 The engagement partner may decide to assume responsibility for the work of the other practitioner or to make reference to the other practitioner in the practitioner's report. Regardless of whether the engagement partner decides to assume responsibility or make reference, the practitioner is required to communicate clearly with the other practitioner and evaluate whether the other practitioner's work is adequate for the purposes of the engagement. The nature, timing, and extent of this involvement are affected by the practitioner's understanding of the other practitioner, such as previous experience with, or knowledge of, the other practitioner and the degree to which the engagement team and the other practitioner are subject to common quality control policies and procedures. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Quality Control

Assignment of the Engagement Team and the Practitioner's Specialists (Ref: par. .32a–b[i])

.A61 The practitioner may obtain knowledge about the specific subject matter to which the procedures are to be applied through formal or continuing education, practical experience, or consultation with others. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A62 When considering the appropriate competence and capabilities expected of those involved in the engagement, the engagement partner may take into consideration such matters as their

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.

- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant IT and specialized areas relevant to the subject matter.
- knowledge of relevant industries in which the entity operates.
- ability to apply professional judgment.
- understanding of the firm's quality control policies and procedures.

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A63 Some of the attestation work may be performed by a multidisciplinary team that includes one or more practitioner's specialists. For example, in an examination engagement, a practitioner's specialist may be needed to assist the practitioner in obtaining an understanding of the subject matter and other engagement circumstances or in assessing or responding to the risk of material misstatement. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Leadership Responsibilities for Quality in Attestation Engagements **(Ref: par. .33c)**

.A64 Under QM section 10A, the firm's review responsibility policies and procedures are determined on the basis that suitably experienced team members review the work of other team members. The engagement partner may delegate part of the review responsibility to other members of the engagement team, in accordance with the firm's system of quality control. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Engagement Documentation (Ref: par. .34–.35)

.A65 Documentation prepared at the time work is performed or shortly thereafter is likely to be more accurate than documentation prepared at a much later time. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A66 The completion of the assembly of the final engagement file is an administrative process that does not involve the performance of new procedures or the drawing of new conclusions. Changes may, however, be made to the documentation during the final assembly process if they are administrative in nature. Examples of such changes include the following:

- Deleting or discarding superseded documentation
- Sorting, collating, and cross-referencing working papers
- Signing off on completion checklists relating to the file assembly process
- Documenting evidence that the practitioner has obtained, discussed, and agreed with the relevant members of the engagement team before the date of the practitioner's report
- Adding information received after the date of the report, for example, an original confirmation that was previously faxed

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Engagement Quality Control Review (Ref: par. .42)

.A67 Other matters that may be considered in an engagement quality control review include the following:

- a. The engagement team's evaluation of the firm's independence in relation to the engagement
- b. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
- c. Whether engagement documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Professional Skepticism and Professional Judgment***Professional Skepticism (Ref: par. .43)***

.A68 Professional skepticism includes being alert to matters such as the following:

- Evidence that contradicts other evidence obtained
- Information that brings into question the reliability of documents and responses to inquiries to be used as evidence
- Circumstances that may indicate fraud
- Circumstances that suggest the need for procedures in addition to those required by relevant AT-C sections

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A69 Professional skepticism is necessary to the critical assessment of evidence. This includes questioning contradictory evidence and the reliability of documents and responses to inquiries and other information obtained from the appropriate party. It also includes consideration of the sufficiency and appropriateness of evidence obtained in light of the circumstances. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A70 The practitioner neither assumes that the appropriate party is dishonest nor assumes unquestioned honesty. The practitioner cannot be expected to disregard past experience of the honesty and integrity of those who provide evidence. Nevertheless, a belief that those who provide evidence are honest and have integrity does not relieve the practitioner of the need to maintain professional skepticism or allow the practitioner to be satisfied with less than sufficient appropriate evidence for the service being provided. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

Professional Judgment (Ref: par. .45)

.A71 Professional judgment is essential to the proper conduct of an attestation engagement. This is because interpretation of relevant ethical requirements and relevant AT-C sections and the informed decisions required throughout the engagement cannot be made without the application of relevant knowledge and experience to the facts and circumstances. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A72 For examination and review engagements, professional judgment is necessary regarding decisions about the following matters:

- Materiality and attestation risk
- The nature, timing, and extent of procedures used to meet the requirements of relevant AT-C sections and gather evidence
- Evaluating whether sufficient appropriate evidence for the service being provided has been obtained and whether more needs to be done to achieve the objectives of this section, section 205, or section 210, and any relevant subject-matter-specific AT-C sections and thereby the overall objectives of the practitioner
- The evaluation of the responsible party's judgments in applying the criteria
- The drawing of conclusions based on the evidence obtained, for example, assessing the reasonableness of the evaluation or measurement of subject matter or an assertion

[Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A73 The distinguishing feature of professional judgment expected of a practitioner is that such judgment is exercised based on competencies necessary to achieve reasonable judgments developed by the practitioner through relevant training, knowledge, and experience. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A74 The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the practitioner. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, assist the practitioner in making informed and reasonable judgments. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A75 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of the attestation standards and measurement or evaluation principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the practitioner up to the date of the practitioner's report. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

.A76 The requirement to exercise professional judgment applies throughout the engagement. Professional judgment also needs to be appropriately documented as required by sections 205 and 210. [Paragraph renumbered by the issuance of SSAE No. 19, December 2019.]

AT-C Section 9105A

Concepts Common to All Attestation Engagements: Attestation Interpretations of Section 105

1. Responding to Requests for Reports on Matters Relating to Solvency

.01 Question—Lenders, as a requisite to the closing of certain secured financings in connection with leveraged buyouts, recapitalizations, and certain other financial transactions, have sometimes requested written assurance from an accountant regarding the prospective borrower's solvency and related matters.¹ The lender is concerned that such financings not be considered to include a fraudulent conveyance or transfer under the United States Bankruptcy Code² or the relevant state fraudulent conveyance or transfer statute.³ If the financing is subsequently determined to have included a fraudulent conveyance or transfer, repayment obligations and security interests may be set aside or subordinated to the claims of other creditors.

.02 May a practitioner provide assurance concerning *matters relating to solvency*, as hereinafter defined?

.03 Interpretation—No. For reasons set forth subsequently, a practitioner should not provide any form of assurance, through an examination, review, or agreed-upon procedures engagement, that an entity

¹ Although this interpretation describes requests from secured lenders and summarizes the potential effects of fraudulent conveyance or transfer laws upon such lenders, the interpretation is not limited to requests from lenders. All requests for assurance on matters relating to solvency are governed by this interpretation.

² Chapter 5 of the United States Bankruptcy Code addresses *fraudulent transfers and obligations* and states the following:

(a)(1)The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor, that was made or incurred on or within two years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer occurred or such obligation was incurred, indebted; or

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

³ State fraudulent conveyance or transfer statutes such as the Uniform Fraudulent Conveyance Act and the Uniform Fraudulent Transfer Act reflect substantially similar provisions. These state laws may be employed absent a declaration of bankruptcy or by a bankruptcy trustee under Section 544(1) of the United States Bankruptcy Code. Although the statute of limitations varies from state to state, in some states, financing transactions may be vulnerable to challenge for up to six years from closing.

- is not insolvent at the time the debt is incurred or would not be rendered insolvent thereby.
- does not have unreasonably small capital.
- has the ability to pay its debts as they mature.

In the context of particular transactions, other terms are sometimes used or defined by the parties as equivalents of or substitutes for the preceding terms (for example, *fair salable value of assets exceeds liabilities*). These terms, and those matters listed previously, are hereinafter referred to as *matters relating to solvency*. The prohibition extends to providing assurance concerning all such terms.

.04 Section 105, *Concepts Common to All Attestation Engagements*, indicates that one of the preconditions for performing an attestation engagement is that the criteria to be applied in the preparation and evaluation of the subject matter are suitable and will be available to the intended users.⁴ Section 105 also indicates that suitable criteria exhibit all the following characteristics:⁵

- *Relevance*. Criteria are relevant to the subject matter.
- *Objectivity*. Criteria are free from bias.
- *Measurability*. Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness*. Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of the subject matter.

.05 The matters relating to solvency mentioned in paragraph .03 of this interpretation are subject to legal interpretation under, and varying legal definition in, the United States Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense and, therefore, are subject to varying interpretations, they do not provide the practitioner with suitable criteria required to evaluate the subject matter or an assertion. In addition, lenders are concerned with legal issues on matters relating to solvency, and the practitioner is generally unable to evaluate or provide assurance on these matters of legal interpretation. Therefore, practitioners are precluded from giving any form of assurance on matters relating to solvency or any financial presentation of matters relating to solvency.

.06 Under existing AICPA standards, the practitioner may provide a client with various professional services that may be useful to the client in connection with a financing. These services include the following:

- Audit of historical financial statements
- Review of historical financial information (a review in accordance with AU-C section 930, *Interim Financial Information*, of interim financial information or in accordance with AR-C section 90A, *Review of Financial Statements*)
- Examination or review of pro forma financial information (section 310, *Reporting on Pro Forma Financial Information*).

⁴ Paragraph .25b(ii) of section 105, *Concepts Common to All Attestation Engagements*.

⁵ Paragraph .A42 of section 105.

- Examination of prospective financial information in accordance with section 305, *Prospective Financial Information*, or compilation of prospective financial information in accordance with AR-C section 80A, *Compilation Engagements*.⁶

.07 Although a practitioner may not provide an agreed-upon procedures report under section 215, *Agreed-Upon Procedures Engagements*, that addresses matters related to solvency, a practitioner may provide an agreed-upon procedures report that addresses other subject matter that can be useful to a client or lender in connection with a financing. For example, the practitioner may perform an agreed-upon procedures engagement in which the client and lender specify the procedures to be applied to various financial presentations, such as historical financial information, pro forma financial information, and prospective financial information, which can be useful to a client or lender in connection with a financing.

.08 The practitioner should be aware that certain of the services described in paragraph .06 require that the practitioner have an appropriate level of knowledge of the entity's accounting and financial reporting practices and its internal control. This has ordinarily been obtained by the practitioner auditing historical financial statements of the entity for the most recent annual period or by otherwise obtaining an equivalent knowledge base. When considering acceptance of an engagement relating to a financing, the practitioner should consider whether he or she can perform these services without an equivalent knowledge base.

.09 Section 215 indicates that the practitioner's agreed-upon procedures report should not express an opinion or conclusion about whether the subject matter is in accordance with (or based on) the criteria or whether the assertion is fairly stated.⁷ Accordingly, a report on agreed-upon procedures should not express an opinion or conclusion on matters relating to solvency or any financial presentation of matters relating to solvency (for example, fair salable value of assets less liabilities or fair salable value of assets less liabilities, contingent liabilities, and other commitments). A practitioner's report on the results of applying agreed-upon procedures should contain the report elements set forth in section 215 (or section 305 if applying agreed-upon procedures to prospective financial information).⁸ The practitioner's report on the results of applying agreed-upon procedures should state that

- the service has been requested in connection with a financing (no reference should be made to any solvency provisions in the financing agreement).
- no representations are provided regarding questions of legal interpretation.
- no assurance is provided concerning the borrower's
 - solvency,
 - adequacy of capital, or
 - ability to pay its debts.

⁶ Paragraph .01 of AR-C section 80A, *Compilation Engagements*. Section 305, *Prospective Financial Information*, does not address compilations of prospective financial information—a service that is included in AT section 301, *Financial Forecasts and Projections*. Paragraph .01 of AR-C section 80A states that AR-C section 80A (which is applicable to compilations of historical financial statements) also may be applied, adapted as necessary in the circumstances, to other historical or prospective financial information.

⁷ Paragraph .25 of section 215, *Agreed-Upon Procedures Engagements*.

⁸ Paragraph .35 of section 215 and paragraph .39 of section 305.

- the procedures should not be taken to supplant any additional inquiries and procedures that the lender should undertake in its consideration of the proposed financing.
- where applicable, an audit of recent historical financial statements has previously been performed and that no audit of any historical financial statements for a subsequent period has been performed. In addition, if any services have been performed pursuant to paragraph .06, they may be referred to.

.10 The financing agreement ordinarily specifies the date, often referred to as the *cut-off date*, to which the report is to relate (for example, a date three business days before the date of the report). The report should state that the inquiries and other procedures carried out in connection with the report did not cover the period from the cut-off date to the date of the report.

.11 The practitioner might consider furnishing the client with a draft of the agreed-upon procedures report. The draft report should deal with all matters expected to be covered in terms expected to be used in the final report. The draft report should be identified as a draft in order to avoid giving the impression that the procedures described therein have been performed. This practice of furnishing a draft report at an early point permits the practitioner to make clear to the client and lender what they may expect the accountant to furnish and gives them an opportunity to change the financing agreement or the agreed-upon procedures if they so desire. [Issue Date: May 1988; Amended: February 1993; Revised: January 2001; November 2006; Revised: December 2012; Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

2. Applicability of Attestation Standards to Litigation Services

.12 Question—Does Interpretation No. 1, "Responding to Requests for Reports on Matters Relating to Solvency," of section 105 prohibit a practitioner from providing expert testimony, as described in section 105, before a trier of fact on matters relating to solvency?⁹

.13 Interpretation—No. Matters relating to solvency mentioned in paragraph .03 of Interpretation No. 1 are subject to legal interpretation under, and varying legal definition in, the United States Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense and, therefore, subject to varying interpretations, they do not provide the practitioner with the suitable criteria required to evaluate the assertion. Thus, Interpretation No. 1 prohibits a practitioner from providing any form of assurance in reporting upon examination, review, or agreed-upon procedures engagements about matters relating to solvency (as defined in paragraph .03 of Interpretation No. 1).

.14 However, a practitioner who is involved with pending or potential formal legal or regulatory proceedings before a trier of fact in connection with the resolution of a dispute between two or more parties may provide an expert opinion or consulting advice about matters relating to solvency. The prohibition in Interpretation No. 1 does not apply in such engagements because as part of the legal or regulatory proceedings, each party to the dispute has the opportunity to analyze and challenge the legal definition and interpretation of the matters relating to solvency and the criteria the practitioner uses to evaluate matters

⁹ Paragraph .A2 of section 105.

related to solvency. Such services are not intended to be used by others who do not have the opportunity to analyze and challenge such definitions and interpretations. [Issue Date: July 1990; Revised: January 2001; Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

3. Providing Access to or Copies of Engagement Documentation to a Regulator^{10, 11}

.15 Question—Section 105 states that "Because engagement documentation often contains confidential information, the practitioner should adopt reasonable procedures to maintain the confidentiality of that information."¹² However, practitioners are sometimes required by law, regulation, or contract¹³ to provide a regulator, or a duly appointed representative, access to engagement documentation. For example, a regulator may request access to the engagement documentation to fulfill a quality review requirement or to assist in establishing the scope of a regulatory examination. Furthermore, as part of the regulator's review of the engagement documentation, the regulator may request copies of all or selected portions of the engagement documentation during or after the review. The regulator may intend, or decide, to make copies (or information derived from the engagement documentation) available to others, including other governmental agencies, for their particular purposes, with or without the knowledge of the practitioner or the client. When a regulator requests the practitioner to provide access to (and possibly copies of) engagement documentation pursuant to law, regulation, or contract, what actions might the practitioner consider?

.16 Interpretation—When a regulator requests access to engagement documentation pursuant to law, regulation, or contract, the practitioner may take the following steps:

- a. Consider advising the client that the regulator has requested access to (and possibly copies of) the engagement documentation and that the practitioner intends to comply with such request.¹⁴

¹⁰ The term *regulator(s)* includes federal, state, and local government officials with legal oversight authority over the entity. Examples of regulators who may request access to engagement documentation include, but are not limited to, state insurance and utility regulators, various health care authorities, and federal agencies such as the Federal Deposit Insurance Corporation, the Department of Housing and Urban Development, the Department of Labor, and the Rural Electrification Administration.

¹¹ The guidance in this interpretation does not apply to requests from the IRS; firm practice-monitoring programs, to comply with AICPA or state professional requirements such as peer or quality reviews; proceedings relating to alleged ethics violations; or subpoenas.

¹² Paragraph .39 of section 105.

¹³ Paragraphs .26–.30 of this interpretation address situations in which the practitioner is not required by law, regulation, or contract to provide a regulator access to the engagement documentation.

¹⁴ The practitioner may wish (and, in some cases, may be required by law, regulation, or contract) to confirm in writing with the client that the practitioner may be required to provide a regulator access to the engagement documentation. Sample language that may be used follows:

The engagement documentation for this engagement is the property of [name of firm] and constitutes confidential information. However, we may be requested to make certain engagement documentation available to [name of regulator] pursuant to authority given to it by law or regulation. If requested, access to such engagement documentation will be provided under the supervision of [name of firm] personnel. Furthermore, upon request, we may provide copies of selected engagement documentation to [name of regulator]. The [name of regulator] may intend, or decide, to distribute the copies or information contained therein to others, including other governmental agencies.

- b. Make appropriate arrangements with the regulator for the review.
- c. Maintain control over the engagement documentation, and
- d. Consider submitting the letter described in paragraph .19 of this interpretation to the regulator.

.17 Making appropriate arrangements with the regulator may include establishing the specific details, such as the date, time, and location of the review. The engagement documentation may be made available to a regulator at the offices of the client, the practitioner, or a mutually agreed-upon location. However, maintaining control of engagement documentation is necessary in order for the practitioner to maintain the integrity of the engagement documentation and the confidentiality of client information. For example, the practitioner (or the practitioner's representative) may be present when the engagement documentation is reviewed by the regulator.

.18 Ordinarily, the practitioner may not agree to transfer ownership of the engagement documentation to a regulator. Furthermore, the practitioner may not agree, without client authorization, that the information contained therein about the client may be communicated to or made available to any other party. In this regard, the action of a practitioner providing access to, or copies of, the engagement documentation shall not constitute transfer of ownership or authorization to make them available to any other party.

.19 An engagement performed in accordance with the attestation standards is not intended to, and does not, satisfy a regulator's oversight responsibilities. To avoid any misunderstanding, prior to allowing a regulator access to the engagement documentation, the practitioner may submit a letter to the regulator that

- a. sets forth the practitioner's understanding of the purpose for which access is being requested;
- b. describes the examination, review, or agreed-upon procedures process, as applicable, and the limitations inherent in the applicable attestation engagement;
- c. explains the purpose for which the engagement documentation was prepared, and that any individual conclusions or findings must be read in the context of the practitioner's report on the subject matter (or assertion);
- d. states, except when not applicable, that the engagement was not planned or conducted in contemplation of the purpose for which access is being granted or to assess the entity's compliance with laws and regulations;
- e. states that the examination, review, or agreed-upon procedures engagement, as applicable, and the engagement documentation should not supplant other inquiries and procedures that should be undertaken by the regulator for its purposes;
- f. requests confidential treatment under the Freedom of Information Act or similar laws and regulations,¹⁵ when a request for the engagement documentation is made, and that written notice be given to the practitioner before transmitting any information contained in the engagement documentation to others, including

¹⁵ The practitioner may need to consult the regulations of individual agencies and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

other governmental agencies, except when such transfer is required by law or regulation; and

- g. states that if any copies are to be provided, they will be identified as "Confidential Treatment Requested by [name of firm, address, telephone number]."

The practitioner may obtain a signed acknowledgment copy of the letter as evidence of the regulator's receipt of the letter. The letter to a regulator should be tailored to meet the individual engagement characteristics or the purpose of the regulatory request, for example, a quality control review. Illustrative letters for an examination engagement performed in accordance with section 315, *Compliance Attestation*, and an agreed-upon procedures engagement performed in accordance with section 215 follow.

.20 Illustrative letter for an examination engagement:

Illustrative Letter to Regulator¹⁶

[Date]

[Name and Address of Regulatory Agency]

Your representatives have requested access to our engagement documentation in connection with our engagement to examine XYZ Company's compliance with [identify the specified requirements] during the period [date] to [date] [or management's assertion about its compliance with (identify the specified requirements) during the period (date) to (date)]. It is our understanding that the purpose of your request is [state purpose: for example, "to facilitate your regulatory examination"]¹⁷

Our examination was conducted in accordance with attestation standards¹⁸ established by the American Institute of Certified Public Accountants, the objective of which is to obtain reasonable assurance about whether XYZ Company complied with [identify the specified requirements] during the period [date] to [date], in all material respects, and to express an opinion in a written report about whether XYZ Company complied with [identify the specified requirements] during the period [date] to [date] [or whether management's assertion about its compliance with (identify the specified requirements) during the period (date) to (date) is fairly stated], in all material respects, based on our examination. Under these standards, we have the responsibility to plan and perform our examination to provide a reasonable basis for our opinion and to exercise due professional care in the performance of our examination. Our examination is subject to the inherent risk that material noncompliance, if it exists, would not be detected. In addition, our examination does not address the possibility that material noncompliance may occur in the future. Also, our use of

¹⁶ The letter may be modified appropriately when the engagement has been conducted in accordance with Statements on Standards for Attestation Engagements (SSAEs) and also in accordance with additional attestation requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

¹⁷ See footnote 13. Also, if the practitioner is not required by law, regulation, or contract to provide a regulator access to the engagement documentation but otherwise intends to provide such access, the letter should include a statement that "Management of [name of entity] has authorized us to provide you access to our attest documentation for [state purpose]." [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

¹⁸ See footnote 16.

professional judgment and the assessments of attestation risk and materiality for the purpose of our examination means that matters may have existed that would have been assessed differently by you. Our examination does not provide a legal determination on *[name of entity]*'s compliance with specified requirements.

The engagement documentation was prepared for the purpose of providing a sufficient and appropriate record of the basis of our opinion on *[name of entity]*'s compliance and to aid in the performance and supervision of our examination. The engagement documentation is the principal record of attestation procedures performed, relevant evidence obtained, and conclusions reached by the practitioner in the examination. The procedures that we performed were limited to those we considered necessary under attestation standards¹⁹ established by the American Institute of Certified Public Accountants to provide us with reasonable basis for our opinion. Accordingly, we make no representation as to the sufficiency or appropriateness, for your purposes, of either the procedures or information in our engagement documentation. In addition, any notations, comments, and individual conclusions appearing on any of the engagement documentation do not stand alone and should not be read as an opinion on any part of management's assertion or the related subject matter.

Our examination was conducted for the purpose stated above and was not planned or performed in contemplation of your *[state purpose: for example, "regulatory examination"]*. Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our examination, and the engagement documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the *[name of regulatory agency]* for the purpose of monitoring and regulating *[name of entity]*. In addition, we have not performed any procedures since the date of our report with respect to the subject matter *[or management's assertion related thereto]*, and significant events or circumstances may have occurred since that date.

The engagement documentation constitutes and reflects work performed or information obtained by us in the course of our examination. The documents contain trade secrets and confidential commercial and financial information of our firm and *[name of entity]* that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations²⁰ when requests are made for the engagement documentation or information contained therein or any documents created by the *[name of regulatory agency]* containing information derived therefrom. We further request that written notice be given to our firm before distribution of the information in the engagement documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.

[If it is expected that copies will be requested, add the following:]

Any copies of our engagement documentation we agree to provide you will contain a legend "Confidential Treatment Requested by *(name of firm, address, telephone number)*."

[Firm signature]

¹⁹ See footnote 16.

²⁰ This illustrative paragraph may not, in and of itself, be sufficient to gain confidential treatment under the rules and regulations of certain regulatory agencies. The practitioner should consider tailoring this paragraph to the circumstances after consulting the regulations of each applicable regulatory agency and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

.21 The following is an illustrative letter for an agreed-upon procedures engagements:

Illustrative Letter to Regulator²¹

[Date]

[Name and Address of Regulatory Agency]

Your representatives have requested access to our engagement documentation in connection with our engagement to perform agreed-upon procedures on *[identify the subject matter or management's assertion]*. It is our understanding that the purpose of your request is *[state purpose]*: for example, "to facilitate your regulatory examinations."²²

Our agreed-upon procedures engagement was conducted in accordance with attestation standards²³ established by the American Institute of Certified Public Accountants. Under these standards, we have the responsibility to perform the agreed-upon procedures to provide a reasonable basis for the findings expressed in our report. We were not engaged to, and did not, perform an examination, the objective of which would be to form an opinion on *[identify the subject matter or management's assertion]*. Our engagement is subject to the inherent risk that material misstatement of *[identify the subject matter or management's assertion]*, if it exists, would not be detected. *[The practitioner may add the following: "In addition, our engagement does not address the possibility that material misstatement of (identify the subject matter or management's assertion) may occur in the future."]* The procedures that we performed were limited to those agreed to by the specified users, and the sufficiency of these procedures is solely the responsibility of the specified users of the report. Further, our engagement does not provide a legal determination on *[name of entity]*'s compliance with specified requirements.

The engagement documentation was prepared to document agreed-upon procedures applied, information obtained, and related findings in the engagement. Accordingly, we make no representation, for your purposes, as to the sufficiency or appropriateness of the information in our engagement documentation. In addition, any notations, comments, and individual findings appearing on any of the engagement documentation should not be read as an opinion on *[identify the subject matter or management's assertion]*, or any part thereof.

Our engagement was performed for the purpose stated above and was not performed in contemplation of your *[state purpose]*: for example, "regulatory examination". Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our engagement, and the engagement documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the *[name of regulatory agency]* for the purpose of monitoring and regulating *[name of client]*. In addition, we have not performed any procedures since the date of our report with respect to the subject matter or management's assertion related thereto, and significant events or circumstances may have occurred since that date.

The engagement documentation constitutes and reflects procedures performed or information obtained by us in the course of our engagement. The documents contain trade secrets and confidential commercial and financial information of

²¹ See footnote 16.

²² See footnotes 13 and 17. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Revised, April 2016.]

²³ See footnote 16.

our firm and [name of client] that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations when requests are made for the engagement documentation or information contained therein or any documents created by the [name of regulatory agency] containing information derived therefrom. We further request that written notice be given to our firm before distribution of the information in the engagement documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.²⁴

[If it is expected that copies will be requested, add the following:]

Any copies of our engagement documentation we agree to provide you will contain a legend "Confidential Treatment Requested by (name of firm, address, telephone number)."

[Firm signature]

[Issue Date: May 1996; Revised: January 2001; January 2002; Revised: December 2012; Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

.22 Question—A regulator may request access to the engagement documentation before the attestation engagement has been completed and the report released. May the practitioner allow access in such circumstances?

.23 Interpretation—When the engagement has not been completed, the engagement documentation is necessarily incomplete because (a) additional information may be added as a result of further tests and review by supervisory personnel, and (b) any results of the engagement and conclusions reflected in the incomplete engagement documentation may change. Accordingly, it is preferable that access be delayed until all attestation procedures have been completed and all internal reviews have been performed. If access is provided prior to completion of the engagement, the practitioner may issue the letter referred to in paragraph .19 of this interpretation, modified appropriately. The following is an example of additional language that may be included in the letter:

We have been engaged to examine, in accordance with attestation standards established by the American Institute of Certified Public Accountants, XYZ Company's compliance with [identify the specified requirements] during the period [date] to [date] (or management's assertion about its compliance during the period [date] to [date]), but have not yet completed our examination. Accordingly, at this time, we do not express any opinion on XYZ Company's compliance with [identify the specified requirements] during the period [date] to [date] (or management's assertion about its compliance during the period [date] to [date]). Furthermore, the contents of the engagement documentation may change as a result of additional attestation procedures and review of the engagement documentation by supervisory personnel of our firm. Accordingly, our engagement documentation is incomplete.

Because the engagement documentation may change prior to completion of the engagement, it is preferable that the practitioner not provide copies of the engagement documentation until the engagement has been completed.

.24 Question—Some regulators may engage an independent party, such as another independent public accountant, to perform the engagement documentation review on behalf of the regulatory agency. Are there any special precautions the practitioner may observe in these circumstances?

²⁴ See footnote 20.

.25 Interpretation—The practitioner may obtain acknowledgment, preferably in writing, from the regulator stating that the third party is acting on behalf of the regulator and agreement from the third party that he or she is subject to the same restrictions on disclosure and use of engagement documentation and the information contained therein as the regulator.

.26 Question—When a regulator requests the practitioner to provide access to (and possibly copies of) engagement documentation and the practitioner is not otherwise required by law, regulation, or contract to provide such access, what steps may the practitioner take?

.27 Interpretation—The practitioner may obtain an understanding of the reasons for the regulator's request for access to the engagement documentation and may consider consulting with legal counsel regarding the request. If the practitioner decides to provide such access, reasonable procedures to maintain the confidentiality of client information include obtaining the client's consent, preferably in writing, to provide the regulator access to the engagement documentation.

.28 Following is an example of language that may be used in the written communication to the client:

The engagement documentation for this engagement is the property of *[name of firm]* and constitutes confidential information. However, we have been requested to make certain engagement documentation available to *[name of regulator]* for *[describe the regulator's basis for its request]*. Access to such engagement documentation will be provided under the supervision of *[name of firm]* personnel. Furthermore, upon request, we may provide copies of selected engagement documentation to *[name of regulator]*.

You have authorized *[name of firm]* to allow *[name of regulator]* access to the engagement documentation in the manner discussed above. Please confirm your agreement to the above by signing below and returning to *[name of firm, address]*.

[Firm signature]

Agreed and acknowledged:

[Name and title]

[Date]

.29 If the client requests to review the engagement documentation before allowing the regulator access, the practitioner may provide the client with the opportunity to obtain an understanding of the nature of the information about the subject matter contained in the engagement documentation that is being made available to the regulator. When a client reviews the engagement documentation, the need to maintain control of the engagement documentation is as discussed in paragraph .17 of this interpretation.

.30 The guidance in paragraphs .17–.25 of this interpretation, which provide guidance on making arrangements with the regulator for access to the engagement documentation, maintaining control over the engagement documentation, and submitting a letter describing various matters to the regulator, is also applicable. [Issue Date: July, 1994; Revised: June, 1996; Revised: October, 2000; Revised: January, 2002; Revised: December, 2005; Revised: October, 2011, effective for audits of financial statements for periods ending on or after December 15, 2012; Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

4. Performing and Reporting on an Attestation Engagement Under Two Sets of Attestation Standards

.31 Question—Do the AICPA attestation standards permit the performance of, and reporting on, an attestation engagement in which the practitioner follows both the AICPA attestation standards and another set of attestation standards, such as those issued by the International Auditing and Assurance Standards Board or the PCAOB?

.32 Interpretation—Yes, a practitioner may perform and report on an attestation engagement in accordance with AICPA attestation standards in addition to another set of attestation standards, as long as both sets of attestation standards are followed in their entirety.

.33 Question—If a practitioner performs an attestation engagement in accordance with the AICPA attestation standards and the PCAOB interim attestation standards, how would the practitioner reference both sets of attestation standards if the practitioner chooses to do so in the attestation report?

.34 Interpretation—If the practitioner performs an attestation engagement in accordance with both AICPA attestation standards and the PCAOB interim attestation standards, and the report references both sets of attestation standards, the statement that the attestation engagement was conducted in accordance with attestation standards established by the AICPA would be amended to add that the engagement was also conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)."²⁵ A reference to "the standards" of the PCAOB indicates that the practitioner has complied not only with the PCAOB interim attestation standards, but also with the related professional practice standards of the PCAOB, which include the relevant independence rules. If the practitioner is required to comply only with the PCAOB interim attestation standards rather than all the PCAOB standards, the practitioner may include the word "attestation" in the reference to the standards of the PCAOB.²⁶ A practitioner performing an attestation engagement in these circumstances may, nevertheless, be responsible for complying with certain or all of the independence and other related professional practice standards of the PCAOB, for example, when the attestation engagement is subject to regulatory oversight that requires compliance with those rules. Whether the practitioner conducts an attestation engagement in accordance with the standards of the PCAOB or in accordance with the attestation standards of the PCAOB depends on the circumstances of the engagement.

.35 Following are illustrative reports with examples of additional language (in ***bold italics***) that a practitioner may include in attestation reports to indicate that the engagement was conducted in accordance with the AICPA attestation standards and the PCAOB interim attestation standards:

²⁵ PCAOB Release No. 2015-002, *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, states, in part, "...whenever the practitioner is required to make reference in a report to attestation standards established by the American Institute of Certified Public Accountants, the practitioner must instead refer to "the standards of the Public Company Accounting Oversight Board (United States)."

²⁶ By analogy to Staff Question and Answer No. 2, *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 100.01), dated June 30, 2004.

Examination Engagement**Independent Accountant's Report**

[Same first paragraph as the standard report]

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants **and in accordance with the standards of the Public Company Accounting Oversight Board (United States)**. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Review Engagement**Independent Accountant's Report**

[Same first paragraph as the standard report]

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants **and in accordance with the standards of the Public Company Accounting Oversight Board (United States)**. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to *[identify the subject matter, for example, the schedule of investment returns]* in order for it to be in accordance with (or based on) the criteria. A review is substantially less in scope than an examination, the objective of which is to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. We believe that our review provides a reasonable basis for our conclusion.

Agreed-Upon Procedures Engagement**Independent Accountant's Report**

[Same first paragraph as the standard report]

[Include paragraphs to enumerate procedures and findings]

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants **and in accordance with the standards of the Public Company Accounting Oversight Board (United States)**. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on *[identify the subject matter, for example, the accompanying Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]*. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

.36 A practitioner performing an attestation engagement for a nonissuer may be required by law or regulation, or may otherwise determine it is more appropriate to use the form of attestation report included in the PCAOB Interim Attestation Standards adjusted to reflect that the engagement was also performed in accordance with AICPA attestation standards. In these circumstances a practitioner may use the reports illustrated in paragraph .37.

.37 Following are illustrative attestation reports based on the illustrative reports in the PCAOB interim attestation standards.²⁷ The reports are marked to conform with the incremental reporting requirements in AT-C section 205, *Examination Engagements*, AT-C section 210, *Review Engagements*, and AT-C section 215, *Agreed-Upon Procedures Engagements*,²⁸ respectively. Additions to the reports are shown in **bold italics** and deletions are shown in ~~strike through~~. Such edits are intended to illustrate an attestation report that complies with the reporting requirements of both AICPA attestation standards and the PCAOB interim attestation standards.

Examination Engagement

Independent Accountant's Report²⁹

[Appropriate Addressee]

We have examined the *[identify the subject matter—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for **presenting** the schedule of investment returns **in accordance with (or based on) [identify criteria—for example, the ABC criteria set forth in Note 1]**. Our responsibility is to express an opinion **on the schedule of investment returns** based on our examination.

Our examination was conducted in accordance with ***the standards of the Public Company Accounting Oversight Board (United States) and in accordance with*** attestation standards established by the American Institute of Certified Public Accountants. ***Those standards require that we plan and perform the examination to obtain reasonable assurance about whether [identify the subject matter, for example, the schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects,*** and, accordingly, included examining, on a test basis, evidence supporting *[identify the subject matter—for example, XYZ Company's schedule of investment returns]* and performing such other procedures as we considered necessary in the circumstances. We believe that the evidence we obtained in our examination ***is sufficient and appropriate to provide*** a reasonable basis for our opinion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

²⁷ The illustrative attestation reports include the examination report in example 1 of appendix A, "Examination Reports," of AT section 101, *Attest Engagements* (AICPA, *PCAOB Standards and Related Rules*), the review report in example 1 of appendix B, "Review Reports," of AT section 101, and the agreed-upon procedures report in paragraph .32 of AT section 201, *Agreed-Upon Procedures Engagements* (AICPA, *PCAOB Standards and Related Rules*).

²⁸ All AT-C sections can be found in AICPA *Professional Standards*.

²⁹ A firm registered with the PCAOB may use the title "Report of Independent Registered Public Accounting Firm," or another appropriate title that includes the word "independent."

In our opinion, the schedule referred to above presents, in all material respects, *[identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX]* **in accordance with (or based on)** *[identify criteria—for example, the ABC criteria set forth in Note 1].*

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Review Engagement

Independent Accountant's Report³⁰

[Appropriate Addressee]

We have reviewed the *[identify the subject matter—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for **presenting** the schedule of investment returns **in accordance with (or based on)** *[identify criteria—for example, the ABC criteria set forth in Note 1]*. **Our responsibility is to express a conclusion on the schedule of investment returns based on our review.**

Our review was conducted in accordance with ***the standards of the Public Company Accounting Oversight Board (United States) and in accordance with*** attestation standards established by the American Institute of Certified Public Accountants. ***Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to [identify the subject matter—for example, the schedule of investment returns] in order for it to be in accordance with (or based on) the criteria.*** A review is substantially less in scope than an examination, the objective of which is ***to obtain reasonable assurance about whether [identify the subject matter—for example, XYZ Company's schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects and*** the expression of an opinion on *[identify the subject matter—for example, XYZ Company's schedule of investment returns]* and ~~to obtain reasonable assurance about whether [identify the subject matter—for example, XYZ Company's schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects.~~ Accordingly, we do not express such an opinion. ***We believe that our review provides a reasonable basis for our conclusion.***

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Based on our review, ~~nothing came to our attention that caused us to believe that the~~ ***we are not aware of any material modifications that should be made to [identify the subject matter—for example, schedule of investment returns of XYZ Company for the year ended December 31, 20XX] is in order for it to be in accordance with (or based on)*** ~~not presented, in all material~~

³⁰ See footnote 29.

~~respects, in conformity with~~ [identify the criteria—for example, the ABC criteria set forth in Note 1].

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Agreed-Upon Procedures Engagement

Independent Accountant's Report³¹

[Appropriate Addressee]:

We have performed the procedures enumerated below, which were agreed to by the audit committees and managements of ABC Inc. and XYZ Fund, solely to assist you in evaluating the accompanying Statement of Investment Performance Statistics of XYZ Fund (prepared in accordance with the criteria specified therein) for the year ended December 31, 20X1. XYZ Fund's management is responsible for the statement of investment performance statistics. This agreed-upon procedures engagement was conducted in accordance with **the standards of the Public Company Accounting Oversight Board (United States) and in accordance with** attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[Include paragraphs to enumerate procedures and findings.]

We were not engaged to and did not conduct an examination **or a review engagement**, the objective of which would be the expression of an opinion **or conclusion, respectively**, on the accompanying Statement of Investment Performance Statistics of XYZ Fund **for the year ended December 31, 20XX**. Accordingly, we do not express such an opinion **or conclusion**. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the audit committees and managements of ABC Inc. and XYZ Fund, and is not intended to be and should not be used by anyone other than these specified parties.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

[Issue Date: May 2017; Revised: February 2018.]

³¹ See footnote 29.

AT-C Section 200

LEVEL OF SERVICE

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AT-C Section 205

Assertion-Based Examination Engagements

(Supersedes SSAE No. 18 section 205)

Source: SSAE No. 21.

See section 9205 for interpretations of this section.

Effective for practitioners' assertion-based examination reports dated on or after June 15, 2022.

Introduction

.01 This section contains performance and reporting requirements and application guidance for assertion-based examination engagements. The requirements and guidance in this section supplement the requirements and guidance in section 105, *Concepts Common to All Attestation Engagements*. For purposes of applying this section, the term *subject matter* encompasses the terms *underlying subject matter* and *subject matter information*, as defined in section 105. If only one of these terms is applicable, that term is used.

Effective Date

.02 This section is effective for practitioners' assertion-based examination reports dated on or after June 15, 2022.

Objectives

.03 In conducting an assertion-based examination engagement, the objectives of the practitioner are to do the following:

- a. Obtain reasonable assurance about whether the subject matter as measured or evaluated against the criteria is free from material misstatement
- b. Express an opinion in a written report about whether
 - i. the subject matter is in accordance with (or based on) the criteria, in all material respects, or
 - ii. the responsible party's assertion is fairly stated, in all material respects.
- c. Communicate further as required by relevant AT-C sections.

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Appropriateness of evidence. The measure of the quality of evidence, that is, its relevancy and reliability in providing support for the practitioner's opinion.

Modified opinion. A qualified opinion, an adverse opinion, or a disclaimer of opinion.

Risk of material misstatement. The risk that the subject matter is not in accordance with (or based on) the criteria in all material respects or that the assertion is not fairly stated, in all material respects.

Sufficiency of evidence. The measure of the quantity of evidence. The quantity of the evidence needed is affected by the risks of material misstatement and also by the quality of such evidence.

Test of controls. A procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements in the subject matter.

Requirements

Conduct of an Assertion-Based Examination Engagement

.05 In performing an assertion-based examination engagement, the practitioner should comply with this section, section 105, and any subject-matter AT-C section that is relevant to the engagement. A subject-matter AT-C section is relevant to the engagement when it is in effect, and the circumstances addressed by the AT-C section exist. (Ref: par. .A1)

Preconditions for an Assertion-Based Examination Engagement

.06 Section 105 indicates that a practitioner must be independent when performing an attestation engagement in accordance with the attestation standards, unless the practitioner is required by law or regulation to accept the engagement.¹ When the practitioner is not independent but is required by law or regulation to accept the engagement, the practitioner should disclaim an opinion and should specifically state that the practitioner is not independent. The practitioner is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the practitioner chooses to provide the reasons for the lack of independence, the practitioner should include all the reasons therefor.

Agreeing on the Terms of the Engagement

.07 The practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. (Ref: par. .A2)

.08 The agreed-upon terms of the engagement should include the following:

- a. The objective and scope of the engagement
- b. The responsibilities of the practitioner (Ref: par. .A3)
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the AICPA
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different (Ref: par. .A4–.A5)
- e. A statement about the inherent limitations of an examination engagement (Ref: par. .A6)

¹ Paragraph .26 of section 105, *Concepts Common to All Attestation Engagements*.

- f.* Identification of the criteria for the measurement, evaluation, or disclosure of the subject matter
- g.* An acknowledgment that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

.09 Although an engagement may recur, each engagement is considered a separate engagement. The practitioner should assess whether circumstances require revision to the terms of a preceding engagement. If the practitioner concludes that the terms of the preceding engagement need not be revised for the current engagement, the practitioner should remind the engaging party of the terms of the current engagement, and the reminder should be documented.

Requesting a Written Assertion

.10 The practitioner should request from the responsible party a written assertion about the measurement or evaluation of the underlying subject matter against the criteria. The practitioner should use professional judgment in determining whether management has a reasonable basis for making its assertion. When the engaging party is the responsible party and refuses to provide a written assertion, paragraph .84 requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable law or regulation. When the engaging party is not the responsible party, and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement. In that case, paragraph .86 requires the practitioner to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party. (Ref: par. .A7–.A12 and .A107)

Planning and Performing the Engagement

.11 The practitioner should establish an overall engagement strategy that sets the scope, timing, and direction of the engagement and guides the development of the engagement plan. (Ref: par. .A13–.A16)

.12 In establishing the overall engagement strategy, the practitioner should do the following:

- a.* Identify the characteristics of the engagement that define its scope and ascertain the reporting objectives of the engagement in order to plan the timing of the engagement and the nature of the communications required
- b.* Consider the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts
- c.* Consider the results of preliminary engagement activities, such as client acceptance, and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant
- d.* Ascertain the nature, timing, and extent of resources necessary to perform the engagement

.13 The practitioner should develop a plan that includes a description of the following items:

- a.* The nature, timing, and extent of planned risk assessment procedures
- b.* The nature, timing, and extent of planned further procedures (see paragraph .22)

- c. Other planned procedures that are required to be carried out so that the engagement complies with the attestation standards

Risk Assessment Procedures

.14 The practitioner should obtain an understanding of the subject matter and other engagement circumstances sufficient to do the following: (Ref: par. .A17–.A18)

- a. Enable the practitioner to identify and assess the risks of material misstatement in the subject matter information
- b. Provide a basis for designing and performing procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's opinion

.15 In obtaining an understanding of the subject matter in accordance with paragraph .14, the practitioner should obtain an understanding of internal control over the preparation of the subject matter relevant to the engagement. This includes evaluating the design of those controls relevant to the subject matter and determining whether they have been implemented by performing procedures in addition to inquiry of the personnel responsible for the subject matter.

.16 The practitioner should make inquiries of the responsible party regarding whether the responsible party has

- a. an internal audit function. If the responsible party has an internal audit function, the practitioner should make further inquiries to obtain an understanding of the activities and main findings of the internal audit function with respect to the subject matter.
- b. used any specialists in the preparation of the subject matter.

Materiality in Planning and Performing the Engagement

.17 The practitioner should consider materiality when establishing the overall engagement strategy; determining the nature, timing, and extent of procedures; and evaluating whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or the assertion is fairly stated, in all material respects. (Ref: par. .A19–.A25)

.18 The practitioner should reconsider materiality for the subject matter if the practitioner becomes aware of information during the engagement that would have caused the practitioner to have initially determined a different materiality.

Identifying Risks of Material Misstatement

.19 The practitioner should identify and assess risks of material misstatement as the basis for designing and performing further procedures whose nature, timing, and extent (Ref: par. .A26–.A27)

- a. are responsive to assessed risks of material misstatement and
- b. allow the practitioner to obtain reasonable assurance to support the practitioner's opinion.

Responding to Assessed Risks and Obtaining Evidence

.20 To obtain reasonable assurance, the practitioner should obtain sufficient appropriate evidence to reduce attestation risk to an acceptably low level

and thereby enable the practitioner to draw reasonable conclusions on which to base the practitioner's opinion.

.21 The practitioner should design and implement overall responses to address the assessed risks of material misstatement for the subject matter or assertion. (Ref: par. .A28–.A29)

Further Procedures

.22 The practitioner should design and perform further procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement.

.23 In designing and performing further procedures in accordance with paragraph .22, the practitioner should do the following:

- a. Consider the reasons for the assessment given to the risk of material misstatement, including
 - i. the likelihood of material misstatement due to the particular characteristics of the subject matter and
 - ii. whether the practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of other procedures
- b. Obtain more persuasive evidence the higher the practitioner's assessment of risk

.24 When designing and performing procedures, the practitioner should consider the relevance and reliability of the information to be used as evidence. If

- a. evidence obtained from one source is inconsistent with that obtained from another,
- b. the practitioner has doubts about the reliability of information to be used as evidence, or
- c. responses to inquiries of the responsible party or others are inconsistent or otherwise unsatisfactory (for example, vague or implausible), then the practitioner should determine what modifications or additions to procedures are necessary to resolve the matter and should consider the effect of the matter, if any, on other aspects of the engagement.

Tests of Controls

.25 The practitioner should design and perform tests of controls to obtain sufficient appropriate evidence about the operating effectiveness of relevant controls if any of the following apply:

- a. The practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of other procedures.
- b. Procedures other than tests of controls cannot alone provide sufficient appropriate evidence.
- c. The subject matter is internal control.

.26 If the practitioner designed and performed tests of controls to rely on their operating effectiveness and identified deviations in those controls, the practitioner should make specific inquiries and perform other procedures as necessary to understand these matters and their potential consequences. The practitioner also should determine whether

- a. the tests of controls that have been performed provide an appropriate basis for reliance on the controls,
- b. additional tests of controls are necessary, or
- c. the potential risks of misstatement need to be addressed using other procedures.

Procedures Other Than Tests of Controls

.27 Irrespective of the assessed risks of material misstatement, the practitioner should design and perform tests of details or analytical procedures related to the subject matter, except when the subject matter is internal control.

Analytical Procedures Performed in Response to Assessed Risks

.28 When designing and performing analytical procedures in response to assessed risks, the practitioner should do the following: (Ref: par. .A30–.A31)

- a. Determine the suitability of particular analytical procedures for the subject matter, taking into account the assessed risks of material misstatement and any related tests of details;
- b. Evaluate the reliability of data from which the practitioner's expectation is developed, taking into account the source, comparability, nature, and relevance of information available, and controls over their preparation
- c. Develop an expectation that is sufficiently precise to identify possible material misstatements (taking into account whether analytical procedures are to be performed alone or in combination with tests of details).

.29 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ significantly from expected amounts or ratios, the practitioner should investigate such differences by doing the following:

- a. Inquiring of the responsible party and obtaining additional evidence relevant to its responses
- b. Performing other procedures as necessary in the circumstances.

Procedures Regarding Estimates

.30 Based on the assessed risks of material misstatement, the practitioner should evaluate the following:

- a. Whether the responsible party has appropriately applied the requirements of the criteria relevant to any estimated amounts
- b. Whether the methods for making estimates are appropriate and have been applied consistently and whether changes, if any, in reported estimates or in the method for making them from the prior period, if applicable, are appropriate in the circumstances

.31 When responding to an assessed risk of material misstatement related to an estimate, the practitioner should undertake one or more of the following, taking into account the nature of the estimates:

- a. Determine whether events occurring up to the date of the practitioner's report provide evidence regarding the estimate.
- b. Test how the responsible party made the estimate and the data on which it is based. In doing so, the practitioner should evaluate whether the

- i. method of measurement used is appropriate in the circumstances,
 - ii. assumptions used by the responsible party are reasonable, and
 - iii. data on which the estimate is based are sufficiently reliable for the practitioner's purposes.
- c. Test the operating effectiveness of the controls over how the responsible party made the estimate, together with other appropriate further procedures.
- d. Develop a point estimate or a range to evaluate the responsible party's estimate. For this purpose, if the practitioner
 - i. uses assumptions or methods that differ from those of the responsible party, the practitioner should obtain an understanding of the responsible party's assumptions or methods sufficient to establish that the practitioner's point estimate or range takes into account relevant variables and to evaluate any significant differences from the responsible party's point estimate.
 - ii. concludes that it is appropriate to use a range, the practitioner should narrow the range, based on evidence available, until all outcomes within the range are considered reasonable.

Sampling

.32 If sampling is used, the practitioner should, when designing the sample, consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn. Sampling involves the following: (Ref: par. .A32)

- a. Determining a sample size sufficient to reduce sampling risk to an acceptably low level
- b. Selecting items for the sample in such a way that the practitioner can reasonably expect the sample to be representative of the relevant population and likely to provide the practitioner with a reasonable basis for conclusions about the population
- c. Treating a selected item to which the practitioner is unable to apply the designed procedures or suitable alternative procedures as a deviation from the prescribed control in the case of tests of controls or a misstatement in the case of tests of details
- d. Investigating the nature and cause of deviations or misstatements identified and evaluating their possible effect on the purpose of the procedure and on other areas of the engagement
- e. Evaluating the results of the sample, including sampling risk and projecting misstatements found in the sample to the population
- f. Evaluating whether the use of sampling has provided an appropriate basis for conclusions about the population that has been tested

Fraud, Laws, and Regulations

.33 The practitioner should do the following:

- a. Consider whether risk assessment procedures and other procedures related to understanding the subject matter indicate risk of

material misstatement due to fraud or noncompliance with laws or regulations

- b. Make inquiries of the appropriate party to determine whether the party has knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter
- c. Evaluate whether there are unusual or unexpected relationships within the subject matter, or between the subject matter and other related information, that indicate risks of material misstatement due to fraud or noncompliance with laws or regulations
- d. Evaluate whether other information obtained indicates risk of material misstatement due to fraud or noncompliance with laws or regulations

.34 The practitioner should respond appropriately to fraud or suspected fraud and noncompliance or suspected noncompliance with laws or regulations affecting the subject matter that is identified during the engagement. (Ref: par. .A33–.A34)

Revision of Risk Assessment

.35 The practitioner's assessment of the risks of material misstatement may change during the course of the engagement as additional evidence is obtained. In circumstances in which the practitioner obtains evidence from performing further procedures, or if new information is obtained, either of which is inconsistent with the evidence on which the practitioner originally based the assessment, the practitioner should revise the assessment and modify the planned procedures accordingly. (Ref: par. .A35–.A36)

Evaluating the Reliability of Information Produced by the Entity

.36 When using information produced by the entity, the practitioner should evaluate whether the information is sufficiently reliable for the practitioner's purposes, including, as necessary, the following: (Ref: par. .A37–.A38)

- a. Obtaining evidence about the accuracy and completeness of the information
- b. Evaluating whether the information is sufficiently precise and detailed for the practitioner's purposes

Using the Work of a Practitioner's Specialist

.37 When the practitioner expects to use the work of a practitioner's specialist, the practitioner should do the following:

- a. Evaluate whether the practitioner's specialist has the necessary competence, capabilities, and objectivity for the practitioner's purposes. In the case of a practitioner's external specialist, the evaluation of objectivity should include inquiry regarding interests and relationships that may create a threat to the objectivity of the practitioner's specialist. (Ref: par. .A39–.A42)
- b. Obtain a sufficient understanding of the field of expertise of a practitioner's specialist to enable the practitioner to (Ref: par. .A43)
 - i. determine the nature, scope, and objectives of that specialist's work for the practitioner's purposes and

- ii. evaluate the adequacy of that work for the practitioner's purposes.
- c. Agree with the practitioner's specialist regarding (Ref: par. .A44)
 - i. the nature, scope, and objectives of that practitioner's specialist's work;
 - ii. the respective roles and responsibilities of the practitioner and that specialist;
 - iii. the nature, timing, and extent of communication between the practitioner and that specialist, including the form of any report or documentation to be provided by that specialist; and
 - iv. the need for the practitioner's specialist to observe confidentiality requirements.
- d. Evaluate the adequacy of the work of the practitioner's specialist for the practitioner's purposes, including
 - i. the relevance and reasonableness of the findings and conclusions of the practitioner's specialist and their consistency with other evidence;
 - ii. if the work of the practitioner's specialist involves the use of significant assumptions and methods
 - (1) obtaining an understanding of those assumptions and methods and
 - (2) evaluating the relevance and reasonableness of those assumptions and methods in the circumstances, giving consideration to the rationale and support provided by the practitioner's specialist, and in relation to the practitioner's other findings and conclusions; and
 - iii. if the work of the practitioner's specialist involves the use of source data that are significant to the work of the practitioner's specialist, the relevance, completeness, and accuracy of that source data.

.38 If the practitioner determines that the work of the practitioner's specialist is not adequate for the practitioner's purposes, the practitioner should

- a. agree with the practitioner's specialist on the nature and extent of further work to be performed by the practitioner's specialist or
- b. perform additional procedures appropriate to the circumstances.

.39 The nature, timing, and extent of the procedures a practitioner performs when the practitioner expects to use the work of a practitioner's specialist will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the practitioner should consider the following: (See section 105.)²

- a. The significance of that specialist's work in the context of the engagement (See also paragraphs .A45–.A46)
- b. The nature of the matter to which that specialist's work relates
- c. The risks of material misstatement in the matter to which that specialist's work relates

² Paragraph .34 of section 105.

- d. The practitioner's knowledge of, and experience with, previous work performed by that specialist
- e. Whether that specialist is subject to the practitioner's firm's quality control policies and procedures (see also paragraph .A47)

Using the Work of Internal Auditors

.40 When the practitioner expects to use the work of the internal audit function in obtaining evidence or to use internal auditors to provide direct assistance, the practitioner should determine whether the work can be used for purposes of the assertion-based examination by evaluating the following: (Ref: par. .A48–.A50)

- a. The level of competence of the internal audit function or the individual internal auditors providing direct assistance
- b. The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal audit function or for internal auditors providing direct assistance, the existence of threats to the objectivity of those internal auditors and the related safeguards applied to reduce or eliminate those threats
- c. When using the work of the internal audit function, the application by the internal audit function of a systematic and disciplined approach, including quality control

.41 When using the work of the internal audit function, the practitioner should perform sufficient procedures on the body of work of the internal audit function as a whole that the practitioner plans to use to determine its adequacy for the purpose of the assertion-based examination engagement. This includes reperforming some of the body of work of the internal audit function that the practitioner intends to use in obtaining evidence.

.42 Prior to using internal auditors to provide direct assistance, the practitioner should obtain written acknowledgment from the responsible party that internal auditors providing direct assistance to the practitioner will be allowed to follow the practitioner's instructions, and that the responsible party will not intervene in the work the internal auditor performs for the practitioner.

.43 When using internal auditors to provide direct assistance to the practitioner, the practitioner should direct, supervise, and review the work of the internal auditors.

.44 Because the practitioner has sole responsibility for the opinion expressed, the practitioner should make all significant judgments in the assertion-based examination engagement, including when to use the work of the internal audit function in obtaining evidence. To prevent undue use of the internal audit function in obtaining evidence, the external auditor should plan to use less of the work of the function and perform more of the work directly in the following circumstances:

- a. The more judgment is involved in
 - i. planning and performing relevant procedures or
 - ii. evaluating the evidence obtained
- b. the higher the assessed risk of material misstatement;

- c. the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors
- d. the lower the level of competence of the internal audit function.

.45 Before the conclusion of the engagement, the practitioner should evaluate whether the use of the work of the internal audit function or the use of internal auditors to provide direct assistance results in the practitioner still being sufficiently involved in the assertion-based examination given the practitioner's sole responsibility for the opinion expressed.

Evaluating the Results of Procedures

.46 The practitioner should accumulate misstatements identified during the engagement other than those that are clearly trivial. (Ref: par. .A51–.A52)

.47 The practitioner should evaluate the sufficiency and appropriateness of the evidence obtained in the context of the engagement and, if necessary, attempt to obtain further evidence. The practitioner should consider all relevant evidence, regardless of whether it appears to corroborate or contradict the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A53–.A57)

.48 If the practitioner is unable to obtain sufficient appropriate evidence, a scope limitation exists and the practitioner should express a qualified opinion, disclaim an opinion, or withdraw from the engagement, when withdrawal is possible under applicable law or regulation. The practitioner should apply the requirements in paragraphs .70–.86 when a scope limitation exists and the practitioner is determining the type of opinion to be issued.

Considering Subsequent Events and Subsequently Discovered Facts

.49 The practitioner should inquire whether the responsible party, and if different, the engaging party, is aware of any events subsequent to the period (or point in time) covered by the assertion-based examination engagement up to the date of the practitioner's report that could have a significant effect on the subject matter or assertion. If so, the practitioner should apply other appropriate procedures to obtain evidence regarding such events. If the practitioner becomes aware, through inquiry or otherwise, of such an event, or any other event that is of such a nature and significance that its disclosure is necessary to prevent users of the report from being misled, and information about that event is not adequately disclosed by the responsible party in the subject matter or in its assertion, the practitioner should take appropriate action. (Ref: par. .A58–.A60)

.50 The practitioner has no responsibility to perform any procedures regarding the subject matter or assertion after the date of the practitioner's report. Nevertheless, the practitioner should respond appropriately to facts that become known to the practitioner after the date of the report that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. (Ref: par. .A61–.A62)

Written Representations

.51 The practitioner should request from the responsible party written representations in the form of a letter addressed to the practitioner. The representations should do the following: (Ref: par. .A63–.A66)

- a. Include the responsible party's assertion about the subject matter based on the criteria. (Ref: par. .A107)
- b. State that all relevant matters are reflected in the measurement or evaluation of the subject matter or assertion.
- c. State that all known matters contradicting the subject matter or assertion and any communication from regulatory agencies or others affecting the subject matter or assertion have been disclosed to the practitioner, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report.
- d. Acknowledge responsibility for
 - i. the subject matter and the responsible party's assertion;
 - ii. selecting the criteria, when applicable; and
 - iii. determining that such criteria are suitable, will be available to the intended users, and appropriate for the purpose of the engagement.
- e. State that the responsible party has disclosed to the practitioner
 - i. all deficiencies in internal control relevant to the engagement of which the responsible party is aware;
 - ii. its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter; and
 - iii. other matters as the practitioner deems appropriate.
- f. State that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion have been disclosed to the practitioner. (Ref: par. .A65)
- g. State that it has provided the practitioner with all relevant information and access, as agreed upon in the terms of the engagement.
- h. If applicable, state that the responsible party believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the subject matter. (Ref: par. .A66)
- i. If applicable, state that significant assumptions used in making any material estimates are reasonable.

.52 When the engaging party is not the responsible party, and the responsible party refuses to provide the representations in paragraph .51 in writing, the practitioner should make inquiries of the responsible party about, and seek oral responses to, the matters in paragraph .51 (Ref: par. .A67)

.53 When the engaging party is not the responsible party, the practitioner should request written representations from the engaging party in addition to those requested from the responsible party in the form of a letter addressed to the practitioner. The representations should do the following:

- a. Acknowledge that the responsible party is responsible for the subject matter being in accordance with the criteria and for its assertion

- b. Acknowledge the engaging party's responsibility for selecting the criteria
- c. Acknowledge the engaging party's responsibility for determining that such criteria are suitable, will be available to the intended users, and are appropriate for the purpose of the engagement
- d. State that the engaging party is not aware of any material misstatements in the subject matter information or assertion
- e. State that the engaging party has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion. (Ref: par. .A65)
- f. Address other matters as the practitioner deems appropriate

.54 When written representations are directly related to matters that are material to the subject matter, the practitioner should

- a. evaluate their reasonableness and consistency with other evidence obtained, including other representations (oral or written) and
- b. consider whether those making the representations can be expected to be well informed on the particular matters.

.55 The date of the written representations should be as of the date of the practitioner's report. The written representations should address the subject matter and periods covered by the practitioner's opinion.

Requested Written Representations Not Provided or Not Reliable

.56 When the engaging party is the responsible party, and one or more of the requested written representations are not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should do the following: (Ref: par. .A68–.A70)

- a. Discuss the matter with the appropriate party
- b. Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general
- c. If any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the opinion in the practitioner's report

.57 When the engaging party is not the responsible party

- a. if one or more of the requested representations are not provided in writing by the responsible party, but the practitioner receives satisfactory oral responses to the practitioner's inquiries performed in accordance with paragraph .52 sufficient to enable the practitioner to conclude that the practitioner has sufficient appropriate evidence to form an opinion about the subject matter, the practitioner's report should contain a separate paragraph that restricts the use of the report to the engaging party. (Paragraphs .64–.66 contain requirements for the contents of such a paragraph.) (Ref: par. .A72)

- b. if one or more of the requested representations are provided neither in writing nor orally from the responsible party in accordance with paragraph .52, a scope limitation exists, and the practitioner should determine the effect on the report, or the practitioner should withdraw from the engagement. (Ref: par. .A72)

Other Information

.58 If prior to or after the release of the practitioner's report on subject matter or an assertion the practitioner is willing to permit the inclusion of the report in a document that contains the subject matter or assertion and other information, the practitioner should read the other information to identify material inconsistencies, if any, with the subject matter, assertion, or report. If upon reading the other information, in the practitioner's professional judgment either of the following applies, the practitioner should discuss the matter with the appropriate party and take further action as appropriate: (Ref: par. .A73–.A74)

- a. A material inconsistency between the other information and the subject matter, assertion, or the report exists
- b. A material misstatement of fact exists in the other information, the subject matter, assertion, or report

Description of Criteria

.59 The practitioner should evaluate whether the written description of the subject matter or assertion adequately refers to or describes the criteria. (Ref: par. .A75–.A76)

Forming the Opinion

.60 The practitioner should form an opinion about whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or the assertion is fairly stated, in all material respects. In forming that opinion, the practitioner should evaluate

- a. the practitioner's conclusion regarding the sufficiency and appropriateness of evidence obtained and (Ref: par. .A77)
- b. whether uncorrected misstatements are material, individually or in the aggregate. (Ref: par. .A78)

.61 The practitioner should evaluate, based on the evidence obtained, whether the presentation of the subject matter or assertion is misleading within the context of the engagement. (Ref: par. .A79–.A80)

Preparing the Practitioner's Report

.62 The practitioner's report should be in writing. (Ref: par. .A81–.A84)

Content of the Practitioner's Report

.63 The practitioner's report should include the following, unless the practitioner is disclaiming an opinion, in which case, items .63g and .63h should be omitted:

- a. A title that includes the word *independent*. (Ref: par. .A85)
- b. An appropriate addressee as required by the circumstances of the engagement.

- c.* An identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates.
- d.* An identification of the criteria against which the subject matter was measured or evaluated. (Ref: par. .A86)
- e.* A statement that identifies the responsible party and its responsibility for the subject matter being in accordance with (or based on) the criteria or for its assertion. (Ref: par. .A87)
- f.* A statement that the practitioner's responsibility is to express an opinion on the subject matter or assertion, based on the practitioner's examination. (Ref: par. .A88)
- g.* A statement that
 - i.* the practitioner's examination was conducted in accordance with attestation standards established by the AICPA. (Ref: par. .A89)
 - ii.* those standards require that the practitioner plan and perform the examination to obtain reasonable assurance about whether
 - (1) the subject matter is in accordance with (or based on) the criteria, in all material respects (or equivalent language regarding the subject matter and criteria, such as the language used in the examples in paragraph. A90) or
 - (2) the responsible party's assertion is fairly stated, in all material respects.
 - iii.* the practitioner believes the evidence the practitioner obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.
- h.* A description of the nature of an assertion-based examination engagement. (Ref: par. .A91–.A93)
- i.* A statement that the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement. (Ref: par. .A94–.A95)
- j.* A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A96)
- k.* The practitioner's opinion about whether (Ref: par. .A97–.A100)
 - i.* the subject matter is in accordance with (or based on) the criteria, in all material respects or
 - ii.* the responsible party's assertion is fairly stated, in all material respects
- l.* The manual or printed signature of the practitioner's firm.
- m.* The city and state where the practitioner's report is issued. (Ref: par. .A101)
- n.* The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate evidence on which to base the practitioner's opinion, including evidence that
 - i.* the attestation documentation has been reviewed,

- ii. if applicable, the written presentation of the subject matter has been prepared, and
- iii. the responsible party has provided a written assertion or, in the circumstances described in paragraph .A72, an oral assertion.) (Ref: par. .A102–.A103)

Restricted-Use Paragraph

.64 In the following circumstances, the practitioner's report should include an alert, in a separate paragraph, that restricts the use of the report: (Ref: par. .A104–.A106)

- a. The practitioner determines that the criteria used to evaluate the subject matter are appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.
- b. The criteria used to evaluate the subject matter are available only to specified parties.
- c. The engaging party is not the responsible party, and the responsible party does not provide the written representations required by paragraph .51 but does provide oral responses to the practitioner's inquiries about the matters in paragraph .51, as provided for in paragraph .52 and .57a. In this case, the use of the practitioner's report should be restricted to the engaging party. (Ref: par. .A107)

.65 The alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties,
- b. identify the specified parties for whom use is intended, and (Ref: par. .A108)
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A109–.A111)

.66 When the engagement is also performed in accordance with *Government Auditing Standards*, the alert that restricts the use of the practitioner's report should include the following information, rather than the information required by paragraph .65:

- a. A description of the purpose of the report
- b. A statement that the report is not suitable for any other purpose

.67 A practitioner should report on a written assertion or directly on the subject matter. If the opinion is modified because of a material misstatement, the practitioner should report directly on the subject matter, even when the assertion acknowledges the misstatement.

.68 If the practitioner is reporting on the assertion, the assertion should be bound with or accompany the practitioner's report, or the assertion should be clearly stated in the report.

Reference to the Practitioner's Specialist

.69 The practitioner should not refer to the work of a practitioner's specialist in the practitioner's report containing an unmodified opinion. (Ref: par. .A112)

Modified Opinions

.70 The practitioner should modify the opinion when either of the following circumstances exist and, in the practitioner's professional judgment, the effect of the matter is or may be material: (Ref: par. .A113–.A114)

- a.* The practitioner is unable to obtain sufficient appropriate evidence to conclude that the subject matter is in accordance with (or based on) the criteria, in all material respects.
- b.* The practitioner concludes, based on evidence obtained, that the subject matter is not in accordance with (or based on) the criteria, in all material respects.

.71 When the practitioner modifies the opinion, the practitioner should include a separate paragraph in the practitioner's report that provides a description of the matter giving rise to the modification.

.72 The practitioner should express a qualified opinion when either of the following applies: (Ref: par. .A115–.A119)

- a.* The practitioner, having obtained sufficient appropriate evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive to the subject matter.
- b.* The practitioner is unable to obtain sufficient appropriate evidence on which to base the opinion, but the practitioner concludes that the possible effects on the subject matter of undetected misstatements, if any, could be material but not pervasive.

.73 When the practitioner expresses a qualified opinion due to a material misstatement of the subject matter, the practitioner should state that, in the practitioner's opinion, except for the effects of the matter or matters giving rise to the modification, the subject matter is in accordance with (or based on) the criteria, in all material respects. When the modification arises from an inability to obtain sufficient appropriate evidence, the practitioner should use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

.74 The practitioner should express an adverse opinion when the practitioner, having obtained sufficient appropriate evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the subject matter.

.75 When the practitioner expresses an adverse opinion, the practitioner should state that, in the practitioner's opinion, because of the significance of the matter or matters giving rise to the modification, the subject matter is not in accordance with (or based on) the criteria, in all material respects.

.76 If the practitioner has concluded that conditions exist that, individually or in combination, result in one or more material misstatements based on the criteria, the practitioner should modify the opinion and express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement.

.77 The practitioner should disclaim an opinion when the practitioner is unable to obtain sufficient appropriate evidence on which to base the opinion, and the practitioner concludes that the possible effects on the subject matter of undetected misstatements, if any, could be both material and pervasive. (Ref: par. .A120)

.78 When the practitioner disclaims an opinion due to an inability to obtain sufficient appropriate evidence, the practitioner's report should state the following:

- a. Because of the significance of the matter or matters giving rise to the modification, the practitioner has not been able to obtain sufficient appropriate evidence to provide a basis for an examination opinion.
- b. Accordingly, the practitioner does not express an opinion on the subject matter.

Description of the Practitioner's Responsibility When the Practitioner Expresses a Qualified or an Adverse Opinion

.79 When the practitioner expresses a qualified or an adverse opinion, the practitioner should amend the description of the practitioner's responsibility to state that the practitioner believes that the evidence the practitioner has obtained is sufficient and appropriate to provide a basis for the practitioner's modified opinion.

Description of the Practitioner's Responsibility When the Practitioner Disclaims an Opinion

.80 When the practitioner disclaims an opinion due to an inability to obtain sufficient appropriate evidence, the practitioner should amend the practitioner's report to state that the practitioner was engaged to examine the subject matter or assertion. The practitioner should also amend the description of the practitioner's responsibility and the description of an assertion-based examination to state only the following:

Our responsibility is to express an opinion on the subject matter or assertion based on conducting the examination in accordance with attestation standards established by the AICPA. Because of the limitation on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the subject matter is in accordance with (or based on) the criteria, in all material respects.

.81 If the practitioner expresses a modified opinion because of a scope limitation but is also aware of a matter that causes the subject matter to be materially misstated, the practitioner should include in the practitioner's report a clear description of both the scope limitation and the matter that causes the subject matter to be materially misstated.

.82 The practitioner's opinion on the subject matter or assertion should be clearly separated from any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities. Any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities should be phrased in a manner that makes it clear that these paragraphs are not intended to detract from that opinion.

.83 When the opinion is modified, reference to an external specialist is permitted when such reference is relevant to an understanding of the modification to the practitioner's opinion. The practitioner should indicate in the practitioner's report that such reference does not reduce the practitioner's responsibility for that opinion.

Responsible Party Refuses to Provide a Written Assertion

.84 If the engaging party is the responsible party and refuses to provide the practitioner with a written assertion as required by paragraph .10, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation.

.85 If law or regulation does not allow the practitioner to withdraw from the engagement, the practitioner should disclaim an opinion.

.86 When the engaging party is not the responsible party and the responsible party refuses to provide the practitioner with a written assertion, the practitioner may report on the subject matter but should disclose in the practitioner's report the responsible party's refusal to provide a written assertion and should restrict the use of the practitioner's report to the engaging party. (Ref: par. .A121–.A123)

Communication Responsibilities

.87 The practitioner should communicate to the responsible party known and suspected fraud and noncompliance with laws or regulations, uncorrected misstatements, and, when relevant to the subject matter, internal control deficiencies identified during the engagement. When the engaging party is not the responsible party, the practitioner should also communicate this information to the engaging party. (Ref: par. .A124)

.88 In the event the practitioner encounters known or suspected fraud or noncompliance with laws or regulations in connection with the engagement, the practitioner should consider responsibilities under the AICPA Code of Professional Conduct and applicable law prior to communicating such information either to the responsible party or the engaging party. (Ref: par. .A125–.A126)

Documentation

.89 The practitioner should prepare engagement documentation that is sufficient to determine the following: (Ref: par. .A127–.A130)

- a. The nature, timing, and extent of the procedures performed to comply with relevant AT-C sections and applicable legal and regulatory requirements, including the following:
 - i. The identifying characteristics of the specific items or matters tested
 - ii. Who performed the engagement work and the date such work was completed
 - iii. The discussions with the responsible party or others about findings or issues that, in the practitioner's professional judgment, are significant, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place
 - iv. When the engaging party is the responsible party and the responsible party will not provide one or more of the requested written representations or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations or that the written

representations are otherwise not reliable, the matters in paragraph .56

- v. When the engaging party is not the responsible party and the responsible party will not provide the written representations regarding the matters in paragraph .51, the oral responses from the responsible party to the practitioner's inquiries regarding the matters in paragraph .51, in accordance with paragraph .52
 - vi. Who reviewed the engagement work performed and the date and extent of such review
 - vii. If the practitioner identified information that is inconsistent with the practitioner's final opinion regarding a significant matter, how the practitioner addressed the inconsistency
- b. The results of the procedures performed and the evidence obtained

.90 If, in circumstances such as those described in paragraph .50, the practitioner performs new or additional procedures or draws new conclusions after the date of the practitioner's report, the practitioner should document the following:

- a. The circumstances encountered
- b. The new or additional procedures performed, evidence obtained, and conclusions reached, and their effect on the report
- c. When and by whom the resulting changes to the documentation were made and reviewed

Application and Other Explanatory Material

Conduct of an Assertion-Based Examination Engagement (Ref: par. .05)

.A1 For example, if a practitioner were examining prospective financial information, section 105, this section, and section 305, *Prospective Financial Information*, would be relevant.

Agreeing on the Terms of the Engagement (Ref: par. .07, .08b, .08d, and .08e)

.A2 It is in the interests of both the engaging party and the practitioner to document the agreed-upon terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the engagement letter or other suitable form of written agreement will vary with the engagement circumstances.

.A3 A practitioner may further describe the responsibilities of the practitioner by adding the following items to the engagement letter or other suitable form of written agreement:

- a. A statement that an examination is designed to obtain reasonable assurance about whether the subject matter as measured or evaluated against the criteria is free from material misstatement
- b. A statement that the objective of an examination is the expression of an opinion in a written practitioner's report about whether the

subject matter is in accordance with (or based on) the criteria, in all material respects, or whether the responsible party's assertion is fairly stated, in all material respects

.A4 Situations may exist in which the responsible party is not the engaging party and, as such, the responsibilities of each party may differ. For example, when the responsible party is not the engaging party, the engaging party, rather than the responsible party, may be responsible for selecting the criteria.

.A5 The engaging party may request that the practitioner recommend, develop, or assist in developing the criteria for the engagement. Regardless of whether the practitioner recommends, develops, or assists in developing or selecting the criteria for the engagement, the engaging party is required to take responsibility for the criteria.

.A6 If relevant, a statement about the inherent limitations of an examination engagement may indicate that "because of the inherent limitations of an examination engagement, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the examination is properly planned and performed in accordance with the attestation standards."

Requesting a Written Assertion (Ref: par. .10)

.A7 What constitutes a reasonable basis for the responsible party's assertion depends on the nature of the subject matter and other engagement circumstances. In some cases, a formal process with extensive internal control may be needed to provide the responsible party with a reasonable basis for making its assertion. The fact that the practitioner will report on the subject matter is not a substitute for the responsible party's own processes to have a reasonable basis for its assertion.

.A8 The language of the responsible party's written assertion in paragraph .10 may need to be tailored to reflect the nature of the underlying subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .10 include the following:

- The subject matter is presented in accordance with (or based on) the criteria.
- The subject matter achieved the objectives, for example, when the objectives are the criteria.
- The subject matter is presented fairly, based on the criteria.

.A9 Situations may arise in which the current responsible party was not present during some or all of the period covered by the practitioner's report. Such persons may contend that they are not in a position to provide a written assertion that covers the entire period because they were not in place during some or all of the period. This fact, however, does not diminish such persons' responsibilities for the subject matter as a whole. Accordingly, the requirement for the practitioner to request a written assertion from the responsible party that covers the entire relevant period or periods still applies.

.A10 Paragraph .51a requires the practitioner to request a written representation from the responsible party that is the same as the responsible party's assertion. If the responsible party provides the practitioner with the written representation in paragraph .51a, the practitioner need not request a separate written assertion unless a separate written assertion is called for by the engagement circumstances.

.A11 A practitioner may also be engaged to assist the responsible party in measuring or evaluating the subject matter against the criteria in connection with the responsible party providing a written assertion.

.A12 Regardless of the procedures performed by the practitioner, the responsible party is required to accept responsibility for its assertion and the subject matter. An assertion based solely on the practitioner's procedures would not be considered a reasonable basis for the assertion.³

Planning and Performing the Engagement (Ref: par. .11)

.A13 Planning involves the engagement partner and other key members of the engagement team and may involve the practitioner's specialists in developing

- an overall strategy for the scope, timing, and conduct of the engagement and
- an engagement plan, consisting of a detailed approach for the nature, timing, and extent of procedures to be performed.

Adequate planning helps the practitioner devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis, and properly organize and manage the engagement for it to be performed in an effective and efficient manner.

Adequate planning also assists the practitioner in properly assigning work to engagement team members and facilitates the direction, supervision, and review of their work. Further, it assists, when applicable, the coordination of work performed by other practitioners and practitioner's specialists. The nature and extent of planning activities will vary with the engagement circumstances, for example, the complexity of the assessment or evaluation of the subject matter and the practitioner's previous experience with it. Examples of relevant matters that may be considered include the following:

- The characteristics of the engagement that define its scope, including the terms of the engagement, the characteristics of the subject matter, and the criteria
- The expected timing and the nature of the communications required
- The results of preliminary engagement activities, such as client acceptance, and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the appropriate party is relevant
- The engagement process, including possible sources of evidence, and choices among alternative measurement or evaluation methods
- The practitioner's understanding of the appropriate party and its environment, including the risks that the subject matter or assertion may be materially misstated
- Identification of intended users and their information needs and consideration of materiality and the components of attestation risk

³ The "Nonattest Services" subtopic (ET sec. 1.295) of the AICPA Code of Professional Conduct addresses the practitioner's provision of nonattest services for an attest client.

All ET sections can be found in AICPA *Professional Standards*.

- The risk of fraud relevant to the engagement
- The effect on the engagement of using the internal audit function

.A14 The practitioner may decide to discuss elements of planning with the appropriate party to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work of the responsible party's personnel). Although these discussions often occur, the overall engagement strategy and the engagement plan remain the practitioner's responsibility. When discussing matters included in the overall engagement strategy or engagement plan, care is needed to avoid compromising the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the responsible party may compromise the effectiveness of the engagement by making the procedures too predictable.

.A15 Planning is not a discrete phase but, rather, a cumulative and iterative process throughout the engagement. Because of unexpected events, changes in conditions, or evidence obtained, the practitioner may need to revise the overall strategy and engagement plan and, thereby, the resulting nature, timing, and extent of planned procedures.

.A16 In smaller or less complex engagements, the entire engagement may be conducted by a very small engagement team, possibly involving the engagement partner (who may be a sole practitioner) working without any other engagement team members. With a smaller team, coordination of and communication among team members is easier. In such cases, establishing the overall engagement strategy need not be a complex or time-consuming exercise; it varies according to the size of the entity, complexity of the engagement, and size of the engagement team.

Risk Assessment Procedures (Ref: par. .14)

.A17 Obtaining an understanding of the subject matter and other engagement circumstances provides the practitioner with a frame of reference for exercising professional judgment throughout the engagement, for example, when doing the following:

- Considering the characteristics of the subject matter
- Assessing the suitability of criteria
- Considering the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts, including situations in which special consideration may be necessary (for example, when there is a need for specialized skills or the work of a specialist)
- Establishing and evaluating the continued appropriateness of quantitative materiality levels (when appropriate) and considering qualitative materiality factors
- Developing expectations when performing analytical procedures
- Designing and performing procedures
- Evaluating evidence, including the reasonableness of the written representations received by the practitioner

.A18 In assessing inherent risk, the practitioner may consider factors relevant to assertion-based examination engagements, such as the following:

- The complexity of the subject matter or assertion

- The length of time during which the entity has had experience with the subject matter or assertion
- Prior experience with the entity's assessment of the subject matter or assertion

Materiality in Planning and Performing the Engagement (Ref: par. .17–.18)

.A19 Materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative factors and quantitative factors when considering materiality in a particular engagement is a matter for the practitioner's professional judgment.

.A20 Professional judgments about materiality are made considering surrounding circumstances, but they are not affected by the level of assurance, that is, for the same intended users, materiality for an assertion-based examination engagement is the same as it is for a review engagement because materiality is based on the information needs of intended users and not the level of assurance.

.A21 In general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by intended users based on the subject matter. The practitioner's consideration of materiality is a matter of professional judgment and is affected by the practitioner's perception of the common information needs of intended users as a group. For purposes of determining materiality, the practitioner may assume that intended users

- a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.
- b. understand that the subject matter is measured or evaluated and subjected to procedures using appropriate levels of materiality and that they have an understanding of any materiality concepts included in the criteria.
- c. understand any inherent uncertainties involved in measuring or evaluating the subject matter.
- d. make reasonable judgments based on the subject matter.

Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.

.A22 Qualitative factors may include the following:

- The interaction between, and relative importance of, various aspects of the subject matter, such as numerous performance indicators
- The wording chosen with respect to subject matter that is expressed in narrative form, for example, the wording chosen does not omit or distort the information
- The characteristics of the presentation adopted for the subject matter when the criteria allow for variations in that presentation
- The nature of a misstatement, for example, the nature of observed deviations in the operation of a control when the responsible party asserts that the control is effective
- Whether a misstatement affects compliance with laws or regulations

- In the case of periodic reporting on a subject matter, whether the effect of an adjustment affects past or current information about the subject matter or is likely to affect future information about the subject matter
- Whether a misstatement is the result of an intentional act or is unintentional
- Whether a misstatement is significant with regard to the practitioner's understanding of known previous communications to users, for example, in relation to the expected outcome of the measurement or evaluation of the subject matter
- Whether a misstatement relates to the relationship between the responsible party, and if different, the engaging party or its relationship with other parties

.A23 Quantitative factors relate to the magnitude of misstatements relative to reported amounts for those aspects of the subject matter, if any, that are

- expressed numerically or
- otherwise related to numerical values, for example, the number of observed deviations in the operation of a control when the assertion-based examination involves the effectiveness of the control.

.A24 When quantitative factors are applicable, planning the engagement solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the subject matter to be materially misstated. Applying materiality to elements of the subject matter ordinarily is not a simple mechanical calculation but involves the exercise of professional judgment. It is affected by the practitioner's understanding of the subject matter and the responsible party, updated during the performance of the risk assessment procedures, and consideration of the nature and extent of misstatements identified in previous attestation engagements.

.A25 The criteria may discuss the concept of materiality in the context of the preparation and presentation of the subject matter and thereby provide a frame of reference for the practitioner in considering materiality for the engagement. Although criteria may discuss materiality in different terms, the concept of materiality generally includes the matters discussed in paragraphs .A19–.A24. If the criteria do not include a discussion of the concept of materiality, these paragraphs provide the practitioner with a frame of reference.

Identifying Risks of Material Misstatement (Ref: par. .19)

.A26 Most of the practitioner's work in forming an opinion consists of obtaining and evaluating evidence. Procedures to obtain evidence can include inspection, observation, confirmation, recalculation, reperformance, and analytical procedures, often in some combination, in addition to inquiry.

.A27 In some cases, a subject-matter-specific section may include requirements that affect the nature, timing, and extent of procedures. For example, a subject-matter-specific section may describe the nature or extent of particular procedures to be performed in a particular type of engagement. Even in such cases, determining the exact nature, timing, and extent of procedures is a matter of professional judgment and will vary from one engagement to the next.

Responding to Assessed Risks and Obtaining Evidence (Ref: par. .21)

.A28 Overall responses to address the assessed risks of material misstatement of the subject matter or assertion may include the following:

- Emphasizing to the engagement team the need to maintain professional skepticism
- Assigning more experienced staff or those with specialized skills or using specialists
- Providing more supervision
- Incorporating additional elements of unpredictability in the selection of further procedures to be performed
- Making changes to the nature, timing, or extent of procedures (for example, performing procedures at period-end instead of at an interim date or modifying the nature of procedures to obtain more persuasive evidence)

.A29 The assessment of the risks of material misstatement of the subject matter or assertion is affected by the practitioner's understanding of the control environment. An effective control environment may allow the practitioner to have more confidence in internal control and the reliability of evidence generated internally within the entity and, thus, for example, may allow the practitioner to conduct some procedures at an interim date, rather than at the period-end. Deficiencies in the control environment, however, have the opposite effect. For example, the practitioner may respond to an ineffective control environment by doing the following:

- Conducting more procedures as of the period-end, rather than at an interim date
- Obtaining more extensive evidence from procedures other than tests of controls
- Increasing the number of locations to be included in the scope of the assertion-based examination

Analytical Procedures Performed in Response to Assessed Risks (Ref: par. .28)

.A30 An understanding of the purposes of analytical procedures and the limitations of those procedures is important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires professional judgment by the practitioner.

.A31 Analytical procedures involve comparisons of expectations developed by the practitioner to recorded amounts or ratios developed from recorded amounts. The practitioner develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the subject matter; the practices used by the responsible party to measure, recognize, and record the subject matter; and, if applicable, the industry in which the entity operates.

Sampling (Ref: par. .32)

.A32 The AICPA Audit Guide *Audit Sampling* provides guidance that may be useful to a practitioner who has decided to use sampling in performing attestation procedures.

Fraud, Laws, and Regulations (Ref: par. .34)

.A33 In responding to fraud or suspected fraud identified during the engagement, it may be appropriate, unless prohibited by law, regulation, or ethics standards, for the practitioner to, for example, do the following:

- Discuss the matter with the appropriate party
- Request that the responsible party consult with an appropriately qualified third party, such as the entity's legal counsel or a regulator
- Consider the implications of the matter in relation to other aspects of the engagement, including the practitioner's risk assessment and the reliability of written representations from the responsible party
- Obtain legal advice about the consequences of different courses of action
- Communicate with third parties (for example, a regulator)
- Withdraw from the engagement

.A34 The actions noted in paragraph .A33 may also be appropriate in responding to noncompliance or suspected noncompliance with laws or regulations identified during the engagement. It may be appropriate to describe the matter in a separate paragraph in the practitioner's report, unless either of the following apply:

- a. The practitioner is precluded by the responsible party from obtaining sufficient appropriate evidence to evaluate whether noncompliance that may be material to the subject matter has, or is likely to have, occurred, in which case, paragraphs .70a and .77 apply.
- b. The practitioner concludes that the noncompliance results in a material misstatement of the subject matter, in which case, paragraphs .70b and .76 apply.

Revision of Risk Assessment (Ref: par. .35)

.A35 Information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the responsible party to examine the matter identified by the practitioner and to make adjustments to the subject matter, if appropriate.

.A36 The practitioner may become aware of a matter that causes the practitioner to believe the subject matter may be materially misstated, for example, when performing analytical procedures, the practitioner identifies a fluctuation or relationship that is inconsistent with other relevant information or that differs significantly from expectations.

Evaluating the Reliability of Information Produced by the Entity (Ref: par. .36)

.A37 Reliable information is sufficiently accurate and complete.

.A38 Obtaining evidence about the accuracy and completeness of information produced by the entity may be accomplished concurrently with the actual

procedure applied to the information when obtaining such evidence is an integral part of the procedure itself. In other situations, the practitioner may have obtained evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the practitioner may determine that additional procedures are needed.

Using the Work of a Practitioner's Specialist

The Competence, Capabilities, and Objectivity of a Practitioner's Specialist (Ref: par. .37a)

.A39 Information regarding the competence, capabilities, and objectivity of a practitioner's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other practitioners or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The firm's quality control policies and procedures

.A40 Although a practitioner's specialist does not require the same proficiency as the practitioner in performing all aspects of an assertion-based examination engagement, a practitioner's specialist whose work is used may need a sufficient understanding of relevant AT-C sections to enable that specialist to relate the work assigned to that specialist to the engagement objective.

.A41 The evaluation of the significance of threats to objectivity and whether there is a need for safeguards may depend upon the role of the practitioner's specialist and the significance of the specialist's work in the context of the engagement. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level, for example, if in an assertion-based examination engagement a practitioner's specialist is an individual who has played a significant role in measuring, evaluating, or disclosing the subject matter.

.A42 When evaluating the objectivity of a practitioner's external specialist, it may be relevant to do the following:

- Inquire of the appropriate party about any known interests or relationships that the appropriate party has with the practitioner's external specialist that may affect that specialist's objectivity
- Discuss with that specialist any applicable safeguards, including any professional requirements that apply to that specialist, and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with the practitioner's specialist include
 - financial interests.
 - business and personal relationships.

- provision of other services by the specialist, including by the organization in the case of an external specialist that is an organization.

In some cases, it may also be appropriate for the practitioner to obtain a written representation from the practitioner's external specialist about any interests or relationships with the appropriate party of which that specialist is aware.

Obtaining an Understanding of the Field of Expertise of a Practitioner's Specialist (Ref: par. .37b)

.A43 Aspects of a practitioner's specialist's field of expertise relevant to the practitioner's understanding may include the following:

- Whether that specialist's field has areas of specialty within it that are relevant to the engagement
- Whether any professional or other standards and regulatory or legal requirements apply
- What assumptions and methods, including models, when applicable, are used by the practitioner's specialist and whether they are generally accepted within that specialist's field and appropriate in the circumstances of the engagement
- The nature of internal and external data or information the practitioner's specialist uses

Agreement With a Practitioner's Specialist (Ref: par. .37c)

.A44 The matters noted in paragraph .A46 may affect the level of detail and formality of the agreement between the practitioner and the practitioner's specialist, including whether it is appropriate that the agreement be in writing. The agreement between the practitioner and a practitioner's external specialist is often in the form of an engagement letter.

Integrating the Work of a Practitioner's Specialist (Ref: par. .39a)

.A45 Assertion-based examination engagements may be performed on a wide range of subject matters that require specialized skills and knowledge beyond those possessed by the practitioner and for which the work of a practitioner's specialist is used. In some situations, the practitioner's specialist will be consulted to provide advice on an individual matter, but the greater the significance of the work of the practitioner's specialist in the context of the engagement, the more likely it is that the specialist will work as part of a multidisciplinary team comprising subject-matter specialists and other attestation personnel. The more that specialist's work is integrated in nature, timing, and extent with the overall work effort, the more important effective two-way communication is between the practitioner's specialist and other attestation personnel. Effective two-way communication facilitates the proper integration of the specialist's work with the work of others on the engagement.

.A46 When the work of a practitioner's specialist is to be used, it may be appropriate to perform some of the procedures required by paragraph .37 at the engagement acceptance or continuance stage. In particular, this is appropriate when the work of the practitioner's specialist is to be used in the early stages of the engagement, for example, during initial planning and risk assessment.

The Practitioner's Firm's Quality Control Policies and Procedures (Ref: par. .39e)

.A47 Engagement teams are entitled to rely on their own firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the practitioner's procedures with respect to matters, such as the following:

- The practitioner's evaluation of the objectivity of the practitioner's internal specialist. (The practitioner's internal specialists are subject to relevant ethical requirements, including those pertaining to independence.)
- The practitioner's evaluation of the adequacy of the practitioner's internal specialist's work. (For example, the firm's training programs may provide the practitioner's internal specialists with an appropriate understanding of the interrelationship of their expertise with the evidence-gathering process. Reliance on such training and other firm processes, such as protocols for scoping the work of the practitioner's internal specialists, may affect the nature, timing, and extent of the practitioner's procedures to evaluate the adequacy of the practitioner's specialist's work.)
- Adherence to regulatory and legal requirements through monitoring processes.
- Agreement with the practitioner's specialist.

Such reliance does not reduce the practitioner's responsibility to meet the requirements of this section.

Using the Work of Internal Auditors (Ref: par. .40)

.A48 Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function nor whether it is performed by the entity or a third-party service provider are sole determinants of whether the practitioner can use the work of internal auditors. Rather, it is the nature of the activities, the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, the competence of the internal auditors, and the systematic and disciplined approach of the function that are relevant. References in this section to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

.A49 A practitioner planning to use the work of the internal audit function to obtain evidence may find it effective and efficient to discuss the planned use of the work with the internal audit function as a basis for coordinating activities.

.A50 The practitioner has sole responsibility for the opinion expressed, and that responsibility is not reduced by the practitioner's use of the work of internal auditors on the engagement. The objectivity and competence of internal auditors are important in determining whether to use their work and, if the practitioner decides to use their work, the nature and extent of the use of their work. However, a high degree of objectivity cannot compensate for a low degree of competence, nor can a high degree of competence compensate for a low degree of objectivity. Additionally, neither a high level of competence nor strong

support for the objectivity of the internal auditors compensates for the lack of a systematic and disciplined approach when using the work of the internal audit function.

Evaluating the Results of Procedures (Ref: par. .46–.47)

.A51 Uncorrected misstatements are accumulated during the engagement for the purpose of evaluating whether, individually or in aggregate, they are material when forming the practitioner's opinion. (See also paragraph .60b)

.A52 "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality and will be matters that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

.A53 Sufficient appropriate evidence is necessary to support the practitioner's opinion and report. It is cumulative in nature and is primarily obtained from procedures performed during the course of the engagement. It may, however, also include information obtained from other sources such as previous engagements (provided the practitioner has determined whether changes have occurred since the previous engagement that may affect its relevance to the current engagement) or a firm's quality control procedures for client acceptance and continuance. Evidence may come from sources inside and outside the appropriate party. Also, information that may be used as evidence may have been prepared by a specialist employed or engaged by the appropriate party. *Evidence* comprises both information that supports and corroborates aspects of the subject matter and any information that contradicts aspects of the subject matter. In addition, in some cases, the absence of information (for example, refusal by the appropriate party to provide a requested representation) is considered by the practitioner and, therefore, also constitutes evidence.

.A54 The sufficiency and appropriateness of evidence are interrelated. *Sufficiency of evidence* is the measure of the quantity of evidence. The quantity of the evidence needed is affected by the risks of material misstatement and also by the quality of such evidence.

.A55 *Appropriateness of evidence* is the measure of the quality of evidence, that is, its relevance and reliability in providing support for the practitioner's opinion. The reliability of evidence is influenced by its source and nature and is dependent on the individual circumstances under which it is obtained. Generalizations about the reliability of various kinds of evidence can be made; however, such generalizations are subject to important exceptions. Even when evidence is obtained from sources external to the responsible party, circumstances may exist that could affect its reliability. For example, evidence obtained from an independent external source may not be reliable if the source is not knowledgeable. Recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:

- Evidence is more reliable when it is obtained from independent sources outside the appropriate party.
- Evidence that is generated internally is more reliable when the related controls are effective.
- Evidence obtained directly by the practitioner (for example, observation of the application of a control) is more reliable than

evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

- Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a contemporaneously written record of a meeting is ordinarily more reliable than a subsequent oral representation of what was discussed).
- Evidence provided by original documents is more reliable than evidence provided by photocopies, facsimiles, or documents that have been filmed, digitized, or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

.A56 Evidence obtained from different sources or of a different nature ordinarily provides more assurance than evidence from items considered individually. In addition, obtaining evidence from different sources or of a different nature may indicate that an individual item of evidence is not reliable. For example, corroborating information obtained from a source independent of the responsible party may increase the assurance the practitioner obtains from a representation from the responsible party. Conversely, when evidence obtained from one source is inconsistent with that obtained from another, the practitioner determines what additional procedures are necessary to resolve the inconsistency.

.A57 Whether sufficient appropriate evidence has been obtained on which to base the practitioner's opinion is a matter of professional judgment.

Considering Subsequent Events and Subsequently Discovered Facts (Ref: par. .49–.50)

.A58 For certain subject-matter AT-C sections, specific subsequent events requirements and related application guidance have been developed for engagement performance and reporting.

.A59 Procedures that a practitioner may perform to identify subsequent events include inquiring about and considering information

- contained in relevant reports issued during the subsequent period by internal auditors, other practitioners, or regulatory agencies.
- obtained through other professional engagements for that entity.

.A60 If the responsible party refuses to disclose a subsequent event for which disclosure is necessary to prevent users of the practitioner's report from being misled, appropriate actions the practitioner may take include the following:

- Disclosing the event in the practitioner's report and modifying the practitioner's opinion
- Withdrawing from the engagement

.A61 Subsequent to the date of the practitioner's report, the practitioner may become aware of facts that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. In such circumstances, the practitioner undertakes to determine if the facts existed at the date of the report and, if so, whether persons who would attach importance to these facts are currently using, or are likely to use, the report and related subject matter or assertion. This may include discussing the matter with the appropriate party and requesting the appropriate party's cooperation in whatever investigation or further action that may be necessary. The specific actions

to be taken in a particular case by the appropriate party and the practitioner may vary with the circumstances. Consideration may be given to, among other things, the time elapsed since the date of the report and whether issuance of a subsequent report is imminent. The practitioner may need to perform additional procedures deemed necessary to determine whether the subject matter or assertion needs revision and whether the previously issued report continues to be appropriate.

.A62 Depending on the circumstances, the practitioner may determine that notification of the situation by the appropriate party to persons who would attach importance to the facts and who are currently using, or are likely to use, the practitioner's report is necessary. This may be the case, for example, when

- a. the report is not to be relied upon because the subject matter or assertion needs revision or the practitioner is unable to determine whether revision is necessary, and
- b. issuance of a subsequent report is not imminent.

If the appropriate party failed to take the necessary steps to prevent reliance on the report, the practitioner's course of action depends upon the practitioner's legal and ethical rights and obligations. Consequently, the practitioner may consider it appropriate to seek legal advice prior to making any disclosure of the situation. Disclosure of the situation directly by the practitioner may include a description of the nature of the matter and its effect on the subject matter or assertion and the report, avoiding comments concerning the conduct or motives of any person.

Written Representations (Ref: par. .51–.52, .53e, and .57a)

.A63 Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the responsible party. The person from whom the practitioner requests written representations is ordinarily a member of senior management or those charged with governance depending on, for example, the management and governance structure of the responsible party, which may vary by entity, reflecting influences such as size and ownership characteristics.

.A64 Representations by the responsible party cannot replace other evidence the practitioner could reasonably expect to be available. Although written representations provide evidence, they do not provide sufficient appropriate evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other evidence that the practitioner obtains.

.A65 A discussion of what is considered a material effect on the subject matter or assertion may be included explicitly in the representation letter in qualitative or quantitative terms.

.A66 A summary of uncorrected misstatements ordinarily is included in or attached to the written representation.

.A67 Certain subject-matter AT-C sections do not permit the practitioner to perform the alternative procedures described in paragraphs .52 and .57a (making inquiries of the responsible party and restricting the use of the practitioner's report).

Requested Written Representations Not Provided or Not Reliable (Ref: par. .56–.57)

.A68 The engaging party's refusal to furnish written representations constitutes a limitation on the scope of the assertion-based examination. Such refusal is often sufficient to preclude an unmodified opinion and, particularly with respect to the representations in paragraph .53, may cause a practitioner to disclaim an opinion or withdraw from the engagement when withdrawal is possible under applicable law or regulation. However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate.

.A69 Circumstances in which the practitioner may be unable to obtain one or more requested written representations from a responsible party that is not the engaging party include, for example, the following:

- When the engaging party does not have a relationship with the responsible party
- When the assertion-based examination is undertaken against the wishes of the responsible party, for example, when required by law or regulation

In these or other circumstances, the practitioner may need to reconsider whether the responsible party is able or willing to take responsibility for the subject matter. Additionally, the practitioner may not have access to the evidence to support a conclusion that the responsible party has taken responsibility for the subject matter. (Ref: par. .48, .72*b*, and .77)

.A70 After performing the procedures in items (a)–(b) of paragraph .56 the practitioner may determine that an oral representation may provide evidence needed with respect to the matter addressed by the representation, for example, when the engaging party is not the responsible party.

.A71 Even when the responsible party provides oral responses to the matters in paragraph .51, the practitioner may find it appropriate to consider whether there are significant concerns about the competence, integrity, ethical values, or diligence of those providing the oral responses or whether the oral responses are otherwise not reliable and the potential effect, if any, on the practitioner's report.

.A72 Paragraph .10 provides an exception to the requirement for a written assertion when the engaging party is not the responsible party. Nonetheless, because the assertion is the representation called for by paragraph .51*a*, application of paragraph .57*a* requires the practitioner to obtain an oral assertion when a written assertion is not obtained. Paragraph .57*b* applies when the responsible party provides neither a written nor an oral assertion.

Other Information (Ref: par. .58)

.A73 Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example, the following:

- Requesting the appropriate party to consult with a qualified third party, such as the appropriate party's legal counsel
- Obtaining legal advice about the consequences of different courses of action

- If required or permissible, communicating with third parties (for example, a regulator)
- Describing the material inconsistency in the practitioner's report
- Withdrawing from the engagement, when withdrawal is possible under applicable laws and regulations.

.A74 Other information does not include information contained on the appropriate party's website. Websites are a means of distributing information and are not, themselves, documents for the purposes of paragraph .58.

Description of Criteria (Ref: par. .59)

.A75 The description of the criteria on which the subject matter or assertion is based is particularly important when there are significant differences among various criteria regarding how particular matters may be treated in the subject matter.

.A76 A description of the criteria that states that the subject matter is prepared in accordance with (or based on) particular criteria is appropriate only if the subject matter complies with all relevant requirements of those criteria that are effective.

Forming the Opinion (Ref: par. .60–.61)

.A77 The practitioner's professional judgment regarding what constitutes sufficient appropriate evidence is influenced by such factors as the following:

- The significance of a potential misstatement and the likelihood that it will have a material effect, individually or aggregated with other potential misstatements, on the subject matter or assertion
- The effectiveness of the responsible party's responses to address the known risks
- The experience gained during previous examination or review engagements with respect to similar potential misstatements
- The results of procedures performed, including whether such procedures identified specific misstatements
- The source and reliability of the available information
- The persuasiveness of the evidence
- The practitioner's understanding of the responsible party and its environment

.A78 An assertion-based examination engagement is a cumulative and iterative process. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to change the nature, timing, or extent of other planned procedures. Information that differs significantly from the information on which the risk assessments and planned procedures were based may come to the practitioner's attention. Examples of such information include the following:

- The extent of the misstatements that the practitioner detects is greater than expected. (This may alter the practitioner's professional judgment about the reliability of particular sources of information.)
- The practitioner may become aware of discrepancies in relevant information or conflicting or missing evidence.

- Procedures performed toward the end of the engagement may indicate a previously unrecognized risk of material misstatement. In such circumstances, the practitioner may need to reevaluate the planned procedures.

.A79 In making the evaluation required by paragraph .61, the practitioner may consider whether additional disclosures are necessary to describe the subject matter, assertion, or criteria. Additional disclosures may, for example, include the following:

- The measurement or evaluation methods used when the criteria allow for choice among methods
- Significant interpretations made in applying the criteria in the engagement circumstances
- Subsequent events, depending on their nature and significance
- Whether there have been any changes in the measurement or evaluation methods used

.A80 Paragraph .61 does not require the practitioner to determine whether the presentation discloses all matters related to the subject matter, assertion, or criteria or all matters intended users may consider in making decisions based on the presentation.

Preparing the Practitioner's Report (Ref: par. .62)

.A81 Oral and other forms of expressing an opinion can be misunderstood without the support of a written practitioner's report. For this reason, the practitioner may not report orally or by use of symbols (such as a web seal) under the attestation standards without also providing a written report that is readily available whenever the oral report is provided or the symbol is used. For example, a symbol could be hyperlinked to a written report on the internet.

.A82 This section does not require a standardized format for reporting on all assertion-based examination engagements. Instead, it identifies the basic elements that the practitioner's report is to include. The report is tailored to the specific engagement circumstances. The practitioner may use headings, separate paragraphs, paragraph numbers, typographical devices (for example, the bolding of text), and other mechanisms to enhance the clarity and readability of the report.

.A83 The practitioner may choose to issue a report that contains only the minimum reporting elements included in paragraphs .63–.64 of this section or may issue a report that expands on or supplements those elements. In addition to the basic elements, the report may include information or explanations that are not intended to affect the practitioner's opinion, for example, detail about the terms of the engagement, the applicable criteria being used, findings relating to particular aspects of the engagement, details of the qualifications and experience of the practitioner and others involved with the engagement, a description of the procedures the practitioner performed, and, in some cases, recommendations. The practitioner may find it helpful to consider the importance of providing such information to the information needs of the intended users. As required by paragraph .82, additional information, such as recommendations, is clearly separated from the practitioner's opinion and phrased in a manner that makes clear that it is not intended to detract from the opinion.

.A84 All of the following reporting options are available to a practitioner, except when the circumstances described in paragraph .76 exist:

<i>The practitioner's report may state that the practitioner examined</i>	<i>and</i>	<i>expresses an opinion on</i>
the subject matter		the subject matter
the responsible party's assertion		the responsible party's assertion
the responsible party's assertion		the subject matter

Content of the Practitioner's Report

Title (Ref: par. .63a)

.A85 A title indicating that the practitioner's report is the report of an independent practitioner (for example, "Independent Practitioner's Report," "Report of Independent Certified Public Accountant," or "Independent Accountant's Report") affirms that the practitioner has met all the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

Criteria (Ref: par. .63d)

.A86 The practitioner's report may include the criteria or refer to them if they are included in the subject matter presentation, in the assertion, or are otherwise readily available. It may be relevant in the circumstances to disclose the source of the criteria or the relevant matters discussed in paragraph .A79.

Relevant Responsibilities (Ref: par. .63e–f)

.A87 Identifying relative responsibilities informs the intended users that the responsible party is responsible for the subject matter, and the practitioner's role is to independently express an opinion about it.

.A88 The practitioner may wish to expand the discussion of the responsible party's responsibility, for example, to indicate that the responsible party is responsible for the preparation and presentation of the subject matter in accordance with (or based on) the criteria, including the design, implementation, and maintenance of internal control to prevent, or detect and correct, misstatement of the subject matter, due to fraud or error.

Statement About the Subject Matter and the Criteria (Ref: par. .63g(ii)(1))

.A89 In identifying the standards under which the engagement was performed, the practitioner may specify the AT-C section under which the engagement was performed, for example, section 320, *Reporting on an Examination of Controls Relevant to User Entities' Internal Control Over Financial Reporting*, of the attestation standards established by the AICPA.

.A90 The language in paragraph .63g(ii)(1) may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .63g(ii)(1) include, "to obtain reasonable assurance about whether

- the subject matter is presented in accordance with (or based on) the criteria, in all material respects."
- the subject matter achieves the objectives, in all material respects." (For example, when the objectives are the criteria)

- the subject matter is presented fairly, in all material respects, based on the criteria." (The practitioner's professional judgment concerning the fairness of the presentation of the subject matter relates to whether the measurement, recognition, presentation, and disclosure of all material items in the presentation of the subject matter achieve fair presentation.)

Description of the Nature of an Assertion-Based Examination Engagement (Ref: par. .63h)

.A91 A description of the nature of an assertion-based examination engagement may state, for example, the following:

- An examination involves performing procedures to obtain evidence about the subject matter and that the nature, timing, and extent of the procedures selected depend on the practitioner's judgment, including an assessment of the risks of material misstatement of the subject matter, whether due to fraud or error.
- An examination also involves examining evidence about the subject matter.
- In making an assessment of the risks of material misstatement, the practitioner considered and obtained an understanding of internal control relevant to the subject matter in order to design procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, no such opinion is expressed.

.A92 The practitioner may decide to more fully describe the practitioner's responsibility, for example, to

- perform procedures to obtain evidence based on the practitioner's assessment of the risk of material misstatement about whether the subject matter is presented in accordance with (or based on) the criteria.
- obtain an understanding of internal control over the subject matter.

.A93 A practitioner may be requested to provide, in a separate section of the practitioner's report, a description of the procedures performed and the results thereof in support of the practitioner's opinion. The following factors are relevant when determining whether to include such a description in the report:

- Whether such a description is likely to overshadow the practitioner's overall opinion or cause report users to misunderstand the opinion.
- Whether the parties making the request have an appropriate business need or reasonable basis for requesting the information. For example, the specified parties are required to maintain and monitor controls that either encompass or are dependent on controls that are the subject of an assertion-based examination and, therefore, need information about the tests of controls to enable them to have a basis for concluding that they have met the requirements applicable to them.
- Whether the parties have an understanding of the nature and subject matter of the engagement and experience in using the information in such reports.

- Whether the practitioner's procedures performed directly relate to the subject matter of the engagement.

The addition of procedures performed and the results thereof in a separate section of an assertion-based examination report may increase the potential for the report to be misunderstood when taken out of the context of the knowledge of the requesting parties. This potential for an increase in the risk of misunderstanding may lead the practitioner to add a restricted-use paragraph to the practitioner's report.

Relevant Ethical Requirements (Ref: par. .63i)

.A94 Relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. When the AICPA Code of Professional Conduct applies, the practitioner's other ethical responsibilities relate to the "Principles of Professional Conduct" (ET sec. 0.300).

.A95 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the practitioner may choose to name the relevant sources (for example, the name of the code, rule, or applicable regulation, or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources.

Inherent Limitations (Ref: par. .63j)

.A96 In some cases, identification of specific inherent limitations is required by an AT-C section. For example, section 305, *Prospective Financial Information*, requires that the practitioner's report include a statement indicating that the prospective results may not be achieved.⁴ To implement that requirement, the illustrative practitioner's assertion-based examination report on a forecast in section 305 states, "There will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material."⁵ When not explicitly required by an AT-C section, identification in the report of inherent limitations is based on the practitioner's judgment.

Opinion (Ref: par. .63k)

.A97 The practitioner's opinion can be worded either in terms of the subject matter and the criteria (for example, "In our opinion, the schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is in accordance with [or based on] the ABC criteria set forth in Note 1, in all material respects.") or in terms of an assertion made by the responsible party (for example, "In our opinion, management's assertion that the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with [or based on] the ABC criteria set forth in Note 1 is fairly stated, in all material respects.").

.A98 The language of the practitioner's opinion in paragraph .63k may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .63k(i) include the following:

⁴ Paragraph .31i of section 305, *Prospective Financial Information*.

⁵ Example 1 in paragraph .A43 of section 305.

- The subject matter is presented in accordance with (or based on) the criteria, in all material respects.
- The subject matter achieved the objectives, in all material respects (when the objectives are the criteria).
- The subject matter is free from material misstatement based on the criteria.
- The subject matter is presented fairly, in all material respects, based on the criteria. (The practitioner's professional judgment concerning the fairness of the presentation of the subject matter relates to whether the measurement, recognition, presentation, and disclosure of all material items in the presentation of the subject matter achieve fair presentation.)

.A99 A single practitioner's report may cover more than one aspect of a subject matter or an assertion about the subject matter. When that is the case, the report may contain separate opinions or conclusions on each aspect of the subject matter or assertion (for example, examination level related to some aspects or assertions and review level related to others, or an unmodified opinion on some aspects or assertions and a modified opinion on others).

.A100 A practitioner may report on subject matter or an assertion at multiple dates or covering multiple periods during which criteria have changed (for example, a practitioner's report on comparative information). Criteria are clearly described when they identify the criteria for each period and how the criteria have changed from one period to the next. If the criteria for the current date or period have changed from the criteria for a preceding date or period, changes in the criteria may be significant to users of the report. If so, the criteria and the fact that they have changed may be disclosed in the presentation of the subject matter, in the written assertion about the subject matter, or in the report, even if the subject matter for the preceding date or period is not presented.

Location (Ref: par. .63m)

.A101 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date (Ref: par. .63n)

.A102 Including the date of the practitioner's report informs the intended users that the practitioner has considered the effect of the events that occurred up to that date on the subject matter and the report.

.A103 Because the practitioner expresses an opinion on the subject matter or assertion and the subject matter or assertion is the responsibility of the responsible party, the practitioner is not in a position to conclude that sufficient appropriate evidence has been obtained until evidence is obtained that all the elements that the subject matter or assertion comprises, including any related notes, when applicable, have been prepared, and the responsible party has accepted responsibility for them.

Restricted-Use Paragraph (Ref: par. .10, .51, .64, and .65b–c)

.A104 A practitioner's report for which the conditions in paragraph .64 do not apply need not include an alert that restricts its use. However, nothing in

the attestation standards precludes a practitioner from including such an alert in any practitioner's report or other practitioner's written communication.

.A105 A practitioner's report that is required by paragraph .64 to include an alert that restricts the use of the report may be included in a document that also contains a practitioner's report that is for general use. In such circumstances, the use of the general use report is not affected.

.A106 A practitioner may also issue a single combined practitioner's report that includes

- a. a practitioner's report that is required by paragraph .64 to include an alert that restricts its use, and
- b. a report that is for general use.

If these two types of reports are clearly differentiated within the combined report, such as through the use of appropriate headings, the alert that restricts the use of the report may be limited to the report required by paragraph .64 to include such an alert. In such circumstances, the use of the general use report is not affected.

.A107 The written representations required by paragraph .51 include an assertion. If the engaging party is not the responsible party and the responsible party provides an oral assertion, rather than a written assertion, paragraph .64c calls for an alert that restricts the use of the practitioner's report to the engaging party.

.A108 The practitioner may identify the specified parties by naming them, referring to a list of those parties, or identifying the class of parties, for example, "all customers of XYZ Company during some or all of the period January 1, 20XX to December 31, 20XX." The method of identifying the specified parties is determined by the practitioner.

.A109 In some cases, the criteria used to measure or evaluate the subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts users of the practitioner's report to this fact and, therefore, that the report is intended solely for the information and use of the specified parties.

.A110 The alert that restricts the use of the practitioner's report is designed to avoid misunderstandings related to the use of the report, particularly if the report is taken out of the context in which the report is intended to be used. A practitioner may consider informing the responsible party and, if different, the engaging party or other specified parties that the report is not intended for distribution to parties other than those specified in the report. The practitioner may, in connection with establishing the terms of the engagement, reach an understanding with the responsible party or, if different, the engaging party, that the intended use of the report will be restricted and may obtain the responsible party's agreement that the responsible party and specified parties will not distribute such report to parties other than those identified therein. A practitioner is not responsible for controlling, and cannot control, distribution of the report after its release.

.A111 In some cases, a restricted-use practitioner's report filed with regulatory agencies is required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency, as part of its oversight responsibility for an entity, may require access to a restricted-use report in which it is not named as a specified party.

Reference to the Practitioner’s Specialist (Ref: par. .69)

.A112 The practitioner has sole responsibility for the opinion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's specialist.

Modified Opinions (Ref: par. .70, .72, and .77)

.A113 The three types of modified opinions are a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon the following:

- a. The nature of the matter giving rise to the modification (that is, whether the subject matter of the engagement is in accordance with (or based on) the criteria, in all material respects or, in the case of an inability to obtain sufficient appropriate evidence, may be materially misstated)
- b. The practitioner's professional judgment about the pervasiveness of the effects or possible effects of the matter on the subject matter of the engagement

.A114 A practitioner may express an unmodified opinion only when the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that the practitioner considers necessary in the circumstances.

.A115 The term *pervasive* describes the effects on the subject matter of misstatements or the possible effects on the subject matter of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate evidence. Pervasive effects on the subject matter are those that, in the practitioner's professional judgment

- a. are not confined to specific aspects of the subject matter;
- b. if so confined, represent or could represent a substantial proportion of the subject matter; or
- c. in relation to disclosures, are fundamental to the intended users' understanding of the subject matter.

.A116 The following table illustrates how the practitioner's professional judgment about the nature of the matter giving rise to the modification and the pervasiveness of its effects or possible effects on the subject matter affects the type of practitioner's report to be issued.

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Practitioner’s Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Subject Matter</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Scope limitation. An inability to obtain sufficient appropriate evidence.	Qualified opinion	Disclaimer of opinion
Subject matter is materially misstated.	Qualified opinion	Adverse opinion

.A117 A scope limitation may arise from the following:

- a. Circumstances beyond the control of the appropriate party. For example, documentation that the practitioner considers necessary to inspect may have been accidentally destroyed.
- b. Circumstances relating to the nature or timing of the practitioner's work. For example, a physical process that the practitioner considers necessary to observe may have occurred before the practitioner's engagement.
- c. Limitations imposed by the responsible party or the engaging party on the practitioner that, for example, may prevent the practitioner from performing a procedure that the practitioner considers necessary in the circumstances.

Limitations of this kind may have other implications for the engagement, such as for the practitioner's consideration of risks of material misstatement and engagement acceptance and continuance.

.A118 The inability to obtain written representations from the responsible party ordinarily would result in a scope limitation. However, when the engaging party is not the responsible party, paragraph .52 enables the practitioner to make inquiries of the responsible party and, if the responsible party's oral responses enable the practitioner to conclude that the practitioner has sufficient appropriate evidence to form an opinion about the subject matter, paragraph .57a indicates this would not cause a scope limitation. Further, paragraph .57a requires that the practitioner's report in these circumstances contain an alert paragraph that restricts the use of the report to the engaging party.

.A119 The practitioner's decision to express a qualified opinion, disclaim an opinion, or withdraw from the engagement because of a scope limitation depends on an assessment of the effect of the omitted procedures on the practitioner's ability to express an opinion. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question and by their significance to the subject matter.

.A120 An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate evidence by performing alternative procedures.

Responsible Party Refuses to Provide a Written Assertion (Ref: par. .86)

.A121 The following is an example of the disclosure required by paragraph .86:

Attestation standards established by the AICPA require that we request a written statement from [identify the responsible party] stating that [identify the subject matter] that we examined has been accurately measured or evaluated. We requested that [identify the responsible party] provide such a written statement but [identify the responsible party] refused to do so.

.A122 The practitioner's report discussed in paragraph .86 is appropriate only when the engagement is to report on the subject matter; it is not appropriate for a report on an assertion. When reporting on an assertion, the practitioner is required to obtain a written assertion from the responsible party.

.A123 If the responsible party's failure to provide the practitioner with written representations causes the practitioner to conclude that a scope limitation exists and, thus, qualify or disclaim an opinion, the practitioner need

not restrict the use of the practitioner's report but is required by paragraph .71 to describe the matter that gave rise to the modified opinion. Paragraph .A104 notes, however, that the practitioner is not precluded from restricting the use of any report.

Communication Responsibilities (Ref: par. .87–.88)

.A124 Other matters that may be appropriate to communicate to the responsible party or, if different, the engaging party, include bias in the measurement, evaluation, or disclosure of the subject matter.

.A125 Disclosure of confidential information as defined in the Code of Professional Conduct requires the explicit consent of the engaging party or the responsible party, as appropriate. In circumstances in which such matters are identified, the practitioner may consider discussing with legal counsel or others prior to communicating or taking further action.

.A126 If the practitioner is performing an assertion-based examination engagement in accordance with *Government Auditing Standards*, the practitioner may be required to report on compliance with laws, regulations, and provisions of contracts or grant agreements as part of the assertion-based examination. The practitioner also may be required to communicate instances of noncompliance to appropriate oversight bodies and funding agencies.

Documentation (Ref: par. .89)

.A127 Documentation includes a record of the practitioner's reasoning on all significant findings or issues that require the exercise of professional judgment and related conclusions. The existence of difficult questions of principle or professional judgment calls for the documentation to include the relevant facts that were known by the practitioner at the time the conclusion was reached.

.A128 It is neither necessary nor practical to document every matter considered, or professional judgment made, during an engagement. Further, it is unnecessary for the practitioner to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included in the engagement file. Similarly, the practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A129 In applying professional judgment to assess the extent of documentation to be prepared and retained, the practitioner may consider what is necessary to provide an experienced practitioner, having no previous connection with the engagement, with an understanding of the work performed and the basis of the principal decisions made.

.A130 Documentation ordinarily includes a record of the following:

- Issues identified with respect to compliance with relevant ethical requirements and how they were resolved
- Conclusions on compliance with independence requirements that apply to the engagement and any relevant discussions with the firm that support these conclusions
- Conclusions reached regarding the acceptance and continuance of client relationships and attestation engagements
- The nature and scope of, and conclusions resulting from, consultations undertaken during the engagement

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Exhibit — Illustrative Practitioner's Assertion-Based Examination Reports

The illustrative practitioner's assertion-based examination reports in this exhibit meet the applicable reporting requirements in paragraphs .62–.86. A practitioner may use alternative language in drafting an assertion-based examination report, provided that the language meets the applicable requirements in paragraphs .62–.86. The criteria for evaluating the subject matter in examples 1–3 and 5–6 have been determined by the practitioner to be suitable and available to all users of the practitioner's report; therefore, these practitioner's reports may be for general use. The criteria for evaluating the subject matter in example 4 are suitable but available only to specified parties; therefore, use of this practitioner's report is restricted to the specified parties who either participated in the establishment of the criteria or can be presumed to have an adequate understanding of the criteria. (See paragraph .65 for the information to be included in a separate paragraph of the report that contains an alert that restricts the use of the report and paragraph .66 for the content of that paragraph when the engagement is also performed in accordance with *Government Auditing Standards*.)

Example 1: Practitioner's Assertion-Based Examination Report on Subject Matter; Unmodified Opinion

The following is an illustrative practitioner's report for an assertion-based examination engagement in which the practitioner has examined the subject matter and is reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have examined [identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]. XYZ Company's management is responsible for [identify the subject matter, for example, presenting the schedule of investment returns] in accordance with (or based on) [identify the criteria, for example, the ABC criteria set forth in Note 1]. Our responsibility is to express an opinion on [identify the subject matter, for example, the schedule of investment returns] based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether [identify the subject matter, for example, the schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about [identify the subject matter, for example, the schedule of investment returns]. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of [identify the subject matter, for example, the schedule of investment returns], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter, for example, the schedule of investment returns of XYZ Company for the year ended December 31, 20XX, or the schedule of investment returns referred to above]*, is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 2: Practitioner's Assertion-Based Examination Report on an Assertion; Unmodified Opinion

The following is an illustrative practitioner's report for an assertion-based examination engagement in which the practitioner has examined the responsible party's assertion and is reporting on that assertion.

Independent Accountant's Report

[Appropriate Addressee]

We have examined management of XYZ Company's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with (or based on) the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for its assertion. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects. An examination involves performing procedures to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, management's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is*

presented in accordance with (or based on) the ABC criteria set forth in Note 1]
is fairly stated, in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 3: Practitioner's Assertion-Based Examination Report in Which the Practitioner Examines Management's Assertion and Reports Directly on the Subject Matter; Unmodified Opinion

The following is an illustrative practitioner's report for an assertion-based examination engagement in which the practitioner has examined the responsible party's assertion and is reporting directly on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have examined management of XYZ Company's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with (or based on) the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for its assertion. Our responsibility is to express an opinion on *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is presented in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX or the schedule of investment returns referred to above]* is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 4: Practitioner's Assertion-Based Examination Report on Subject Matter; Unmodified Opinion; Use of the Practitioner's Report Is Restricted to Specified Parties

The following is an illustrative practitioner's report for an assertion-based examination engagement in which the criteria are suitable but available only to specified parties; therefore, use of the report is restricted to the specified parties who either participated in the establishment of the criteria or can be presumed to have an adequate understanding of the criteria. The practitioner has examined the subject matter and is reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have examined *[identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company ... or gallons of gas sold in the United States by XYZ Company to ABC Company) during the year ended December 31, 20XX,]* to determine whether it has been calculated in accordance with (or based on) *[identify the criteria, for example, the agreement dated (date) between ABC Company and XYZ Company, as further described in Note 1]*. XYZ Company's management is responsible for *[identify the subject matter, for example, the number of widgets sold]* being calculated in accordance with *[identify the criteria, for example, the agreement dated (date) between ABC Company and XYZ Company, as further described in Note 1]*. Our responsibility is to express an opinion on *[identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company ... or gallons of gas sold in the United States by XYZ Company to ABC Company) during the year ended December 31, 20XX,]* based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the number of widgets sold, tons of coal mined, or gallons of gas sold]* is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the number of widgets sold, tons of coal mined, or gallons of gas sold]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company, or gallons of gas sold in the United States by XYZ Company to ABC Company)]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company, or gallons of gas sold in the United States by XYZ Company to ABC Company) during the year ended December 31, 20XX,]* has been calculated in accordance with (or based on) *[identify the criteria, for example, the agreement dated (date)*

between ABC Company and XYZ Company, as further described in Note 1], in all material respects.

This report is intended solely for the information and use of *[identify the specified parties, for example, ABC Company and XYZ Company]* and is not intended to be and should not be used by anyone other than the specified parties.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 5: Practitioner's Assertion-Based Examination Report on Subject Matter; Qualified Opinion

The following is an illustrative practitioner's report for an assertion-based examination engagement in which the practitioner expresses a qualified opinion because conditions exist that, individually or in combination, result in one or more material, but not pervasive, misstatements of the subject matter based on (or, in certain engagements, deviations from, exceptions to, or instances of non-compliance with) the criteria. The practitioner has examined the subject matter and is reporting on the subject matter. Paragraph .76 states, "If the practitioner has concluded that conditions exist that, individually or in combination, result in one or more material misstatements based on the criteria, the practitioner should modify the opinion and should express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement."

Independent Accountant's Report

[Appropriate Addressee]

We have examined *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]* in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*.

Our responsibility is to express an opinion on *[identify the subject matter, for example, the schedule of investment returns]* based on our examination. Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is presented in accordance with (or based on) the criteria, in all material respects.

An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our qualified opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Our examination disclosed *[describe conditions that, individually or in the aggregate, resulted in a material misstatement or deviation from the criteria]*.

In our opinion, except for the effects of the material misstatement *[or deviation from the criteria]* described in the preceding paragraph, *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, or the schedule of investment returns referred to above]*, is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 6: Practitioner's Assertion-Based Examination Report; Practitioner Engaged to Report on Subject Matter; Disclaimer of Opinion Because of Scope Limitation

The following is an illustrative practitioner's report for an assertion-based examination engagement in which the practitioner was engaged to report on the subject matter but is disclaiming an opinion because of a scope limitation. (See paragraphs .70–.86 and the related application guidance for reporting guidance when a scope limitation exists.)

Independent Accountant's Report

[Appropriate Addressee]

We were engaged to examine *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]* in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]* (Our responsibility is to express an opinion on *[identify the subject matter, for example, the schedule of investment returns]* based on conducting the examination in accordance with attestation standards established by the AICPA.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[The first sentence of the practitioner's report has been revised to state, "We were engaged to examine" rather than "We have examined." The standards under which the practitioner conducts an examination have been identified at the end of the second sentence of the report, rather than in a separate sentence in the second paragraph of the report.]

[The report should omit statements

- *indicating what those standards require of the practitioner.*
- *indicating that the practitioner believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.*
- *describing the nature of an examination engagement.]*

[Include a paragraph to describe scope limitations.]

Because of the limitation on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether *[identify the subject matter,*

for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, or the schedule of investment returns referred to above] is in accordance with (or based on) [identify the criteria, for example, the ABC criteria set forth in Note 1], in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

AT-C Section 9205

Examination Engagements: Attestation Interpretations of Section 205

1. Reporting on Attestation Engagements Performed in Accordance With *Government Auditing Standards*¹

Alert to Readers – This interpretation has not been revised to reflect any changes necessary for the 2018 revision of *Government Auditing Standards*.

.01 Question—Chapter 5, "Standards for Attestation Engagements," of the 2011 revision of *Government Auditing Standards* (referred to herein as the Yellow Book) sets forth additional fieldwork and reporting standards for attestation engagements performed pursuant to generally accepted government auditing standards (GAGAS). Practitioners performing attestation engagements under GAGAS are also required to follow the general standards set forth in chapter 3, "General Standards," of the Yellow Book, as well as the guidance and requirements in chapter 1, "Government Auditing: Foundation and Ethical Principles," and chapter 2, "Standards for Use and Application of GAGAS." For examination attestation engagements performed pursuant to GAGAS, paragraph 5.18 of the Yellow Book prescribes additional reporting standards² that go beyond the standards of reporting set forth in section 205, *Assertion-Based Examination Engagements*, and section 210, *Review Engagements*.³ When a practitioner performs an attestation examination in accordance with GAGAS, how should the report be modified?

.02 Interpretation—The practitioner should modify the scope paragraph of the attestation report to indicate that the examination or review was "conducted in accordance with attestation standards established by the AICPA and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States."

.03 Additionally, GAGAS requires the practitioner's attestation report to disclose any matters (often referred to as *findings*) that are set forth in paragraphs 5.20–.26 of the Yellow Book. Paragraphs 5.27–.28 of the Yellow Book set forth the presentation requirements that the practitioner should use, to the

¹ Although separate interpretations for other AT-C sections have not been issued to address attestation engagements performed in accordance with *Government Auditing Standards*, a practitioner may use this guidance to help the practitioner appropriately modify an attestation report pursuant to other AT-C sections.

² Paragraph 5.18 of the Yellow Book sets forth the additional reporting requirements: (a) reporting auditors' compliance with generally accepted government auditing standards, (b) reporting deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse, (c) reporting views of responsible officials, (d) reporting confidential or sensitive information, and (e) distributing reports. [Footnote revised, January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

³ Paragraphs .62–.86 of section 205, *Assertion-Based Examination Engagements*, and paragraphs .44–.62 of section 210, *Review Engagements*.

extent possible, in reporting a finding. The following illustration is a standard examination report modified to make reference to a schedule of findings when any of the matters set forth in paragraphs 5.20–.26 have been identified. This report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. A written assertion has been obtained from the responsible party. Although the following illustrative report modifications would comply with the Yellow Book requirement, this illustration is not intended to preclude a practitioner from complying with these additional Yellow Book reporting requirements in other ways. In this illustrative report, the practitioner is reporting on the subject matter.

Independent Accountant's Report

We have examined *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*.⁴ XYZ Agency's management is responsible for presenting the *[identify the subject matter, for example, the schedule of performance measures]* in accordance with *[identify the criteria]*. Our responsibility is to express an opinion on *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*, based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]* is in accordance with *[identify the criteria]*, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter, for example, the performance measures of XYZ Agency for the year ended December 31, 20XX]*, is presented in accordance with *[identify criteria, for example, the criteria set forth in Note 1]*, in all material respects.

[When any of the matters set forth in paragraphs 5.20–.26 of the Yellow Book have been identified, the following paragraph would be added.]

⁴ If the practitioner is reporting on an assertion about the subject matter, the practitioner would identify the assertion, rather than the subject matter, for example, "management's assertion that the accompanying schedule presents the performance measures of XYZ Agency for the year ended December 31, 20XX, in conformity with the criteria in Note 1." [Footnote added, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

In accordance with *Government Auditing Standards*, we are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses in internal control; fraud and noncompliance with provisions of laws or regulations that have a material effect on [identify the subject matter, for example, XYZ Agency's schedule of performance measures]; and any other instances that warrant the attention of those charged with governance; noncompliance with provisions of contracts or grant agreements, and abuse that has a material effect on the subject matter.⁵ We are also required to obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as any planned corrective actions. We performed our examination to express an opinion on whether [identify the subject matter, for example, XYZ Agency's schedule of performance measures] is presented in accordance with the criteria described above and not for the purpose of expressing an opinion on the internal control over [identify the subject matter, for example, reporting of performance measures] or on compliance and other matters; accordingly, we express no such opinions. Our examination disclosed certain findings that are required to be reported under *Government Auditing Standards* and those findings, along with the views of responsible officials, are described in the attached Schedule of Findings.⁶

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Illustrative Schedule of Findings

XYZ Agency Schedule of Findings⁷ Year Ended December 31, 20XX

Finding No. 1

Criteria

Condition

Cause

⁵ Note that paragraph 5.25 of the Yellow Book states that when auditors detect instances of noncompliance with provisions of contracts or grant agreements or abuse that have an effect on the subject matter or an assertion about the subject matter that is less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to entity officials. When auditors detect any instances of fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment. [Footnote added, January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

⁶ [Footnote renumbered and deleted to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

⁷ Refer to paragraphs 5.11–.15 of the Yellow Book regarding the content of the schedule of findings. [Footnote renumbered and revised: January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

Effect or Potential EffectManagement's ResponseFinding No. 2CriteriaConditionCauseEffect or Potential EffectManagement's Response

[Issue Date: December 2004. Revised, January 2008. Revised, December 2012. Revised, April 2016, effective for practitioners' reports dated on or after May 1, 2017. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

2. Reporting on the Design of Internal Control

.04 Question—A practitioner may be asked to report on the suitability⁸ of the design of an entity's internal control over financial reporting (internal control) for preventing, or detecting and correcting, material misstatements of the entity's financial statements on a timely basis. Such requests may be made by, for example,

- an entity applying for a government grant or contract that is required to submit a written pre-award survey by management about the suitability of the design of the entity's internal control or a portion of the entity's internal control, together with a practitioner's report thereon.
- a new casino applying for a license to operate that is required by a regulatory agency to submit a practitioner's report on whether the entity's internal control *that it plans to implement* is suitably designed to provide reasonable assurance that the control objectives specified in the regulatory agency's regulations would be achieved. (In this situation, the casino would not yet have begun operations, and audited financial statements or financial data relevant to the period covered by the engagement may not exist.)

May a practitioner report on the suitability of the design of an entity's internal control based on the risk assessment procedures the auditor performs to obtain a sufficient understanding of the entity and its environment, including its internal control, in an audit of the entity's financial statements?

.05 Interpretation—No. In a financial statement audit, the purpose of the auditor's understanding of the entity and its environment, including its internal control, is to enable the auditor to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The understanding obtained in a financial statement audit does not provide the practitioner with a

⁸ In this interpretation, the *suitability of the design of internal control* means the same thing as the *design effectiveness of an entity's internal control*. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

sufficient basis to report on the suitability of the design of an entity's internal control or any portion thereof.

.06 Question—How may a practitioner report on the suitability of the design of an entity's internal control or a portion thereof?

.07 Interpretation—The practitioner may perform an examination of the suitability of the design of an entity's internal control under section 205 or apply agreed-upon procedures to that subject matter under section 215. AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, does not directly apply when a practitioner is engaged to examine the suitability of design of an entity's internal control. However, it may be useful in planning and performing such engagements. Paragraphs .33 and .A61–.A62 of AU-C section 940 discuss how the auditor evaluates the design effectiveness of controls.

.08 When the engagement involves the application of agreed-upon procedures related to the suitability of the design of an entity's internal control over compliance with specified requirements, the practitioner should follow the provisions of section 315, *Compliance Attestation*.⁹

.09 The following is an illustrative report a practitioner may issue when reporting on the suitability of the design of an entity's internal control that has been implemented. The report may be modified, as appropriate, to fit the particular circumstances.

Independent Accountant's Report

[Introductory paragraph]

We have examined the suitability of the design of W Company's internal control over financial reporting to prevent, or detect and correct, material misstatements in its financial statements on a timely basis as of December 31, 20XX.¹⁰ W Company's management is responsible for the suitability of the design of W Company's internal control over financial reporting, based on *[identify the criteria]*. Our responsibility is to express an opinion on the suitability of the design of W Company's internal control over financial reporting based on our examination.

[Scope paragraph]

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether W Company's internal control over financial reporting was suitably designed based on *[identify the criteria]*, in all material respects. An examination involves performing procedures to obtain evidence about the suitability of the design of W Company's internal control over financial reporting. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of a material weakness in the suitability of the design of W Company's internal control over financial reporting. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion. We were not engaged to examine and report on the operating effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, and, accordingly, we express no opinion on operating effectiveness.

⁹ Paragraphs .01–.05, .07–.08, and .23–.26 of section 315, *Compliance Attestation*.

¹⁰ This report assumes that the control criteria are both suitable and available to users as discussed in paragraph .27b(ii) of section 105, *Concepts Common to All Attestation Engagements*. Therefore, the use of this report is not restricted. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Inherent limitations paragraph]

Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements. Also, projections of any evaluation of the suitability of the design or effectiveness of W Company's internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

[Opinion paragraph]

In our opinion, W Company's internal control over financial reporting was suitably designed to prevent, or detect and correct, material misstatements in the financial statements on a timely basis as of December 31, 20XX, based on *[identify criteria]*, in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

.10 When reporting on the suitability of the design of an entity's internal control that has not yet been implemented, the practitioner would be unable to confirm that the controls have been implemented and should disclose that information in the practitioner's report. In those circumstances, the practitioner should modify (1) the scope paragraph of the illustrative report in paragraph .09 to inform readers that the controls identified in the report have not yet been implemented and (2) the inherent limitations paragraph to reflect the related risk. Following are modified illustrative report paragraphs for use when controls have not yet been implemented.

(New language is shown in boldface italics. Deleted language is shown in strikethrough.)

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether W Company's internal control over financial reporting was suitably designed based on *[identify the criteria]*, in all material respects. An examination involves performing procedures to obtain evidence about the suitability of the design of W Company's internal control over financial reporting. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of a material weakness in the suitability of the design of W Company's internal control over financial reporting. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion. ***Because operations had not begun as of December 31, 20XX, we could not confirm that the specified controls were implemented. Accordingly, our report solely addresses the suitability of the design of the Company's internal control and does not address whether the controls were implemented. Furthermore, because the specified controls have not yet been implemented, we were unable to test, and did not test,*** the operating effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, and, accordingly, we express no opinion on operating effectiveness.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[Inherent limitations paragraph]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any evaluation of the suitability of the design or effectiveness of W Company's internal control over financial reporting to future periods are subject to the risk that controls **may not be implemented as intended when operations begin** or may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

.11 Question—A practitioner may be asked to sign a prescribed form developed by the party to whom the form is to be submitted regarding the design of an entity's internal control. What are the practitioner's responsibilities when requested to sign such a form if it includes language that is not consistent with the practitioner's function or responsibility or with the reporting requirements of professional standards?

.12 Interpretation—In the circumstances described in paragraph .11 of this interpretation, section 105, *Concepts Common to All Attestation Engagements*, requires the practitioner to reword the prescribed form of report or attach an appropriately worded separate report.¹¹ Section 105 indicates that some report forms can be made acceptable by inserting additional wording to include the report elements required by the applicable section.¹² However, some report forms required by law or regulation can be made acceptable only by complete revision because the prescribed language of the practitioner's report calls for statements by the practitioner that are not consistent with the practitioner's function or responsibility, for example, a report form that requests the practitioner to "certify" the subject matter. When reporting on the suitability of the design of an entity's internal control under section 205, the practitioner's report should contain all of the report elements required by section 205, which can be accomplished by either rewording the prescribed form of report or attaching an appropriately worded separate report in place of the prescribed form.¹³

.13 Question—An entity may be required to submit a practitioner's report about an entity's *ability* to establish suitably designed internal control (or its assertion thereon). May a practitioner issue such a report based on (a) the risk assessment procedures related to existing internal control that the auditor performs in an audit of an entity's financial statements or (b) the performance of an attestation engagement?

.14 Interpretation—No. Neither the risk assessment procedures the auditor performs in an audit of an entity's financial statements nor the performance of an attestation engagement provide the practitioner with a basis for issuing a report on the *ability* of an entity to establish suitably designed internal control. There are no suitable criteria for evaluating an entity's ability to establish suitably designed internal control. The requesting party may be willing to accept a report of the practitioner on a consulting service. The practitioner may include in the consulting service report

- a. a statement that the practitioner is unable to perform an attestation engagement that addresses the entity's ability to establish suitably designed internal control because there are no suitable criteria for evaluating the entity's ability to do so;
- b. a description of the nature and scope of the practitioner's services; and
- c. the practitioner's findings.

¹¹ Paragraph .20 of section 105.

¹² Paragraph .A28 of section 105.

¹³ Paragraph .63–.68 of section 205.

The practitioner may refer to the guidance in CS section 100, *Consulting Services: Definitions and Standards*.

[Issue Date: December 2008. Revised, December 2012. Revised, April 2016, effective for practitioners' reports dated on or after May 1, 2017. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

AT-C Section 205A^{*}

Examination Engagements

Source: SSAE No. 18; SSAE No. 20.

See section 9205A for interpretations of this section.

Effective for practitioners' examination reports dated on or after May 1, 2017, unless otherwise indicated.

Introduction

.01 This section contains performance and reporting requirements and application guidance for all examination engagements. The requirements and guidance in this section supplement the requirements and guidance in section 105, *Concepts Common to All Attestation Engagements*.

Effective Date

.02 This section is effective for practitioners' examination reports dated on or after May 1, 2017.

Objectives

.03 In conducting an examination engagement, the objectives of the practitioner are to

- a. obtain reasonable assurance about whether the subject matter as measured or evaluated against the criteria is free from material misstatement;
- b. express an opinion in a written report about whether
 - i. the subject matter is in accordance with (or based on) the criteria, in all material respects, or
 - ii. the responsible party's assertion is fairly stated, in all material respects; and
- c. communicate further as required by relevant AT-C sections.

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Appropriateness of evidence. The measure of the quality of evidence, that is, its relevancy and reliability in providing support for the practitioner's opinion.

Modified opinion. A qualified opinion, an adverse opinion, or a disclaimer of opinion.

Risk of material misstatement. The risk that the subject matter is not in accordance with (or based on) the criteria in all material

* This section contains an "AT-C" identifier, instead of an "AT" identifier, to avoid confusion with references to existing "AT" sections, which remain effective through April 2017.

respects or that the assertion is not fairly stated, in all material respects.

Sufficiency of evidence. The measure of the quantity of evidence. The quantity of the evidence needed is affected by the risks of material misstatement and also by the quality of such evidence.

Test of controls. A procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements in the subject matter.

Requirements

Conduct of an Examination Engagement

.05 In performing an examination engagement, the practitioner should comply with this section, section 105, and any subject-matter AT-C section that is relevant to the engagement. A subject-matter AT-C section is relevant to the engagement when it is in effect, and the circumstances addressed by the AT-C section exist. (Ref: par. .A1)

Preconditions for an Examination Engagement

.06 Section 105 indicates that a practitioner must be independent when performing an attestation engagement in accordance with the attestation standards, unless the practitioner is required by law or regulation to accept the engagement and report on the subject matter or assertion.¹ When the practitioner is not independent but is required by law or regulation to accept the engagement and report on the subject matter or assertion, the practitioner should disclaim an opinion and should specifically state that the practitioner is not independent. The practitioner is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the practitioner chooses to provide the reasons for the lack of independence, the practitioner should include all the reasons therefor.

Agreeing on the Terms of the Engagement

.07 The practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. (Ref: par. .A2)

.08 The agreed-upon terms of the engagement should include the following:

- a. The objective and scope of the engagement
- b. The responsibilities of the practitioner (Ref: par. .A3)
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different
- e. A statement about the inherent limitations of an examination engagement (Ref: par. .A4)

¹ Paragraph .24 of section 105, *Concepts Common to All Attestation Engagements*.

- f.* Identification of the criteria for the measurement, evaluation, or disclosure of the subject matter
- g.* An acknowledgement that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

.09 Although an engagement may recur, each engagement is considered a separate engagement. The practitioner should assess whether circumstances require revision to the terms of a preceding engagement. If the practitioner concludes that the terms of the preceding engagement need not be revised for the current engagement, the practitioner should remind the engaging party of the terms of the current engagement, and the reminder should be documented.

Requesting a Written Assertion

.10 The practitioner should request from the responsible party a written assertion about the measurement or evaluation of the subject matter against the criteria. When the engaging party is the responsible party and refuses to provide a written assertion, paragraph .82 requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable law or regulation. When the engaging party is not the responsible party, and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement. In that case, paragraph .84 requires the practitioner to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party. (Ref: par. .A5–.A8 and .A97)

Planning and Performing the Engagement

.11 The practitioner should establish an overall engagement strategy that sets the scope, timing, and direction of the engagement and guides the development of the engagement plan. (Ref: par. .A9–.A12)

.12 In establishing the overall engagement strategy, the practitioner should

- a.* identify the characteristics of the engagement that define its scope and ascertain the reporting objectives of the engagement in order to plan the timing of the engagement and the nature of the communications required;
- b.* consider the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts;
- c.* consider the results of preliminary engagement activities, such as client acceptance, and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- d.* ascertain the nature, timing, and extent of resources necessary to perform the engagement.

.13 The practitioner should develop a plan that includes a description of the following items:

- a.* The nature, timing, and extent of planned risk assessment procedures
- b.* The nature, timing, and extent of planned further procedures (see paragraph .21)
- c.* Other planned procedures that are required to be carried out so that the engagement complies with the attestation standards

Risk Assessment Procedures

.14 The practitioner should obtain an understanding of the subject matter and other engagement circumstances sufficient to (Ref: par. .A13–.A14)

- a. enable the practitioner to identify and assess the risks of material misstatement in the subject matter and
- b. provide a basis for designing and performing procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's opinion.

.15 In obtaining an understanding of the subject matter in accordance with paragraph .14, the practitioner should obtain an understanding of internal control over the preparation of the subject matter relevant to the engagement. This includes evaluating the design of those controls relevant to the subject matter and determining whether they have been implemented by performing procedures in addition to inquiry of the personnel responsible for the subject matter.

Materiality in Planning and Performing the Engagement

.16 When establishing the overall engagement strategy, the practitioner should consider materiality for the subject matter. (Ref: par. .A15–.A21)

.17 The practitioner should reconsider materiality for the subject matter if the practitioner becomes aware of information during the engagement that would have caused the practitioner to have initially determined a different materiality.

Identifying Risks of Material Misstatement

.18 The practitioner should identify and assess risks of material misstatement as the basis for designing and performing further procedures whose nature, timing, and extent (Ref: par. .A22–.A23)

- a. are responsive to assessed risks of material misstatement and
- b. allow the practitioner to obtain reasonable assurance about whether the subject matter is in accordance with (or based on) the criteria, in all material respects.

Responding to Assessed Risks and Obtaining Evidence

.19 To obtain reasonable assurance, the practitioner should obtain sufficient appropriate evidence to reduce attestation risk to an acceptably low level and thereby enable the practitioner to draw reasonable conclusions on which to base the practitioner's opinion.

.20 The practitioner should design and implement overall responses to address the assessed risks of material misstatement for the subject matter or assertion. (Ref: par. .A24–.A25)

Further Procedures

.21 The practitioner should design and perform further procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement.

.22 In designing and performing further procedures in accordance with paragraph .21, the practitioner should

- a. consider the reasons for the assessment given to the risk of material misstatement, including
 - i. the likelihood of material misstatement due to the particular characteristics of the subject matter and
 - ii. whether the practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of other procedures, and
- b. obtain more persuasive evidence the higher the practitioner's assessment of risk.

.23 When designing and performing procedures, the practitioner should consider the relevance and reliability of the information to be used as evidence. If

- a. evidence obtained from one source is inconsistent with that obtained from another,
- b. the practitioner has doubts about the reliability of information to be used as evidence, or
- c. responses to inquiries of the responsible party or others are inconsistent or otherwise unsatisfactory (for example, vague or implausible),

the practitioner should determine what modifications or additions to procedures are necessary to resolve the matter and should consider the effect of the matter, if any, on other aspects of the engagement.

Tests of Controls

.24 The practitioner should design and perform tests of controls to obtain sufficient appropriate evidence about the operating effectiveness of relevant controls if

- a. the practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing, and extent of other procedures;
- b. procedures other than tests of controls cannot alone provide sufficient appropriate evidence; or
- c. the subject matter is internal control.

.25 If the practitioner designed and performed tests of controls to rely on their operating effectiveness and identified deviations in those controls, the practitioner should make specific inquiries and perform other procedures as necessary to understand these matters and their potential consequences. The practitioner also should determine whether

- a. the tests of controls that have been performed provide an appropriate basis for reliance on the controls,
- b. additional tests of controls are necessary, or
- c. the potential risks of misstatement need to be addressed using other procedures.

Procedures Other Than Tests of Controls

.26 Irrespective of the assessed risks of material misstatement, the practitioner should design and perform tests of details or analytical procedures related to the subject matter, except when the subject matter is internal control.

Analytical Procedures Performed in Response to Assessed Risks

.27 When designing and performing analytical procedures in response to assessed risks, the practitioner should (Ref: par. .A26–.A27)

- a. determine the suitability of particular analytical procedures for the subject matter, taking into account the assessed risks of material misstatement and any related tests of details;
- b. evaluate the reliability of data from which the practitioner's expectation is developed, taking into account the source, comparability, nature, and relevance of information available, and controls over their preparation; and
- c. develop an expectation that is sufficiently precise to identify possible material misstatements (taking into account whether analytical procedures are to be performed alone or in combination with tests of details).

.28 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ significantly from expected amounts or ratios, the practitioner should investigate such differences by

- a. inquiring of the responsible party and obtaining additional evidence relevant to its responses and
- b. performing other procedures as necessary in the circumstances.

Procedures Regarding Estimates

.29 Based on the assessed risks of material misstatement, the practitioner should evaluate whether

- a. the responsible party has appropriately applied the requirements of the criteria relevant to any estimated amounts and
- b. the methods for making estimates are appropriate and have been applied consistently and whether changes, if any, in reported estimates or in the method for making them from the prior period, if applicable, are appropriate in the circumstances.

.30 When responding to an assessed risk of material misstatement related to an estimate, the practitioner should undertake one or more of the following, taking into account the nature of the estimates:

- a. Determine whether events occurring up to the date of the practitioner's report provide evidence regarding the estimate.
- b. Test how the responsible party made the estimate and the data on which it is based. In doing so, the practitioner should evaluate whether the
 - i. method of measurement used is appropriate in the circumstances,
 - ii. assumptions used by the responsible party are reasonable, and
 - iii. data on which the estimate is based are sufficiently reliable for the practitioner's purposes.
- c. Test the operating effectiveness of the controls over how the responsible party made the estimate, together with other appropriate further procedures.
- d. Develop a point estimate or a range to evaluate the responsible party's estimate. For this purpose, if the practitioner

- i. uses assumptions or methods that differ from those of the responsible party, the practitioner should obtain an understanding of the responsible party's assumptions or methods sufficient to establish that the practitioner's point estimate or range takes into account relevant variables and to evaluate any significant differences from the responsible party's point estimate.
- ii. concludes that it is appropriate to use a range, the practitioner should narrow the range, based on evidence available, until all outcomes within the range are considered reasonable.

Sampling

.31 If sampling is used, the practitioner should, when designing the sample, consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn. Sampling involves (Ref: par. .A28)

- a. determining a sample size sufficient to reduce sampling risk to an acceptably low level.
- b. selecting items for the sample in such a way that the practitioner can reasonably expect the sample to be representative of the relevant population and likely to provide the practitioner with a reasonable basis for conclusions about the population.
- c. treating a selected item to which the practitioner is unable to apply the designed procedures or suitable alternative procedures as a deviation from the prescribed control in the case of tests of controls or a misstatement in the case of tests of details.
- d. investigating the nature and cause of deviations or misstatements identified and evaluating their possible effect on the purpose of the procedure and on other areas of the engagement.
- e. evaluating the results of the sample, including sampling risk and projecting misstatements found in the sample to the population, and
- f. evaluating whether the use of sampling has provided an appropriate basis for conclusions about the population that has been tested.

Fraud, Laws, and Regulations

.32 The practitioner should

- a. consider whether risk assessment procedures and other procedures related to understanding the subject matter indicate risk of material misstatement due to fraud or noncompliance with laws or regulations.
- b. make inquiries of appropriate parties to determine whether they have knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter.
- c. evaluate whether there are unusual or unexpected relationships within the subject matter, or between the subject matter and other related information, that indicate risks of material misstatement due to fraud or noncompliance with laws or regulations.

- d. evaluate whether other information obtained indicates risk of material misstatement due to fraud or noncompliance with laws or regulations.

.33 The practitioner should respond appropriately to fraud or suspected fraud and noncompliance or suspected noncompliance with laws or regulations affecting the subject matter that is identified during the engagement. (Ref: par. .A29–.A30)

Revision of Risk Assessment

.34 The practitioner's assessment of the risks of material misstatement may change during the course of the engagement as additional evidence is obtained. In circumstances in which the practitioner obtains evidence from performing further procedures, or if new information is obtained, either of which is inconsistent with the evidence on which the practitioner originally based the assessment, the practitioner should revise the assessment and modify the planned procedures accordingly. (Ref: par. .A31–.A32)

Evaluating the Reliability of Information Produced by the Entity

.35 When using information produced by the entity, the practitioner should evaluate whether the information is sufficiently reliable for the practitioner's purposes, including, as necessary, the following: (Ref: par. .A33–.A34)

- a. Obtaining evidence about the accuracy and completeness of the information
- b. Evaluating whether the information is sufficiently precise and detailed for the practitioner's purposes

Using the Work of a Practitioner's Specialist

.36 When the practitioner expects to use the work of a practitioner's specialist, the practitioner should do the following:

- a. Evaluate whether the practitioner's specialist has the necessary competence, capabilities, and objectivity for the practitioner's purposes. In the case of a practitioner's external specialist, the evaluation of objectivity should include inquiry regarding interests and relationships that may create a threat to the objectivity of the practitioner's specialist. (Ref: par. .A38–.A41)
- b. Obtain a sufficient understanding of the field of expertise of a practitioner's specialist to enable the practitioner to (Ref: par. .A42)
 - i. determine the nature, scope, and objectives of that specialist's work for the practitioner's purposes and
 - ii. evaluate the adequacy of that work for the practitioner's purposes.
- c. Agree with the practitioner's specialist regarding (Ref: par. .A43)
 - i. the nature, scope, and objectives of that practitioner's specialist's work;
 - ii. the respective roles and responsibilities of the practitioner and that specialist;
 - iii. the nature, timing, and extent of communication between the practitioner and that specialist, including the form of

any report or documentation to be provided by that specialist; and

- iv. the need for the practitioner's specialist to observe confidentiality requirements.
- d. Evaluate the adequacy of the work of the practitioner's specialist for the practitioner's purposes, including
 - i. the relevance and reasonableness of the findings and conclusions of the practitioner's specialist and their consistency with other evidence;
 - ii. if the work of the practitioner's specialist involves the use of significant assumptions and methods
 - (1) obtaining an understanding of those assumptions and methods and
 - (2) evaluating the relevance and reasonableness of those assumptions and methods in the circumstances, giving consideration to the rationale and support provided by the practitioner's specialist, and in relation to the practitioner's other findings and conclusions;
 - iii. if the work of the practitioner's specialist involves the use of source data that are significant to the work of the practitioner's specialist, the relevance, completeness, and accuracy of that source data.

.37 If the practitioner determines that the work of the practitioner's specialist is not adequate for the practitioner's purposes, the practitioner should

- a. agree with the practitioner's specialist on the nature and extent of further work to be performed by the practitioner's specialist or
- b. perform additional procedures appropriate to the circumstances.

.38 The nature, timing, and extent of the procedures a practitioner performs when the practitioner expects to use the work of a practitioner's specialist will vary depending on the circumstances. In determining the nature, timing, and extent of those procedures, the practitioner should consider the following: (See section 105.²)

- a. The significance of that specialist's work in the context of the engagement (See also paragraphs .A35–.A36.)
- b. The nature of the matter to which that specialist's work relates
- c. The risks of material misstatement in the matter to which that specialist's work relates
- d. The practitioner's knowledge of, and experience with, previous work performed by that specialist
- e. Whether that specialist is subject to the practitioner's firm's quality control policies and procedures (see also paragraph .A37)

Using the Work of Internal Auditors

.39 When the practitioner expects to use the work of the internal audit function in obtaining evidence or to use internal auditors to provide direct assistance, the practitioner should determine whether the work can be used for purposes of the examination by evaluating (Ref: par. .A44–.A46)

² Paragraph .32 of section 105.

- a. the level of competence of the internal audit function or the individual internal auditors providing direct assistance;
- b. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal audit function or for internal auditors providing direct assistance, the existence of threats to the objectivity of those internal auditors and the related safeguards applied to reduce or eliminate those threats; and
- c. when using the work of the internal audit function, the application by the internal audit function of a systematic and disciplined approach, including quality control.

.40 When using the work of the internal audit function, the practitioner should perform sufficient procedures on the body of work of the internal audit function as a whole that the practitioner plans to use to determine its adequacy for the purpose of the examination engagement, including reperforming some of the body of work of the internal audit function that the practitioner intends to use in obtaining evidence.

.41 Prior to using internal auditors to provide direct assistance, the practitioner should obtain written acknowledgment from the responsible party that internal auditors providing direct assistance to the practitioner will be allowed to follow the practitioner's instructions, and that the responsible party will not intervene in the work the internal auditor performs for the practitioner.

.42 When using internal auditors to provide direct assistance to the practitioner, the practitioner should direct, supervise, and review the work of the internal auditors.

.43 Because the practitioner has sole responsibility for the opinion expressed, the practitioner should make all significant judgments in the examination engagement, including when to use the work of the internal audit function in obtaining evidence. To prevent undue use of the internal audit function in obtaining evidence, the practitioner should plan to use less of the work of the function and perform more of the work directly:

- a. The more judgment is involved in
 - i. planning and performing relevant procedures or
 - ii. evaluating the evidence obtained
- b. the higher the assessed risk of material misstatement;
- c. the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
- d. the lower the level of competence of the internal audit function.

.44 Before the conclusion of the engagement, the practitioner should evaluate whether the use of the work of the internal audit function or the use of internal auditors to provide direct assistance results in the practitioner still being sufficiently involved in the examination given the practitioner's sole responsibility for the opinion expressed.

Evaluating the Results of Procedures

.45 The practitioner should accumulate misstatements identified during the engagement other than those that are clearly trivial. (Ref: par. .A47–.A48)

.46 The practitioner should evaluate the sufficiency and appropriateness of the evidence obtained in the context of the engagement and, if necessary,

attempt to obtain further evidence. The practitioner should consider all relevant evidence, regardless of whether it appears to corroborate or contradict the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A49–.A53)

.47 If the practitioner is unable to obtain necessary further evidence, the practitioner should consider the implications for the practitioner's opinion in paragraphs .68–.84.

Considering Subsequent Events and Subsequently Discovered Facts

.48 The practitioner should inquire whether the responsible party, and if different, the engaging party, is aware of any events subsequent to the period (or point in time) covered by the examination engagement up to the date of the practitioner's report that could have a significant effect on the subject matter or assertion and should apply other appropriate procedures to obtain evidence regarding such events. If the practitioner becomes aware, through inquiry or otherwise, of such an event, or any other event that is of such a nature and significance that its disclosure is necessary to prevent users of the report from being misled, and information about that event is not adequately disclosed by the responsible party in the subject matter or in its assertion, the practitioner should take appropriate action. (Ref: par. .A54–.A56)

.49 The practitioner has no responsibility to perform any procedures regarding the subject matter or assertion after the date of the practitioner's report. Nevertheless, the practitioner should respond appropriately to facts that become known to the practitioner after the date of the report that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. (Ref: par. .A57–.A58)

Written Representations

.50 The practitioner should request from the responsible party written representations in the form of a letter addressed to the practitioner. The representations should (Ref: par. .A59–.A62)

- a. include the responsible party's assertion about the subject matter based on the criteria. (Ref: par. .A97)
- b. state that all relevant matters are reflected in the measurement or evaluation of the subject matter or assertion.
- c. state that all known matters contradicting the subject matter or assertion and any communication from regulatory agencies or others affecting the subject matter or assertion have been disclosed to the practitioner, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report.
- d. acknowledge responsibility for
 - i. the subject matter and the assertion;
 - ii. selecting the criteria, when applicable; and
 - iii. determining that such criteria are appropriate for the responsible party's purposes.
- e. state that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a

material effect on the subject matter or assertion have been disclosed to the practitioner. (Ref: par. .A61)

- f.* state that it has provided the practitioner with all relevant information and access.
- g.* if applicable, state that the responsible party believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the subject matter. (Ref: par. .A62)
- h.* if applicable, state that significant assumptions used in making any material estimates are reasonable.
- i.* state that the responsible party has disclosed to the practitioner
 - i.* all deficiencies in internal control relevant to the engagement of which the responsible party is aware;
 - ii.* its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter; and
 - iii.* other matters as the practitioner deems appropriate.

.51 When the engaging party is not the responsible party, and the responsible party refuses to provide the representations in paragraph .50 in writing, the practitioner should make inquiries of the responsible party about, and seek oral responses to, the matters in paragraph .50. (Ref: par. .A63)

.52 When the engaging party is not the responsible party, the practitioner should request written representations from the engaging party, in addition to those requested from the responsible party, in the form of a letter addressed to the practitioner. The representations should

- a.* acknowledge that the responsible party is responsible for the subject matter and assertion.
- b.* acknowledge the engaging party's responsibility for selecting the criteria, when applicable.
- c.* acknowledge the engaging party's responsibility for determining that such criteria are appropriate for its purposes.
- d.* state that the engaging party is not aware of any material misstatements in the subject matter or assertion.
- e.* state that the engaging party has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion. (Ref: par. .A61)
- f.* address other matters as the practitioner deems appropriate.

.53 When written representations are directly related to matters that are material to the subject matter, the practitioner should

- a.* evaluate their reasonableness and consistency with other evidence obtained, including other representations (oral or written) and
- b.* consider whether those making the representations can be expected to be well informed on the particular matters.

.54 The date of the written representations should be as of the date of the practitioner's report. The written representations should address the subject matter and periods covered by the practitioner's opinion.

Requested Written Representations Not Provided or Not Reliable

.55 When the engaging party is the responsible party, and one or more of the requested written representations are not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should (Ref: par. .A64)

- a. discuss the matter with the appropriate party(ies);
- b. reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general; and
- c. if any of the matters are not resolved to the practitioner's satisfaction, take appropriate action.

.56 When the engaging party is not the responsible party

- a. if one or more of the requested representations are not provided in writing by the responsible party, but the practitioner receives satisfactory oral responses to the practitioner's inquiries performed in accordance with paragraph .51 sufficient to enable the practitioner to conclude that the practitioner has sufficient appropriate evidence to form an opinion about the subject matter, the practitioner's report should contain a separate paragraph that restricts the use of the report to the engaging party. (Paragraphs .65–.66 contain requirements for the contents of such a paragraph.) (Ref: par. .A63 and .A65)
- b. if one or more of the requested representations are provided neither in writing nor orally from the responsible party in accordance with paragraph .51, a scope limitation exists, and the practitioner should determine the effect on the report, or the practitioner should withdraw from the engagement. (Ref: par. .A66)

Other Information

.57 If prior to or after the release of the practitioner's report on subject matter or an assertion, the practitioner is willing to permit the inclusion of the report in a document that contains the subject matter or assertion and other information, the practitioner should read the other information to identify material inconsistencies, if any, with the subject matter, assertion, or the report. If upon reading the other information, in the practitioner's professional judgment (Ref: par. .A67–.A68)

- a. a material inconsistency between that other information and the subject matter, assertion, or the report exists or
- b. a material misstatement of fact exists in the other information, the subject matter, assertion, or the report

the practitioner should discuss the matter with the responsible party and take further action as appropriate.

Description of Criteria

.58 The practitioner should evaluate whether the written description of the subject matter or assertion adequately refers to or describes the criteria. (Ref: par. .A69–.A70)

Forming the Opinion

.59 The practitioner should form an opinion about whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or the assertion is fairly stated, in all material respects. In forming that opinion, the practitioner should evaluate

- a. the practitioner's conclusion regarding the sufficiency and appropriateness of evidence obtained and (Ref: par. .A71)
- b. whether uncorrected misstatements are material, individually or in the aggregate. (Ref: par. .A72)

.60 The practitioner should evaluate, based on the evidence obtained, whether the presentation of the subject matter or assertion is misleading within the context of the engagement. (Ref: par. .A73–.A74)

Preparing the Practitioner's Report

.61 The practitioner's report should be in writing. (Ref: par. .A75–.A76)

.62 A practitioner should report on a written assertion or should report directly on the subject matter. If the practitioner is reporting on the assertion, the assertion should be bound with or accompany the practitioner's report, or the assertion should be clearly stated in the report. (Ref: par. .A77)

Content of the Practitioner's Report

.63 The practitioner's report should include the following, unless the practitioner is disclaiming an opinion, in which case, items .63f, and .63g should be omitted:

- a. A title that includes the word *independent*. (Ref: par. .A78)
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates.
- d. An identification of the criteria against which the subject matter was measured or evaluated. (Ref: par. .A79)
- e. A statement that identifies (Ref: par. .A80–.A81)
 - i. the responsible party and its responsibility for the subject matter in accordance with (or based on) the criteria or for its assertion, and
 - ii. the practitioner's responsibility to express an opinion on the subject matter or assertion, based on the practitioner's examination.
- f. A statement that
 - i. the practitioner's examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants.
 - ii. those standards require that the practitioner plan and perform the examination to obtain reasonable assurance about whether

- (1) the subject matter is in accordance with (or based on) the criteria, in all material respects (or equivalent language regarding the subject matter and criteria, such as the language used in the examples in paragraph .A82) or
 - (2) the responsible party's assertion is fairly stated, in all material respects.
- iii. the practitioner believes the evidence the practitioner obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.
- g. A description of the nature of an examination engagement. (Ref: par. .A83–.A85)
- h. A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A86)
- i. The practitioner's opinion about whether (Ref: par. .A87–.A90)
 - i. the subject matter is in accordance with (or based on) the criteria, in all material respects or
 - ii. the responsible party's assertion is fairly stated, in all material respects.
- j. The manual or printed signature of the practitioner's firm.
- k. The city and state where the practitioner practices. (Ref: par. .A91)
- l. The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate evidence on which to base the practitioner's opinion, including evidence that
 - i. the attestation documentation has been reviewed,
 - ii. if applicable, the written presentation of the subject matter has been prepared, and
 - iii. the responsible party has provided a written assertion or, in the circumstances described in paragraph .A66, an oral assertion.)

Restricted Use Paragraph

.64 In the following circumstances, the practitioner's report should include an alert, in a separate paragraph, that restricts the use of the report: (Ref: par. .A94–.A97)

- a. The practitioner determines that the criteria used to evaluate the subject matter are appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.
- b. The criteria used to evaluate the subject matter are available only to specified parties.
- c. The engaging party is not the responsible party, and the responsible party does not provide the written representations required by paragraph .50, but does provide oral responses to the practitioner's inquiries about the matters in paragraph .50, as provided for in paragraph .51 and .56a. In this case, the use of the practitioner's report should be restricted to the engaging party. (Ref: par. .A97)

.65 The alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties,
- b. identify the specified parties for whom use is intended, and (Ref: par. .A98)
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A99–.A101)

.66 When the engagement is also performed in accordance with *Government Auditing Standards*, the alert that restricts the use of the practitioner's report should include the following information, rather than the information required by paragraph .65:

- a. A description of the purpose of the report
- b. A statement that the report is not suitable for any other purpose

Reference to the Practitioner's Specialist

.67 The practitioner should not refer to the work of a practitioner's specialist in the practitioner's report containing an unmodified opinion. (Ref: par. .A102)

Modified Opinions

.68 The practitioner should modify the opinion when either of the following circumstances exist and, in the practitioner's professional judgment, the effect of the matter is or may be material: (Ref: par. .A103–.A104)

- a. The practitioner is unable to obtain sufficient appropriate evidence to conclude that the subject matter is in accordance with (or based on) the criteria, in all material respects.
- b. The practitioner concludes, based on evidence obtained, that the subject matter is not in accordance with (or based on) the criteria, in all material respects.

.69 When the practitioner modifies the opinion, the practitioner should include a separate paragraph in the practitioner's report that provides a description of the matter(s) giving rise to the modification.

.70 The practitioner should express a qualified opinion when (Ref: par. .A105–.A109)

- a. the practitioner, having obtained sufficient appropriate evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive to the subject matter or
- b. the practitioner is unable to obtain sufficient appropriate evidence on which to base the opinion, but the practitioner concludes that the possible effects on the subject matter of undetected misstatements, if any, could be material, but not pervasive.

.71 When the practitioner expresses a qualified opinion due to a material misstatement of the subject matter, the practitioner should state that, in the practitioner's opinion, except for the effects of the matter(s) giving rise to the modification, the subject matter is presented in accordance with (or based on) the criteria, in all material respects. When the modification arises from an inability to obtain sufficient appropriate evidence, the practitioner should use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

.72 The practitioner should express an adverse opinion when the practitioner, having obtained sufficient appropriate evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the subject matter.

.73 When the practitioner expresses an adverse opinion, the practitioner should state that, in the practitioner's opinion, because of the significance of the matter(s) giving rise to the modification, the subject matter is not presented in accordance with (or based on) the criteria, in all material respects.

.74 The practitioner should disclaim an opinion when the practitioner is unable to obtain sufficient appropriate evidence on which to base the opinion, and the practitioner concludes that the possible effects on the subject matter of undetected misstatements, if any, could be both material and pervasive. (Ref: par. .A110)

.75 When the practitioner disclaims an opinion due to an inability to obtain sufficient appropriate evidence, the practitioner's report should state that

- a. because of the significance of the matter(s) giving rise to the modification, the practitioner has not been able to obtain sufficient appropriate evidence to provide a basis for an examination opinion and
- b. accordingly, the practitioner does not express an opinion on the subject matter.

Description of the Practitioner's Responsibility When the Practitioner Expresses a Qualified or an Adverse Opinion

.76 When the practitioner expresses a qualified or an adverse opinion, the practitioner should amend the description of the practitioner's responsibility to state that the practitioner believes that the evidence the practitioner has obtained is sufficient and appropriate to provide a basis for the practitioner's modified opinion.

Description of the Practitioner's Responsibility When the Practitioner Disclaims an Opinion

.77 When the practitioner disclaims an opinion due to an inability to obtain sufficient appropriate evidence, the practitioner should amend the practitioner's report to state that the practitioner was engaged to examine the subject matter (or assertion). The practitioner should also amend the description of the practitioner's responsibility and the description of an examination to state only the following:

Our responsibility is to express an opinion on the subject matter (or assertion) based on conducting the examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Because of the limitation on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the subject matter is in accordance with (or based on) the criteria, in all material respects.

.78 If the practitioner expresses a modified opinion because of a scope limitation but is also aware of a matter(s) that causes the subject matter to be materially misstated, the practitioner should include in the practitioner's report a clear description of both the scope limitation and the matter(s) that causes the subject matter to be materially misstated.

.79 If the practitioner has concluded that conditions exist that, individually or in combination, result in one or more material misstatements based on

the criteria, the practitioner should modify the opinion and express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement.

.80 The practitioner's opinion on the subject matter or assertion should be clearly separated from any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities.

.81 When the opinion is modified, reference to an external specialist is permitted when such reference is relevant to an understanding of the modification to the practitioner's opinion. The practitioner should indicate in the practitioner's report that such reference does not reduce the practitioner's responsibility for that opinion.

Responsible Party Refuses to Provide a Written Assertion

.82 If the engaging party is the responsible party and refuses to provide the practitioner with a written assertion as required by paragraph .10, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation.

.83 If law or regulation does not allow the practitioner to withdraw from the engagement, the practitioner should disclaim an opinion.

.84 When the engaging party is not the responsible party and the responsible party refuses to provide the practitioner with a written assertion, the practitioner may report on the subject matter but should disclose in the practitioner's report the responsible party's refusal to provide a written assertion and should restrict the use of the practitioner's report to the engaging party. (Ref: par. .A111–.A113)

Communication Responsibilities

.85 The practitioner should communicate to the responsible party known and suspected fraud and noncompliance with laws or regulations, uncorrected misstatements, and, when relevant to the subject matter, internal control deficiencies identified during the engagement. When the engaging party is not the responsible party, the practitioner should also communicate this information to the engaging party. (Ref: par. .A114)

.86 If the practitioner has identified or suspects noncompliance with laws or regulations that are not relevant to the subject matter, the practitioner should determine whether the practitioner has a responsibility to report the identified or suspected noncompliance to parties other than the responsible party and the engaging party (if different). (Ref: par. .A115–.A116)

Documentation

.87 The practitioner should prepare engagement documentation that is sufficient to determine (Ref: par. .A117–.A120)

- a. the nature, timing, and extent of the procedures performed to comply with relevant AT-C sections and applicable legal and regulatory requirements, including
 - i. the identifying characteristics of the specific items or matters tested;
 - ii. who performed the engagement work and the date such work was completed;

- iii. the discussions with the responsible party or others about findings or issues that, in the practitioner's professional judgment, are significant, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place;
 - iv. when the engaging party is the responsible party and the responsible party will not provide one or more of the requested written representations or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations; or that the written representations are otherwise not reliable, the matters in paragraph .55;
 - v. when the engaging party is not the responsible party and the responsible party will not provide the written representations regarding the matters in paragraph .50, the oral responses from the responsible party to the practitioner's inquiries regarding the matters in paragraph .50, in accordance with paragraph .51; and
 - vi. who reviewed the engagement work performed and the date and extent of such review.
- b. the results of the procedures performed and the evidence obtained.

.88 If the practitioner identified information that is inconsistent with the practitioner's final conclusion regarding a significant finding or issue, the practitioner should document how the practitioner addressed the inconsistency.

.89 If, in circumstances such as those described in paragraph .49, the practitioner performs new or additional procedures or draws new conclusions after the date of the practitioner's report, the practitioner should document

- a. the circumstances encountered;
- b. the new or additional procedures performed, evidence obtained, and conclusions reached and their effect on the report; and
- c. when and by whom the resulting changes to the documentation were made and reviewed.

Application and Other Explanatory Material

Conduct of an Examination Engagement

(Ref: par. .05)

.A1 For example, if a practitioner were examining prospective financial information, section 105, this section, and section 305, *Prospective Financial Information*, would be relevant.

Agreeing on the Terms of the Engagement

(Ref: par. .07, .08b, and .08e)

.A2 It is in the interests of both the engaging party and the practitioner to document the agreed-upon terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the engagement letter or other suitable form of written agreement will vary with the engagement circumstances.

.A3 A practitioner may further describe the responsibilities of the practitioner by adding the following items to the engagement letter or other suitable form of written agreement:

- a. A statement that an examination is designed to obtain reasonable assurance about whether the subject matter as measured or evaluated against the criteria is free from material misstatement
- b. A statement that the objective of an examination is the expression of an opinion in a written practitioner's report about whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or whether the responsible party's assertion is fairly stated, in all material respects

.A4 If relevant, a statement about the inherent limitations of an examination engagement may indicate that "because of the inherent limitations of an examination engagement, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the examination is properly planned and performed in accordance with the attestation standards."

Requesting a Written Assertion (Ref: par. .10)

.A5 The language of the responsible party's written assertion in paragraph .10 may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .10 include the following:

- The entity maintained effective internal control over the subject matter based on the criteria.
- The subject matter is presented in accordance with (or based on) the criteria.
- The subject matter achieved the objectives, for example, when the objectives are the criteria.
- The subject matter is presented fairly, based on the criteria.

.A6 Situations may arise in which the current responsible party was not present during some or all of the period covered by the practitioner's report. Such persons may contend that they are not in a position to provide a written assertion that covers the entire period because they were not in place during some or all of the period. This fact, however, does not diminish such persons' responsibilities for the subject matter as a whole. Accordingly, the requirement for the practitioner to request a written assertion from the responsible party that covers the entire relevant period(s) still applies.

.A7 Paragraph .50a requires the practitioner to request a written representation from the responsible party that is the same as the responsible party's assertion. If the responsible party provides the practitioner with the written representation in paragraph .50a, the practitioner need not request a separate written assertion unless a separate written assertion is called for by the engagement circumstances.

.A8 A practitioner may also be engaged to assist the responsible party in measuring or evaluating the subject matter against the criteria in connection with the responsible party providing a written assertion. Regardless of the procedures performed by the practitioner, the responsible party is required to

accept responsibility for its assertion and the subject matter and may not base its assertion solely on the practitioner's procedures.³

Planning and Performing the Engagement (Ref: par. .11)

.A9 Planning involves the engagement partner and other key members of the engagement team and may involve the practitioner's specialists in developing

- an overall strategy for the scope, timing, and conduct of the engagement and
- an engagement plan, consisting of a detailed approach for the nature, timing, and extent of procedures to be performed.

Adequate planning helps the practitioner to devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis, and properly organize and manage the engagement in order for it to be performed in an effective and efficient manner. Adequate planning also assists the practitioner in properly assigning work to engagement team members and facilitates the direction, supervision, and review of their work. Further, it assists, when applicable, the coordination of work performed by other practitioners and practitioner's specialists. The nature and extent of planning activities will vary with the engagement circumstances, for example, the complexity of the assessment or evaluation of the subject matter and the practitioner's previous experience with it. Examples of relevant matters that may be considered include the following:

- The characteristics of the engagement that define its scope, including the terms of the engagement, the characteristics of the underlying subject matter, and the criteria
- The expected timing and the nature of the communications required
- The results of preliminary engagement activities, such as client acceptance, and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the appropriate party(ies) is relevant
- The engagement process, including possible sources of evidence, and choices among alternative measurement or evaluation methods
- The practitioner's understanding of the appropriate party(ies) and its (their) environment, including the risks that the subject matter may be materially misstated
- Identification of intended users and their information needs and consideration of materiality and the components of attestation risk
- The risk of fraud relevant to the engagement
- The effect on the engagement of using the internal audit function

.A10 The practitioner may decide to discuss elements of planning with the appropriate party(ies) to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work

³ The "Nonattest Services" subtopic (ET sec. 1.295) of the AICPA Code of Professional Conduct addresses the practitioner's provision of nonattest services for an attest client.

of the responsible party's personnel). Although these discussions often occur, the overall engagement strategy and the engagement plan remain the practitioner's responsibility. When discussing matters included in the overall engagement strategy or engagement plan, care is needed to avoid compromising the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the responsible party may compromise the effectiveness of the engagement by making the procedures too predictable.

.A11 Planning is not a discrete phase but, rather, a cumulative and iterative process throughout the engagement. As a result of unexpected events, changes in conditions, or evidence obtained, the practitioner may need to revise the overall strategy and engagement plan and, thereby, the resulting nature, timing, and extent of planned procedures.

.A12 In smaller or less complex engagements, the entire engagement may be conducted by a very small engagement team, possibly involving the engagement partner (who may be a sole practitioner) working without any other engagement team members. With a smaller team, coordination of, and communication among, team members is easier. In such cases, establishing the overall engagement strategy need not be a complex or time-consuming exercise; it varies according to the size of the entity, complexity of the engagement, and size of the engagement team.

Risk Assessment Procedures (Ref: par. .14)

.A13 Obtaining an understanding of the subject matter and other engagement circumstances provides the practitioner with a frame of reference for exercising professional judgment throughout the engagement, for example, when

- considering the characteristics of the subject matter;
- assessing the suitability of criteria;
- considering the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts, including situations in which special consideration may be necessary (for example, when there is a need for specialized skills or the work of a specialist);
- establishing and evaluating the continued appropriateness of quantitative materiality levels (when appropriate) and considering qualitative materiality factors;
- developing expectations when performing analytical procedures;
- designing and performing procedures;
- evaluating evidence, including the reasonableness of the written representations received by the practitioner.

.A14 In assessing inherent risk, the practitioner may consider factors relevant to examination engagements, such as the following:

- The complexity of the subject matter or assertion
- The length of time during which the entity has had experience with the subject matter or assertion
- Prior experience with the entity's assessment of the subject matter or assertion

Materiality in Planning and Performing the Engagement (Ref: par. .16)

.A15 Materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative factors and quantitative factors when considering materiality in a particular engagement is a matter for the practitioner's professional judgment.

.A16 Professional judgments about materiality are made in light of surrounding circumstances, but they are not affected by the level of assurance, that is, for the same intended users, materiality for an examination engagement is the same as it is for a review engagement because materiality is based on the information needs of intended users and not the level of assurance.

.A17 In general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by intended users based on the subject matter. The practitioner's consideration of materiality is a matter of professional judgment and is affected by the practitioner's perception of the common information needs of intended users as a group. For purposes of determining materiality, the practitioner may assume that intended users

- a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.
- b. understand that the subject matter is measured or evaluated and examined to appropriate levels of materiality and have an understanding of any materiality concepts included in the criteria.
- c. understand any inherent uncertainties involved in measuring or evaluating the subject matter.
- d. make reasonable judgments based on the subject matter.

Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered. [As amended, effective for practitioners' examination reports dated on or after December 15, 2020, by SSAE No. 20.]

.A18 Qualitative factors may include the following:

- The interaction between, and relative importance of, various aspects of the subject matter, such as numerous performance indicators
- The wording chosen with respect to subject matter that is expressed in narrative form, for example, the wording chosen does not omit or distort the information
- The characteristics of the presentation adopted for the subject matter when the criteria allow for variations in that presentation
- The nature of a misstatement, for example, the nature of observed deviations in the operation of a control when the responsible party asserts that the control is effective
- Whether a misstatement affects compliance with laws or regulations
- In the case of periodic reporting on a subject matter, whether the effect of an adjustment affects past or current information about the subject matter or is likely to affect future information about the subject matter

- Whether a misstatement is the result of an intentional act or is unintentional
- Whether a misstatement is significant with regard to the practitioner's understanding of known previous communications to users, for example, in relation to the expected outcome of the measurement or evaluation of the subject matter
- Whether a misstatement relates to the relationship between the responsible party, and if different, the engaging party or its relationship with other parties

.A19 Quantitative factors relate to the magnitude of misstatements relative to reported amounts for those aspects of the subject matter, if any, that are

- expressed numerically or
- otherwise related to numerical values, for example, the number of observed deviations in the operation of a control when the examination involves the effectiveness of the control.

.A20 When quantitative factors are applicable, planning the engagement solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the subject matter to be materially misstated. Applying materiality to elements of the subject matter ordinarily is not a simple mechanical calculation but involves the exercise of professional judgment. It is affected by the practitioner's understanding of the subject matter and the responsible party, updated during the performance of the risk assessment procedures, and consideration of the nature and extent of misstatements identified in previous attestation engagements.

.A21 The criteria may discuss the concept of materiality in the context of the preparation and presentation of the subject matter and thereby provide a frame of reference for the practitioner in considering materiality for the engagement. Although criteria may discuss materiality in different terms, the concept of materiality generally includes the matters discussed in paragraphs .A15–.A20. If the criteria do not include a discussion of the concept of materiality, these paragraphs provide the practitioner with a frame of reference.

Identifying Risks of Material Misstatement (Ref: par. .18)

.A22 Most of the practitioner's work in forming an opinion consists of obtaining and evaluating evidence. Procedures to obtain evidence can include inspection, observation, confirmation, recalculation, reperformance, and analytical procedures, often in some combination, in addition to inquiry.

.A23 In some cases, a subject-matter-specific section may include requirements that affect the nature, timing, and extent of procedures. For example, a subject-matter-specific section may describe the nature or extent of particular procedures to be performed in a particular type of engagement. Even in such cases, determining the exact nature, timing, and extent of procedures is a matter of professional judgment and will vary from one engagement to the next.

Responding to Assessed Risks and Obtaining Evidence (Ref: par. .20)

.A24 Overall responses to address the assessed risks of material misstatement of the subject matter or assertion may include

- emphasizing to the engagement team the need to maintain professional skepticism;
- assigning more experienced staff or those with specialized skills or using specialists;
- providing more supervision;
- incorporating additional elements of unpredictability in the selection of further procedures to be performed; and
- making changes to the nature, timing, or extent of procedures (for example, performing procedures at period-end instead of at an interim date or modifying the nature of procedures to obtain more persuasive evidence).

.A25 The assessment of the risks of material misstatement of the subject matter or assertion is affected by the practitioner's understanding of the control environment. An effective control environment may allow the practitioner to have more confidence in internal control and the reliability of evidence generated internally within the entity and, thus, for example, may allow the practitioner to conduct some procedures at an interim date, rather than at the period-end. Deficiencies in the control environment, however, have the opposite effect, for example, the practitioner may respond to an ineffective control environment by

- conducting more procedures as of the period-end, rather than at an interim date,
- obtaining more extensive evidence from procedures other than tests of controls, and
- increasing the number of locations to be included in the examination scope.

Further Procedures

Analytical Procedures Performed in Response to Assessed Risks (Ref: par. .27)

.A26 An understanding of the purposes of analytical procedures and the limitations of those procedures is important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires professional judgment by the practitioner.

.A27 Analytical procedures involve comparisons of expectations developed by the practitioner to recorded amounts or ratios developed from recorded amounts. The practitioner develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the subject matter; the practices used by the responsible party to measure, recognize, and record the subject matter; and, if applicable, the industry in which the entity operates.

Sampling (Ref: par. .31)

.A28 The AICPA Audit Guide *Audit Sampling* provides guidance that may be useful to a practitioner who has decided to use sampling in performing attestation procedures.

Fraud, Laws, and Regulations (Ref: par. .33)

.A29 In responding to fraud or suspected fraud identified during the engagement, it may be appropriate, unless prohibited by law, regulation, or ethics standards, for the practitioner to, for example,

- discuss the matter with the appropriate party(ies).
- request that the responsible party consult with an appropriately qualified third party, such as the entity's legal counsel or a regulator.
- consider the implications of the matter in relation to other aspects of the engagement, including the practitioner's risk assessment and the reliability of written representations from the responsible party.
- obtain legal advice about the consequences of different courses of action.
- communicate with third parties (for example, a regulator).
- withdraw from the engagement.

.A30 The actions noted in paragraph .A29 also may be appropriate in responding to noncompliance or suspected noncompliance with laws or regulations identified during the engagement. It may be appropriate to describe the matter in a separate paragraph in the practitioner's report, unless the practitioner

- a. is precluded by the responsible party from obtaining sufficient appropriate evidence to evaluate whether noncompliance that may be material to the subject matter has, or is likely to have, occurred, in which case, paragraphs .68a and .77 apply, or
- b. concludes that the noncompliance results in a material misstatement of the subject matter, in which case, paragraph .68b applies.

Revision of Risk Assessment (Ref: par. .34)

.A31 Information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the responsible party to examine the matter identified by the practitioner and to make adjustments to the subject matter if appropriate.

.A32 The practitioner may become aware of a matter(s) that causes the practitioner to believe the subject matter may be materially misstated, for example, when performing analytical procedures the practitioner identifies a fluctuation or relationship that is inconsistent with other relevant information or that differs significantly from expectations.

Evaluating the Reliability of Information Produced by the Entity (Ref: par. .35)

.A33 Reliable information is sufficiently accurate and complete.

.A34 Obtaining evidence about the accuracy and completeness of information produced by the entity may be accomplished concurrently with the actual procedure applied to the information when obtaining such evidence is an integral part of the procedure itself. In other situations, the practitioner may have

obtained evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the practitioner may determine that additional procedures are needed.

Using the Work of a Practitioner's Specialist

Integrating the Work of a Practitioner's Specialist (Ref: par. .38a)

.A35 Examination engagements may be performed on a wide range of subject matters that require specialized skills and knowledge beyond those possessed by the practitioner and for which the work of a practitioner's specialist is used. In some situations, the practitioner's specialist will be consulted to provide advice on an individual matter, but the greater the significance of the work of the practitioner's specialist in the context of the engagement, the more likely it is that the specialist will work as part of a multidisciplinary team comprising subject-matter specialists and other attestation personnel. The more that specialist's work is integrated in nature, timing, and extent with the overall work effort, the more important effective two-way communication is between the practitioner's specialist and other attestation personnel. Effective two-way communication facilitates the proper integration of the specialist's work with the work of others on the engagement.

.A36 When the work of a practitioner's specialist is to be used, it may be appropriate to perform some of the procedures required by paragraph .36 at the engagement acceptance or continuance stage. This is particularly so when the work of the practitioner's specialist is to be used in the early stages of the engagement, for example, during initial planning and risk assessment.

The Practitioner's Firm's Quality Control Policies and Procedures (Ref: par. .38e)

.A37 Engagement teams are entitled to rely on their own firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. The extent of that reliance will vary with the circumstances and may affect the nature, timing, and extent of the practitioner's procedures with respect to matters, such as the following:

- Competence and capabilities, through recruitment and training programs
- The practitioner's evaluation of the objectivity of the practitioner's internal specialist (The practitioner's internal specialists are subject to relevant ethical requirements, including those pertaining to independence.)
- The practitioner's evaluation of the adequacy of the practitioner's internal specialist's work (For example, the firm's training programs may provide the practitioner's internal specialists with an appropriate understanding of the interrelationship of their expertise with the evidence-gathering process. Reliance on such training and other firm processes, such as protocols for scoping the work of the practitioner's internal specialists, may affect the nature, timing, and extent of the practitioner's procedures to evaluate the adequacy of the practitioner's specialist's work.)
- Adherence to regulatory and legal requirements through monitoring processes
- Agreement with the practitioner's specialist

Such reliance does not reduce the practitioner's responsibility to meet the requirements of this section.

The Competence, Capabilities, and Objectivity of a Practitioner's Specialist
(Ref: par. .36a)

.A38 Information regarding the competence, capabilities, and objectivity of a practitioner's specialist may come from a variety of sources, such as the following:

- Personal experience with previous work of that specialist
- Discussions with that specialist
- Discussions with other practitioners or others who are familiar with that specialist's work
- Knowledge of that specialist's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition
- Published papers or books written by that specialist
- The firm's quality control policies and procedures

.A39 Although a practitioner's specialist does not require the same proficiency as the practitioner in performing all aspects of an examination engagement, a practitioner's specialist whose work is used may need a sufficient understanding of relevant AT-C sections to enable that specialist to relate the work assigned to that specialist to the engagement objective.

.A40 The evaluation of the significance of threats to objectivity and of whether there is a need for safeguards may depend upon the role of the practitioner's specialist and the significance of the specialist's work in the context of the engagement. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level, for example, if in an examination engagement a practitioner's specialist is an individual who has played a significant role in measuring, evaluating, or disclosing the subject matter.

.A41 When evaluating the objectivity of a practitioner's external specialist, it may be relevant to

- inquire of the appropriate party(ies) about any known interests or relationships that the appropriate party(ies) has with the practitioner's external specialist that may affect that specialist's objectivity.
- discuss with that specialist any applicable safeguards, including any professional requirements that apply to that specialist, and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that may be relevant to discuss with the practitioner's specialist include
 - financial interests.
 - business and personal relationships.
 - provision of other services by the specialist, including by the organization in the case of an external specialist that is an organization.

In some cases, it may also be appropriate for the practitioner to obtain a written representation from the practitioner's external specialist about any interests or relationships with the appropriate party(ies) of which that specialist is aware.

Obtaining an Understanding of the Field of Expertise of a Practitioner's Specialist (Ref: par. .36b)

.A42 Aspects of a practitioner's specialist's field of expertise relevant to the practitioner's understanding may include the following:

- Whether that specialist's field has areas of specialty within it that are relevant to the engagement
- Whether any professional or other standards and regulatory or legal requirements apply
- What assumptions and methods, including models, when applicable, are used by the practitioner's specialist and whether they are generally accepted within that specialist's field and appropriate in the circumstances of the engagement
- The nature of internal and external data or information the practitioner's specialist uses

Agreement With a Practitioner's Specialist (Ref: par. .36c)

.A43 The matters noted in paragraph .A37 may affect the level of detail and formality of the agreement between the practitioner and the practitioner's specialist, including whether it is appropriate that the agreement be in writing. The agreement between the practitioner and a practitioner's external specialist is often in the form of an engagement letter.

Using the Work of Internal Auditors (Ref: par. .39)

.A44 Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function nor whether it is performed by the entity or a third-party service provider are sole determinants of whether or not the practitioner can use the work of internal auditors. Rather, it is the nature of the activities, the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, the competence of the internal auditors, and the systematic and disciplined approach of the function that are relevant. References in this section to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

.A45 A practitioner planning to use the work of the internal audit function to obtain evidence may find it effective and efficient to discuss the planned use of the work with the internal audit function as a basis for coordinating activities.

.A46 The practitioner has sole responsibility for the opinion expressed, and that responsibility is not reduced by the practitioner's use of the work of internal auditors on the engagement. The objectivity and competence of internal auditors are important in determining whether to use their work and, if so, the nature and extent of the use of their work. However, a high degree of objectivity cannot compensate for a low degree of competence, nor can a high degree of competence compensate for a low degree of objectivity. Additionally, neither a high level of competence nor strong support for the objectivity of the internal auditors compensates for the lack of a systematic and disciplined approach when using the work of the internal audit function.

Evaluating the Results of Procedures (Ref: par. .45–.46)

.A47 Uncorrected misstatements are accumulated during the engagement for the purpose of evaluating whether, individually or in aggregate, they are material when forming the practitioner's opinion. (See also paragraph .59b)

.A48 "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality and will be matters that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

.A49 Sufficient appropriate evidence is necessary to support the practitioner's opinion and report. It is cumulative in nature and is primarily obtained from procedures performed during the course of the engagement. It may, however, also include information obtained from other sources such as previous engagements (provided the practitioner has determined whether changes have occurred since the previous engagement that may affect its relevance to the current engagement) or a firm's quality control procedures for client acceptance and continuance. Evidence may come from sources inside and outside the appropriate party(ies). Also, information that may be used as evidence may have been prepared by a specialist employed or engaged by the appropriate party(ies). *Evidence* comprises both information that supports and corroborates aspects of the subject matter and any information that contradicts aspects of the subject matter. In addition, in some cases, the absence of information (for example, refusal by the appropriate party(ies) to provide a requested representation) is considered by the practitioner and, therefore, also constitutes evidence.

.A50 The sufficiency and appropriateness of evidence are interrelated. Sufficiency of evidence is the measure of the quantity of evidence. The quantity of the evidence needed is affected by the risks of material misstatement and also by the quality of such evidence.

.A51 *Appropriateness of evidence* is the measure of the quality of evidence, that is, its relevance and reliability in providing support for the practitioner's opinion. The reliability of evidence is influenced by its source and nature and is dependent on the individual circumstances under which it is obtained. Generalizations about the reliability of various kinds of evidence can be made; however, such generalizations are subject to important exceptions. Even when evidence is obtained from sources external to the responsible party, circumstances may exist that could affect its reliability. For example, evidence obtained from an independent external source may not be reliable if the source is not knowledgeable. Recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:

- Evidence is more reliable when it is obtained from independent sources outside the appropriate party(ies).
- Evidence that is generated internally is more reliable when the related controls are effective.
- Evidence obtained directly by the practitioner (for example, observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

- Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a contemporaneously written record of a meeting is ordinarily more reliable than a subsequent oral representation of what was discussed).
- Evidence provided by original documents is more reliable than evidence provided by photocopies, facsimiles, or documents that have been filmed, digitized, or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

.A52 Evidence obtained from different sources or of a different nature ordinarily provides more assurance than evidence from items considered individually. In addition, obtaining evidence from different sources or of a different nature may indicate that an individual item of evidence is not reliable. For example, corroborating information obtained from a source independent of the responsible party may increase the assurance the practitioner obtains from a representation from the responsible party. Conversely, when evidence obtained from one source is inconsistent with that obtained from another, the practitioner determines what additional procedures are necessary to resolve the inconsistency.

.A53 Whether sufficient appropriate evidence has been obtained on which to base the practitioner's opinion is a matter of professional judgment.

Considering Subsequent Events and Subsequently Discovered Facts (Ref: par. .48–.49)

.A54 For certain subject-matter AT-C sections, specific subsequent events requirements and related application guidance have been developed for engagement performance and reporting.

.A55 Procedures that a practitioner may perform to identify subsequent events include inquiring about and considering information

- contained in relevant reports issued during the subsequent period by internal auditors, other practitioners, or regulatory agencies.
- obtained through other professional engagements for that entity.

.A56 If the responsible party refuses to disclose a subsequent event for which disclosure is necessary to prevent users of the practitioner's report from being misled, appropriate actions the practitioner may take include

- disclosing the event in the practitioner's report and modifying the practitioner's opinion.
- withdrawing from the engagement.

.A57 Subsequent to the date of the practitioner's report, the practitioner may become aware of facts that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. In such circumstances, the practitioner undertakes to determine whether the facts existed at the date of the report and, if so, whether persons who would attach importance to these facts are currently using, or are likely to use, the report and related subject matter or assertion. This may include discussing the matter with the appropriate party(ies) and requesting the appropriate party(ies)'s cooperation in whatever investigation or further action that may be necessary. The specific actions to be taken in a particular case by the appropriate party(ies) and the practitioner may vary with the circumstances. Consideration may be given to,

among other things, the time elapsed since the date of the report and whether issuance of a subsequent report is imminent. The practitioner may need to perform additional procedures deemed necessary to determine whether the subject matter or assertion needs revision and whether the previously issued report continues to be appropriate.

.A58 Depending on the circumstances, the practitioner may determine that notification of the situation by the appropriate party(ies) to persons who would attach importance to the facts and who are currently using, or are likely to use, the practitioner's report is necessary. This may be the case, for example, when

- a. the report is not to be relied upon because the subject matter or assertion needs revision or the practitioner is unable to determine whether revision is necessary, and
- b. issuance of a subsequent report is not imminent.

If the appropriate party(ies) failed to take the necessary steps to prevent reliance on the report, the practitioner's course of action depends upon the practitioner's legal and ethical rights and obligations. Consequently, the practitioner may consider it appropriate to seek legal advice prior to making any disclosure of the situation. Disclosure of the situation directly by the practitioner may include a description of the nature of the matter and its effect on the subject matter or assertion and the report, avoiding comments concerning the conduct or motives of any person.

Written Representations (Ref: par. .50–.51, .52e, and .56a)

.A59 Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the responsible party. The person(s) from whom the practitioner requests written representations is ordinarily a member of senior management or those charged with governance depending on, for example, the management and governance structure of the responsible party(ies), which may vary by entity, reflecting influences such as size and ownership characteristics.

.A60 Representations by the responsible party cannot replace other evidence the practitioner could reasonably expect to be available. Although written representations provide evidence, they do not provide sufficient appropriate evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other evidence that the practitioner obtains.

.A61 A discussion of what is considered a material effect on the subject matter or assertion may be included explicitly in the representation letter in qualitative or quantitative terms.

.A62 A summary of uncorrected misstatements ordinarily is included in or attached to the written representation.

.A63 Certain subject-matter AT-C sections do not permit the practitioner to perform the alternative procedures described in paragraphs .51 and .56a (making inquiries of the responsible party and restricting the use of the practitioner's report).

Requested Written Representations Not Provided or Not Reliable (Ref: par. .55–.56)

.A64 In the situation discussed in paragraph .55, the refusal to furnish such evidence in the form of written representations constitutes a limitation on the scope of an examination sufficient to preclude an unmodified opinion and may be sufficient to cause the practitioner to withdraw from the engagement.

.A65 Even when the responsible party provides oral responses to the matters in paragraph .50, the practitioner may find it appropriate to consider whether there are significant concerns about the competence, integrity, ethical values, or diligence of those providing the oral responses or whether the oral responses are otherwise not reliable and the potential effect, if any, on the practitioner's report.

.A66 Paragraph .10 provides an exception to the requirement for a written assertion when the engaging party is not the responsible party. Nonetheless, because the assertion is the representation called for by paragraph .50a, application of paragraph .56a requires the practitioner to obtain an oral assertion when a written assertion is not obtained. Paragraph .56b applies when the responsible party provides neither a written nor an oral assertion.

Other Information (Ref: par. .57)

.A67 Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example, the following:

- Requesting the appropriate party(ies) to consult with a qualified third party, such as the appropriate party(ies)'s legal counsel
- Obtaining legal advice about the consequences of different courses of action
- If required or permissible, communicating with third parties (for example, a regulator)
- Describing the material inconsistency in the practitioner's report
- Withdrawing from the engagement, when withdrawal is possible under applicable laws and regulations

.A68 Other information does not include information contained on the appropriate party(ies)'s website. Websites are a means of distributing information and are not, themselves, documents for the purposes of paragraph .57.

Description of Criteria (Ref: par. .58)

.A69 The description of the criteria on which the subject matter or assertion is based is particularly important when there are significant differences among various criteria regarding how particular matters may be treated in the subject matter.

.A70 A description of the criteria that states that the subject matter is prepared in accordance with (or based on) particular criteria is appropriate only if the subject matter complies with all relevant requirements of those criteria that are effective.

Forming the Opinion (Ref: par. .59–.60)

.A71 The practitioner's professional judgment regarding what constitutes sufficient appropriate evidence is influenced by such factors as the following:

- The significance of a potential misstatement and the likelihood that it will have a material effect, individually or aggregated with other potential misstatements, on the subject matter or assertion
- The effectiveness of the responsible party's responses to address the known risks
- The experience gained during previous examination or review engagements with respect to similar potential misstatements
- The results of procedures performed, including whether such procedures identified specific misstatements
- The source and reliability of the available information
- The persuasiveness of the evidence
- The practitioner's understanding of the responsible party and its environment

.A72 An examination engagement is a cumulative and iterative process. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to change the nature, timing, or extent of other planned procedures. Information that differs significantly from the information on which the risk assessments and planned procedures were based may come to the practitioner's attention, for example

- the extent of the misstatements that the practitioner detects is greater than expected. (This may alter the practitioner's professional judgment about the reliability of particular sources of information.)
- the practitioner may become aware of discrepancies in relevant information or conflicting or missing evidence.
- procedures performed toward the end of the engagement may indicate a previously unrecognized risk of material misstatement. In such circumstances, the practitioner may need to reevaluate the planned procedures.

.A73 In making the evaluation required by paragraph .60, the practitioner may consider whether additional disclosures are necessary to describe the subject matter, assertion, or criteria. Additional disclosures may, for example, include

- the measurement or evaluation methods used when the criteria allow for choice among methods;
- significant interpretations made in applying the criteria in the engagement circumstances;
- subsequent events, depending on their nature and significance; and
- whether there have been any changes in the measurement or evaluation methods used.

.A74 Paragraph .60 does not require the practitioner to determine whether the presentation discloses all matters related to the subject matter, assertion, or criteria or all matters intended users may consider in making decisions based on the presentation.

Preparing the Practitioner's Report (Ref: par. .61–.62)

.A75 Oral and other forms of expressing an opinion can be misunderstood without the support of a written practitioner's report. For this reason, the practitioner may not report orally or by use of symbols (such as a web seal) under the attestation standards without also providing a written report that is readily available whenever the oral report is provided or the symbol is used. For example, a symbol could be hyperlinked to a written report on the Internet.

.A76 This section does not require a standardized format for reporting on all examination engagements. Instead, it identifies the basic elements that the practitioner's report is to include. The report is tailored to the specific engagement circumstances. The practitioner may use headings, separate paragraphs, paragraph numbers, typographical devices (for example, the bolding of text), and other mechanisms to enhance the clarity and readability of the report.

.A77 All of the following reporting options are available to a practitioner, except when the circumstances described in paragraph .79 exist:

<i>The practitioner's report may state that the practitioner examined</i>	<i>and</i>	<i>expresses an opinion on</i>
the subject matter		the subject matter
the responsible party's assertion		the responsible party's assertion
the responsible party's assertion		the subject matter

Content of the Practitioner's Report

Title (Ref: par. .63a)

.A78 A title indicating that the practitioner's report is the report of an independent practitioner (for example, "Independent Practitioner's Report," "Report of Independent Certified Public Accountant," or "Independent Accountant's Report") affirms that the practitioner has met all the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

Criteria (Ref: par. .63d)

.A79 The practitioner's report may include the criteria or refer to them if they are included in the subject matter presentation, in the assertion, or are otherwise readily available. It may be relevant in the circumstances to disclose the source of the criteria or the relevant matters discussed in paragraph .A73.

Relevant Responsibilities (Ref: par. .63e)

.A80 Identifying relative responsibilities informs the intended users that the responsible party is responsible for the subject matter, and the practitioner's role is to independently express an opinion about it.

.A81 The practitioner may wish to expand the discussion of the responsible party's responsibility, for example, to indicate that the responsible party is responsible for the preparation and presentation of the subject matter in accordance with (or based on) the criteria, including the design, implementation, and maintenance of internal control to prevent, or detect and correct, misstatement of the subject matter, due to fraud or error.

Statement About the Subject Matter and the Criteria (Ref: par. .63f(ii)(1))

.A82 The language in paragraph .63f(ii)(1) may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .63f(ii)(1) include, "to obtain reasonable assurance about whether

- the entity maintained effective internal control over the subject matter, based on the criteria, in all material respects."
- the subject matter is presented in accordance with (or based on) the criteria, in all material respects."
- the subject matter achieves the objectives, in all material respects." (For example, when the objectives are the criteria.)
- the subject matter is presented fairly, in all material respects, based on the criteria." (The practitioner's professional judgment concerning the fairness of the presentation of the subject matter relates to whether the measurement, recognition, presentation, and disclosure of all material items in the presentation of the subject matter achieve fair presentation.)

Description of the Nature of an Examination Engagement (Ref: par. .63g)

.A83 A description of the nature of an examination engagement may state, for example, that

- an examination involves performing procedures to obtain evidence about the subject matter and that the nature, timing, and extent of the procedures selected depend on the practitioner's judgment, including an assessment of the risks of material misstatement of the subject matter, whether due to fraud or error.
- an examination also involves examining evidence about the subject matter or assertion.
- in making an assessment of the risks of material misstatement, the practitioner considered and obtained an understanding of internal control relevant to the subject matter in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, no such opinion is expressed.

.A84 The practitioner may decide to more fully describe the practitioner's responsibility, for example, to

- perform procedures to obtain evidence based on the practitioner's assessment of the risk of material misstatement about whether the subject matter is presented in accordance with (or based on) the criteria.
- obtain an understanding of internal control over the subject matter.

.A85 A practitioner may be requested to provide in a separate section of the practitioner's report a description of the procedures performed and the results thereof in support of the practitioner's opinion. The following factors are relevant when determining whether to include such a description in the report:

- Whether such a description is likely to overshadow the practitioner's overall opinion or cause report users to misunderstand the opinion

- Whether the parties making the request have an appropriate business need or reasonable basis for requesting the information (for example, the specified parties are required to maintain and monitor controls that either encompass or are dependent on controls that are the subject of an examination and, therefore, need information about the tests of controls to enable them to have a basis for concluding that they have met the requirements applicable to them)
- Whether the parties have an understanding of the nature and subject matter of the engagement and experience in using the information in such reports
- Whether the practitioner's procedures performed directly relate to the subject matter of the engagement

The addition of procedures performed and the results thereof in a separate section of an examination report may increase the potential for the report to be misunderstood when taken out of the context of the knowledge of the requesting parties. This potential for an increase in the risk of misunderstanding may lead the practitioner to add a restricted-use paragraph to the practitioner's report.

Inherent Limitations (Ref: par. .63h)

.A86 In some cases, identification of specific inherent limitations is required by an AT-C section. For example, section 305, *Prospective Financial Information*, requires that the practitioner's report include a statement indicating that the prospective results may not be achieved.⁴ To implement that requirement, the illustrative practitioner's examination report on a forecast in section 305 states, "There will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material."⁵ When not explicitly required by an AT-C section, identification in the report of inherent limitations is based on the practitioner's judgment

Opinion (Ref: par. .63i)

.A87 The practitioner's opinion can be worded either in terms of the subject matter and the criteria (for example, "In our opinion, the schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is in accordance with [or based on] the ABC criteria set forth in Note 1, in all material respects."), or in terms of an assertion made by the responsible party (for example, "In our opinion, management's assertion that the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with [or based on] the ABC criteria set forth in Note 1 is fairly stated, in all material respects.").

.A88 The language of the practitioner's opinion in paragraph .63i(i) may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .63i(i) include the following:

- The entity maintained effective internal control over the subject matter, in all material respects, based on the criteria.
- The subject matter is presented in accordance with (or based on) the criteria, in all material respects.

⁴ Paragraph .32i of section 305, *Prospective Financial Information*.

⁵ Example 1 in paragraph .A43 of section 305.

- The subject matter achieved the objectives, in all material respects (when the objectives are the criteria).
- The subject matter is free from material misstatement based on the criteria.
- The subject matter is presented fairly, in all material respects, based on the criteria. (The practitioner's professional judgment concerning the fairness of the presentation of the subject matter relates to whether the measurement, recognition, presentation, and disclosure of all material items in the presentation of the subject matter achieve fair presentation.)

.A89 A single practitioner's report may cover more than one aspect of a subject matter or an assertion about the subject matter. When that is the case, the report may contain separate opinions or conclusions on each aspect of the subject matter or assertion (for example, examination level related to some aspects or assertions and review level related to others, or an unmodified opinion on some aspects or assertions and a modified opinion on others).

.A90 A practitioner may report on subject matter or an assertion at multiple dates or covering multiple periods during which criteria have changed (for example, a practitioner's report on comparative information). Criteria are clearly described when they identify the criteria for each period and how the criteria have changed from one period to the next. If the criteria for the current date or period have changed from the criteria for a preceding date or period, changes in the criteria may be significant to users of the report. If so, the criteria and the fact that they have changed may be disclosed in the presentation of the subject matter, in the written assertion, or in the report, even if the subject matter for the preceding date or period is not presented.

Location (Ref: par. .63k)

.A91 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date (Ref: par. .63l)

.A92 Including the date of the practitioner's report informs the intended users that the practitioner has considered the effect of the events that occurred up to that date on the subject matter and the report.

.A93 Because the practitioner expresses an opinion on the subject matter or assertion and the subject matter or assertion is the responsibility of the responsible party, the practitioner is not in a position to conclude that sufficient appropriate evidence has been obtained until evidence is obtained that all the elements that the subject matter or assertion comprises, including any related notes, when applicable, have been prepared, and the responsible party has accepted responsibility for them.

Restricted-Use Paragraph (Ref: par. .10, .50, .64, and .65b–c)

.A94 A practitioner's report for which the conditions in paragraph .64 do not apply need not include an alert that restricts its use. However, nothing in the attestation standards precludes a practitioner from including such an alert in any practitioner's report or other practitioner's written communication.

.A95 A practitioner's report that is required by paragraph .64 to include an alert that restricts the use of the report may be included in a document that also contains a practitioner's report that is for general use. In such circumstances, the use of the general use report is not affected.

.A96 A practitioner may also issue a single combined practitioner's report that includes (a) a practitioner's report that is required by paragraph .64 to include an alert that restricts its use, and (b) a report that is for general use. If these two types of reports are clearly differentiated within the combined report, such as through the use of appropriate headings, the alert that restricts the use of the report may be limited to the report required by paragraph .64 to include such an alert. In such circumstances, the use of the general use report is not affected.

.A97 The written representations required by paragraph .50 include an assertion. If the engaging party is not the responsible party and the responsible party provides an oral assertion rather than a written assertion, paragraph .64c calls for an alert that restricts the use of the practitioner's report to the engaging party.

.A98 The practitioner may identify the specified parties by naming them, referring to a list of those parties, or identifying the class of parties, for example, "all customers of XYZ Company during some or all of the period January 1, 20XX to December 31, 20XX." The method of identifying the specified parties is determined by the practitioner.

.A99 In some cases, the criteria used to measure or evaluate the subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts users of the practitioner's report to this fact and, therefore, that the report is intended solely for the information and use of the specified parties.

.A100 The alert that restricts the use of the practitioner's report is designed to avoid misunderstandings related to the use of the report, particularly if the report is taken out of the context in which the report is intended to be used. A practitioner may consider informing the responsible party and, if different, the engaging party or other specified parties that the report is not intended for distribution to parties other than those specified in the report. The practitioner may, in connection with establishing the terms of the engagement, reach an understanding with the responsible party or, if different, the engaging party, that the intended use of the report will be restricted and may obtain the responsible party's agreement that the responsible party and specified parties will not distribute such report to parties other than those identified therein. A practitioner is not responsible for controlling, and cannot control, distribution of the report after its release.

.A101 In some cases, a restricted-use practitioner's report filed with regulatory agencies is required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency, as part of its oversight responsibility for an entity, may require access to a restricted-use report in which it is not named as a specified party.

Reference to the Practitioner's Specialist (Ref: par. .67)

.A102 The practitioner has sole responsibility for the opinion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's specialist.

Modified Opinions (Ref: par. .68, .70, and .74)

.A103 The three types of modified opinions are a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon the following:

- a. The nature of the matter giving rise to the modification (that is, whether the subject matter of the engagement is in accordance with [or based on] the criteria, in all material respects or, in the case of an inability to obtain sufficient appropriate evidence, may be materially misstated)
- b. The practitioner's professional judgment about the pervasiveness of the effects or possible effects of the matter on the subject matter of the engagement

.A104 A practitioner may express an unmodified opinion only when the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that the practitioner considers necessary in the circumstances.

.A105 The term *pervasive* describes the effects on the subject matter of misstatements or the possible effects on the subject matter of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate evidence. Pervasive effects on the subject matter are those that, in the practitioner's professional judgment

- a. are not confined to specific aspects of the subject matter;
- b. if so confined, represent or could represent a substantial proportion of the subject matter; or
- c. in relation to disclosures, are fundamental to the intended users' understanding of the subject matter.

.A106 The following table illustrates how the practitioner's professional judgment about the nature of the matter giving rise to the modification and the pervasiveness of its effects or possible effects on the subject matter affects the type of practitioner's report to be issued.

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Practitioner's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Subject Matter</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Scope limitation. An inability to obtain sufficient appropriate evidence.	Qualified opinion	Disclaimer of opinion
Subject matter is materially misstated.	Qualified opinion	Adverse opinion

.A107 A scope limitation may arise from the following:

- a. Circumstances beyond the control of the appropriate party(ies). For example, documentation that the practitioner considers necessary to inspect may have been accidentally destroyed.
- b. Circumstances relating to the nature or timing of the practitioner's work. For example, a physical process that the practitioner considers necessary to observe may have occurred before the practitioner's engagement.
- c. Limitations imposed by the responsible party or the engaging party on the practitioner that, for example, may prevent the practitioner from performing a procedure that the practitioner

considers necessary in the circumstances. Limitations of this kind may have other implications for the engagement, such as for the practitioner's consideration of risks of material misstatement and engagement acceptance and continuance.

.A108 The inability to obtain written representations from the responsible party ordinarily would result in a scope limitation. However, when the engaging party is not the responsible party, paragraph .51 enables the practitioner to make inquiries of the responsible party and if the responsible party's oral responses enable the practitioner to conclude that the practitioner has sufficient appropriate evidence to form an opinion about the subject matter, paragraph .56a indicates this would not cause a scope limitation. Further, paragraph .56a requires that the practitioner's report in these circumstances contain an alert paragraph that restricts the use of the report to the engaging party.

.A109 The practitioner's decision to express a qualified opinion, disclaim an opinion, or withdraw from the engagement because of a scope limitation depends on an assessment of the effect of the omitted procedure(s) on the practitioner's ability to express an opinion. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question and by their significance to the subject matter or assertion.

.A110 An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate evidence by performing alternative procedures.

Responsible Party Refuses to Provide a Written Assertion (Ref: par. .84)

.A111 The following is an example of the disclosure required by paragraph .84:

Attestation standards established by the American Institute of Certified Public Accountants require that we request a written statement from *[identify the responsible party]* stating that *[identify the subject matter]* that we examined has been accurately measured or evaluated. We requested that *[identify the responsible party]* provide such a written statement but *[identify the responsible party]* refused to do so.

.A112 The practitioner's report discussed in paragraph .84 is appropriate only when the engagement is to report on the subject matter; it is not appropriate for a report on an assertion. When reporting on an assertion, the practitioner is required to obtain a written assertion from the responsible party.

.A113 If the responsible party's failure to provide the practitioner with written representations causes the practitioner to conclude that a scope limitation exists and, thus, qualify or disclaim an opinion, the practitioner need not restrict the use of the practitioner's report but is required by paragraph .69 to describe the matter that gave rise to the modified opinion. Paragraph .A94 notes, however, that the practitioner is not precluded from restricting the use of any report.

Communication Responsibilities (Ref: par. .85–.86)

.A114 Other matters that may be appropriate to communicate to the responsible party or, if different, the engaging party, include bias in the measurement, evaluation, or disclosure of the subject matter. (Ref: par. .85)

.A115 The practitioner's professional duty to maintain the confidentiality of client information may preclude the practitioner from reporting identified or suspected noncompliance with laws or regulations that is not relevant to the

subject matter to a party other than the responsible party and, if different, the engaging party. However, the practitioner's legal responsibilities may vary by jurisdiction, and in certain circumstances, the duty of confidentiality may be overridden by statute, the law, or courts of law. In the following circumstances, a duty to notify parties outside the entity may exist:

- In response to a court order
- In compliance with requirements for examinations of entities that receive financial assistance from a government agency

Because potential conflicts with the practitioner's ethical and legal obligations for confidentiality may be complex, the practitioner may consult with legal counsel before discussing noncompliance with parties outside the entity. (Ref: par. .86)

.A116 If the practitioner is performing an examination engagement in accordance with *Government Auditing Standards*, the practitioner may be required to report on compliance with laws, regulations, and provisions of contracts or grant agreements as part of the examination. The practitioner also may be required to communicate instances of noncompliance to appropriate oversight bodies and funding agencies. (Ref: par. .86)

Documentation (Ref: par. .87)

.A117 Documentation includes a record of the practitioner's reasoning on all significant findings or issues that require the exercise of professional judgment and related conclusions. The existence of difficult questions of principle or professional judgment calls for the documentation to include the relevant facts that were known by the practitioner at the time the conclusion was reached.

.A118 It is neither necessary nor practical to document every matter considered, or professional judgment made, during an engagement. Further, it is unnecessary for the practitioner to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included in the engagement file. Similarly, the practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A119 In applying professional judgment to assess the extent of documentation to be prepared and retained, the practitioner may consider what is necessary to provide an experienced practitioner, having no previous connection with the engagement, with an understanding of the work performed and the basis of the principal decisions made.

.A120 Documentation ordinarily includes a record of

- issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- conclusions on compliance with independence requirements that apply to the engagement and any relevant discussions with the firm that support these conclusions.
- conclusions reached regarding the acceptance and continuance of client relationships and attestation engagements.
- the nature and scope of, and conclusions resulting from, consultations undertaken during the course of the engagement.

.A121

Exhibit—Illustrative Practitioner's Examination Reports

The illustrative practitioner's examination reports in this exhibit meet the applicable reporting requirements in paragraphs .61–.84. A practitioner may use alternative language in drafting an examination report, provided that the language meets the applicable requirements in paragraphs .61–.84. The criteria for evaluating the subject matter in examples 1–3 and 5–6 have been determined by the practitioner to be suitable and available to all users of the practitioner's report; therefore, these practitioner's reports may be for general use. The criteria for evaluating the subject matter in example 4 are suitable but available only to specified parties; therefore, use of this practitioner's report is restricted to the specified parties who either participated in the establishment of the criteria or can be presumed to have an adequate understanding of the criteria. (See paragraph .65 for the information to be included in a separate paragraph of the report that contains an alert that restricts the use of the report and paragraph .66 for the content of that paragraph when the engagement is also performed in accordance with *Government Auditing Standards*.)

Example 1: Practitioner's Examination Report on Subject Matter; Unmodified Opinion

The following is an illustrative practitioner's report for an examination engagement in which the practitioner has examined the subject matter and is reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have examined [identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]. XYZ Company's management is responsible for [identify the subject matter, for example, presenting the schedule of investment returns] in accordance with (or based on) [identify the criteria, for example, the ABC criteria set forth in Note 1]. Our responsibility is to express an opinion on [identify the subject matter, for example, the schedule of investment returns] based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether [identify the subject matter, for example, the schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about [identify the subject matter, for example, the schedule of investment returns]. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of [identify the subject matter, for example, the schedule of investment returns], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter, for example, the schedule of investment returns of XYZ Company for the year ended December 31, 20XX or the schedule of investment returns referred to above]*, is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Example 2: Practitioner's Examination Report on an Assertion; Unmodified Opinion

The following is an illustrative practitioner's report for an examination engagement in which the practitioner has examined the responsible party's assertion and is reporting on that assertion.

Independent Accountant's Report

[Appropriate Addressee]

We have examined management of XYZ Company's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with [or based on] the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for its assertion. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects. An examination involves performing procedures to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, management's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with [or based on] the ABC criteria set forth in Note 1]* is fairly stated, in all material respects.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Example 3: Practitioner's Examination Report in Which the Practitioner Examines Management's Assertion and Reports Directly on the Subject Matter; Unmodified Opinion

The following is an illustrative practitioner's report for an examination engagement in which the practitioner has examined the responsible party's assertion and is reporting directly on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have examined management of XYZ Company's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with [or based on] the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for its assertion. Our responsibility is to express an opinion on *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is presented in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX or the schedule of investment returns referred to above]* is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Example 4: Practitioner's Examination Report on Subject Matter; Unmodified Opinion; Use of the Practitioner's Report Is Restricted to Specified Parties

The following is an illustrative practitioner's report for an examination engagement in which the criteria are suitable, but available only to specified parties; therefore, use of the report is restricted to the specified parties who either participated in the establishment of the criteria or can be presumed to have an adequate understanding of the criteria. The practitioner has examined the subject matter and is reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have examined [identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company... or gallons of gas sold in the United States by XYZ Company to ABC Company) during the year ended December 31, 20XX,] to determine whether it has been calculated in accordance with (or based on) [identify the criteria, for example, the agreement dated (date) between ABC Company and XYZ Company, as further described in Note 1]. XYZ Company's management is responsible for [identify the subject matter; for example, calculating the number of widgets sold]. Our responsibility is to express an opinion on [identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company... or gallons of gas sold in the United States by XYZ Company to ABC Company) during the year ended December 31, 20XX,] based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether [identify the subject matter, for example, the number of widgets sold, tons of coal mined, or gallons of gas sold] is in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about [identify the subject matter, for example, the number of widgets sold, tons of coal mined, or gallons of gas sold]. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of [identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company, or gallons of gas sold in the United States by XYZ Company to ABC Company)], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, [identify the subject matter, for example, the number of widgets sold by XYZ Company to ABC Company (or tons of coal mined by XYZ Company, or gallons of gas sold in the United States by XYZ Company to ABC Company) during the year ended December 31, 20XX,] has been calculated in accordance with (or based on) [identify the criteria, for example, the agreement dated (date) between ABC Company and XYZ Company, as further described in Note 1], in all material respects.

This report is intended solely for the information and use of [identify the specified parties, for example, ABC Company and XYZ Company], and is not intended to be and should not be used by anyone other than the specified parties.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

**Example 5: Practitioner's Examination Report on Subject Matter;
Qualified Opinion**

The following is an illustrative practitioner's report for an examination engagement in which the practitioner expresses a qualified opinion because conditions

exist that, individually or in combination, result in one or more material, but not pervasive, misstatements of the subject matter based on (or in certain engagements, deviations from, exceptions to, or instances of noncompliance with) the criteria. The practitioner has examined the subject matter and is reporting on the subject matter. Paragraph .79 states, "If the practitioner has concluded that conditions exist that, individually or in combination, result in one or more material misstatements based on the criteria, the practitioner should modify the opinion and should express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement."

Independent Accountant's Report

[Appropriate Addressee]

We have examined *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]* in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. Our responsibility is to express an opinion on *[identify the subject matter, for example, the schedule of investment returns]* based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is presented in accordance with (or based on) the criteria, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the schedule of investment returns]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter, for example, the schedule of investment returns]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our modified opinion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Our examination disclosed *[describe condition(s) that, individually or in the aggregate, resulted in a material misstatement or deviation from the criteria]*.

In our opinion, except for the material misstatement *[or deviation from the criteria]* described in the preceding paragraph, *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, or the schedule of investment returns referred to above]*, is presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Example 6: Practitioner's Examination Report; Practitioner Engaged to Report on Subject Matter; Disclaimer of Opinion Because of Scope Limitation

The following is an illustrative practitioner's report for an examination engagement in which the practitioner was engaged to report on the subject matter but is disclaiming an opinion because of a scope limitation. (See paragraphs .68–.84 and the related application guidance for reporting guidance when a scope limitation exists.)

Independent Accountant's Report

[Appropriate Addressee]

We were engaged to examine *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]*. Our responsibility is to express an opinion on *[identify the subject matter; for example, the schedule of investment returns]* based on conducting the examination in accordance with attestation standards established by the American Institute of Certified Public Accountants.

[The first sentence of the practitioner's report has been revised to state, "We were engaged to examine" rather than "We have examined." The standards under which the practitioner conducts an examination have been identified at the end of the second sentence of the report, rather than in a separate sentence in the second paragraph of the report.]

[The report should omit statements

- *indicating what those standards require of the practitioner.*
- *indicating that the practitioner believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.*
- *describing the nature of an examination engagement.]*

[Include a paragraph to describe scope limitations.]

Because of the limitation on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, or the schedule of investment returns referred to above]* is in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

AT-C Section 9205A

Examination Engagements: Attestation Interpretations of Section 205A

1. Reporting on Attestation Engagements Performed in Accordance With *Government Auditing Standards*¹

.01 Question — Chapter 5, "Standards for Attestation Engagements," of the 2011 revision of *Government Auditing Standards* (referred to herein as the Yellow Book) sets forth additional fieldwork and reporting standards for attestation engagements performed pursuant to generally accepted government auditing standards (GAGAS). Practitioners performing attestation engagements under GAGAS are also required to follow the general standards set forth in chapter 3, "General Standards," of the Yellow Book, as well as the guidance and requirements in chapter 1, "Government Auditing: Foundation and Ethical Principles," and chapter 2, "Standards for Use and Application of GAGAS." For examination attestation engagements performed pursuant to GAGAS, paragraph 5.18 of the Yellow Book prescribes additional reporting standards² that go beyond the standards of reporting set forth in section 205A, *Examination Engagements*, and section 210A, *Review Engagements*.³ When a practitioner performs an attestation examination in accordance with GAGAS, how should the report be modified?

.02 Interpretation — The practitioner should modify the scope paragraph of the attestation report to indicate that the examination or review was "conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States."

.03 Additionally, GAGAS requires the practitioner's attestation report to disclose any matters (often referred to as *findings*) that are set forth in paragraphs 5.20–.26 of the Yellow Book. Paragraphs 5.27–.28 of the Yellow Book set forth the presentation requirements that the practitioner should use, to the extent possible, in reporting a finding. The following illustration is a standard examination report modified to make reference to a schedule of findings when any of the matters set forth in paragraphs 5.20–.26 have been identified. This

¹ Although separate interpretations for other AT-C sections have not been issued to address attestation engagements performed in accordance with *Government Auditing Standards*, a practitioner may use this guidance to help the practitioner appropriately modify an attestation report pursuant to other AT-C sections.

² Paragraph 5.18 of the Yellow Book sets forth the additional reporting requirements: (a) reporting auditors' compliance with generally accepted government auditing standards, (b) reporting deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse, (c) reporting views of responsible officials, (d) reporting confidential or sensitive information, and (e) distributing reports. [Footnote revised, January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

³ Paragraphs .61–.84 of section 205A, *Examination Engagements*, and paragraphs .44–.60 of section 210A, *Review Engagements*.

report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. A written assertion has been obtained from the responsible party. Although the following illustrative report modifications would comply with the Yellow Book requirement, this illustration is not intended to preclude a practitioner from complying with these additional Yellow Book reporting requirements in other ways. In this illustrative report, the practitioner is reporting on the subject matter.

Independent Accountant's Report

We have examined *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*.⁴ XYZ Agency's management is responsible for presenting the *[identify the subject matter, for example, the schedule of performance measures]* in accordance with *[identify the criteria]*. Our responsibility is to express an opinion on *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*, based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]* is in accordance with *[identify the criteria]*, in all material respects. An examination involves performing procedures to obtain evidence about *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the *[identify the subject matter, for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December 31, 20XX]*, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

In our opinion, the schedule referred to above presents *[identify the subject matter, for example, the performance measures of XYZ Agency for the year ended December 31, 20XX]*, in accordance with *[identify criteria, for example, the criteria set forth in Note 1]*, in all material respects.

[When any of the matters set forth in paragraphs 5.20–26 of the Yellow Book have been identified, the following paragraph would be added.]

In accordance with *Government Auditing Standards*, we are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses in internal control; fraud and noncompliance with provisions

⁴ If the practitioner is reporting on an assertion about the subject matter, the practitioner would identify the assertion, rather than the subject matter, for example, "management's assertion that the accompanying schedule presents the performance measures of XYZ Agency for the year ended December 31, 20XX, in conformity with the criteria in Note 1." [Footnote added, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

of laws or regulations that have a material effect on [*identify the subject matter, for example, XYZ Agency's schedule of performance measures*]; and any other instances that warrant the attention of those charged with governance; noncompliance with provisions of contracts or grant agreements, and abuse that has a material effect on the subject matter.⁵ We are also required to obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as any planned corrective actions. We performed our examination to express an opinion on whether [*identify the subject matter, for example, XYZ Agency's schedule of performance measures*] is presented in accordance with the criteria described above and not for the purpose of expressing an opinion on the internal control over [*identify the subject matter, for example, reporting of performance measures*] or on compliance and other matters; accordingly, we express no such opinions. Our examination disclosed certain findings that are required to be reported under *Government Auditing Standards* and those findings, along with the views of responsible officials, are described in the attached Schedule of Findings.⁶

[*Practitioner's signature*]

[*Practitioner's city and state*]

[*Date of practitioner's report*]

Illustrative Schedule of Findings

XYZ Agency Schedule of Findings⁷ Year Ended December 31, 20XX

Finding No. 1

Criteria

Condition

Cause

Effect or Potential Effect

Management's Response

⁵ Note that paragraph 5.25 of the Yellow Book states that when auditors detect instances of noncompliance with provisions of contracts or grant agreements or abuse that have an effect on the subject matter or an assertion about the subject matter that is less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to entity officials. When auditors detect any instances of fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment. [Footnote added, January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

⁶ [Footnote renumbered and deleted to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

⁷ Refer to paragraphs 5.11–.15 of the Yellow Book regarding the content of the schedule of findings. [Footnote renumbered and revised: January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

Finding No. 2CriteriaConditionCauseEffect or Potential EffectManagement's Response

[Issue Date: December 2004; Revised: January 2008; Revised: December 2012; Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

2. Reporting on the Design of Internal Control

.04 Question — A practitioner may be asked to report on the suitability⁸ of the design of an entity's internal control over financial reporting (internal control) for preventing, or detecting and correcting, material misstatements of the entity's financial statements on a timely basis. Such requests may be made by, for example,

- an entity applying for a government grant or contract that is required to submit a written pre-award survey by management about the suitability of the design of the entity's internal control or a portion of the entity's internal control, together with a practitioner's report thereon.
- a new casino applying for a license to operate that is required by a regulatory agency to submit a practitioner's report on whether the entity's internal control *that it plans to implement* is suitably designed to provide reasonable assurance that the control objectives specified in the regulatory agency's regulations would be achieved. (In this situation, the casino would not yet have begun operations, and audited financial statements or financial data relevant to the period covered by the engagement may not exist.)

May a practitioner report on the suitability of the design of an entity's internal control based on the risk assessment procedures the auditor performs to obtain a sufficient understanding of the entity and its environment, including its internal control, in an audit of the entity's financial statements?

.05 Interpretation — No. In a financial statement audit, the purpose of the auditor's understanding of the entity and its environment, including its internal control, is to enable the auditor to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The understanding obtained in a financial statement audit does not provide the practitioner with a sufficient basis to report on the suitability of the design of an entity's internal control or any portion thereof.

.06 Question — How may a practitioner report on the suitability of the design of an entity's internal control or a portion thereof?

⁸ In this interpretation, the *suitability of the design of internal control* means the same thing as the *design effectiveness of an entity's internal control*. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

.07 Interpretation — The practitioner may perform an examination of the suitability of the design of an entity's internal control under section 205A or apply agreed-upon procedures to that subject matter under section 215. AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, does not directly apply when a practitioner is engaged to examine the suitability of design of an entity's internal control. However, it may be useful in planning and performing such engagements. Paragraphs .33 and .A61–.A62 of AU-C section 940 discuss how the auditor evaluates the design effectiveness of controls.

.08 When the engagement involves the application of agreed-upon procedures related to the suitability of the design of an entity's internal control over compliance with specified requirements, the practitioner should follow the provisions of section 315, *Compliance Attestation*.⁹

.09 The following is an illustrative report a practitioner may issue when reporting on the suitability of the design of an entity's internal control that has been implemented. The report may be modified, as appropriate, to fit the particular circumstances.

Independent Accountant's Report

[Introductory paragraph]

We have examined the suitability of the design of W Company's internal control over financial reporting to prevent, or detect and correct, material misstatements in its financial statements on a timely basis as of December 31, 20XX.¹⁰ W Company's management is responsible for the suitability of the design of W Company's internal control over financial reporting, based on *[identify the criteria]*. Our responsibility is to express an opinion on the suitability of the design of W Company's internal control over financial reporting based on our examination.

[Scope paragraph]

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether W Company's internal control over financial reporting was suitably designed based on *[identify the criteria]*, in all material respects. An examination involves performing procedures to obtain evidence about the suitability of the design of W Company's internal control over financial reporting. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of a material weakness in the suitability of the design of W Company's internal control over financial reporting. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion. We were not engaged to examine and report on the operating effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, and, accordingly, we express no opinion on operating effectiveness.

[Inherent limitations paragraph]

Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements. Also, projections of any

⁹ Paragraphs .01–.05, .07–.08, and .23–.26 of section 315, *Compliance Attestation*.

¹⁰ This report assumes that the control criteria are both suitable and available to users as discussed in paragraph .25b(ii) of section 105A, *Concepts Common to All Attestation Engagements*. Therefore, the use of this report is not restricted. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

evaluation of the suitability of the design or effectiveness of W Company's internal control over financial reporting to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

[Opinion paragraph]

In our opinion, W Company's internal control over financial reporting was suitably designed to prevent, or detect and correct, material misstatements in the financial statements on a timely basis as of December 31, 20XX, based on *[identify criteria]*.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

.10 When reporting on the suitability of the design of an entity's internal control that has not yet been implemented, the practitioner would be unable to confirm that the controls have been implemented and should disclose that information in the practitioner's report. In those circumstances, the practitioner should modify (1) the scope paragraph of the illustrative report in paragraph .09 to inform readers that the controls identified in the report have not yet been implemented and (2) the inherent limitations paragraph to reflect the related risk. Following are modified illustrative report paragraphs for use when controls have not yet been implemented.

(New language is shown in boldface italics. Deleted language is shown in strikethrough.)

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether W Company's internal control over financial reporting was suitably designed based on *[identify the criteria]*, in all material respects. An examination involves performing procedures to obtain evidence about the suitability of the design of W Company's internal control over financial reporting. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of a material weakness in the suitability of the design of W Company's internal control over financial reporting. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion. ***Because operations had not begun as of December 31, 20XX, we could not confirm that the specified controls were implemented. Accordingly, our report solely addresses the suitability of the design of the Company's internal control and does not address whether the controls were implemented. Furthermore, because the specified controls have not yet been implemented, we were unable to test, and did not test,*** the operating effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, and, accordingly, we express no opinion on operating effectiveness.

[Inherent limitations paragraph]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any evaluation of the suitability of the design or effectiveness of W Company's internal control over financial reporting to future periods are subject to the risk that controls ***may not be implemented as intended when operations begin*** or may become inadequate because of changes in conditions, ~~or that the degree of compliance with the policies or procedures may deteriorate.~~

.11 Question — A practitioner may be asked to sign a prescribed form developed by the party to whom the form is to be submitted regarding the design

of an entity's internal control. What are the practitioner's responsibilities when requested to sign such a form if it includes language that is not consistent with the practitioner's function or responsibility or with the reporting requirements of professional standards?

.12 Interpretation — In the circumstances described in paragraph .11 of this interpretation, section 105A, *Concepts Common to All Attestation Engagements*, requires the practitioner to reword the prescribed form of report or attach an appropriately worded separate report.¹¹ Section 105A indicates that some report forms can be made acceptable by inserting additional wording to include the report elements required by the applicable section.¹² However, some report forms required by law or regulation can be made acceptable only by complete revision because the prescribed language of the practitioner's report calls for statements by the practitioner that are not consistent with the practitioner's function or responsibility, for example, a report form that requests the practitioner to "certify" the subject matter. When reporting on the suitability of the design of an entity's internal control under section 205A, the practitioner's report should contain all of the report elements required by section 205A, which can be accomplished by either rewording the prescribed form of report or attaching an appropriately worded separate report in place of the prescribed form.¹³

.13 Question — An entity may be required to submit a practitioner's report about an entity's *ability* to establish suitably designed internal control (or its assertion thereon). May a practitioner issue such a report based on (a) the risk assessment procedures related to existing internal control that the auditor performs in an audit of an entity's financial statements or (b) the performance of an attestation engagement?

.14 Interpretation — No. Neither the risk assessment procedures the auditor performs in an audit of an entity's financial statements nor the performance of an attestation engagement provide the practitioner with a basis for issuing a report on the *ability* of an entity to establish suitably designed internal control. There are no suitable criteria for evaluating an entity's ability to establish suitably designed internal control. The requesting party may be willing to accept a report of the practitioner on a consulting service. The practitioner may include in the consulting service report

- a. a statement that the practitioner is unable to perform an attestation engagement that addresses the entity's ability to establish suitably designed internal control because there are no suitable criteria for evaluating the entity's ability to do so;
- b. a description of the nature and scope of the practitioner's services; and
- c. the practitioner's findings.

The practitioner may refer to the guidance in CS section 100, *Consulting Services: Definitions and Standards*.

[Issue Date: December 2008; Revised: December 2012; Revised: April 2016, effective for practitioners' reports dated on or after May 1, 2017.]

¹¹ Paragraph .18 of section 105A.

¹² Paragraph .A28 of section 105A.

¹³ Paragraph .63–.66 of section 205A.

AT-C Section 206

Direct Examination Engagements

Source: SSAE No. 21.

Effective for practitioners' direct examination reports dated on or after June 15, 2022.

Introduction

.01 This section contains performance and reporting requirements and application guidance for direct examination engagements.

.02 In addition to complying with this section, a practitioner performing a direct examination engagement is required to comply with section 105, *Concepts Common to All Attestation Engagements*.^{*} This section addresses direct examination engagements in which the practitioner obtains reasonable assurance by measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of that measurement or evaluation. In a direct examination engagement, the responsible party does not provide an assertion. (Ref: par. .A1–.A2)

Effective Date

.03 This section is effective for practitioners' direct examination reports dated on or after June 15, 2022.

Objectives

.04 In conducting a direct examination engagement, the objectives of the practitioner are to

- a. obtain reasonable assurance by measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence,
- b. express an opinion in a written report that conveys the results of the practitioner's measurement or evaluation, and
- c. communicate as required by this AT-C section, in accordance with the results of the practitioner's procedures.

Requirements

Requirements in AT-C Section 205 to Be Adapted to a Direct Examination Engagement and Requirements in This Section That Differ From and Replace Related Requirements in AT-C Section 205 or Are in Addition to Requirements in AT-C Section 205

.05 In performing a direct examination engagement, the practitioner is not required to request a written assertion from the responsible party.¹ However,

^{*} All AT-C sections can be found in AICPA *Professional Standards*.

¹ Paragraph .10 of section 205, *Assertion-Based Examination Engagements*.

the practitioner is required to apply the other requirements in section 205 to a direct examination engagement unless

- a. the requirement cannot be applied as written because of the nature of a direct examination engagement, in which case, the practitioner should adapt and apply the requirement (Ref: par. .A3–.A7)
- b. specified requirements in this section differ from and replace the related requirements in section 205. (These requirements are tailored to a direct examination engagement and identified in paragraph .06 of this section.) (Ref: par. .A8)

Requirements in This Section That Differ From and Replace Related Requirements in AT-C Section 205 or Are in Addition to Requirements in AT-C Section 205

.06 When the practitioner performs examination procedures that address the following aspects of a direct examination engagement, the practitioner should apply the requirements in the paragraphs identified in items *a–d*, which differ from and replace the related requirements in section 205 or are in addition to the requirements in section 205. (Ref: par. .A9)

- a. Matters relevant to accepting or continuing a direct examination engagement (paragraphs .07–.08)
- b. Terms of the engagement (paragraph .09)
- c. The written representations that a practitioner is required to request of the responsible party and of the engaging party when the engaging party is not the responsible party (paragraphs .10–.11)
- d. The required elements of the practitioner's direct examination report (paragraph .12)

Acceptance and Continuance

Determining Whether to Perform a Direct Examination Engagement

.07 Before accepting or continuing a direct examination engagement, the practitioner should obtain an understanding of the following matters through inquiries of the appropriate party: (Ref: par. .A10–.A14)

- a. The intended purpose of the engagement, how the practitioner's report will be used, and why the engaging party wishes to engage the practitioner to perform a direct examination engagement
- b. If the responsible party has not measured or evaluated the underlying subject matter against the criteria, why the responsible party has not done so
- c. If the responsible party has measured or evaluated the underlying subject matter against the criteria, why the responsible party does not intend to provide an assertion

.08 Based on the information obtained from the following, the practitioner should evaluate whether to perform a direct examination engagement:

- a. The inquiries in paragraph .07
- b. Previous engagements performed for the engaging party, if any
- c. Preliminary discussions with the engaging party, including discussion when agreeing upon the terms of the engagement

Terms of the Engagement

.09 Paragraph .07 of section 205 requires the practitioner to agree upon the terms of the engagement with the engaging party and that the agreement be in sufficient detail in an engagement letter or other suitable form of written agreement. In a direct examination engagement, the agreed-upon terms of the engagement should include the following: (Ref: par. .A15)

- a. The objective and scope of the engagement
- b. The responsibilities of the practitioner
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the AICPA
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different, including the following: (Ref: par. .A16)
 - i. The responsible party is responsible for the underlying subject matter
 - ii. The responsible party or engaging party, as applicable, is responsible for the following:
 - (1) Selecting the criteria for the measurement, evaluation, or disclosure of the underlying subject matter (Ref: par. .A17)
 - (2) Determining that such criteria are suitable, will be available to the intended users, and are appropriate for the purpose of the engagement
- e. A statement about the inherent limitations of an examination engagement (Ref: par. .A18)
- f. Identification of the criteria for the measurement, evaluation, or disclosure of the underlying subject matter
- g. An acknowledgment that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

Written Representations

.10 The practitioner should request from the responsible party written representations in the form of a letter addressed to the practitioner. The representations should (Ref: par. .A19–.A20)

- a. state that all known matters contradicting the measurement or evaluation of the underlying subject matter or the subject matter information, and any communication from regulatory agencies or others affecting the underlying subject matter or subject matter information have been disclosed to the practitioner, including communications received between the end of the period addressed by the practitioner's report and the date of the practitioner's report.
- b. acknowledge responsibility for
 - i. the underlying subject matter;
 - ii. selecting the criteria, when applicable; (Ref: par. .A17) and
 - iii. determining that such criteria are suitable, will be available to the intended users, and are appropriate for the purpose of the engagement.

- c. state that the responsible party has disclosed to the practitioner
 - i. all deficiencies in internal control relevant to the underlying subject matter of which the responsible party is aware;
 - ii. its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the underlying subject matter or subject matter information; and
 - iii. other matters as the practitioner deems appropriate
- d. state that any known events occurring subsequent to the period (or point in time) of the underlying subject matter or subject matter information being reported on that would have a material effect on the underlying subject matter or subject matter information have been disclosed to the practitioner. (Ref: par. .A21)
- e. state that it has provided the practitioner with all relevant information and access as agreed upon in the terms of the engagement.

.11 When the engaging party is not the responsible party, the practitioner should request written representations from the engaging party in addition to those requested from the responsible party, in the form of a letter addressed to the practitioner. The representations should

- a. acknowledge that the responsible party is responsible for the underlying subject matter.
- b. acknowledge the engaging party's responsibility for selecting the criteria, when applicable.
- c. acknowledge the engaging party's responsibility for determining that such criteria are suitable, will be available to the intended users, and are appropriate for the purpose of the engagement.
- d. state that the engaging party is not aware of any material misstatements in the underlying subject matter or subject matter information.
- e. state that the engaging party has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter information being reported on that would have a material effect on the subject matter information.
- f. address other matters as the practitioner deems appropriate.

Content of the Practitioner's Report

.12 The practitioner's report should include the following, unless the practitioner is disclaiming an opinion, in which case, items .12f–g should be omitted:

- a. A title that includes the word *independent*. (Ref: par. .A22)
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification or description of the subject matter information being reported on, including the point in time or period of time to which the measurement or evaluation of the underlying subject matter against the criteria relates.

- d.* An identification of the criteria against which the underlying subject matter was measured or evaluated. (Ref: par. .A23)
- e.* An identification of (Ref: par. .A24)
 - i.* the responsible party and its responsibility for the underlying subject matter.
 - ii.* the practitioner's responsibility for
 - (1) measuring or evaluating the underlying subject matter against the criteria and performing other procedures,
 - (2) expressing an opinion that conveys the results of the practitioner's measurement or evaluation of the underlying subject matter against the criteria, based on the practitioner's examination, and
 - (3) presenting any subject matter information as part of the practitioner's measurement or evaluation, when applicable.
- f.* A statement that
 - i.* the practitioner's examination was conducted in accordance with attestation standards established by the AICPA.
 - ii.* those standards require that the practitioner obtain reasonable assurance by measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the result of that measurement or evaluation.
 - iii.* the practitioner believes the evidence the practitioner obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.
- g.* A description of the nature of a direct examination engagement. (Ref: par. .A25–.A26)
- h.* A statement that the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement. (Ref: par. .A27–.A28)
- i.* A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the underlying subject matter against the criteria. (Ref: par. .A29)
- j.* The practitioner's opinion conveying the results of the practitioner's measurement or evaluation of the underlying subject matter against the criteria (Ref: par. .A30–.A32)
- k.* The manual or printed signature of the practitioner's firm.
- l.* The city and state where the practitioner's report is issued. (Ref: par. .A33)
- m.* The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate evidence on which to base the practitioner's opinion, including evidence that

- i. the attestation documentation has been reviewed, and
- ii. if applicable, the written presentation of the subject matter information has been prepared. [Ref par. .A34–.A35])

Application and Other Explanatory Material

Introduction (Ref: par. .01–.02)

.A1 The practitioner's objective in a direct examination engagement is to obtain reasonable assurance, just as it is in an assertion-based examination engagement.

.A2 This section is not applicable to examination engagements related to subject matter for which other AT-C sections require the application of section 205, *Assertion-Based Examination Engagements*. Those sections are as follows: (Ref: par. .02)

- a. AT-C section 305, *Prospective Financial Information*
- b. AT-C section 310, *Reporting on Pro Forma Financial Information*
- c. AT-C section 315, *Compliance Attestation*
- d. AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*
- e. AT-C section 395, *Management's Discussion and Analysis*

Requirements in AT-C Section 205 to Be Adapted to a Direct Examination Engagement and Requirements in This Section That Differ From and Replace Related Requirements in AT-C Section 205 or Are in Addition to Requirements in AT-C Section 205 (Ref: par. .05 and .06)

.A3 In a direct examination engagement, obtaining reasonable assurance is the benchmark the practitioner uses for determining how and the extent to which section 205 may need to be adapted.

.A4 The nature of a direct examination engagement is one in which the responsible party does not provide an assertion, and the extent to which the responsible party has measured or evaluated the underlying subject matter against the criteria may vary.

.A5 An example of a requirement in section 205 that the practitioner may be unable to apply, as written, is the requirement in paragraph .30a of section 205 to evaluate whether the responsible party has appropriately applied the requirements of the criteria to any estimated amounts. In a direct examination engagement, the responsible party may not have fully applied the criteria to the underlying subject matter to develop the estimate. Therefore, the practitioner would be unable to evaluate the responsible party's method for making the estimate. However, the practitioner might adapt the requirement by determining the method used by other entities in the same industry to make the estimate and then using that method in developing the estimate.

.A6 Although the practitioner could not evaluate the appropriateness of the responsible party's method for making the estimate, as required by section 205, the practitioner, as part of developing the estimate, would be able to perform other procedures that are relevant to making the estimate, such as obtaining an understanding of

- how the responsible party's information system captures and records data and other information that provides a basis for the estimate (that is, underlying subject matter).
- the relevant controls over that data and other information.
- the factors both internal and external to the entity that affect the estimate.

Obtaining an understanding of these matters also assists the practitioner in determining the appropriate method to use for making the estimate, assessing the accuracy and completeness of the data, and considering other relevant information to be used in developing the estimate.

.A7 Paragraph .13 of section 205 requires the practitioner to develop a plan that includes a description of the

- nature, timing, and extent of planned risk assessment procedures and further procedures.
- other planned procedures that are required to be carried out so that the engagement complies with the attestation standards.

Applying paragraph .13 to a direct examination engagement may increase the extent or change the nature of the work the practitioner needs to perform because in a direct examination engagement the practitioner measures or evaluates the underlying subject matter against the criteria and performs other procedures to obtain reasonable assurance. In an assertion-based examination engagement, the practitioner tests subject matter information prepared by the responsible party. Also, in a direct examination engagement, risk assessment procedures may primarily address

- the accuracy and completeness of the underlying subject matter,
- the practitioner's competence and experience with the underlying subject matter and criteria, and
- the complexity of the measurement or evaluation of the underlying subject matter against the criteria.

.A8 To provide context for the requirements identified in this section or to present a complete list of requirements for a particular aspect of a direct examination engagement, some paragraphs in this section repeat requirements that are the same as those for an assertion-based examination engagement. (Ref: par. .05b)

Requirements in This Section That Differ From and Replace Related Requirements in AT-C Section 205 or Are in Addition to Requirements in AT-C Section 205 (Ref: par. .06)

.A9 The following table identifies paragraphs in this section that contain requirements that differ from and replace related requirements in section 205 or are in addition to the requirements in section 205:

<i>Aspect of a Direct Examination</i>	<i>Paragraphs in AT-C Section 206 That Contain Requirements That Differ From and Replace Related Requirements in AT-C Section 205 or Are in Addition to Requirements in AT-C Section 205</i>	<i>Paragraphs in AT-C Section 205 That Are Replaced by Paragraphs in AT-C Section 206</i>
Acceptance or Continuance	.07–.08	
Terms of the Engagement	.09	.08
Written Representations	.10–.11	.51 and .53
Required Elements of the Report	.12	.63

Acceptance and Continuance (Ref: par. .07–.08)

Determining Whether to Perform a Direct Examination Engagement

.A10 In some cases, the responsible party may be unable to provide a written assertion because the entity does not have the personnel or systems needed to establish a reasonable basis for such an assertion. In other cases, the responsible party may simply wish to engage the practitioner to measure or evaluate the underlying subject matter against the criteria, or an engaging party other than the responsible party may engage the practitioner to do so.

.A11 In determining whether to accept or continue a direct examination engagement, the practitioner may inquire whether the responsible party is required by law, regulation, or contract to measure or evaluate the underlying subject matter against the criteria or provide a written assertion regarding the outcome of that measurement or evaluation.

.A12 If the responsible party states that it has measured or evaluated the underlying subject matter against the criteria, the practitioner may request the results of that measurement or evaluation.

.A13 The responsible party may not intend to provide an assertion because, for example, the responsible party performed only a partial measurement or evaluation of the underlying subject matter but not to an extent that would provide a reasonable basis for an assertion.

.A14 A practitioner may be requested to change an assertion-based examination engagement, in accordance with section 205, to a direct examination engagement. A change from an assertion-based examination engagement to a direct examination engagement would not be considered a change to a lower level of service as described in paragraph .32 of section 105 because both services entail obtaining reasonable assurance and result in an examination report.

Terms of the Engagement (Ref: par. .09)

.A15 A practitioner may further describe the terms of the engagement by adding the following items to the engagement letter or other suitable form of written agreement:

- a. A statement that a direct examination is designed to obtain reasonable assurance about whether the subject matter information is free from material misstatement
- b. A statement that the objective of a direct examination is
 - i. to obtain reasonable assurance by measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence
 - ii. to express an opinion in a written practitioner's report that conveys the results of the practitioner's measurement or evaluation of the underlying subject matter against the criteria

.A16 Situations may exist in which the responsible party is not the engaging party and, as such, the responsibilities of each party may differ. For example, when the responsible party is not the engaging party, the engaging party, rather than the responsible party, may be responsible for selecting the criteria.

.A17 The engaging party may request that the practitioner recommend, develop, or assist in developing the criteria for the engagement. Regardless of whether the practitioner recommends, develops, or assists in developing the criteria for the engagement, the engaging party is required to determine that the criteria are suitable, will be available to the intended users, and are appropriate for the purpose of the engagement.

.A18 If relevant, a statement about the inherent limitations of an examination engagement may indicate that "because of the inherent limitations of an examination engagement, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the examination is properly planned and performed in accordance with the attestation standards."

Written Representations (Ref: par. .10)

.A19 Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the responsible party. The person from whom the practitioner requests written representations is ordinarily a member of senior management or those charged with governance depending on, for example, the management and governance structure of the responsible party, which may vary by entity, reflecting influences such as size and ownership characteristics.

.A20 Representations by the responsible party cannot replace other evidence the practitioner could reasonably expect to be available. Although written representations provide evidence, they do not provide sufficient appropriate evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other evidence that the practitioner obtains.

.A21 A discussion of what is considered a material effect on the underlying subject matter or subject matter information may be included explicitly in the representation letter in qualitative or quantitative terms.

Content of the Practitioner's Report

Title (Ref: par. .12a)

.A22 A title indicating that the practitioner's report is the report of an independent practitioner (for example, "Independent Practitioner's Report," "Report of Independent Certified Public Accountant," or "Independent Accountant's Report") affirms that the practitioner has met all the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

Criteria (Ref: par. .12d)

.A23 The practitioner's report may include the criteria or refer to them if they are included in the subject matter information or are otherwise readily available. It may be relevant in the circumstances to disclose the source of the criteria or the relevant matters discussed in paragraph .A86 of section 205.

Relevant Responsibilities (Ref: par. .12e)

.A24 Identifying relative responsibilities informs the intended users that the responsible party is responsible for the underlying subject matter, and the practitioner's role is to obtain reasonable assurance by measuring or evaluating the underlying subject matter against the criteria, and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of that measurement or evaluation.

Description of the Nature of a Direct Examination Engagement (Ref: par. .12g)

.A25 A description of the nature of a direct examination engagement may state, for example, that

- a direct examination involves measuring or evaluating the underlying subject matter against the criteria and performing other procedures to obtain sufficient appropriate evidence.
- in making an assessment of the risks of material misstatement, the practitioner considered and obtained an understanding of internal control relevant to the underlying subject matter in order to design procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, no such opinion is expressed.
- the nature, timing, and extent of the procedures selected depend on the practitioner's judgment, including an assessment of the risks of material misstatement of the subject matter information, whether due to fraud or error.

.A26 A practitioner may be requested to provide in a separate section of the practitioner's report a description of the procedures performed and the results thereof in support of the practitioner's opinion. The following factors are relevant when determining whether to include such a description in the report:

- Whether such a description is likely to overshadow the practitioner's overall opinion or cause report users to misunderstand the opinion
- Whether the parties making the request have an appropriate business need or reasonable basis for requesting the information (for example, the specified parties are required to maintain and

monitor controls that either encompass or are dependent on controls that are the subject of a direct examination and, therefore, need information about the tests of controls to enable them to have a basis for concluding that they have met the requirements applicable to them)

- Whether the parties have an understanding of the nature and underlying subject matter of the engagement and experience in using the information in such reports

Relevant Ethical Requirements (Ref: par. .12h)

.A27 Relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. When the AICPA Code of Professional Conduct applies, the practitioner's other ethical responsibilities relate to the "Principles of Professional Conduct" (ET sec. 0.300).²

.A28 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the practitioner may choose to name the relevant sources (for example, the name of the code, rule, or applicable regulation, or *Government Auditing Standards* promulgated by the Comptroller General of the United States, or may refer to a term that appropriately describes those sources.

Inherent Limitations (Ref: par. .12i)

.A29 When not explicitly required by an AT-C section, identification in the report of inherent limitations is based on the practitioner's judgment.

Opinion (Ref: par. .12j)

.A30 The following are examples of language the practitioner may use in the opinion to convey the results of the practitioner's measurement or evaluation of the underlying subject matter against the criteria, as required by paragraph .12j:

- The underlying subject matter is presented in accordance with (or based on) the criteria, in all material respects.
- The subject matter information is free from material misstatement based on the criteria.
- The subject matter information is presented fairly, in all material respects, based on the criteria. (The practitioner's professional judgment concerning the fairness of the presentation of the subject matter information relates to whether the measurement, recognition, presentation, and disclosure of all material items in the presentation of the subject matter achieve fair presentation.)

.A31 A single practitioner's report may cover more than one aspect of subject matter information. When that is the case, the report may contain separate opinions or conclusions on each aspect of the subject matter information.

.A32 A practitioner may report on subject matter information at multiple dates or covering multiple periods during which criteria have changed (for example, a practitioner's report on comparative information). Criteria are clearly

² All ET sections can be found in AICPA *Professional Standards*.

described when they identify the criteria for each period and how the criteria have changed from one period to the next. If the criteria for the current date or period have changed from the criteria for a preceding date or period, changes in the criteria may be significant to users of the report. If so, the criteria and the fact that they have changed may be disclosed in the presentation of the subject matter information, or in the report, even if the subject matter for the preceding date or period is not presented.

Location (Ref: par. .12l)

.A33 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date (Ref: par. .12m)

.A34 Including the date of the practitioner's report informs the intended users that the practitioner has considered the effect of the events that occurred up to that date on the subject matter information and the report.

.A35 The practitioner is not in a position to conclude that sufficient appropriate evidence has been obtained until evidence is obtained that all the elements that the subject matter information comprises, including any related notes, when applicable, have been prepared.

.A36

Exhibit — Illustrative Direct Examination Reports

The illustrative practitioner's direct examination reports in this exhibit meet the applicable reporting requirements in paragraph .12 of this section. A practitioner may use alternative language in drafting a direct examination report, provided that the language meets the applicable requirements in paragraph .12 of this section.

Example 1

Circumstances include the following:

The practitioner was engaged to

- measure the rates of return (subject matter information) on XYZ Company's investment transactions during the year ended December 31, 20XX (the underlying subject matter) based on specified criteria
- present the rates of return on the investment transactions in a schedule of investment returns (subject matter information).

Independent Accountant's Report

[Appropriate Addressee]

We have examined¹ *[identify the underlying subject matter, for example, the investment transactions of XYZ Company during the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify the underlying subject matter, for example, its investment transactions during the year ended December 31, 20XX]* and maintaining a record of those transactions. Our responsibility is to obtain reasonable assurance by measuring (or evaluating) *[identify the underlying subject matter, for example, the investment transactions of XYZ Company during the year ended December 31, 20XX]* against *[identify the criteria, for example, the ABC criteria set forth in Note 1 of the accompanying schedule of investment returns]* to determine *[identify the subject matter information, for example, the rates of return on those investment transactions]* and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of our measurement (or evaluation) based on our examination. We have presented the results of our measurement in the accompanying schedule of investment returns.

Our examination was conducted in accordance with the attestation standards for a direct examination engagement established by the AICPA. Those standards require that we obtain reasonable assurance by measuring (or evaluating) *[identify the underlying subject matter, for example, the investment transactions of XYZ Company during the year ended December 31, 20XX]* against *[identify the criteria, for example, the ABC criteria set forth in Note 1 of the accompanying schedule of investment returns]* and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of our measurement or evaluation of *[identify the underlying subject matter, for example, the investment transactions of XYZ Company during the year ended December 31, 20XX]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of *[identify the subject matter information, for example,*

¹ The practitioner may revise the first sentence of the report to read "We have directly examined ..." or "We have performed a direct examination of ..." or similar.

the rates of return on those investment transactions for the year ended December 31, 20XX, as presented in the schedule of investment returns], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent of *[identify the responsible party, for example, XYZ Company]* and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our examination engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the underlying subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement, the underlying subject matter, or the subject matter information.]

In our opinion, *[identify the subject matter information, for example, the rates of return on the investment transactions of XYZ Company during the year ended December 31, 20XX included in the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX,]* are fairly presented in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*, in all material respects.

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

Example 2

Circumstances include the following:

The practitioner was engaged to

- evaluate a daycare center's safety practices during the year ended December 31, 20XX, and implementation of those practices (the underlying subject matter) based on criteria established by an educational organization.
- express an opinion (subject matter information) about whether the daycare center's safety practices and implementation of those practices were in accordance with the criteria.

Independent Accountant's Report

[Appropriate Addressee]

We have examined ¹ *[identify the underlying subject matter, for example, Indulgent Daycare Center's safety practices and its implementation of those practices during the year ended December 31, 20XX]*. Indulgent Daycare Center's management is responsible for *[identify the underlying subject matter, for example, its safety practices and its implementation of those practices]*. Our responsibility is to obtain reasonable assurance by measuring (or evaluating) *[identify the underlying subject matter, for example, Indulgent Daycare Center's safety practices and its implementation of those practices during the year ended December 31, 20XX]* against *[identify the criteria, for example, XYZ Educator's Best Safety Practices for Daycare Centers]* and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of our measurement (or evaluation) based on our examination.

¹ The practitioner may revise the first sentence of the report to read "We have directly examined ..." or "We have performed a direct examination of ..." or similar.

Our examination was conducted in accordance with the attestation standards for a direct examination engagement established by the AICPA. Those standards require that we obtain reasonable assurance by measuring (or evaluating) *[identify the underlying subject matter, for example, Indulgent Daycare Center's safety practices and its implementation of those practices during the year ended December 31, 20XX]* against *[identify the criteria, for example, XYZ Educator's Best Safety Practices for Daycare Centers]* and performing other procedures to obtain sufficient appropriate evidence to express an opinion that conveys the results of our measurement or evaluation of *[identify the underlying subject matter, for example, Indulgent Daycare Center's safety practices and its implementation of those practices during the year ended December 31, 20XX]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks that *[identify the underlying subject matter, for example, Indulgent Daycare Center's safety practices and its implementation of those practices]* were not in accordance with *[identify the criteria, for example, XYZ Educator's Best Safety Practices for Daycare Centers]* in all material respects, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent of *[identify the responsible party, for example, Indulgent Daycare Center]*, and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our examination engagement.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the underlying subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement, the underlying subject matter, or the subject matter information.]

In our opinion, *[identify the underlying subject matter, for example, Indulgent Daycare Center's safety practices and its implementation of those practices during the year ended December 31, 20XX]*, were in accordance with (or based on) *[identify the criteria, for example, XYZ Educator's Best Safety Practices for Daycare Centers]*, in all material respects.

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

AT-C Section 210

Review Engagements

(Supersedes SSAE No. 18 section 210.)

Source: SSAE No. 22.

Effective for practitioners' review reports dated on or after June 15, 2022.

Introduction

.01 This section contains performance and reporting requirements and application guidance for review engagements performed in accordance with the attestation standards. The requirements and guidance in this section supplement the requirements and guidance in section 105, *Concepts Common to All Attestation Engagements*. For purposes of applying this section, the term *subject matter* encompasses the terms *underlying subject matter* and *subject matter information*, as defined in section 105. If only one of these terms is applicable, that term is used.

Effective Date

.02 This section is effective for practitioners' review reports dated on or after June 15, 2022. Early implementation is permitted only if the practitioner also implements early the amendments to section 105 included in Statement on Standards for Attestation Engagements (SSAE) No. 21, *Direct Examination Engagements*.

Objectives

.03 In conducting a review engagement, the objectives of the practitioner are to do the following:

- a. Obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria
- b. Express a conclusion in a written report about whether, based on the procedures performed and the review evidence obtained, the practitioner is aware of any material modifications that should be made to
 - i. the subject matter in order for it to be in accordance with (or based on) the criteria or
 - ii. the responsible party's assertion in order for it to be fairly stated
- c. Communicate further as required by relevant AT-C sections

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Appropriateness of review evidence. The measure of the quality of review evidence, that is, its relevancy and reliability in providing support for the practitioner's conclusion.

Modified conclusion. A qualified or an adverse conclusion.

Review evidence. Information used by the practitioner in obtaining limited assurance on which the practitioner's conclusion is based.

Sufficiency of review evidence. The measure of the quantity of review evidence. The quantity of the review evidence needed is affected by the risks of material misstatement and also by the quality of such evidence.

Requirements

Conduct of a Review Engagement

.05 In performing a review engagement, the practitioner should comply with this section, section 105, and any subject-matter AT-C section that is relevant to the engagement. A subject-matter AT-C section is relevant to the engagement when it is in effect, and the circumstances addressed by the AT-C section exist. (Ref: par. .A1)

.06 The practitioner should consider whether the nature of the procedures to be performed would enable the practitioner to obtain sufficient appropriate review evidence to obtain limited assurance.

.07 A practitioner should not perform a review of

- a. prospective financial information,
- b. internal control, or
- c. compliance with requirements of specified laws, regulations, rules, contracts, or grants.

Agreeing on the Terms of the Engagement

.08 The practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. (Ref: par. .A2)

.09 The agreed-upon terms of the engagement should include the following:

- a. The objective and scope of the engagement
- b. The responsibilities of the practitioner (Ref: par. .A3)
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the AICPA
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different (Ref: par. .A4–.A5)
- e. A statement that the procedures performed in a review vary in nature and timing from, and are substantially less in extent than, an examination and, consequently, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed (Ref: par. .A6)

- f.* Identification of the criteria for the measurement, evaluation, or disclosure of the subject matter
- g.* An acknowledgement that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

.10 Although an engagement may recur, each engagement is considered a separate engagement. The practitioner should assess whether circumstances require revision to the terms of a preceding engagement. If the practitioner concludes that the terms of the preceding engagement need not be revised for the current engagement, the practitioner should remind the engaging party of the terms of the current engagement, and the reminder should be documented.

Requesting a Written Assertion

.11 The practitioner should request from the responsible party a written assertion about the measurement or evaluation of the underlying subject matter against the criteria. The practitioner should use professional judgment in determining whether management has a reasonable basis for making its assertion. When the engaging party is the responsible party and refuses to provide a written assertion, paragraph .61 requires the practitioner to withdraw from the engagement, when withdrawal is possible under applicable law or regulation. When the engaging party is not the responsible party, and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement. In that case, paragraph .62 requires the practitioner to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party. (Ref: par. .A7–.A11 and .A88)

Planning and Performing the Engagement

.12 The practitioner should establish an overall engagement strategy that sets the scope, timing, and direction of the engagement and determine the nature, timing, and extent of the procedures that are necessary to achieve the objectives of the engagement. The practitioner should exercise professional judgment in selecting and applying procedures to obtain sufficient appropriate review evidence that provides a reasonable basis for the practitioner's conclusion. (Ref: par. .A12–.A15)

.13 The practitioner should obtain an understanding of the subject matter and other engagement circumstances sufficient to do the following: (Ref: par. .A16)

- a.* Enable the practitioner to identify areas in which a material misstatement is likely to arise (Ref: par. .A17)
- b.* Provide a basis for designing and performing procedures to address the areas identified in item (*a*) and to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria, or the assertion, in order for it to be fairly stated

.14 The practitioner should make inquiries of the responsible party regarding

- a.* whether the responsible party has an internal audit function. If the responsible party has an internal audit function, the practitioner should make further inquiries to obtain an understanding

of the activities and main findings of the internal audit function with respect to the subject matter.

- b. whether the responsible party has used any specialists in the preparation of the subject matter.

Materiality in Planning and Performing the Engagement

.15 The practitioner should consider materiality when establishing the overall engagement strategy, determining the nature, timing, and extent of procedures, and evaluating whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the assertion in order for it to be fairly stated. (Ref: par. .A18–.A24)

.16 The practitioner should reconsider materiality for the subject matter if the practitioner becomes aware of information during the engagement that would have caused the practitioner to have initially determined a different materiality.

Procedures to Be Performed to Obtain Limited Assurance

.17 To obtain limited assurance, the practitioner should obtain sufficient appropriate review evidence to reduce attestation risk to a level that is acceptable in the circumstances of the engagement as a basis for expressing a conclusion about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria, or the assertion, in order for it to be fairly stated.

.18 Based on the practitioner's understanding obtained pursuant to paragraph .13, the practitioner should design and perform procedures to obtain limited assurance to support the practitioner's conclusion. In doing so, the practitioner should identify and place increased focus on those areas in which the practitioner believes there are increased risks that the subject matter may be materially misstated. Inquiry procedures alone are not sufficient to obtain limited assurance. (Ref: par. .A25–.A30)

Analytical Procedures

.19 If designing and performing analytical procedures to obtain limited assurance, the practitioner should do the following: (Ref: par. .A31–.A32)

- a. Determine the suitability of particular analytical procedures for the subject matter, taking into account the practitioner's awareness of risks
- b. Evaluate the reliability of data from which the practitioner's expectation is developed, taking into account the source, comparability, nature, and relevance of information available
- c. Develop an expectation with respect to recorded amounts or ratios

.20 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ significantly from expected amounts or ratios, the practitioner should do the following: (Ref: par. .A33)

- a. Inquire of the responsible party about such differences
- b. Consider the responses to these inquiries to determine whether other procedures are necessary in the circumstances

Inquiries

.21 The practitioner should inquire of the responsible party about the following:

- a. Whether the subject matter has been prepared in accordance with (or based on) the criteria
- b. The practices used by the responsible party to measure, recognize, and record the subject matter
- c. Questions that have arisen in the course of applying the procedures
- d. Communications from regulatory agencies or others, if relevant

.22 The practitioner should consider the reasonableness and consistency of the responsible party's responses in light of the results of other procedures and the practitioner's knowledge of the subject matter, criteria, and responsible party.

Fraud, Laws, and Regulations

.23 The practitioner should make inquiries of the appropriate party to determine whether the party has knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter.

.24 The practitioner should respond appropriately to fraud or suspected fraud and noncompliance or suspected noncompliance with laws or regulations affecting the subject matter that is identified during the engagement. (Ref: par. .A34–.A35)

Incorrect, Incomplete, or Otherwise Unsatisfactory Information

.25 During the performance of procedures, if the practitioner becomes aware that information coming to the practitioner's attention is incorrect, incomplete, or otherwise unsatisfactory, the practitioner should request that the responsible party consider the effect of these matters on the subject matter and communicate the results of its consideration to the practitioner. The practitioner should consider the results communicated to the practitioner by the responsible party and the potential effect, if any, on the practitioner's report.

.26 If the practitioner believes the subject matter may be materially misstated, the practitioner should perform additional procedures sufficient to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the assertion in order for it to be fairly stated.

Using the Work of a Practitioner's Specialist or Internal Auditors

.27 When the practitioner expects to use the work of a practitioner's specialist or internal auditors, the practitioner should apply the requirements in section 205, *Assertion-Based Examination Engagements*, and the related application guidance, as appropriate, for a review engagement.¹

Evaluating the Results of Procedures

.28 The practitioner should accumulate misstatements identified during the engagement, other than those that are clearly trivial. (Ref: par. .A36–.A37)

¹ Paragraphs .37–.45 of section 205, *Assertion-Based Examination Engagements*.

.29 The practitioner should evaluate whether sufficient appropriate review evidence has been obtained from the procedures performed and, if not, the practitioner should perform additional procedures based on the practitioner's professional judgment to be necessary in the circumstances to be able to form a conclusion on the subject matter. (Ref: par. .A38–.A40)

.30 If the practitioner is unable to obtain sufficient appropriate review evidence, a scope limitation exists, and paragraph .60 applies.

Considering Subsequent Events and Subsequently Discovered Facts

.31 The practitioner should inquire whether the responsible party, and if different, the engaging party, is aware of any events subsequent to the period (or point in time) covered by the review engagement up to the date of the practitioner's report that could have a significant effect on the subject matter or assertion. If so, the practitioner should apply other appropriate procedures to obtain review evidence regarding such events. If the practitioner becomes aware, through inquiry or otherwise, of such an event, or any other event that is of such a nature and significance that its disclosure is necessary to prevent users of the report from being misled, and information about that event is not adequately disclosed by the responsible party in the subject matter or in its assertion, the practitioner should take appropriate action. (Ref: par. .A41–.A43)

.32 The practitioner has no responsibility to perform any procedures regarding the subject matter or assertion after the date of the practitioner's report. Nevertheless, the practitioner should respond appropriately to facts that become known to the practitioner after the date of the report that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. (Ref: par. .A44–.A45)

Written Representations

.33 The practitioner should request from the responsible party written representations in the form of a letter addressed to the practitioner. The representations should do the following: (Ref: par. .A46–.A49)

- a. Include the responsible party's assertion about the subject matter based on the criteria (Ref: par. .A88)
- b. State that all relevant matters are reflected in the measurement or evaluation of the subject matter or assertion
- c. State that all known matters contradicting the subject matter or assertion and any communication from regulatory agencies or others affecting the subject matter or assertion have been disclosed to the practitioner, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report
- d. Acknowledge responsibility for
 - i. the subject matter and the responsible party's assertion;
 - ii. selecting the criteria, when applicable; and
 - iii. determining that such criteria are suitable, will be available to the intended users, and appropriate for the purpose of the engagement

- e. State that the responsible party has disclosed to the practitioner
 - i. all deficiencies in internal control relevant to the engagement of which the responsible party is aware;
 - ii. its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter; and
 - iii. other matters as the practitioner deems appropriate
- f. State that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion have been disclosed to the practitioner (Ref: par. .A48)
- g. State that the responsible party has provided the practitioner with all relevant information and access, as agreed upon in the terms of the engagement
- h. If applicable, state that the responsible party believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the subject matter (Ref: par. .A48–.A49)
- i. If applicable, state that significant assumptions used in making any material estimates are reasonable

.34 When the engaging party is not the responsible party, and the responsible party refuses to provide the representations in paragraph .33 in writing, the practitioner should make inquiries of the responsible party about, and seek oral responses to, the matters in paragraph .33. (Ref: par. .A50)

.35 When the engaging party is not the responsible party, the practitioner should request written representations from the engaging party, in addition to those requested from the responsible party, in the form of a letter addressed to the practitioner. The representations should do the following:

- a. Acknowledge that the responsible party is responsible for the subject matter being in accordance with the criteria and for its assertion
- b. Acknowledge the engaging party's responsibility for selecting the criteria
- c. Acknowledge the engaging party's responsibility for determining that such criteria are suitable, will be available to the intended users, and are appropriate for the purposes of the engagement
- d. State that the engaging party is not aware of any material misstatements in the subject matter information or assertion
- e. State that the engaging party has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion (Ref: par. .A42)
- f. Address other matters as the practitioner deems appropriate

.36 When written representations are directly related to matters that are material to the subject matter, the practitioner should

- a. evaluate their reasonableness and consistency with other review evidence obtained, including other representations (oral or written), and
- b. consider whether those making the representations can be expected to be well-informed on the particular matters.

.37 The date of the written representations should be as of the date of the practitioner's report. The written representations should address the subject matter and periods covered by the practitioner's conclusion.

Requested Written Representations Not Provided or Not Reliable

.38 When the engaging party is the responsible party, and one or more of the requested written representations are not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should do the following (Ref: par. .A51–.A52)

- a. Discuss the matter with the appropriate party.
- b. Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and review evidence in general.
- c. If any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's conclusion.

.39 When the engaging party is not the responsible party (Ref: par. .A53–.A55)

- a. if one or more of the requested representations are not provided in writing by the responsible party, but the practitioner receives satisfactory oral responses to the practitioner's inquiries performed in accordance with paragraph .34 sufficient to enable the practitioner to conclude that the practitioner has sufficient appropriate review evidence to form a conclusion about the subject matter, the practitioner's report should contain a separate paragraph that restricts the use of the practitioner's report to the engaging party. (Paragraphs .47–.48 contain requirements for the contents of such a paragraph.)
- b. if one or more of the requested representations are provided neither in writing nor orally from the responsible party in accordance with paragraph .34, a scope limitation exists, and paragraph .60 applies.

Other Information

.40 If prior to or after the release of the practitioner's report on subject matter or an assertion the practitioner is willing to permit the inclusion of the practitioner's report in a document that contains the subject matter or assertion and other information, the practitioner should read the other information to identify material inconsistencies, if any, with the subject matter, assertion, or the report. If upon reading the other information, in the practitioner's professional judgment either of the following applies, the practitioner should discuss the matter with the appropriate party and take further action, as appropriate: (Ref: par. .A56–.A57)

- a. A material inconsistency between that other information and the subject matter, assertion, or report exists.
- b. A material misstatement of fact exists in the other information, the subject matter, assertion, or the report.

Description of Criteria

.41 The practitioner should evaluate whether the written description of the subject matter or assertion adequately refers to or describes the criteria. (Ref: par. .A58–.A59)

Forming the Conclusion

.42 The practitioner should form a conclusion about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or to the responsible party's assertion in order for it to be fairly stated. In forming that conclusion, the practitioner should evaluate

- a. the sufficiency and appropriateness of the review evidence obtained and (Ref: par. .A60)
- b. whether uncorrected misstatements are material, individually or in the aggregate. (Ref: par. .A61)

.43 The practitioner should evaluate, based on the review evidence obtained, whether the presentation of the subject matter or assertion is misleading within the context of the engagement. (Ref: par. .A62–.A63)

Preparing the Practitioner's Report

.44 The practitioner's report should be in writing. (Ref: par. .A64–.A67)

Content of the Practitioner's Report

.45 The practitioner's report should include the following:

- a. A title that includes the word *independent*. (Ref: par. .A68)
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates.
- d. An identification of the criteria against which the subject matter was measured or evaluated. (Ref: par. .A69)
- e. A statement that identifies the responsible party and its responsibility for the subject matter being in accordance with (or based on) the criteria or for its assertion. (Ref: par. .A70–.A71)
- f. A statement that the practitioner's responsibility is to express a conclusion on the subject matter or assertion based on the practitioner's review.
- g. A statement that
 - i. the practitioner's review was conducted in accordance with attestation standards established by the AICPA. (Ref: par. .A72–.A73).
 - ii. those standards require that the practitioner plan and perform the review to obtain limited assurance about whether any material modifications should be made to

- (1) the subject matter in order for it to be in accordance with (or based on) the criteria (or equivalent language regarding the subject matter and criteria, such as the language used in the examples in paragraph .A74) or
 - (2) the responsible party's assertion in order for it to be fairly stated.
 - iii. the practitioner believes the review evidence the practitioner obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's conclusion.
- h. A statement that the procedures performed in a review vary in nature and timing from, and are substantially less in extent than, an examination, the objective of which is to obtain reasonable assurance about whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or the responsible party's assertion is fairly stated, in all material respects, in order to express an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed.
- i. A statement that the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements relating to the review engagement. (Ref: par. .A74–.A75)
- j. A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A76)
- k. A description of the work performed as a basis for the practitioner's conclusion. (Ref: par. .A77–.A78)
- l. The practitioner's conclusion about whether, based on the review, the practitioner is aware of any material modifications that should be made to (Ref: par. .A79–.A81)
 - i. the subject matter in order for it be in accordance with (or based on) the criteria or
 - ii. the responsible party's assertion in order for it to be fairly stated.
- m. The manual or printed signature of the practitioner's firm.
- n. The city and state where the practitioner's report is issued. (Ref: par. .A82)
- o. The date of the report. The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate review evidence on which to base the practitioner's conclusion, including review evidence that (Ref: par. .A83–.A84)
 - i. the attestation documentation has been reviewed,
 - ii. if applicable, the written presentation of the subject matter has been prepared, and
 - iii. the responsible party has provided a written assertion or, in the circumstance described in paragraph .A55, an oral assertion.

Restricted-Use Paragraph

.46 In the following circumstances, the practitioner's report should include an alert, in a separate paragraph, that restricts the use of the report: (Ref: par. .A85–.A87)

- a. The practitioner determines that the criteria used to evaluate the subject matter are appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.
- b. The criteria used to evaluate the subject matter are available only to specified parties.
- c. The engaging party is not the responsible party, and the responsible party does not provide the written representations required by paragraph .33 but does provide oral responses to the practitioner's inquiries about the matters in paragraph .33, as provided for in paragraphs .34 and .39a. In this case, use of the report should be restricted to the engaging party. (Ref: par. .A88)

.47 The alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties,
- b. identify the specified parties for whom use is intended, and (Ref: par. .A89)
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A90–.A92)

.48 When the engagement is also performed in accordance with *Govern-ment Auditing Standards*, the alert that restricts the use of the practitioner's report should include the following information, rather than the information required by paragraph .47:

- a. A description of the purpose of the report
- b. A statement that the report is not suitable for any other purpose

Reporting on Subject Matter or a Written Assertion

.49 A practitioner should report on a written assertion or directly on the subject matter.

.50 If the practitioner is reporting on the assertion, the assertion should be bound with or accompany the practitioner's report, or the assertion should be clearly stated in the report.

Reference to the Practitioner's Specialist

.51 The practitioner should not refer to the work of a practitioner's specialist in the practitioner's report containing an unmodified conclusion. (Ref: par. .A93)

Modified Conclusions***Misstatement of Subject Matter***

.52 A practitioner who is engaged to perform a review may become aware that the subject matter is misstated. If the misstatement is not corrected,

the practitioner should consider whether modification of the standard practitioner's report is sufficient to disclose the misstatement of the subject matter. (Ref: par. .A94–.A95)

.53 The practitioner should express a modified conclusion when, in the practitioner's professional judgment, the subject matter is materially misstated. In such cases, the practitioner should express a qualified conclusion or an adverse conclusion. (Ref: par. .A96)

.54 When the practitioner modifies the conclusion, the practitioner should include a separate paragraph in the practitioner's report that provides a description of the nature of the matter giving rise to the modification and, if practicable, includes the effects on the subject matter.

.55 The practitioner should express a qualified conclusion when, in the practitioner's professional judgment, the effects of a matter are material but not pervasive. A qualified conclusion is expressed as being "except for" the effects of the matter to which the qualification relates. (Ref: par. .A97–.A98)

.56 The practitioner should express an adverse conclusion when the practitioner, having obtained sufficient appropriate review evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the subject matter. (Ref: par. .A97–.A98)

.57 If the practitioner believes that conditions exist that, individually or in combination, result in one or more material misstatements based on the criteria, the practitioner should modify the conclusion and express a qualified or an adverse conclusion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement.

.58 The practitioner's conclusion on the subject matter or assertion should be clearly separated from any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities. Any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities should be phrased in a manner that makes it clear that these paragraphs are not intended to detract from that conclusion or to imply that the practitioner has obtained reasonable assurance.

.59 When the conclusion is modified, reference to an external specialist is permitted when such reference is relevant to an understanding of the modification to the practitioner's conclusion. The practitioner should indicate in the practitioner's report that such reference does not reduce the practitioner's responsibility for that conclusion.

Scope Limitations

.60 If the practitioner is unable to obtain sufficient appropriate review evidence, a scope limitation exists. When a scope limitation exists, the practitioner should withdraw from the engagement, when withdrawal is possible under applicable laws and regulations. (Ref: par. .A53 and .A99–.A101)

Responsible Party Refuses to Provide a Written Assertion

.61 If the engaging party is the responsible party and refuses to provide the practitioner with a written assertion as required by paragraph .11, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation.

.62 When the engaging party is not the responsible party and the responsible party refuses to provide the practitioner with a written assertion, the

practitioner may report on the subject matter but should disclose in the practitioner's report the responsible party's refusal to provide a written assertion and should restrict the use of the practitioner's report to the engaging party. (Ref: par. .A102–.A103)

Communication Responsibilities

.63 The practitioner should communicate to the responsible party known and suspected fraud and noncompliance with laws or regulations, as well as uncorrected misstatements. When the engaging party is not the responsible party, the practitioner should also communicate this information to the engaging party. (Ref: par. .A104)

.64 In the event the practitioner encounters known or suspected fraud or noncompliance with laws or regulations in connection with the engagement, the practitioner should consider responsibilities under the AICPA Code of Professional Conduct (AICPA code) and applicable law prior to communicating such information either to the responsible party or the engaging party. (Ref: par. A105)

Documentation

.65 The practitioner should prepare engagement documentation that is sufficient to determine the following: (Ref: par. .A106–.A109)

- a.* The nature, timing, and extent of the procedures performed to comply with relevant AT-C sections and applicable legal and regulatory requirements, including the following:
 - i. The identifying characteristics of the specific items or matters tested
 - ii. Who performed the engagement work and the date such work was completed
 - iii. The discussions with the responsible party or others about findings or issues that, in the practitioner's professional judgment, are significant, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place
 - iv. When the engaging party is the responsible party and the responsible party will not provide one or more of the requested written representations or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or that the written representations are otherwise not reliable, the matters in paragraph .38
 - v. When the engaging party is not the responsible party and the responsible party will not provide the written representations regarding the matters in paragraph .33, the oral responses from the responsible party to the practitioner's inquiries regarding the matters in paragraph .33, in accordance with paragraph .34
 - vi. Who reviewed the engagement work performed and the date and extent of such review
 - vii. If the practitioner identified information that is inconsistent with the practitioner's final conclusion regarding a

significant matter, how the practitioner addressed the inconsistency

- b. The results of the procedures performed and the review evidence obtained

.66 If, in circumstances such as those described in paragraph .32, the practitioner performs new or additional procedures or draws new conclusions after the date of the practitioner's report, the practitioner should document the following:

- a. The circumstances encountered
- b. The new or additional procedures performed, review evidence obtained, and conclusions reached and their effect on the report
- c. When and by whom the resulting changes to the documentation were made and reviewed

Application and Other Explanatory Material

Conduct of a Review Engagement (Ref: par. .05)

.A1 For example, if a practitioner was performing a review on pro forma financial information, section 105, this section, and section 310, *Reporting on Pro Forma Financial Information*, would be relevant.

Agreeing on the Terms of the Engagement (Ref: par. .08–.09)

.A2 It is in the interests of both the engaging party and the practitioner to document the agreed-upon terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the engagement letter or other suitable form of written agreement will vary with the engagement circumstances.

.A3 A practitioner may further describe the responsibilities of the practitioner by adding the following items to the engagement letter or other suitable form of written agreement:

- a. A statement that a review is designed to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria
- b. A statement that the objective of a review is the expression of a conclusion in a written practitioner's report about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the responsible party's assertion in order for it to be fairly stated

.A4 Situations may exist in which the responsible party is not the engaging party and, as such, the responsibilities of each party may differ. For example, when the responsible party is not the engaging party, the engaging party may be responsible for identifying the criteria.

.A5 The engaging party may request that the practitioner recommend, develop, or assist in developing the criteria for the engagement. Regardless of whether the practitioner recommends, develops, or assists in developing or identifying the criteria for the engagement, the engaging party is required to take responsibility for the criteria.

.A6 If relevant, a statement about the inherent limitations of a review engagement may indicate that "because of the inherent limitations of a review engagement, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the review is properly planned and performed in accordance with the attestation standards."

Requesting a Written Assertion (Ref: par. .11)

.A7 What constitutes a reasonable basis for the responsible party's assertion depends on the nature of the subject matter and other engagement circumstances. In some cases, a formal process with extensive internal control may be needed to provide the responsible party with a reasonable basis for making its assertion. The fact that the practitioner will report on the subject matter is not a substitute for the responsible party's own processes to have a reasonable basis for its assertion.

.A8 The language of the responsible party's written assertion in paragraph .11 may need to be tailored to reflect the nature of the underlying subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .11 include the following:

- The subject matter is presented in accordance with (or based on) the criteria.
- The subject matter achieved the objectives, for example, when the objectives are the criteria.

.A9 Situations may arise in which the current responsible party was not present during some or all of the period covered by the practitioner's report. Such persons may contend that they are not in a position to provide a written assertion that covers the entire period because they were not in place during some or all of the period. This fact, however, does not diminish such persons' responsibilities for the subject matter as a whole. Accordingly, the requirement for the practitioner to request a written assertion from the responsible party that covers the entire relevant period or periods still applies.

.A10 Paragraph .33a requires the practitioner to request a written representation from the responsible party that is the same as the responsible party's assertion. If the responsible party provides the practitioner with the written representation in paragraph .33a, the practitioner need not request a separate written assertion, unless a separate written assertion is called for by the engagement circumstances.

.A11 Regardless of the procedures performed by the practitioner, the responsible party is required to accept responsibility for its assertion and the subject matter. An assertion based solely on the practitioner's procedures would not be considered a reasonable basis for its assertion.²

Planning and Performing the Engagement (Ref: par. .12–.13)

.A12 Planning involves the engagement partner and other key members of the engagement team and may involve the practitioner's specialists. Adequate planning helps the practitioner devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis,

² The "Nonattest Services" subtopic (ET sec. 1.295) of the AICPA Code of Professional Conduct addresses the practitioner's provision of nonattest services for an attest client.

and properly organize and manage the engagement for it to be performed in an effective and efficient manner. Adequate planning also assists the practitioner in properly assigning work to engagement team members and facilitates the direction, supervision, and review of their work. Further, it assists, when applicable, the coordination of work performed by other practitioners and practitioner's specialists. The nature and extent of planning activities will vary with the engagement circumstances, for example, the complexity of the assessment or evaluation of the subject matter and the practitioner's previous experience with it. Examples of relevant matters that may be considered include the following:

- The characteristics of the engagement that define its scope, including the terms of the engagement, the characteristics of the subject matter, and the criteria
- The expected timing and nature of the communications required
- The results of preliminary engagement activities, such as client acceptance, and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the appropriate party is relevant
- The engagement process, including possible sources of review evidence and choices among alternative measurement or evaluation methods
- The practitioner's understanding of the appropriate party and its environment, including the risks that the subject matter or assertion may be materially misstated
- Identification of intended users and their information needs and consideration of materiality and the components of attestation risk
- The risk of fraud relevant to the engagement
- The effect on the engagement of using the internal audit function

.A13 The practitioner may decide to discuss elements of planning with the appropriate party to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work of the responsible party's personnel). Although these discussions often occur, the elements of planning remain the practitioner's responsibility. When discussing planning matters, care is needed to avoid compromising the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the responsible party may compromise the effectiveness of the engagement by making the procedures too predictable.

.A14 Planning is not a discrete phase but, rather, a cumulative and iterative process throughout the engagement. Because of unexpected events, changes in conditions, or review evidence obtained, the practitioner may need to revise the nature, timing, and extent of planned procedures.

.A15 In smaller or less complex engagements, the entire engagement may be conducted by a very small engagement team, possibly involving the engagement partner (who may be a sole practitioner) working without any other engagement team members. With a smaller team, coordination of and communication among team members is easier. In such cases, planning the engagement need not be a complex or time-consuming exercise; it varies according to the size of the entity, the complexity of the engagement, and the size of the engagement team.

.A16 Obtaining an understanding of the subject matter and other engagement circumstances provides the practitioner with a frame of reference for exercising professional judgment throughout the engagement, for example, when doing the following:

- Considering the characteristics of the subject matter
- Assessing the suitability of the criteria
- Considering the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts, including situations in which special consideration may be necessary (for example, when there is a need for specialized skills or the work of a specialist)
- Establishing and evaluating the continued appropriateness of quantitative materiality levels (when appropriate) and considering qualitative materiality factors
- Developing expectations when performing analytical procedures
- Designing and performing procedures
- Evaluating review evidence, including the reasonableness of the written representations received by the practitioner

In some review engagements, the practitioner may obtain an understanding of internal control over the measurement, evaluation, or disclosure of the subject matter.

.A17 Identifying the areas in which a material misstatement of the subject matter is likely to arise enables the practitioner to focus procedures on those areas. For example, the practitioner may focus procedures on areas that are subjective in nature.

Materiality in Planning and Performing the Engagement **(Ref: par. .15)**

.A18 Materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative factors and quantitative factors when considering materiality in a particular engagement is a matter for the practitioner's professional judgment.

.A19 Professional judgments about materiality are made considering surrounding circumstances, but they are not affected by the level of assurance; that is, for the same intended users, materiality for a review engagement is the same as it is for an examination engagement because materiality is based on the information needs of intended users and not the level of assurance.

.A20 In general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by intended users based on the subject matter. The practitioner's consideration of materiality is a matter of professional judgment and is affected by the practitioner's perception of the common information needs of intended users as a group. For purposes of determining materiality, the practitioner may assume that intended users

- a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.
- b. understand that the subject matter is measured or evaluated and subjected to procedures using appropriate levels of materiality

and that they have an understanding of any materiality concepts included in the criteria.

- c. understand any inherent uncertainties involved in measuring or evaluating the subject matter.
- d. make reasonable judgments based on the subject matter.

Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.

.A21 Qualitative factors may include the following:

- The interaction between, and relative importance of, various aspects of the subject matter, such as numerous performance indicators
- The wording chosen with respect to subject matter that is expressed in narrative form, for example, the wording chosen does not omit or distort the information
- The characteristics of the presentation adopted for the subject matter when the criteria allow for variations in that presentation
- The nature of a misstatement
- Whether a misstatement affects compliance with laws or regulations
- In the case of periodic reporting on a subject matter, whether the effect of an adjustment that affects past or current information about the subject matter or is likely to affect future information about the subject matter
- Whether a misstatement is the result of an intentional act or is unintentional
- Whether a misstatement is significant with regard to the practitioner's understanding of known previous communications to users, for example, in relation to the expected outcome of the measurement or evaluation of the subject matter
- Whether a misstatement relates to the relationship between the responsible party and, if different, the engaging party or its relationship with other parties

.A22 Quantitative factors relate to the magnitude of misstatements relative to reported amounts for those aspects of the subject matter, if any, that are

- expressed numerically or
- otherwise related to numerical values.

.A23 When quantitative factors are applicable, planning the engagement solely to detect individually material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the subject matter to be materially misstated. Applying materiality to elements of the subject matter ordinarily is not a simple mechanical calculation but involves the exercise of professional judgment. It is affected by the practitioner's understanding of the subject matter and the responsible party and consideration of the nature and extent of misstatements identified in previous attestation engagements.

.A24 The criteria may discuss the concept of materiality in the context of the preparation and presentation of the subject matter and thereby provide a

frame of reference for the practitioner in considering materiality for the engagement. Although criteria may discuss materiality in different terms, the concept of materiality generally includes the matters discussed in paragraphs .A18–.A23. If the criteria do not include a discussion of the concept of materiality, these paragraphs provide the practitioner with a frame of reference.

Procedures to Be Performed to Obtain Limited Assurance (Ref: par. .18)

.A25 The practitioner's work in forming a conclusion consists of obtaining and evaluating review evidence. In addition to inquiry, examples of procedures to obtain review evidence include the following:

- Analytical procedures
- Inspection
- Observation
- Confirmation
- Recalculation
- Repperformance

.A26 Review evidence obtained through the performance of inquiry and analytical procedures will ordinarily provide the practitioner with a reasonable basis for obtaining limited assurance. However, analytical procedures may not be possible when the subject matter is qualitative, rather than quantitative. Additionally, analytical procedures may not provide sufficient appropriate review evidence if an expectation (see paragraph .A33) cannot be developed. Therefore, the practitioner may determine that other procedures are more effective or efficient to obtain limited assurance.

.A27 Information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based. As the practitioner performs planned procedures, the review evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the responsible party to examine the matter identified by the practitioner and to make adjustments to the subject matter, if appropriate.

.A28 In some cases, a subject-matter AT-C section may include requirements that affect the nature, timing, and extent of procedures. For example, a subject-matter AT-C section may describe the nature or extent of particular procedures to be performed in a particular type of engagement. Even in such cases, determining the exact nature, timing, and extent of procedures is a matter of professional judgment and will vary from one engagement to the next.

.A29 The results of the practitioner's procedures may modify the practitioner's risk awareness.

.A30 The practitioner may become aware of a matter that causes the practitioner to believe that the subject matter may be materially misstated. For example, when performing analytical procedures, the practitioner may identify a fluctuation or relationship that is inconsistent with other relevant information or that differs significantly from expected amounts or ratios. In such cases, the practitioner's investigation of such differences may include inquiring of the responsible party or performing other procedures as appropriate in the circumstances.

Analytical Procedures (Ref: par. .19–.20)

.A31 An understanding of the purposes of analytical procedures and the limitations of those procedures is important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires professional judgment by the practitioner.

.A32 Analytical procedures involve comparisons of expectations developed by the practitioner to recorded amounts or ratios developed from recorded amounts. The practitioner develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the subject matter; the practices used by the responsible party to measure, recognize, and record the subject matter; and, if applicable, the industry in which the entity operates.

.A33 Analytical procedures in a review engagement are not designed to identify misstatements with the level of precision expected in an examination engagement. In an examination engagement, analytical procedures performed in response to the engagement risk involve developing expectations that are sufficiently precise to identify material misstatements. In a review engagement, the results of analytical procedures may be compared to expectations regarding the direction of trends, relationships, and ratios, rather than to identify misstatements with the level of precision expected in an examination engagement. Further, when significant fluctuations, relationships, or differences are identified, appropriate review evidence in a review engagement may often be obtained by making inquiries of the responsible party and considering responses received in light of known engagement circumstances without obtaining additional review evidence as required in the case of an examination engagement.

Fraud, Laws, and Regulations (Ref: par. .24)

.A34 In responding to fraud or suspected fraud identified during the engagement, it may be appropriate, unless prohibited by law, regulation, or ethics standards, for the practitioner to, for example, do the following:

- Discuss the matter with the appropriate party
- Request that the responsible party consult with an appropriately qualified third party, such as the entity's legal counsel or a regulator
- Consider the implications of the matter in relation to other aspects of the engagement, including the practitioner's planning and the reliability of written representations from the responsible party
- Obtain legal advice about the consequences of different courses of action
- Communicate with third parties (for example, a regulator)
- Withdraw from the engagement when withdrawal is possible under applicable law or regulation

.A35 The actions noted in paragraph .A34 also may be appropriate in responding to noncompliance or suspected noncompliance with laws or regulations identified during the engagement. It may also be appropriate to describe the matter in a separate paragraph of the practitioner's report, unless either of the following apply:

- a. The practitioner is precluded by the responsible party from obtaining sufficient appropriate review evidence to evaluate whether noncompliance that may be material to the subject matter has or is likely to have occurred, in which case, paragraph .60 applies.
- b. The practitioner concludes that the noncompliance results in a material misstatement of the subject matter, in which case, paragraphs .52–.59 apply.

Evaluating the Results of Review Procedures (Ref: par. .28–.29)

.A36 Uncorrected misstatements are accumulated during the engagement for the purpose of evaluating whether, individually or in aggregate, they are material when forming the practitioner's conclusion.

.A37 "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality and will be matters that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

.A38 Sufficient appropriate review evidence is necessary to support the practitioner's conclusion and report.

.A39 The sufficiency and appropriateness of review evidence are interrelated. *Sufficiency of review evidence* is the measure of the quantity of review evidence. The quantity of the review evidence needed is affected by the risks of material misstatement and also by the quality of such review evidence.

.A40 Whether sufficient appropriate review evidence has been obtained on which to base the practitioner's conclusion is a matter of professional judgment. In some circumstances, the practitioner may not have obtained the review evidence that the practitioner had expected to obtain through the design and performance of procedures. In these circumstances, the practitioner may

- extend the work performed, or
- perform other procedures based on the practitioner's professional judgement to be necessary in the circumstances.

When neither of these is practicable in the circumstances, the practitioner will not be able to obtain sufficient appropriate review evidence to be able to form a conclusion, a scope limitation exists, and paragraph .60 applies.

Considering Subsequent Events and Subsequently Discovered Facts (Ref: par. .31–.32)

.A41 For certain subject-matter AT-C sections, specific subsequent events requirements and related application guidance have been developed for engagement performance and reporting.

.A42 Procedures that a practitioner may perform to identify subsequent events include inquiring about and considering information

- contained in relevant reports issued during the subsequent period by internal auditors, other practitioners, or regulatory agencies.
- obtained through other professional engagements for that entity.

.A43 If the responsible party refuses to disclose a subsequent event for which disclosure is necessary to prevent users of the practitioner's report from being misled, appropriate actions the practitioner may take include

- disclosing the event in the report and modifying the practitioner's conclusion.
- withdrawing from the engagement when withdrawal is possible under applicable law or regulation.

.A44 Subsequent to the date of the practitioner's report, the practitioner may become aware of facts that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. In such circumstances, the practitioner undertakes to determine whether the facts existed at the date of the report and, if so, whether persons who would attach importance to these facts are currently using or are likely to use the report and related subject matter or assertion. This may include discussing the matter with the appropriate party and requesting the appropriate party's cooperation in whatever investigation or further action that may be necessary. The specific actions to be taken in a particular case by the appropriate party and the practitioner may vary with the circumstances. Consideration may be given to, among other things, the time elapsed since the date of the report and whether issuance of a subsequent report is imminent. The practitioner may need to perform additional procedures deemed necessary to determine whether the subject matter or assertion needs revision and whether the previously issued report continues to be appropriate.

.A45 Depending on the circumstances, the practitioner may determine that notification of the situation by the appropriate party to persons who would attach importance to the facts and who are currently using, or are likely to use, the practitioner's report is necessary. This may be the case, for example, when

- a. the report is not to be relied upon because the subject matter or assertion needs revision or the practitioner is unable to determine whether revision is necessary, and
- b. issuance of a subsequent report is not imminent.

If the appropriate party failed to take the necessary steps to prevent reliance on the report, the practitioner's course of action depends upon the practitioner's legal and ethical rights and obligations. Consequently, the practitioner may consider it appropriate to seek legal advice prior to making any disclosure of the situation. Disclosure of the situation directly by the practitioner may include a description of the nature of the matter and of its effect on the subject matter or assertion and the report, avoiding comments concerning the conduct or motives of any person.

Written Representations (Ref: par. .33–.34)

.A46 Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the responsible party. The person from whom the practitioner requests written representations is ordinarily a member of senior management or those charged with governance depending on, for example, the management and governance structure of the responsible party, which may vary by entity, reflecting influences such as size and ownership characteristics.

.A47 Representations by the responsible party cannot replace other review evidence the practitioner could reasonably expect to be available. Although written representations provide review evidence, they do not provide sufficient

appropriate review evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other review evidence that the practitioner obtains.

.A48 A discussion of what is considered a material effect on the subject matter or assertion may be included explicitly in the representation letter in qualitative or quantitative terms.

.A49 A summary of uncorrected misstatements ordinarily is included in or attached to the written representation.

.A50 Certain subject-matter AT-C sections do not permit the practitioner to perform the alternative procedures described in paragraphs .34 and .39a (making inquiries of the responsible party and restricting the use of the practitioner's report).

Requested Written Representations Not Provided or Not Reliable (Ref: par. .38 and .60)

.A51 The engaging party's refusal to furnish written representations constitutes a limitation on the scope of the review. Such refusal may cause the practitioner to withdraw, when withdrawal is possible under applicable law or regulation.

.A52 The practitioner may determine, after performing the procedures in items (a)–(b) of paragraph .38, that an oral representation may provide a portion of the review evidence needed with respect to the matter addressed by the representation.

.A53 Circumstances in which the practitioner may be unable to obtain one or more requested written representations from a responsible party that is not the engaging party include, for example, the following:

- When the engaging party does not have a relationship with the responsible party
- When the review is undertaken against the wishes of the responsible party, for example, when required by law or regulation

In these or other circumstances, the practitioner may need to reconsider whether the responsible party is able or willing to take responsibility for the subject matter. Additionally, the practitioner may not have access to the review evidence to support a conclusion that the responsible party has taken responsibility for the subject matter.

.A54 Even when the responsible party provides oral responses to the matters in paragraph .33, the practitioner may find it appropriate to consider whether there are significant concerns about the competence, integrity, ethical values, or diligence of those providing the oral responses or whether the oral responses are otherwise not reliable and the potential effect, if any, on the practitioner's report.

.A55 Paragraph .11 provides an exception to the requirement for a written assertion when the engaging party is not the responsible party. Nonetheless, because the assertion is the representation called for by paragraph .33a, application of paragraph .39a requires the practitioner to obtain an oral assertion, when a written assertion is not obtained. Paragraph .39b applies when the responsible party provides neither a written nor an oral assertion.

Other Information (Ref: par. .40)

.A56 Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example, the following:

- Requesting the appropriate party to consult with a qualified third party, such as the appropriate party's legal counsel
- Obtaining legal advice about the consequences of different courses of action
- If required or permissible, communicating with third parties (for example, a regulator)
- Describing the material inconsistency in the practitioner's report
- Withdrawing from the engagement, when withdrawal is possible under applicable law or regulation

.A57 Other information does not include information contained on the appropriate party's website. Websites are a means of distributing information and are not, themselves, documents for the purposes of paragraph .40.

Description of Criteria (Ref: par. .41)

.A58 The description of the criteria on which the subject matter or assertion is based is particularly important when there are significant differences between various criteria regarding how particular matters may be treated in the subject matter.

.A59 A description of the criteria that states that the subject matter is prepared in accordance with (or based on) particular criteria is appropriate only if the subject matter complies with all relevant requirements of those criteria that are effective.

Forming the Conclusion (Ref: par. .42–.43)

.A60 The practitioner's professional judgment regarding what constitutes sufficient appropriate review evidence is influenced by such factors as the following:

- The significance of a potential misstatement and the likelihood that it will have a material effect, individually or aggregated with other potential misstatements, on the subject matter or assertion
- The effectiveness of the responsible party's responses to address the known risks
- The experience gained during previous examination or review engagements with respect to similar potential misstatements
- The results of procedures performed, including whether such procedures identified specific misstatements
- The source and reliability of the available information
- The persuasiveness of the review evidence
- The practitioner's understanding of the responsible party and its environment

.A61 A review engagement is a cumulative and iterative process. As the practitioner performs planned procedures, the review evidence obtained may cause the practitioner to change the nature, timing, or extent of other planned

procedures. Information that differs significantly from the information on which the planned procedures were based may come to the practitioner's attention. Examples of such information include the following:

- The extent of the misstatements that the practitioner detects is greater than expected. (This may alter the practitioner's professional judgment about the reliability of particular sources of information.)
- The practitioner may become aware of discrepancies in relevant information or conflicting or missing review evidence.
- Procedures performed toward the end of the engagement may indicate a previously unrecognized risk of material misstatement. In such circumstances, the practitioner may need to reevaluate the planned procedures.

.A62 In making the evaluation required by paragraph .43, the practitioner may consider whether additional disclosures are necessary to describe the subject matter, assertion, or criteria. Additional disclosures may, for example, include the following:

- The measurement or evaluation methods used when the criteria allow for choice among methods
- Significant interpretations made in applying the criteria in the engagement circumstances
- Subsequent events, depending on their nature and significance
- Whether there have been any changes in the measurement or evaluation methods used

.A63 Paragraph .43 does not require the practitioner to determine whether the presentation discloses all matters related to the subject matter, assertion, or criteria or all matters intended users may consider in making decisions based on the presentation.

Preparing the Practitioner's Report (Ref: par. .44–.45)

.A64 Oral and other forms of expressing a conclusion can be misunderstood without the support of a written practitioner's report. For this reason, the practitioner may not report orally or by use of symbols (such as a web seal) under the attestation standards without also providing a written report that is readily available whenever the oral report is provided or the symbol is used. For example, a symbol could be hyperlinked to a written report on the internet.

.A65 This section does not require a standardized format for reporting on all review engagements. Instead, it identifies the basic elements that the practitioner's report is to include. The report is tailored to the specific engagement circumstances. The practitioner may use headings, separate paragraphs, paragraph numbers, typographical devices (for example, the bolding of text), and other mechanisms to enhance the clarity and readability of the report.

.A66 The practitioner may choose to issue a report that contains only the minimum reporting elements included in paragraph .45 or may issue a report that expands on or supplements those elements. In addition to the basic elements, a report may include information and explanations that are not intended to affect the practitioner's conclusion, for example, detail about the terms of the engagement, the applicable criteria being used, findings relating to particular aspects of the engagement, details of the qualifications and experience of the practitioner and others involved in the engagement, and, in some cases,

recommendations. The practitioner may find it helpful to consider the importance of providing such information to the information needs of the intended users. As required by paragraph .58, additional information is clearly separated from the practitioner's conclusion and phrased in a manner that makes it clear that it is not intended to detract from that conclusion or to imply that the practitioner has obtained reasonable assurance.

.A67 All of the following reporting options are available to a practitioner, except when the circumstances described in paragraph .49 exist.

<i>The practitioner's report may state that the practitioner reviewed</i>	<i>and</i>	<i>concludes on</i>
the subject matter		the subject matter
the responsible party's assertion		the responsible party's assertion
the responsible party's assertion		the subject matter

Content of the Practitioner’s Report

Title (Ref: par. .45a)

.A68 A title indicating that the practitioner's report is the report of an independent practitioner (for example, "Independent Practitioner's Report," "Report of Independent Certified Public Accountant," or "Independent Accountant's Report") affirms that the practitioner has met all the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

Criteria (Ref: par. .45d)

.A69 The practitioner's report may include the criteria or refer to them if they are included in the subject matter presentation, in the assertion, or are otherwise readily available. It may be relevant in the circumstances to disclose the source of the criteria or the relevant matters discussed in paragraph .A62.

Relevant Responsibilities (Ref: par. .45e)

.A70 Identifying relevant responsibilities informs the intended users that the responsible party is responsible for the subject matter and that the practitioner's role is to independently express a conclusion about it.

.A71 The practitioner may wish to expand the discussion of the responsible party's responsibility, for example, to indicate that the responsible party is responsible for the preparation and presentation of the subject matter in accordance with (or based on) the criteria, including the design, implementation, and maintenance of internal control to prevent, or detect and correct, misstatement of the subject matter, due to fraud or error.

Statement About the Subject Matter and Criteria (Ref: par. 45g)

.A72 In identifying the standards under which the engagement was performed, the practitioner may specify the AT-C section under which the engagement was performed, for example, section 310, *Reporting on Pro Forma Financial Information*, of the attestation standards established by the AICPA.

.A73 The language in paragraph .45g(ii)(1) may need to be tailored to reflect the nature of the subject matter and criteria for the engagement.

Examples of language that meet the requirements in paragraph .45g(ii)(1) include, "to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to

- be presented in accordance with (or based on) the criteria."
- meet the objectives," for example, when the objectives are the criteria.

Relevant Ethical Requirements (Ref: par. .45i)

.A74 Relevant ethical requirements consist of the AICPA code together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. When the AICPA code applies, the practitioner's other ethical responsibilities relate to the "Principles of Professional Conduct" (ET sec. 0.300).

.A75 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the practitioner may choose to name the relevant sources (for example, the name of the code, rule, or applicable regulation, or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources.

Inherent Limitations (Ref: par. .45j)

.A76 In some cases, identification of specific inherent limitations may be required by an AT-C section. To communicate specific inherent limitations, the illustrative practitioner's report on a review of pro forma financial information under AT-C section 310, for example, indicates that the objective of pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date. It also indicates that the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the specified transaction (or event) actually occurred earlier.³ When not explicitly required by an AT-C section, identification in the report of inherent limitations is based on the practitioner's judgment.

Description of the Work Performed (Ref: par. .45k)

.A77 The summary of the work performed helps the intended users understand the basis for the practitioner's conclusion. The summary may be as brief as "the procedures we performed were based on our professional judgment and consisted primarily of analytical procedures and inquiries" or may be more detailed. Factors to consider in determining the level of detail to be provided in the summary of the work performed may include the following:

- Circumstances specific to the entity (for example, the differing nature of the entity's activities compared to those typical in the industry)

³ Paragraph .18k and examples 2, "Practitioner's Review Report on Pro Forma Financial Information: Unmodified Conclusion," and 3, "Practitioner's Examination Report on Pro Forma Financial Information at Year-End With a Review of Pro Forma Financial Information for a Subsequent Interim Date: Unmodified Opinion and Unmodified Conclusion," in paragraph .A24 of section 310, *Reporting on Pro Forma Financial Information*.

- Specific engagement circumstances affecting the nature and extent of the procedures performed
- The intended users' expectations of the level of detail to be provided in the report, based on market practice, or applicable law or regulation

.A78 It is important that the summary be written in an objective way that allows intended users to understand the work done as the basis for the practitioner's conclusion. In most cases, this will not involve detailing the entire work plan. On the other hand, it is important that the description of the work is not so concise as to be vague or ambiguous but also not written in a way that is overstated or embellished.

Conclusion (Ref: par. .45l)

.A79 The practitioner's conclusion can be worded either in terms of the subject matter and the criteria (for example, "Based on our review, we are not aware of any material modifications that should be made to the XYZ schedule in order for it to be in accordance with [or based on] the ABC criteria.") or in terms of an assertion made by the responsible party (for example, "Based on our review, we are not aware of any material modifications that should be made to management of XYZ Company's assertion in order for it to be fairly stated.").

.A80 A single practitioner's report may cover more than one aspect of a subject matter or an assertion about the subject matter. When that is the case, the report may contain separate opinions or conclusions on each aspect of the subject matter or assertion (for example, examination level related to some aspects or assertions and review level related to others, or an unmodified conclusion on some aspects or assertions and a modified conclusion on others).

.A81 A practitioner may report on subject matter or an assertion at multiple dates or covering multiple periods during which criteria have changed (for example, a practitioner's report on comparative information). Criteria are clearly described when they identify the criteria for each period and how the criteria have changed from one period to the next. If the criteria for the current date or period have changed from the criteria for a preceding date or period, changes in the criteria may be significant to users of the report. If so, the criteria and the fact that they have changed may be disclosed in the presentation of the subject matter, in the written assertion about the subject matter, or in the report, even if the subject matter for the preceding date or period is not presented.

Location (Ref: par. .45n)

.A82 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date (Ref: par. .45o)

.A83 Including the date of the practitioner's report informs the intended users that the practitioner has considered the effect of the events that occurred up to that date on the subject matter and the report.

.A84 Because the practitioner expresses a conclusion on the subject matter or assertion and the subject matter or assertion is the responsibility of the responsible party, the practitioner is not in a position to conclude that sufficient appropriate review evidence has been obtained until review evidence is obtained that all the elements that the subject matter or assertion comprises, including any related notes, when applicable, have been prepared, and the responsible party has accepted responsibility for them.

Restricted-Use Paragraph (Ref: par. .11, .33, .46, and .47b–c)

.A85 A practitioner's report for which the conditions in paragraph .46 do not apply need not include an alert that restricts its use. However, nothing in the attestation standards precludes a practitioner from including such an alert in any practitioner's report or other practitioner's written communication.

.A86 A practitioner's report that is required by paragraph .46 to include an alert that restricts the use of the report may be included in a document that also contains a practitioner's report that is for general use. In such circumstances, the use of the general use report is not affected.

.A87 A practitioner may also issue a single combined practitioner's report that includes

- a. a practitioner's report that is required by paragraph .46 to include an alert that restricts its use and
- b. a report that is for general use.

If these two types of reports are clearly differentiated within the combined report, such as through the use of appropriate headings, the alert that restricts the use of the report may be limited to the report required by paragraph .46 to include such an alert. In such circumstances, the use of the general use report is not affected.

.A88 The representations required by paragraph .33 include an assertion. If the engaging party is not the responsible party and the responsible party provides an oral assertion, rather than a written assertion, paragraph .46c calls for an alert that restricts the use of the practitioner's report to the engaging party.

.A89 The practitioner may identify the specified parties by naming them, referring to a list of those parties, or identifying the class of parties, for example, "all customers of XYZ Company during some or all of the period January 1, 20XX to December 31, 20XX." The method of identifying the specified parties is determined by the practitioner.

.A90 In some cases, the criteria used to measure or evaluate the subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts users of the practitioner's report to this fact and, therefore, that the report is intended solely for the information and use of the specified parties.

.A91 The alert that restricts the use of the practitioner's report is designed to avoid misunderstandings related to the use of the report, particularly if the report is taken out of the context in which the report is intended to be used. A practitioner may consider informing the responsible party and, if different, the engaging party or other specified parties that the report is not intended for distribution to parties other than those specified in the report. The practitioner may, in connection with establishing the terms of the engagement, reach an understanding with the responsible party or, if different, the engaging party, that the intended use of the report will be restricted and may obtain the responsible party's agreement that the responsible party and specified parties will not distribute such report to parties other than those identified therein. A practitioner is not responsible for controlling, and cannot control, distribution of the report after its release.

.A92 In some cases, a restricted-use practitioner's report filed with regulatory agencies is required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency, as part of its oversight

responsibility for an entity, may require access to the restricted-use report in which it is not named as a specified party.

Reference to the Practitioner's Specialist (Ref: par. .51)

.A93 The practitioner has sole responsibility for the conclusion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's specialist.

Modified Conclusions (Ref: par. .52-.53 and .55)

.A94 The two types of modified conclusions are a qualified conclusion and an adverse conclusion. The decision regarding what type of modified conclusion is appropriate depends on the following:

- a. The nature of the matter giving rise to the modification (that is, whether the subject matter of the engagement is in accordance with [or based on] the criteria or may be materially misstated)
- b. The practitioner's professional judgment about the pervasiveness of the effects or possible effects of the matter on the subject matter of the engagement

.A95 A practitioner may express an unmodified conclusion only when the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that the practitioner considers necessary in the circumstances.

.A96 Example of a qualified conclusion or an adverse conclusion are as follows:

- *Qualified conclusion (an example for a material but not pervasive misstatement).* "Based on our review, except for the matter(s) described in [the Basis for Qualified Conclusion section of our report], we are not aware of any material modifications that should be made to [the subject matter] for it to be in accordance with [the criteria]."
- *Adverse conclusion (an example for a material and pervasive misstatement).* "Based on our review, because of the significance of the matter described in [the Basis for Adverse Conclusion section of our report], the [subject matter] is not in accordance with [the criteria]. Had we been engaged to perform an examination, other matters might have come to our attention."

.A97 The term *pervasive* describes the effects on the subject matter of misstatements. Pervasive effects on the subject matter are those that, in the practitioner's professional judgment

- a. are not confined to specific aspects of the subject matter;
- b. if so confined, represent or could represent a substantial proportion of the subject matter; or
- c. in relation to disclosures, are fundamental to the intended users' understanding of the subject matter.

.A98 The nature of the misstatement, and the practitioner's judgment about the pervasiveness of the effects of the material misstatement on the subject matter, affect the type of conclusion to be expressed.

Scope Limitations (Ref: par. .60)

.A99 The procedures performed in a review engagement are, by definition, limited compared with those performed in an examination engagement. Limitations known to exist prior to accepting a review engagement are a relevant consideration when establishing whether the preconditions for a review engagement are present, in particular, whether the practitioner expects to be able to obtain the review evidence needed to arrive at the practitioner's conclusion. (See section 105.)⁴ If a further limitation is imposed by the appropriate party after a review engagement has been accepted, it may be appropriate to withdraw from the engagement, when withdrawal is possible under applicable laws and regulations.

.A100 The inability to obtain written representations from the responsible party ordinarily would result in a scope limitation. However, when the engaging party is not the responsible party, paragraph .34 enables the practitioner to make inquiries of the responsible party, and if the responsible party's oral responses enable the practitioner to conclude that the practitioner has sufficient appropriate review evidence to form a conclusion about the subject matter, paragraph .39a indicates that this would not cause a scope limitation. Further, paragraph .39a requires that the practitioner's report, in these circumstances, contain an alert paragraph that restricts the use of the report to the engaging party.

.A101 An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate review evidence by performing alternative procedures.

Responsible Party Refuses to Provide a Written Assertion (Ref: par. .62)

.A102 The following is an example of the disclosure required by paragraph .62:

Attestation standards established by the AICPA require that we request a written statement from *[identify the responsible party]* stating that *[identify the subject matter]* that we reviewed has been accurately measured or evaluated. We requested that *[identify the responsible party]* provide such a written statement but *[identify the responsible party]* refused to do so.

.A103 The practitioner's report discussed in paragraph .62 is appropriate only when the engagement is to report on the subject matter; it is not appropriate for a report on an assertion. When reporting on an assertion, the practitioner is required to obtain a written assertion from the responsible party.

Communication Responsibilities (Ref: par. .63–.64)

.A104 Other matters that may be appropriate to communicate to the responsible party or, if different, the engaging party, include deficiencies in internal control identified during the engagement or bias in the measurement, evaluation, or disclosure of the subject matter.

.A105 Disclosure of confidential information as defined in the AICPA code requires the explicit consent of the engaging party or the responsible party, as

⁴ Paragraph .27b(iii) of section 105, *Concepts Common to All Attestation Engagements*.

appropriate. In circumstances in which such matters are identified, the practitioner may consider discussing with legal counsel or others prior to communicating or taking further action.

Documentation (Ref: par. .65)

.A106 Documentation includes a record of the practitioner's reasoning on all significant findings or issues that require the exercise of professional judgment and related conclusions. The existence of difficult questions of principle or professional judgment calls for the documentation to include the relevant facts that were known by the practitioner at the time the conclusion was reached.

.A107 It is neither necessary nor practical to document every matter considered, or professional judgment made, during an engagement. Further, it is unnecessary for the practitioner to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included in the engagement file. Similarly, the practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A108 In applying professional judgment to assess the extent of documentation to be prepared and retained, the practitioner may consider what is necessary to provide an experienced practitioner, having no previous connection with the engagement, with an understanding of the work performed and the basis of the principal decisions made.

.A109 Documentation ordinarily includes a record of the following:

- Issues identified with respect to compliance with relevant ethical requirements and how they were resolved
- Conclusions on compliance with independence requirements that apply to the engagement and any relevant discussions with the firm that support these conclusions
- Conclusions reached regarding the acceptance and continuance of client relationships and attestation engagements
- The nature and scope of and conclusions resulting from consultations undertaken during the engagement

.A110

Exhibit — Illustrative Practitioner's Review Reports

The illustrative practitioner's review reports in this exhibit meet the applicable reporting requirements in paragraphs .44–.62. A practitioner may use alternative language in drafting a review report, provided that the language meets the applicable requirements in paragraphs .44–.62. The criteria for evaluating the subject matter in examples 1, 3, and 4 have been determined by the practitioner to be suitable and available to all users of the practitioner's report; therefore, these practitioner's reports may be for general use. The criteria for evaluating the subject matter in example 2 are suitable but available only to specified parties; therefore, use of this report is restricted to the specified parties who either participated in the establishment of the criteria or can be presumed to have an adequate understanding of the criteria. (See paragraph .47 for the information to be included in a separate paragraph of the report that contains an alert that restricts the use of the report and paragraph .48 for the content of that paragraph when the engagement is also performed in accordance with *Government Auditing Standards*.)

Example 1: Practitioner's Review Report on Subject Matter; Unmodified Conclusion

The following is an illustrative practitioner's review report in which the practitioner has reviewed the subject matter and is reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have reviewed [identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]. XYZ Company's management is responsible for [identify the subject matter, for example, presenting the schedule of investment returns] in accordance with (or based on) [identify the criteria, for example, the ABC criteria set forth in Note 1]. Our responsibility is to express a conclusion on [identify the subject matter, for example, the schedule of investment returns] based on our review.

Our review was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to [identify the subject matter, for example, the schedule of investment returns] in order for it to be in accordance with (or based on) the criteria. The procedures performed in a review vary in nature and timing from and are substantially less in extent than, an examination, the objective of which is to obtain reasonable assurance about whether [identify the subject matter, for example, the schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

[Include a description of the work performed as a basis for the practitioner's conclusion.]

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Based on our review, we are not aware of any material modifications that should be made to *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, in order for it to be in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 2: Practitioner's Review Report on an Assertion; Unmodified Conclusion; Use of the Report Is Restricted to Specified Parties

The following is an illustrative practitioner's report for a review engagement in which the practitioner has reviewed the responsible party's assertion and is reporting on that assertion. Although suitable criteria exist for the subject matter, use of the report is restricted to specified parties because the criteria are available only to the specified parties.

Independent Accountant's Report

[Appropriate Addressee]

We have reviewed management of XYZ Company's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with (or based on) the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for its assertion. Our responsibility is to express a conclusion on management's assertion based on our review.

Our review was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to management's assertion in order for it to be fairly stated. The procedures performed in a review vary in nature and timing from and are substantially less in extent than, an examination, the objective of which is to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

[Include a description of the work performed as a basis for the practitioner's conclusion.]

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Based on our review, we are not aware of any material modifications that should be made to management of XYZ Company's assertion in order for it to be fairly stated.

This report is intended solely for the information and use of *[identify the specified parties, for example, ABC Company and XYZ Company]*, and is not intended to be, and should not be, used by anyone other than the specified parties.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 3: Practitioner's Review Report on Subject Matter; Qualified Conclusion

The following is an illustrative practitioner's report for a review engagement in which the practitioner expresses a qualified conclusion because the review identified conditions that, individually or in combination, result in one or more material, but not pervasive, misstatements of the subject matter, based on the criteria. The practitioner has reviewed the subject matter and is also reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have reviewed *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]* based on *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. Our responsibility is to express a conclusion on *[identify the subject matter, for example, the schedule of investment returns]* based on our review.

Our review was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to *[identify the subject matter, for example, the schedule of investment returns]* in order for it to be in accordance with (or based on) the criteria. The procedures performed in a review vary in nature and timing from and are substantially less in extent than, an examination, the objective of which is to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

[Include a description of the work performed as a basis for the practitioner's conclusion.]

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraphs may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Our review identified *[describe conditions that, individually or in the aggregate, resulted in a material misstatement, or deviation from, the criteria]*.

Based on our review, except for the matters described in the preceding paragraph, we are not aware of any material modifications that should be made to *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, in order for it to be in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 4: Practitioner's Review Report on Subject Matter; Adverse Conclusion

The following is an illustrative practitioner's report for a review engagement in which the practitioner expresses an adverse conclusion because the review identified conditions that, individually or in combination, result in one or more material and pervasive misstatements of the subject matter based on the criteria. The practitioner has reviewed the subject matter and is also reporting on the subject matter.

Independent Accountant's Report

[Appropriate Addressee]

We have undertaken a review of *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]* based on *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. Our responsibility is to express a conclusion on *[identify the subject matter, for example, the schedule of investment returns]* based on our review.

Our review was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform this engagement to obtain limited assurance about whether any material modifications should be made to *[identify the subject matter, for example, the schedule of investment returns]* in order for it to be in accordance with (or based on) the criteria. The procedures performed in a review vary in nature and timing from and are substantially less in extent than, an examination, the objective of which is to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

XYZ Company has not *[describe the material and pervasive misstatement of the subject matter]*. Had XYZ Company properly accounted for *[describe the material and pervasive misstatement of the subject matter]*, many elements in *[identify the subject matter, for example, the schedule of investment returns]* would have been materially affected. The effects on the *[identify the subject matter, for example, the schedule of investment returns]* have not been determined.

Based on our review, because of the significance of the matter described in the preceding paragraph [*identify the subject matter, for example, the schedule of investment returns*], is not in accordance with [*identify the criteria, for example, the ABC criteria set forth in Note 1*]. [Had we been engaged to perform an examination, other matters might have come to our attention.]

[*Practitioner's signature*]

[*City and state where the practitioner's report is issued*]

[*Date of practitioner's report*]

AT-C Section 210A^{*}

Review Engagements

Source: SSAE No. 18; SSAE No. 20.

Effective for practitioners' review reports dated on or after May 1, 2017, unless otherwise indicated.

Introduction

.01 This section contains performance and reporting requirements and application guidance for all review engagements. The requirements and guidance in this section supplement the requirements and guidance in section 105, *Concepts Common to All Attestation Engagements*.

Effective Date

.02 This section is effective for practitioners' review reports dated on or after May 1, 2017.

Objectives

.03 In conducting a review engagement, the objectives of the practitioner are to

- a. obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria;
- b. express a conclusion in a written report about whether the practitioner is aware of any material modifications that should be made to
 - i. the subject matter in order for it to be in accordance with (or based on) the criteria or
 - ii. the responsible party's assertion in order for it to be fairly stated; and
- c. communicate further as required by relevant AT-C sections.

Definitions

.04 For purposes of this section, the following terms have the meanings attributed as follows:

Appropriateness of review evidence. The measure of the quality of review evidence, that is, its relevancy and reliability in providing support for the practitioner's conclusion.

Review evidence. Information used by the practitioner in obtaining limited assurance on which the practitioner's review report is based.

* This section contains an "AT-C" identifier, instead of an "AT" identifier, to avoid confusion with references to existing "AT" sections, which remain effective through April 2017.

Sufficiency of review evidence. The measure of the quantity of review evidence. The quantity of the review evidence needed is affected by the risks of material misstatement and also by the quality of such evidence.

Requirements

Conduct of a Review Engagement

.05 In performing a review engagement, the practitioner should comply with this section, section 105, and any subject-matter AT-C section that is relevant to the engagement. A subject-matter AT-C section is relevant to the engagement when it is in effect, and the circumstances addressed by the AT-C section exist. (Ref: par. .A1)

.06 The practitioner should consider whether the nature of review procedures would enable the practitioner to obtain sufficient appropriate review evidence to obtain limited assurance. (Ref: par. .A2)

.07 A practitioner should not perform a review of (Ref: par. .A2)

- a. prospective financial information,
- b. internal control, or
- c. compliance with requirements of specified laws, regulations, rules, contracts, or grants.

Agreeing on the Terms of the Engagement

.08 The practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. (Ref: par. .A3)

.09 The agreed-upon terms of the engagement should include the following:

- a. The objective and scope of the engagement
- b. The responsibilities of the practitioner (Ref: par. .A4)
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different
- e. A statement that a review is substantially less in scope than an examination, the objective of which is to obtain reasonable assurance about whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or the assertion is fairly stated, in all material respects, in order to express an opinion, and that, accordingly, the practitioner will not express such an opinion
- f. Identification of the criteria for the measurement, evaluation, or disclosure of the subject matter
- g. An acknowledgement that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

.10 Although an engagement may recur, each engagement is considered a separate engagement. The practitioner should assess whether circumstances require revision to the terms of a preceding engagement. If the practitioner concludes that the terms of the preceding engagement need not be revised for the current engagement, the practitioner should remind the engaging party of the terms of the current engagement, and the reminder should be documented.

Requesting a Written Assertion

.11 The practitioner should request from the responsible party a written assertion about the measurement or evaluation of the subject matter against the criteria. When the engaging party is the responsible party and refuses to provide a written assertion, paragraph .59 requires the practitioner to withdraw from the engagement, when withdrawal is possible under applicable laws and regulations. When the engaging party is not the responsible party, and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement. In that case, paragraph .60 requires the practitioner to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party. (Ref: par. .A5–.A8 and .A76)

Planning and Performing the Engagement

.12 The practitioner should set the scope, timing, and direction of the engagement and determine the nature, timing, and extent of the planned procedures that are required to be carried out in order to achieve the objectives of the engagement. (Ref: par. .A9–.A12)

.13 The practitioner should obtain an understanding of the subject matter and other engagement circumstances sufficient to provide a basis for designing and performing procedures in order to achieve the objectives of the engagement. That understanding should include the practices used to measure, recognize, and record the subject matter. (Ref: par. .A13)

Materiality in Planning and Performing the Engagement

.14 The practitioner should consider materiality when (Ref: par. .A14–.A19)

- planning and performing the review engagement, including when determining the nature, timing, and extent of procedures.
- evaluating whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the assertion in order for it to be fairly stated.

Procedures to Be Performed

.15 To obtain limited assurance, the practitioner should obtain sufficient appropriate review evidence in order to express a conclusion about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria, or the assertion, in order for it to be fairly stated.

.16 The practitioner should apply professional judgment in determining the specific nature, timing, and extent of review procedures. Based on (Ref: par. .A20–.A23)

- a.* the practitioner's understanding of

- i. the subject matter and the practices used by the responsible party to measure, recognize, and record the subject matter and
 - ii. the engagement circumstances, and
- b. the practitioner's awareness of the risk that the practitioner may unknowingly fail to modify the practitioner's report when the subject matter is materially misstated,

the practitioner should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to accumulate review evidence in obtaining limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria, or the assertion, in order for it to be fairly stated.

.17 Analytical procedures may not be possible when the subject matter is qualitative, rather than quantitative. In those circumstances, the practitioner should perform other procedures, in addition to inquiries, that provide equivalent levels of review evidence. (Ref: par. .A24)

.18 The practitioner should place increased focus in those areas in which the practitioner believes there are increased risks that the subject matter may be materially misstated. (Ref: par. .A25–.A26)

Analytical Procedures

.19 When designing and performing analytical procedures, the practitioner should (Ref: par. .A27–.A28)

- a. determine the suitability of particular analytical procedures for the subject matter, taking into account the practitioner's awareness of risks;
- b. evaluate the reliability of data from which the practitioner's expectation is developed, taking into account the source, comparability, nature, and relevance of information available; and
- c. develop an expectation with respect to recorded amounts or ratios.

.20 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ significantly from expected amounts or ratios, the practitioner should (Ref: par. .A29)

- a. inquire of the responsible party about such differences and
- b. consider the responses to these inquiries to determine whether other procedures are necessary in the circumstances.

Inquiries and Other Review Procedures

.21 The practitioner should inquire of the responsible party about the following: (Ref: par. .A30)

- a. Whether the subject matter has been prepared in accordance with (or based on) the criteria
- b. The practices used by the responsible party to measure, recognize, and record the subject matter
- c. Questions that have arisen in the course of applying the review procedures
- d. Communications from regulatory agencies or others, if relevant

.22 The practitioner should consider the reasonableness and consistency of the responsible party's responses in light of the results of other review procedures and the practitioner's knowledge of the subject matter, criteria, and responsible party.

Fraud, Laws, and Regulations

.23 The practitioner should make inquiries of appropriate parties to determine whether they have knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter.

.24 The practitioner should respond appropriately to fraud or suspected fraud and noncompliance or suspected noncompliance with laws or regulations affecting the subject matter that is identified during the engagement. (Ref: par. .A31–.A32)

Incorrect, Incomplete, or Otherwise Unsatisfactory Information

.25 During the performance of review procedures, if the practitioner becomes aware that information coming to the practitioner's attention is incorrect, incomplete, or otherwise unsatisfactory, the practitioner should request that the responsible party consider the effect of these matters on the subject matter and communicate the results of its consideration to the practitioner. The practitioner should consider the results communicated to the practitioner by the responsible party and the potential effect, if any, on the practitioner's report.

.26 If the practitioner believes the subject matter may be materially misstated, the practitioner should perform additional procedures sufficient to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or the assertion in order for it to be fairly stated.

Using the Work of a Practitioner's Specialist or Internal Auditors

.27 When the practitioner expects to use the work of a practitioner's specialist or internal auditors, the practitioner should apply the requirements in section 205, *Examination Engagements*, and the related application guidance, as appropriate, for a review engagement.¹

Evaluating the Results of Review Procedures

.28 The practitioner should accumulate misstatements identified during the engagement, other than those that are clearly trivial. (Ref: par. .A33–.A34)

.29 The practitioner should evaluate the sufficiency and appropriateness of the review evidence obtained in the context of the engagement and, if necessary, attempt to obtain further review evidence. The practitioner should consider all relevant review evidence, regardless of whether it appears to corroborate or contradict the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A35–.A37)

.30 If the practitioner concludes that the subject matter is materially misstated or is unable to obtain review evidence sufficient for limited assurance, the practitioner should consider the implications for the practitioner's conclusion in paragraphs .51–.60.

¹ Paragraphs .36–.44 of section 205, *Examination Engagements*.

Considering Subsequent Events and Subsequently Discovered Facts

.31 The practitioner should inquire whether the responsible party, and if different, the engaging party, is aware of any events subsequent to the period (or point in time) covered by the review engagement up to the date of the practitioner's report that could have a significant effect on the subject matter or assertion. If the practitioner becomes aware, through inquiry or otherwise, of such an event, or any other event that is of such a nature and significance that its disclosure is necessary to prevent users of the report from being misled, and information about that event is not adequately disclosed by the responsible party in the subject matter or in its assertion, the practitioner should take appropriate action. (Ref: par. .A38–.A40)

.32 The practitioner has no responsibility to perform any procedures regarding the subject matter or assertion after the date of the practitioner's report. Nevertheless, the practitioner should respond appropriately to facts that become known to the practitioner after the date of the report that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. (Ref: par. .A41–.A42)

Written Representations

.33 The practitioner should request from the responsible party written representations in the form of a letter addressed to the practitioner. The representations should (Ref: par. .A43–.A46)

- a. include the responsible party's assertion about the subject matter based on the criteria. (Ref: par. .A76)
- b. state that all relevant matters are reflected in the measurement or evaluation of the subject matter or assertion.
- c. state that all known matters contradicting the subject matter or assertion and any communication from regulatory agencies or others affecting the subject matter or assertion have been disclosed to the practitioner, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report.
- d. acknowledge responsibility for
 - i. the subject matter and the assertion;
 - ii. selecting the criteria, when applicable; and
 - iii. determining that such criteria are appropriate for the responsible party's purposes.
- e. state that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion have been disclosed to the practitioner. (Ref: par. .A45)
- f. state that it has provided the practitioner with all relevant information and access.
- g. if applicable, state that the responsible party believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the subject matter. (Ref: par. .A46)
- h. if applicable, state that significant assumptions used in making any material estimates are reasonable.
- i. state that the responsible party has disclosed to the practitioner

- i. all deficiencies in internal control relevant to the engagement of which the responsible party is aware;
- ii. its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter; and
- iii. other matters as the practitioner deems appropriate.

.34 When the engaging party is not the responsible party, and the responsible party refuses to provide the representations in paragraph .33 in writing, the practitioner should make inquiries of the responsible party about, and seek oral responses to, the matters in paragraph .33. (Ref: par. .A47)

.35 When the engaging party is not the responsible party, the practitioner should request written representations from the engaging party, in addition to those requested from the responsible party, in the form of a letter addressed to the practitioner. The representations should

- a. acknowledge that the responsible party is responsible for the subject matter and assertion.
- b. acknowledge the engaging party's responsibility for selecting the criteria, when applicable.
- c. acknowledge the engaging party's responsibility for determining that such criteria are appropriate for its purposes.
- d. state that the engaging party is not aware of any material misstatements in the subject matter or assertion.
- e. state that the engaging party has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion. (Ref: par. .A45)
- f. address other matters as the practitioner deems appropriate.

.36 When written representations are directly related to matters that are material to the subject matter, the practitioner should

- a. evaluate their reasonableness and consistency with other review evidence obtained, including other representations (oral or written) and
- b. consider whether those making the representations can be expected to be well informed on the particular matters.

.37 The date of the written representations should be as of the date of the practitioner's report. The written representations should address the subject matter and periods covered by the practitioner's conclusion.

Requested Written Representations Not Provided or Are Unreliable

.38 When the engaging party is the responsible party, and one or more of the requested written representations are not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should

- a. discuss the matter with the appropriate party(ies),
- b. reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may

have on the reliability of representations and review evidence in general, and

- c. if any of the matters are not resolved to the practitioner's satisfaction, withdraw from the engagement.

.39 When the engaging party is not the responsible party (Ref: par. .A47–.A49)

- a. if one or more of the requested representations are not provided in writing by the responsible party, but the practitioner receives satisfactory oral responses to the practitioner's inquiries performed in accordance with paragraph .34 sufficient to enable the practitioner to conclude that the practitioner has sufficient appropriate review evidence to form a conclusion about the subject matter, the practitioner's report should contain a separate paragraph that restricts the use of the practitioner's report to the engaging party. (Paragraphs .48–.49 contain requirements for the contents of such a paragraph.)
- b. if one or more of the requested representations are provided neither in writing nor orally from the responsible party in accordance with paragraph .34, a scope limitation exists, and the practitioner should withdraw from the engagement.

Other Information

.40 If prior to or after the release of the practitioner's report on subject matter or an assertion, the practitioner is willing to permit the inclusion of the practitioner's report in a document that contains the subject matter or assertion and other information, the practitioner should read the other information to identify material inconsistencies, if any, with the subject matter, assertion, or the practitioner's report. If on reading the other information, in the practitioner's professional judgment (Ref: par. .A50–.A51)

- a. a material inconsistency between that other information and the subject matter, assertion, or the practitioner's report exists, or
- b. a material misstatement of fact exists in the other information, the subject matter, assertion, or the practitioner's report

the practitioner should discuss the matter with the responsible party and take further action as appropriate.

Description of Criteria

.41 The practitioner should evaluate whether the written description of the subject matter or assertion adequately refers to or describes the criteria. (Ref: par. .A52–.A53)

Forming the Conclusion

.42 The practitioner should form a conclusion about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria or to the responsible party's assertion in order for it to be fairly stated. In forming that conclusion, the practitioner should evaluate

- a. the practitioner's conclusion regarding the sufficiency and appropriateness of the review evidence obtained and (Ref: par. .A54)

- b. whether uncorrected misstatements are material, individually or in the aggregate. (Ref: par. .A55)

.43 The practitioner should evaluate, based on the review evidence obtained, whether the presentation of the subject matter or assertion is misleading within the context of the engagement. (Ref: par. .A56–.A57)

Preparing the Practitioner's Report

.44 The practitioner's report should be in writing. (Ref: par. .A58–.A59)

.45 A practitioner should report on a written assertion or should report directly on the subject matter. If the practitioner is reporting on the assertion, the assertion should be bound with or accompany the practitioner's report, or the assertion should be clearly stated in the report. (Ref: par. .A60)

Content of the Practitioner's Report

.46 The practitioner's report should include the following:

- a. A title that includes the word *independent*. (Ref: par. .A61)
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates.
- d. An identification of the criteria against which the subject matter was measured or evaluated. (Ref: par. .A62)
- e. A statement that identifies
 - i. the responsible party and its responsibility for the subject matter in accordance with (or based on) the criteria or for its assertion and (Ref: par. .A63–.A64)
 - ii. the practitioner's responsibility to express a conclusion on the subject matter or assertion, based on the practitioner's review. (Ref: par. .A63)
- f. A statement that
 - i. the practitioner's review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants.
 - ii. those standards require that the practitioner plan and perform the review to obtain limited assurance about whether any material modifications should be made to
 - (1) the subject matter in order for it to be in accordance with (or based on) the criteria (or equivalent language regarding the subject matter and criteria, such as the language used in the examples in paragraph .A65) or
 - (2) the responsible party's assertion in order for it to be fairly stated.
 - iii. a review is substantially less in scope than an examination, the objective of which is to obtain reasonable assurance about whether the subject matter is in accordance with (or based on) the criteria, in all material respects, or

the responsible party's assertion is fairly stated, in all material respects, in order to express an opinion. Accordingly, the practitioner does not express such an opinion.

- iv. the practitioner believes the review provides a reasonable basis for the practitioner's conclusion.
- g. A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria. (Ref: par. .A66)
- h. The practitioner's conclusion about whether, based on the review, the practitioner is aware of any material modifications that should be made to (Ref: par. .A67–.A69)
 - i. the subject matter in order for it be in accordance with (or based on) the criteria (or equivalent language regarding the subject matter and criteria, such as the language used in the examples in paragraph .A67) or
 - ii. the responsible party's assertion in order for it to be fairly stated.
- i. The manual or printed signature of the practitioner's firm.
- j. The city and state where the practitioner practices. (Ref: par. .A70)
- k. The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate review evidence on which to base the practitioner's conclusion, including evidence that
 - i. the attestation documentation has been reviewed,
 - ii. if applicable, the written presentation of the subject matter has been prepared, and
 - iii. the responsible party has provided a written assertion or, in the circumstance described in paragraph .A49, an oral assertion.) (Ref: par. .A71–.A72)

Restricted-Use Paragraph

.47 In the following circumstances, the practitioner's report should include an alert, in a separate paragraph, that restricts the use of the report: (Ref: par. .A73–.A76)

- a. The practitioner determines that the criteria used to evaluate the subject matter are appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.
- b. The criteria used to evaluate the subject matter are available only to specified parties.
- c. The engaging party is not the responsible party, and the responsible party does not provide the written representations required by paragraph .33, but does provide oral responses to the practitioner's inquiries about the matters in paragraph .33, as provided for in paragraphs .34 and .39a. In this case, use of the report should be restricted to the engaging party. (Ref: par. .A76)

.48 The alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties,
- b. identify the specified parties for whom use is intended, and (Ref: par. .A77)

- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A78–.A80)

.49 When the engagement is also performed in accordance with *Government Auditing Standards*, the alert that restricts the use of the practitioner's report should include the following information, rather than the information required by paragraph .48:

- a. A description of the purpose of the report
- b. A statement that the report is not suitable for any other purpose

Reference to the Practitioner's Specialist

.50 The practitioner should not refer to the work of a practitioner's specialist in the practitioner's report containing an unmodified conclusion. (Ref: par. .A81)

Modified Conclusions

Misstatement of Subject Matter

.51 A practitioner who is engaged to perform a review engagement may become aware that the subject matter is misstated. If the misstatement is not corrected, the practitioner should consider whether qualification of the conclusion in the standard practitioner's report is adequate to disclose the misstatement of the subject matter. (Ref: par. .A82)

.52 When the practitioner qualifies the conclusion, the practitioner should include a separate paragraph in the practitioner's report that provides a description of the matter(s) giving rise to the qualification.

.53 The practitioner should express a qualified conclusion when the effects of a matter are material but not pervasive. A qualified conclusion is expressed as being "except for the effects" of the matter to which the qualification relates. When the effects of a matter are material and also pervasive, the practitioner should withdraw from the engagement, when withdrawal is possible under applicable laws and regulations. (Ref: par. .A83)

.54 If the practitioner has concluded that the material misstatement results in a qualified conclusion, the practitioner should report directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement.

.55 If the practitioner believes that qualification of the conclusion in the standard practitioner's report is not adequate to indicate the misstatements in the subject matter, the practitioner should withdraw from the engagement.

.56 The practitioner's conclusion on the subject matter or assertion should be clearly separated from any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities.

.57 When the conclusion is qualified, reference to an external specialist is permitted when such reference is relevant to an understanding of the qualification to the practitioner's conclusion. The practitioner should indicate in the practitioner's report that such reference does not reduce the practitioner's responsibility for that conclusion.

Scope Limitations

.58 If the practitioner is unable to obtain sufficient appropriate review evidence, a scope limitation exists. When a scope limitation exists, the practitioner

should withdraw from the engagement, when withdrawal is possible under applicable laws and regulations. (Ref: par. .A84–.A86)

Responsible Party Refuses to Provide a Written Assertion

.59 If the engaging party is the responsible party and refuses to provide the practitioner with a written assertion as required by paragraph .11, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation.

.60 When the engaging party is not the responsible party and the responsible party refuses to provide the practitioner with a written assertion, the practitioner may report on the subject matter but should disclose in the practitioner's report the responsible party's refusal to provide a written assertion and should restrict the use of the practitioner's report to the engaging party. (Ref: par. .A87–.A88)

Communication Responsibilities

.61 The practitioner should communicate to the responsible party known and suspected fraud and noncompliance with laws or regulations, as well as uncorrected misstatements. When the engaging party is not the responsible party, the practitioner should also communicate this information to the engaging party. (Ref: par. .A89)

Documentation

.62 The practitioner should prepare engagement documentation that is sufficient to determine (Ref: par. .A90–.A93)

- a. the nature, timing, and extent of the procedures performed to comply with relevant AT-C sections and applicable legal and regulatory requirements, including
 - i. the identifying characteristics of the specific items or matters tested;
 - ii. who performed the engagement work and the date such work was completed;
 - iii. the discussions with the responsible party or others about findings or issues that, in the practitioner's professional judgment, are significant, including the nature of the significant findings or issues discussed, and when and with whom the discussions took place;
 - iv. when the engaging party is the responsible party and the responsible party will not provide one or more of the requested written representations; the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations; or that the written representations are otherwise not reliable, the matters in paragraph .38;
 - v. when the engaging party is not the responsible party and the responsible party will not provide the written representations regarding the matters in paragraph .33, the oral responses from the responsible party to the practitioner's inquiries regarding the matters in paragraph .33, in accordance with paragraph .34; and

- vi. who reviewed the engagement work performed and the date and extent of such review.
- b. the results of the procedures performed and the review evidence obtained.

.63 If the practitioner identified information that is inconsistent with the practitioner's final conclusion regarding a significant finding or issue, the practitioner should document how the practitioner addressed the inconsistency.

.64 If, in circumstances such as those described in paragraph .32, the practitioner performs new or additional procedures or draws new conclusions after the date of the practitioner's report, the practitioner should document

- a. the circumstances encountered;
- b. the new or additional procedures performed, evidence obtained, and conclusions reached and their effect on the report; and
- c. when and by whom the resulting changes to the documentation were made and reviewed.

Application and Other Explanatory Material

Conduct of a Review Engagement (Ref: par. .05–.07)

.A1 For example, if a practitioner was reviewing pro forma financial information, section 105, this section, and section 310, *Reporting on Pro Forma Financial Information*, would be relevant.

.A2 Review procedures generally are limited to inquiries and analytical procedures. In circumstances in which inquiry and analytical procedures are not expected to provide sufficient appropriate review evidence, or when the nature of the subject matter does not lend itself to the application of analytical procedures, the practitioner may perform other procedures that he or she believes can provide the practitioner with a level of assurance equivalent to that which inquiries and analytical procedures would have provided. If the practitioner cannot design other procedures to obtain sufficient appropriate review evidence, a review engagement may not be appropriate.

Agreeing on the Terms of the Engagement (Ref: par. .08 and .09b)

.A3 It is in the interests of both the engaging party and the practitioner to document the agreed-upon terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the engagement letter or other suitable form of written agreement will vary with the engagement circumstances.

.A4 A practitioner may further describe the responsibilities of the practitioner by adding the following items to the engagement letter or other suitable form of written agreement:

- a. A statement that a review is designed to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to be in accordance with (or based on) the criteria
- b. A statement that the objective of a review is the expression of a conclusion in a written practitioner's report about whether the

practitioner is aware of any material modifications that should be made to

- i. the subject matter in order for it be in accordance with (or based on) the criteria or
- ii. the responsible party's assertion in order for it to be fairly stated

Requesting a Written Assertion (Ref: par. .11)

.A5 The language of the responsible party's written assertion in paragraph .11 may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .11 include the following:

- The subject matter is presented in accordance with (or based on) the criteria.
- The subject matter achieved the objectives, for example, when the objectives are the criteria.

.A6 Situations may arise in which the current responsible party was not present during some or all of the period covered by the practitioner's report. Such persons may contend that they are not in a position to provide a written assertion that covers the entire period because they were not in place during some or all of the period. This fact, however, does not diminish such persons' responsibilities for the subject matter as a whole. Accordingly, the requirement for the practitioner to request a written assertion from the responsible party that covers the entire relevant period(s) still applies.

.A7 Paragraph .33a requires the practitioner to request a written representation from the responsible party that is the same as the responsible party's assertion. If the responsible party provides the practitioner with the written representation in paragraph .33a, the practitioner need not request a separate written assertion, unless a separate written assertion is called for by the engagement circumstances. (Ref: par. .11)

.A8 A practitioner may also be engaged to assist the responsible party in measuring or evaluating the subject matter against the criteria in connection with the responsible party providing a written assertion. Regardless of the procedures performed by the practitioner, the responsible party is required to accept responsibility for its assertion and the subject matter and may not base its assertion solely on the practitioner's procedures.²

Planning and Performing the Engagement (Ref: par. .12–.13)

.A9 Planning involves the engagement partner and other key members of the engagement team and may involve the practitioner's specialists. Adequate planning helps the practitioner devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis, and properly organize and manage the engagement in order for it to be performed in an effective and efficient manner. Adequate planning also assists the practitioner in properly assigning work to engagement team members, and facilitates the direction, supervision, and the review of their work. Further, it assists, when applicable, the coordination of work performed by other practitioners and practitioner's specialists. The nature and extent of planning activities will vary

² The "Nonattest Services" subtopic (ET sec. 1.295) of the AICPA Code of Professional Conduct addresses the practitioner's provision of nonattest services for an attest client.

with the engagement circumstances, for example, the complexity of the assessment or evaluation of the subject matter and the practitioner's previous experience with it. Examples of relevant matters that may be considered include the following:

- The characteristics of the engagement that define its scope, including the terms of the engagement, the characteristics of the underlying subject matter, and the criteria
- The expected timing and nature of the communications required
- The results of preliminary engagement activities, such as client acceptance, and, when applicable, whether knowledge gained on other engagements performed by the engagement partner for the appropriate party(ies) is relevant
- The engagement process, including possible sources of review evidence, and choices among alternative measurement or evaluation methods
- The practitioner's understanding of the appropriate party(ies) and its (their) environment, including the risks that the subject matter may be materially misstated
- Identification of intended users and their information needs and consideration of materiality and the components of attestation risk
- The risk of fraud relevant to the engagement
- The effect on the engagement of using the internal audit function

.A10 The practitioner may decide to discuss elements of planning with the appropriate party(ies) to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work of the responsible party's personnel). Although these discussions often occur, the elements of planning remain the practitioner's responsibility. When discussing planning matters, care is needed to avoid compromising the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the responsible party may compromise the effectiveness of the engagement by making the procedures too predictable.

.A11 Planning is not a discrete phase but, rather, a cumulative and iterative process throughout the engagement. As a result of unexpected events, changes in conditions, or review evidence obtained, the practitioner may need to revise the nature, timing, and extent of planned procedures.

.A12 In smaller or less complex engagements, the entire engagement may be conducted by a very small engagement team, possibly involving the engagement partner (who may be a sole practitioner) working without any other engagement team members. With a smaller team, coordination of, and communication among, team members is easier. In such cases, planning the engagement need not be a complex or time-consuming exercise; it varies according to the size of the entity, the complexity of the engagement, and the size of the engagement team.

.A13 Obtaining an understanding of the subject matter and other engagement circumstances provides the practitioner with a frame of reference for exercising professional judgment throughout the engagement, for example, when

- considering the characteristics of the subject matter;
- assessing the suitability of the criteria;

- considering the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts, including situations in which special consideration may be necessary (for example, when there is a need for specialized skills or the work of a specialist);
- establishing and evaluating the continued appropriateness of quantitative materiality levels (when appropriate) and considering qualitative materiality factors;
- developing expectations when performing analytical procedures;
- designing and performing procedures; and
- evaluating review evidence, including the reasonableness of the written representations received by the practitioner.

In some review engagements, the practitioner may obtain an understanding of internal control over the measurement, evaluation, or disclosure of the subject matter.

Materiality in Planning and Performing the Engagement **(Ref: par. .14)**

.A14 Materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative factors and quantitative factors when considering materiality in a particular engagement is a matter for the practitioner's professional judgment.

.A15 Professional judgments about materiality are made in light of surrounding circumstances, but they are not affected by the level of assurance, that is, for the same intended users, materiality for a review engagement is the same as it is for an examination engagement because materiality is based on the information needs of intended users and not the level of assurance.

.A16 In general, misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by intended users based on the subject matter. The practitioner's consideration of materiality is a matter of professional judgment and is affected by the practitioner's perception of the common information needs of intended users as a group. For purposes of determining materiality, the practitioner may assume that intended users

- a. have a reasonable knowledge of the subject matter and a willingness to study the subject matter with reasonable diligence.
- b. understand that the subject matter is measured or evaluated and reviewed to appropriate levels of materiality and have an understanding of any materiality concepts included in the criteria.
- c. understand any inherent uncertainties involved in measuring or evaluating the subject matter.
- d. make reasonable judgments based on the subject matter.

Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered. [As amended, effective for practitioners' review reports dated on or after December 15, 2020, by SSAE No. 20.]

.A17 Qualitative factors may include the following:

- The interaction between, and relative importance of, various aspects of the subject matter, such as numerous performance indicators
- The wording chosen with respect to subject matter that is expressed in narrative form, for example, the wording chosen does not omit or distort the information
- The characteristics of the presentation adopted for the subject matter when the criteria allow for variations in that presentation
- The nature of a misstatement
- Whether a misstatement affects compliance with laws or regulations
- In the case of periodic reporting on a subject matter, the effect of an adjustment that affects past or current information about the subject matter or is likely to affect future information about the subject matter
- Whether a misstatement is the result of an intentional act or is unintentional
- Whether a misstatement is significant with regard to the practitioner's understanding of known previous communications to users, for example, in relation to the expected outcome of the measurement or evaluation of the subject matter
- Whether a misstatement relates to the relationship between the responsible party and, if different, the engaging party or its relationship with other parties

.A18 Quantitative factors relate to the magnitude of misstatements relative to reported amounts for those aspects of the subject matter, if any, that are

- expressed numerically or
- otherwise related to numerical values.

.A19 The criteria may discuss the concept of materiality in the context of the preparation and presentation of the subject matter and thereby provide a frame of reference for the practitioner in considering materiality for the engagement. Although criteria may discuss materiality in different terms, the concept of materiality generally includes the matters discussed in paragraphs .A14–.A18. If the criteria do not include a discussion of the concept of materiality, these paragraphs provide the practitioner with a frame of reference.

Procedures to Be Performed (Ref: par. .16–.18)

.A20 Review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the practitioner with a reasonable basis for obtaining limited assurance. However, the practitioner may determine it is appropriate to perform additional procedures if the practitioner determines such procedures to be necessary in order to meet the objectives of this section.

.A21 The degree to which procedures beyond analytical procedures and inquiry may be performed may be influenced by factors specific to the engagement. The practitioner may substitute other procedures that provide equivalent levels of review evidence.

.A22 Information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was

based. As the practitioner performs planned procedures, the review evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the responsible party to examine the matter identified by the practitioner and to make adjustments to the subject matter, if appropriate.

.A23 In some cases, a subject-matter AT-C section may include requirements that affect the nature, timing, and extent of procedures. For example, a subject-matter AT-C section may describe the nature or extent of particular procedures to be performed in a particular type of engagement. Even in such cases, determining the exact nature, timing, and extent of procedures is a matter of professional judgment and will vary from one engagement to the next.

.A24 Review procedures generally are limited to inquiries and analytical procedures. In circumstances in which inquiry and analytical procedures are not expected to provide sufficient appropriate review evidence, or when the nature of the subject matter does not lend itself to the application of analytical procedures, the practitioner may perform other procedures that he or she believes can provide the practitioner with a level of assurance equivalent to that which inquiries and analytical procedures would have provided. If the practitioner cannot design other procedures to obtain sufficient appropriate review evidence, a review engagement may not be appropriate.

.A25 The results of the practitioner's analytical procedures and inquiries may modify the practitioner's risk awareness.

.A26 The practitioner may become aware of a matter(s) that causes the practitioner to believe that the subject matter may be materially misstated when, for example, performing analytical procedures if the practitioner identifies a fluctuation or relationship that is inconsistent with other relevant information or that differs significantly from expected amounts or ratios. In such cases, the practitioner's investigation of such differences may include inquiring of the responsible party or performing other procedures as appropriate in the circumstances.

Analytical Procedures (Ref: par. .19–.20)

.A27 An understanding of the purposes of analytical procedures and the limitations of those procedures is important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires professional judgment by the practitioner.

.A28 Analytical procedures involve comparisons of expectations developed by the practitioner to recorded amounts or ratios developed from recorded amounts. The practitioner develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the subject matter; the practices used by the responsible party to measure, recognize, and record the subject matter; and, if applicable, the industry in which the entity operates.

.A29 Analytical procedures in a review engagement are not designed to identify misstatements with the level of precision expected in an examination engagement. Further, when significant fluctuations, relationships, or differences are identified, appropriate review evidence in a review engagement may often be obtained by making inquiries of the responsible party and considering responses received in the light of known engagement circumstances without obtaining additional evidence required in the case of an examination engagement.

Inquiries and Other Review Procedures (Ref: par. .21)

.A30 The practitioner is not ordinarily required to corroborate the responsible party's responses with other review evidence.

Fraud, Laws, and Regulations (Ref: par. .24)

.A31 In responding to fraud or suspected fraud identified during the engagement, it may be appropriate, unless prohibited by law, regulation, or ethics standards, for the practitioner to, for example

- discuss the matter with the appropriate party(ies).
- request that the responsible party consult with an appropriately qualified third party, such as the entity's legal counsel or a regulator.
- consider the implications of the matter in relation to other aspects of the engagement, including the practitioner's planning and the reliability of written representations from the responsible party.
- obtain legal advice about the consequences of different courses of action.
- communicate with third parties (for example, a regulator).
- withdraw from the engagement.

.A32 The actions noted in paragraph .A31 also may be appropriate in responding to noncompliance or suspected noncompliance with laws or regulations identified during the engagement. It may also be appropriate to describe the matter in a separate paragraph of the practitioner's report, unless the practitioner

- a. is precluded by the responsible party from obtaining sufficient appropriate review evidence to evaluate whether noncompliance that may be material to the subject matter has, or is likely to have, occurred, in which case, paragraph .58 applies or
- b. concludes that the noncompliance results in a material misstatement of the subject matter, in which case, paragraphs .51–.57 apply.

Evaluating the Results of Review Procedures (Ref: par. .28–.29)

.A33 Uncorrected misstatements are accumulated during the engagement for the purpose of evaluating whether, individually or in aggregate, they are material when forming the practitioner's conclusion. (See paragraph .42b.)

.A34 "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality and will be matters that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

.A35 Sufficient appropriate review evidence is necessary to support the practitioner's conclusion and report.

.A36 The sufficiency and appropriateness of review evidence are interrelated. Sufficiency of review evidence is the measure of the quantity of review

evidence. The quantity of the review evidence needed is affected by the risks of material misstatement and also by the quality of such review evidence.

.A37 Whether sufficient appropriate review evidence has been obtained on which to base the practitioner's conclusion is a matter of professional judgment.

Considering Subsequent Events and Subsequently Discovered Facts (Ref: par. .31–.32)

.A38 For certain subject-matter AT-C sections, specific subsequent events requirements and related application guidance have been developed for engagement performance and reporting.

.A39 Procedures that a practitioner may perform to identify subsequent events include inquiring about and considering information

- contained in relevant reports issued during the subsequent period by internal auditors, other practitioners, or regulatory agencies
- obtained through other professional engagements for that entity

.A40 If the responsible party refuses to disclose a subsequent event for which disclosure is necessary to prevent users of the practitioner's report from being misled, appropriate actions the practitioner may take include

- disclosing the event in the report and modifying the practitioner's conclusion.
- withdrawing from the engagement.

.A41 Subsequent to the date of the practitioner's report, the practitioner may become aware of facts that, had they been known to the practitioner at that date, may have caused the practitioner to revise the report. In such circumstances, the practitioner undertakes to determine whether the facts existed at the date of the report and, if so, whether persons are currently using or likely to use the report and related subject matter or assertion who would attach importance to these facts. This may include discussing the matter with the appropriate party(ies) and requesting the appropriate party(ies)'s cooperation in whatever investigation or further action that may be necessary. The specific actions to be taken in a particular case by the appropriate party(ies) and the practitioner may vary with the circumstances. Consideration may be given to, among other things, the time elapsed since the date of the report and whether issuance of a subsequent report is imminent. The practitioner may need to perform additional procedures deemed necessary to determine whether the subject matter or assertion needs revision and whether the previously issued report continues to be appropriate.

.A42 Depending on the circumstances, the practitioner may determine that notification of the situation by the appropriate party(ies) to persons who would attach importance to these facts and who are currently using, or are likely to use, the practitioner's report who would attach importance to the facts is necessary. This may be the case, for example, when

- a. the report is not to be relied upon because the subject matter or assertion needs revision or the practitioner is unable to determine whether revision is necessary, and
- b. issuance of a subsequent report is not imminent.

If the appropriate party(ies) failed to take the necessary steps to prevent reliance on the report, the practitioner's course of action depends upon the practitioner's legal and ethical rights and obligations. Consequently, the practitioner may consider it appropriate to seek legal advice prior to making any disclosure

of the situation. Disclosure of the situation directly by the practitioner may include a description of the nature of the matter and of its effect on the subject matter or assertion and the report, avoiding comments concerning the conduct or motives of any person.

Written Representations (Ref: par. .33–.34, .35e, and .39a)

.A43 Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the responsible party. The person(s) from whom the practitioner requests written representations is ordinarily a member of senior management or those charged with governance depending on, for example, the management and governance structure of the responsible party(ies), which may vary by entity, reflecting influences such as size and ownership characteristics.

.A44 Representations by the responsible party cannot replace other review evidence the practitioner could reasonably expect to be available. Although written representations provide review evidence, they do not provide sufficient appropriate review evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other review evidence that the practitioner obtains.

.A45 A discussion of what is considered a material effect on the subject matter or assertion may be included explicitly in the representation letter in qualitative or quantitative terms.

.A46 A summary of uncorrected misstatements ordinarily is included in or attached to the written representation.

.A47 Certain subject-matter AT-C sections do not permit the practitioner to perform the alternative procedures described in paragraphs .34 and .39a (making inquiries of the responsible party and restricting the use of the practitioner's report).

Requested Written Representations Not Provided or Not Reliable (Ref: par. .39)

.A48 Even when the responsible party provides oral responses to the matters in paragraph .33, the practitioner may find it appropriate to consider whether there are significant concerns about the competence, integrity, ethical values, or diligence of those providing the oral responses or whether the oral responses are otherwise not reliable and the potential effect, if any, on the practitioner's report.

.A49 Paragraph .11 provides an exception to the requirement for a written assertion when the engaging party is not the responsible party. Nonetheless, because the assertion is the representation called for by paragraph .33a, application of paragraph .39a requires the practitioner to obtain an oral assertion, when a written assertion is not obtained. Paragraph .39b applies when the responsible party provides neither a written nor an oral assertion.

Other Information (Ref: par. .40)

.A50 Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example, the following:

- Requesting the appropriate party(ies) to consult with a qualified third party, such as the appropriate party(ies)'s legal counsel
- Obtaining legal advice about the consequences of different courses of action
- If required or permissible, communicating with third parties (for example, a regulator)
- Describing the material inconsistency in the practitioner's report
- Withdrawing from the engagement, when withdrawal is possible under applicable law or regulation

.A51 Other information does not include information contained on the appropriate party(ies)'s website. Websites are a means of distributing information and are not, themselves, documents for the purposes of paragraph .40.

Description of Criteria (Ref: par. .41)

.A52 The description of the criteria on which the subject matter or assertion is based is particularly important when there are significant differences between various criteria regarding how particular matters may be treated in the subject matter.

.A53 A description of the criteria that states that the subject matter is prepared in accordance with (or based on) particular criteria is appropriate only if the subject matter complies with all relevant requirements of those criteria that are effective.

Forming the Conclusion (Ref: par. .42–.43)

.A54 The practitioner's professional judgment regarding what constitutes sufficient appropriate review evidence is influenced by such factors as the following:

- The significance of a potential misstatement and the likelihood that it will have a material effect, individually or aggregated with other potential misstatements, on the subject matter or assertion
- The effectiveness of the responsible party's responses to address the known risks
- The experience gained during previous examination or review engagements with respect to similar potential misstatements
- The results of procedures performed, including whether such procedures identified specific misstatements
- The source and reliability of the available information
- The persuasiveness of the review evidence
- The practitioner's understanding of the responsible party and its environment

.A55 A review engagement is a cumulative and iterative process. As the practitioner performs planned procedures, the review evidence obtained may cause the practitioner to change the nature, timing, or extent of other planned procedures. Information that differs significantly from the information on which the planned procedures were based may come to the practitioner's attention, for example

- the extent of the misstatements that the practitioner detects is greater than expected. (This may alter the practitioner's

professional judgment about the reliability of particular sources of information.)

- the practitioner may become aware of discrepancies in relevant information or conflicting or missing review evidence.
- procedures performed toward the end of the engagement may indicate a previously unrecognized risk of material misstatement. In such circumstances, the practitioner may need to reevaluate the planned procedures.

.A56 In making the evaluation required by paragraph .43, the practitioner may consider whether additional disclosures are necessary to describe the subject matter, assertion, or criteria. Additional disclosures may, for example, include

- the measurement or evaluation methods used when the criteria allow for choice among methods;
- significant interpretations made in applying the criteria in the engagement circumstances;
- subsequent events, depending on their nature and significance; and
- whether there have been any changes in the measurement or evaluation methods used.

.A57 Paragraph .43 does not require the practitioner to determine whether the presentation discloses all matters related to the subject matter, assertion, or criteria or all matters users may consider in making decisions based on the presentation.

Preparing the Practitioner's Report (Ref: par. .44–.45)

.A58 Oral and other forms of expressing a conclusion can be misunderstood without the support of a written practitioner's report. For this reason, the practitioner may not report orally or by use of symbols (such as a web seal) under the attestation standards without also providing a written report that is readily available whenever the oral report is provided or the symbol is used. For example, a symbol could be hyperlinked to a written report on the Internet.

.A59 This section does not require a standardized format for reporting on all review engagements. Instead, it identifies the basic elements that the practitioner's report is to include. The report is tailored to the specific engagement circumstances. The practitioner may use headings, separate paragraphs, paragraph numbers, typographical devices (for example, the bolding of text), and other mechanisms to enhance the clarity and readability of the report.

.A60 All of the following reporting options are available to a practitioner, except when the circumstances described in paragraph .54 exist.

<i>The practitioner's report may state that the practitioner examined</i>	<i>and</i>	<i>expresses an opinion on</i>
the subject matter		the subject matter
the responsible party's assertion		the responsible party's assertion
the responsible party's assertion		the subject matter

Content of the Practitioner's Report

Title (Ref: par. .46a)

.A61 A title indicating that the practitioner's report is the report of an independent practitioner (for example, "Independent Practitioner's Report," "Report of Independent Certified Public Accountant," or "Independent Accountant's Review Report") affirms that the practitioner has met all the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

Criteria (Ref: par. .46d)

.A62 The practitioner's report may include the criteria or refer to them if they are included in the subject matter presentation, in the assertion, or are otherwise readily available.

Relative Responsibilities (Ref: par. .46e)

.A63 Identifying relative responsibilities informs the intended users that the responsible party is responsible for the subject matter, and the practitioner's role is to independently express a conclusion about it.

.A64 The practitioner may wish to expand the discussion of the responsible party's responsibility, for example, to indicate that the responsible party is responsible for the preparation and presentation of the subject matter in accordance with (or based on) the criteria, including the design, implementation, and maintenance of internal control to prevent, or detect and correct, misstatement of the subject matter, due to fraud or error.

Statement About the Subject Matter and Criteria (Ref: par. 46f(ii)(1))

.A65 The language in paragraph .46f(ii)(1) may need to be tailored to reflect the nature of the subject matter and criteria for the engagement. Examples of language that meet the requirements in paragraph .46f(ii)(1) include, "to obtain limited assurance about whether any material modifications should be made to the subject matter in order for it to

- be presented in accordance with (or based on) the criteria."
- meet the objectives," for example, when the objectives are the criteria.

Inherent Limitations (Ref: par. .46g)

.A66 In some cases, identification of specific inherent limitations may be required by an AT-C section. To communicate specific inherent limitations, the illustrative practitioner's report on a review of pro forma financial information under section 310, for example, indicates that the objective of pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date and that the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the specified transaction (or event) actually occurred earlier.³ When not explicitly required by an AT-C section, identification in the report of inherent limitations is based on the practitioner's judgment.

³ Paragraph .18k and examples 2 and 3 in paragraph .A24 of section 310, *Reporting on Pro Forma Financial Information*.

Conclusion (Ref: par. .46h)

.A67 The practitioner's conclusion can be worded either in terms of the subject matter and the criteria (for example, "Based on our review, we are not aware of any material modifications that should be made to the XYZ schedule in order for it to be in accordance with [or based on] the ABC criteria.") or in terms of an assertion made by the responsible party (for example, "Based on our review, we are not aware of any material modifications that should be made to management of XYZ Company's assertion in order for it to be fairly stated.").

.A68 A single practitioner's report may cover more than one aspect of a subject matter or an assertion about the subject matter. When that is the case, the report may contain separate opinions or conclusions on each aspect of the subject matter or assertion (for example, examination level related to some aspects or assertions and review level related to others, or an unmodified conclusion on some aspects or assertions and a modified conclusion on others).

.A69 A practitioner may report on subject matter or an assertion at multiple dates or covering multiple periods during which criteria have changed (for example, a practitioner's report on comparative information). Criteria are clearly described when they identify the criteria for each period and how the criteria have changed from one period to the next. If the criteria for the current date or period have changed from the criteria for a preceding date or period, changes in the criteria may be significant to users of the report. If so, the criteria and the fact that they have changed may be disclosed in the presentation of the subject matter, in the written assertion, or in the report, even if the subject matter for the preceding date or period is not presented.

Location (Ref: par. .46j)

.A70 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date (Ref: par. .46k)

.A71 Including the date of the practitioner's report informs the intended users that the practitioner has considered the effect on the subject matter and on the report of events that occurred up to that date.

.A72 Because the practitioner expresses a conclusion on the subject matter or assertion and the subject matter or assertion is the responsibility of the responsible party, the practitioner is not in a position to conclude that sufficient appropriate review evidence has been obtained until evidence is obtained that all of the elements that the subject matter or assertion comprises, including any related notes, when applicable, have been prepared, and the responsible party has accepted responsibility for them.

Restricted Use Paragraph (Ref: par. .47 and .48b–c)

.A73 A practitioner's report for which the conditions in paragraph .47 do not apply need not include an alert that restricts its use. However, nothing in the attestation standards precludes a practitioner from including such an alert in any practitioner's report or other practitioner's written communication.

.A74 A practitioner's report that is required by paragraph .47 to include an alert that restricts the use of the report may be included in a document that also contains a practitioner's report that is for general use. In such circumstances, the use of the general use report is not affected.

.A75 A practitioner may also issue a single combined practitioner's report that includes (a) a practitioner's report that is required by paragraph .47 to

include an alert that restricts its use, and (b) a report that is for general use. If these two types of reports are clearly differentiated within the combined report, such as through the use of appropriate headers, the alert that restricts the use of the report may be limited to the report required by paragraph .47 to include such an alert. In such circumstances, the use of the general use report is not affected.

.A76 The representations required by paragraph .33 include an assertion. If the engaging party is not the responsible party and the responsible party provides an oral assertion, rather than a written assertion, paragraph .47c calls for an alert that restricts the use of the practitioner's report to the engaging party.

.A77 The practitioner may identify the specified parties by naming them, referring to a list of those parties, or identifying the class of parties, for example, "all customers of XYZ Company during some or all of the period January 1, 20XX to December 31, 20XX." The method of identifying the specified parties is determined by the practitioner.

.A78 In some cases, the criteria used to measure or evaluate the subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts users of the practitioner's report to this fact and, therefore, that the report is intended solely for the information and use of the specified parties.

.A79 The alert that restricts the use of the practitioner's report is designed to avoid misunderstandings related to the use of the report, particularly if the report is taken out of the context in which the report is intended to be used. A practitioner may consider informing the responsible party and, if different, the engaging party or other specified parties that the report is not intended for distribution to parties other than those specified in the report. The practitioner may, in connection with establishing the terms of the engagement, reach an understanding with the responsible party or, if different, the engaging party, that the intended use of the report will be restricted and may obtain the responsible party's agreement that the responsible party and specified parties will not distribute such report to parties other than those identified therein. A practitioner is not responsible for controlling, and cannot control, distribution of the report after its release.

.A80 In some cases, a restricted-use practitioner's report filed with regulatory agencies is required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency, as part of its oversight responsibility for an entity, may require access to the restricted-use report in which it is not named as a specified party.

Reference to the Practitioner's Specialist (Ref: par. .50)

.A81 The practitioner has sole responsibility for the conclusion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's specialist.

Modified Conclusions (Ref: par. .51–.53)

.A82 A practitioner may issue an unmodified conclusion only when the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that the practitioner considers necessary in the circumstances.

.A83 Pervasive effects on the subject matter are those that, in the practitioner's professional judgment

- a. are not confined to specific aspects of the subject matter;
- b. if so confined, represent or could represent a substantial proportion of the subject matter; or
- c. in relation to disclosures, are fundamental to the intended users' understanding of the subject matter.

Scope Limitations (Ref: par. .58)

.A84 The procedures performed in a review engagement are, by definition, limited compared with those performed in an examination engagement. Limitations known to exist prior to accepting a review engagement are a relevant consideration when establishing whether the preconditions for a review engagement are present, in particular, whether the practitioner expects to be able to obtain the evidence needed to arrive at the practitioner's conclusion. (See section 105.)⁴ If a further limitation is imposed by the appropriate party(ies) after a review engagement has been accepted, it may be appropriate to withdraw from the engagement, when withdrawal is possible under applicable laws and regulations.

.A85 The inability to obtain written representations from the responsible party ordinarily would result in a scope limitation. However, when the engaging party is not the responsible party, paragraph .34 enables the practitioner to make inquiries of the responsible party, and if the responsible party's oral responses enable the practitioner to conclude that the practitioner has sufficient appropriate review evidence to form a conclusion about the subject matter, paragraph .39a indicates that this would not cause a scope limitation. Further, paragraph .39a requires that the practitioner's report, in these circumstances, contain an alert paragraph that restricts the use of the report to the engaging party.

.A86 An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate review evidence by performing alternative procedures.

Responsible Party Refuses to Provide a Written Assertion (Ref: par. .60)

.A87 The following is an example of the disclosure required by paragraph .60:

Attestation standards established by the American Institute of Certified Public Accountants require that we request a written statement from *[identify the responsible party]* stating that *[identify the subject matter]* that we reviewed has been accurately measured or evaluated. We requested that *[identify the responsible party]* provide such a written statement but *[identify the responsible party]* refused to do so.

.A88 The practitioner's report discussed in paragraph .60 is appropriate only when the engagement is to report on the subject matter; it is not appropriate for a report on an assertion. When reporting on an assertion, the practitioner is required to obtain a written assertion from the responsible party.

⁴ Paragraph .25b(iii) of section 105, *Concepts Common to All Attestation Engagements*.

Communication Responsibilities (Ref: par. .61)

.A89 Other matters that may be appropriate to communicate to the responsible party or, if different, the engaging party, include deficiencies in internal control identified during the engagement, or bias in the measurement, evaluation, or disclosure of the subject matter.

Documentation (Ref: par. .62)

.A90 Documentation includes a record of the practitioner's reasoning on all significant findings or issues that require the exercise of professional judgment and related conclusions. The existence of difficult questions of principle or professional judgment calls for the documentation to include the relevant facts that were known by the practitioner at the time the conclusion was reached.

.A91 It is neither necessary nor practical to document every matter considered, or professional judgment made, during an engagement. Further, it is unnecessary for the practitioner to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included in the engagement file. Similarly, the practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A92 In applying professional judgment to assess the extent of documentation to be prepared and retained, the practitioner may consider what is necessary to provide an experienced practitioner, having no previous connection with the engagement, with an understanding of the work performed and the basis of the principal decisions made.

.A93 Documentation ordinarily includes a record of

- issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- conclusions on compliance with independence requirements that apply to the engagement and any relevant discussions with the firm that support these conclusions.
- conclusions reached regarding the acceptance and continuance of client relationships and attestation engagements.
- the nature and scope of, and conclusions resulting from, consultations undertaken during the course of the engagement.

.A94

Exhibit — Illustrative Practitioner's Review Reports

The illustrative practitioner's review reports in this exhibit meet the applicable reporting requirements in paragraphs .44–.60. A practitioner may use alternative language in drafting a review report, provided that the language meets the applicable requirements in paragraphs .44–.60. The criteria for evaluating the subject matter in examples 1 and 3 have been determined by the practitioner to be suitable and available to all users of the report; therefore, these reports may be for general use. The criteria for evaluating the subject matter in example 2 are suitable but available only to specified parties; therefore, use of this report is restricted to the specified parties who either participated in the establishment of the criteria or can be presumed to have an adequate understanding of the criteria. (See paragraph .48 for the information to be included in a separate paragraph of the report that contains an alert that restricts the use of the report and paragraph .49 for the content of that paragraph when the engagement is also performed in accordance with *Government Auditing Standards*.)

Example 1: Practitioner's Review Report on Subject Matter; Unmodified Conclusion

The following is an illustrative practitioner's review report in which the practitioner has reviewed the subject matter and is reporting on the subject matter.

Independent Accountant's Review Report

[Appropriate Addressee]

We have reviewed [identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]. XYZ Company's management is responsible for [identify the subject matter, for example, presenting the schedule of investment returns] in accordance with (or based on) [identify the criteria, for example, the ABC criteria set forth in Note 1]. Our responsibility is to express a conclusion on [identify the subject matter, for example, the schedule of investment returns] based on our review.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to [identify the subject matter, for example, the schedule of investment returns] in order for it to be in accordance with (or based on) the criteria. A review is substantially less in scope than an examination, the objective of which is to obtain reasonable assurance about whether [identify the subject matter, for example, the schedule of investment returns] is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. We believe that our review provides a reasonable basis for our conclusion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Based on our review, we are not aware of any material modifications that should be made to *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, in order for it to be in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

Example 2: Practitioner's Review Report on an Assertion; Unmodified Conclusion; Use of the Report Is Restricted to Specified Parties

The following is an illustrative practitioner's report for a review engagement in which the practitioner has reviewed the responsible party's assertion and is reporting on that assertion. Although suitable criteria exist for the subject matter, use of the report is restricted to specified parties because the criteria are available only to the specified parties.

Independent Accountant's Review Report

[Appropriate Addressee]

We have reviewed management of XYZ Company's assertion that *[identify the assertion, including the subject matter and the criteria, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX, is presented in accordance with (or based on) the ABC criteria set forth in Note 1]*. XYZ Company's management is responsible for its assertion. Our responsibility is to express a conclusion on management's assertion based on our review.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to management's assertion in order for it to be fairly stated. A review is substantially less in scope than an examination, the objective of which is to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. We believe that our review provides a reasonable basis for our conclusion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Based on our review, we are not aware of any material modifications that should be made to management of XYZ Company's assertion in order for it to be fairly stated.

This report is intended solely for the information and use of *[identify the specified parties, for example, ABC Company and XYZ Company]*, and is not intended to be, and should not be, used by anyone other than the specified parties.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

**Example 3: Practitioner's Review Report on Subject Matter;
Qualified Conclusion**

The following is an illustrative practitioner's report for a review engagement in which the practitioner expresses a qualified conclusion because the review identified conditions that, individually or in combination, result in one or more material, but not pervasive, misstatements of the subject matter, based on the criteria. The practitioner has reviewed the subject matter and is also reporting on the subject matter. Paragraph .53 states, "If the practitioner has concluded that the material misstatement results in a qualified conclusion, the practitioner should report directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement."

Independent Accountant's Review Report

[Appropriate Addressee]

We have reviewed *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*. XYZ Company's management is responsible for *[identify the subject matter, for example, presenting the schedule of investment returns]* based on *[identify the criteria, for example, the ABC criteria set forth in Note 1]*. Our responsibility is to express a conclusion on *[identify the subject matter, for example, the schedule of investment returns]* based on our review.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the review to obtain limited assurance about whether any material modifications should be made to *[identify the subject matter, for example, the schedule of investment returns]* in order for it to be in accordance with (or based on) the criteria. A review is substantially less in scope than an examination, the objective of which is to obtain reasonable assurance about whether *[identify the subject matter, for example, the schedule of investment returns]* is in accordance with (or based on) the criteria, in all material respects, in order to express an opinion. Accordingly, we do not express such an opinion. We believe that our review provides a reasonable basis for our conclusion.

[Include a description of significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria.]

[Additional paragraph(s) may be added to emphasize certain matters relating to the attestation engagement or the subject matter.]

Our review identified *[describe condition(s) that, individually or in the aggregate, resulted in a material misstatement, or deviation from, the criteria]*.

Based on our review, except for the matter(s) described in the preceding paragraph, we are not aware of any material modifications that should be made to *[identify the subject matter, for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX]*, in order for it to be in accordance with (or based on) *[identify the criteria, for example, the ABC criteria set forth in Note 1]*.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

AT-C Section 215

Agreed-Upon Procedures Engagements

(Supersedes SSAE No. 18 section 215)

Source: SSAE No. 19.

Effective for agreed-upon procedures reports dated on or after July 15, 2021. Early implementation is permitted.

Introduction

Scope of This Statement on Standards for Attestation Engagements

.01 This section contains performance and reporting requirements and application guidance for all agreed-upon procedures engagements. The requirements and guidance in this section supplement the requirements and guidance in section 105, *Concepts Common to All Attestation Engagements*.

.02 An *agreed-upon procedures engagement* is an attestation engagement in which a practitioner performs specific procedures on subject matter and reports the findings without providing an opinion or conclusion. The subject matter may be financial or nonfinancial information. Because the needs of an engaging party may vary widely, the nature, timing, and extent of the procedures may vary, as well. (Ref: par. .A1–.A2)

.03 Because the engaging party best understands its own needs, the engaging party is required to agree to the procedures and acknowledge that the procedures performed are appropriate for the intended purpose of the engagement prior to issuance of the practitioner's agreed-upon procedures report. Engagement circumstances may be such that it is appropriate for parties in addition to the engaging party to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes. The engaging party and intended users assess for themselves the procedures and findings reported by the practitioner and draw their own conclusions from the work performed by the practitioner.

.04 In an engagement performed in accordance with this section, the practitioner does not perform an examination or a review engagement and does not provide an opinion or conclusion. Instead, the agreed-upon procedures report is in the form of procedures and findings.

.05 When a practitioner performs services pursuant to an engagement to apply agreed-upon procedures to subject matter as part of or in addition to another form of service, this section applies only to those services described herein; other professional standards would apply to the other services. Other services may include an audit, review, or compilation of a financial statement, another attestation service performed pursuant to the attestation standards, or a nonattest service. A practitioner's report on applying agreed-upon procedures to subject matter may be combined with a report on such other services, provided the types of services can be clearly distinguished, and the applicable standards for each service are followed.

.06 This section does not apply to engagements to issue letters (commonly referred to as *comfort letters*) to underwriters and certain other requesting parties.¹

Effective Date

.07 This section is effective for agreed-upon procedures reports dated on or after July 15, 2021. Early implementation is permitted.

Objectives

.08 In conducting an agreed-upon procedures engagement, the objectives of the practitioner are to do the following:

- a. Apply specific procedures to subject matter (Ref: par. .A3)
- b. Issue a written practitioner's report that describes the procedures applied and the practitioner's findings without providing an opinion or conclusion on the subject matter
- c. Communicate further as required by relevant AT-C sections

Requirements

Conduct of an Agreed-Upon Procedures Engagement

.09 In performing an agreed-upon procedures engagement, the practitioner should comply with this section, section 105, and any subject matter section that is relevant to the engagement. A subject-matter section is relevant to the engagement when it is in effect, and the circumstances addressed by the section exist. (Ref: par. .A4)

Preconditions for an Agreed-Upon Procedures Engagement

.10 Section 105 indicates that a practitioner must be independent when performing an attestation engagement in accordance with the attestation standards, unless the practitioner is required by law or regulation to accept the engagement and report on the subject matter.² When the practitioner is not independent but is required by law or regulation to accept an agreed-upon procedures engagement and report on the procedures performed and findings obtained, the practitioner's report should specifically state that the practitioner is not independent. The practitioner is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the practitioner chooses to provide the reasons for the lack of independence, the practitioner should include all the reasons therefor. (Ref: par. .A5)

.11 In order to establish that the preconditions for an agreed-upon procedures engagement are present, the practitioner should determine that the following conditions, in addition to the preconditions identified in section 105, are present:³ (Ref: par. .A6–.A7)

- a. The practitioner determines that procedures can be designed, performed, and reported on in accordance with this section.

¹ See AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*.

² Paragraph .24 of section 105, *Concepts Common to All Attestation Engagements*.

³ Paragraphs .24–.28 of section 105.

- b. The engaging party agrees, or will be able to agree, to the procedures and acknowledges that the procedures are appropriate for the intended purpose of the engagement. (Ref: par. .A8)
- c. The procedures to be applied to the subject matter are expected to result in reasonably consistent findings.
- d. When applicable, the practitioner agrees to apply a threshold for reporting exceptions established by the engaging party. (Ref: par. .A36)

.12 The practitioner should establish an understanding with the engaging party regarding the nature of the engagement, including the following:

- a. The intended purpose of the engagement and the intended users of the agreed-upon procedures report
- b. Whether the practitioner's agreed-upon procedures report is expected to be restricted to the use of specified parties (Ref: par. .A8–.A10)
- c. Whether the engagement to be performed is pursuant to any law, regulation, or contract (Ref: par. .A11)
- d. Whether parties in addition to the engaging party will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes (Ref: par. .A12–.A15)

.13 The practitioner is precluded from accepting an agreed-upon procedures engagement if the practitioner believes the intended purpose of the engagement is not clear or the engaging party will not have a basis for agreeing and acknowledging that the procedures are appropriate for the intended purpose of the engagement.

Agreeing on the Terms of the Engagement

.14 The practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. (Ref: par. .A16)

.15 The agreed-upon terms of the engagement should include the following:

- a. The nature of the engagement established pursuant to paragraph .12
- b. Identification of the subject matter and the responsible party
- c. The responsibilities of the practitioner (Ref: par. .A17–.A18)
- d. A statement that the engagement will be conducted in accordance with attestation standards established by the AICPA
- e. A statement that the responsible party is responsible for the subject matter (Ref: par. .A19)
- f. A statement that the engaging party agrees to provide the practitioner, prior to the completion of the engagement, with a written agreement and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement. (Ref: par. .A20)
- g. A statement that the engaging party agrees to provide, at the conclusion of the engagement, a representation letter.

- h. If known at the onset of the engagement, an identification of any other parties, in addition to the engaging party, that will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes. If the request is expected to be made by the engaging party, a statement that the engaging party agrees to provide, at the conclusion of the engagement, a written representation that the engaging party has obtained from all necessary other parties agreement to the procedures and acknowledgment that the procedures performed are appropriate for their purposes.
- i. If the engaging party is not the responsible party, a statement that written representations may be requested from the responsible party.
- j. Reference to the expected form and content of the practitioner's agreed-upon procedures report, including any use restrictions, if applicable.
- k. Disclaimers expected to be included in the practitioner's report, if applicable
- l. Assistance to be provided to the practitioner, if applicable
- m. Involvement of a practitioner's external specialist, if applicable
- n. Specified thresholds for reporting exceptions, if applicable (Ref: par. .A37)

Procedures to Be Performed

.16 The practitioner should perform procedures agreed to and acknowledged by the engaging party to meet the intended purpose of the engagement established with the engaging party pursuant to paragraph .12a. (Ref: par. .A21–.A26).

.17 The practitioner should not perform procedures that are open to varying interpretations or that use vague or ambiguous language. Terms of uncertain meaning (such as *general review*, *limited review*, *check*, or *test*) should not be used in describing the procedures unless such terms are defined within the procedures. (Ref: par. .A27)

.18 The practitioner should obtain evidence from applying the procedures to provide a reasonable basis for the finding or findings expressed in the practitioner's report but need not perform additional procedures outside the scope of the engagement to gather additional evidence.

Using the Work of a Practitioner's External Specialist

.19 The practitioner and the engaging party should explicitly agree to the involvement of a practitioner's external specialist if assisting a practitioner in the performance of an agreed-upon procedures engagement. (Ref: par. .A28–.A30)

.20 The practitioner's report should describe the nature of the assistance provided by the practitioner's external specialist.

Using the Work of Internal Auditors or Other Practitioners

.21 The procedures to be enumerated or referred to in the practitioner's report should be performed by the engagement team or other practitioners and not by internal auditors. (Ref: par. .A31–.A33)

Appropriateness of the Procedures Performed

.22 Prior to the issuance of the practitioner's agreed-upon procedures report, the practitioner should obtain a written agreement of the procedures and acknowledgment from the engaging party that the procedures performed are appropriate for the intended purpose of the engagement. (Ref: par. .A34–.A35)

.23 If the engaging party refuses to provide the written agreement and acknowledgment required by paragraph .22, the practitioner should withdraw from the engagement.

Findings

.24 A practitioner should present the results of applying procedures to specific subject matter in the form of findings. (Ref: par. .A36)

.25 The practitioner should report all findings from application of the procedures. If the engaging party has established a threshold for reporting exceptions, the practitioner should describe such threshold in the practitioner's report. (Ref: par. .A25, .A37, and .A47)

.26 When reporting findings, the practitioner should not (Ref: par. .A41–.A42)

- a. use vague or ambiguous language. (Ref: par. .A38)
- b. include terms of uncertain meaning. (Ref: par. .A39)
- c. express an opinion or conclusion on the subject matter or about whether the subject matter is in accordance with (or based on) the criteria. (Ref: par. .A40)

Written Representations

.27 The practitioner should request from the engaging party written representations in the form of a letter addressed to the practitioner. The representations should include the following: (Ref: par. .A35 and .A43)

- a. A statement that the responsible party is responsible for the subject matter
- b. If applicable, a statement that the engaging party has obtained from all necessary parties agreement to the procedures and acknowledgment that the procedures are appropriate for their purposes
- c. A statement that it has provided the practitioner with all relevant information and access, as applicable, as agreed upon in the terms of the engagement
- d. A statement that all known matters contradicting the subject matter and any communication from regulatory agencies or others affecting the subject matter have been disclosed to the practitioner, including communications received between the end of the period addressed by the subject matter and the date of the practitioner's report
- e. A statement that it is not aware of any material misstatements in the subject matter
- f. A statement that it has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter

- g. Any additional representations that the practitioner determines are appropriate

.28 When the engaging party is not the responsible party, the practitioner should consider requesting the relevant written representations pursuant to paragraph .27 from the responsible party in the form of a letter addressed to the practitioner.

.29 The date of the written representations should be as of the date of the practitioner's report. The written representations should address the subject matter and periods covered by the practitioner's findings.

Requested Written Representations Not Provided or Not Reliable

.30 When one or more of the written representations that the practitioner has requested pursuant to paragraphs .27–.28 are not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should do the following: (Ref: par. .A44)

- a. Discuss the matter with the engaging or responsible party, as appropriate
- b. Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general
- c. If any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's agreed-upon procedures report (Ref: par. .A45)

Preparing the Practitioner's Report

.31 The practitioner's report should be in writing. (Ref: par. .A46)

.32 The practitioner's report should be in the form of procedures and findings.

.33 If, as a result of performing procedures, the practitioner determines that the description of the procedures performed or the corresponding findings, in the practitioner's professional judgment, are misleading in the circumstances of the engagement, the practitioner should discuss the matter with the engaging party and take appropriate action. (Ref: par. .A47–.A48)

Content of the Practitioner's Agreed-Upon Procedures Report

.34 The practitioner's agreed-upon procedures report should include the following:

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant. (Ref: par. .A49)
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. Identification of the engaging party.
- d. Identification of the subject matter to which the procedures have been applied. (Ref: par. .A50–.A51)
- e. Identification of the responsible party, including a statement that the responsible party is responsible for the subject matter. When

the engaging party is not the responsible party and identification of the responsible party and its responsibility for the subject matter is based solely on representations received from the engaging party, the practitioner's agreed-upon procedures report should include a statement to that effect. (Ref: par. .A52)

- f.* A statement that the engaging party acknowledged that the procedures performed are appropriate to meet the intended purpose of the engagement. (Ref: par. .A53–.A54)
- g.* An identification of the intended purpose of the engagement in sufficient detail to enable the user to understand the nature of the work performed. (Ref: par. .A55)
- h.* A statement that the practitioner's report may not be suitable for any other purpose. (Ref: par. .A56)
- i.* A statement that the procedures performed may not address all the items of interest to a user of the report and may not meet the needs of all users of the report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.
- j.* A statement that an agreed-upon procedures engagement involves the practitioner performing specific procedures that the engaging party has agreed to and acknowledged to be appropriate for the intended purpose of the engagement and reporting on findings based on the procedures performed.
- k.* A description of the procedures performed detailing the nature and extent, and if applicable, the timing, of each procedure.
- l.* A description of the findings from each procedure performed, including sufficient details on exceptions found.
- m.* If applicable, a description of any specified threshold established by the engaging party for reporting exceptions.
- n.* A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the AICPA.
- o.* A statement that the practitioner was not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the subject matter. (Ref: par. .A57)
- p.* A statement that the practitioner does not express such an opinion or conclusion.
- q.* A statement that had the practitioner performed additional procedures, other matters might have come to the practitioner's attention that would have been reported.
- r.* A statement that the practitioner is required to be independent of the responsible party and to meet the practitioner's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the agreed-upon procedures engagement. (Ref: par. .A58–.A59)
- s.* If applicable, a description of the nature of the assistance provided by a practitioner's external specialist, as discussed in paragraphs .19–.20.
- t.* When applicable, reservations or restrictions concerning procedures or findings. (Ref: par. .A60)

- u.* The manual or printed signature of the practitioner's firm. (Ref: par. .A61–.A63)
- v.* The city and state where the practitioner's report is issued. (Ref: par. .A64)
- w.* The date of the report. The practitioner's report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that
 - i.* the attestation documentation has been reviewed, and
 - ii.* if applicable, the written presentation of the subject matter has been prepared.

Alert That Restricts the Use of the Practitioner's Agreed-Upon Procedures Report

.35 The practitioner should consider whether to include an alert, in a separate paragraph, that restricts the use of the practitioner's agreed-upon procedures report, taking into account the understanding with the engaging party regarding the nature of the engagement pursuant to paragraph .12*a*. (Ref: par. .A7 and .A65–.A69)

.36 The alert should

- a.* state that the practitioner's report is intended solely for the information and use of the specified parties.
- b.* identify the specified parties for whom use is intended. (Ref: par. .A70)
- c.* state that the report is not intended to be, and should not be, used by anyone other than the specified parties.

Adding Other Specified Parties After the Release of the Practitioner's Report

.37 When the practitioner issues a report that includes an alert restricting the use of the practitioner's report to certain specified parties, and the engaging party subsequently requests the practitioner to add an additional specified party, the practitioner should determine whether to add the additional specified party. As part of this determination, the practitioner should consider whether (Ref: par. .A71)

- a.* the additional specified party has acknowledged or will be requested to acknowledge that the procedures performed are appropriate for their purposes. If the practitioner determines that the acknowledgment is necessary, the practitioner should either obtain such acknowledgment directly from the additional specified party or obtain a representation from the engaging party that the additional specified party has agreed to the procedures and acknowledged that the procedures performed are appropriate for their purposes, and
- b.* the report will be reissued to identify the additional specified party.

.38 If the practitioner provides a written acknowledgment to the engaging party and the additional party that such party has been added as a specified party, the practitioner should state in the acknowledgment that no procedures were performed subsequent to the original date of the practitioner's agreed-upon procedures report.

Restrictions on the Performance of Procedures

.39 When circumstances impose restrictions on the performance of the procedures, the practitioner should discuss with the engaging party whether those restrictions are appropriate and, if the restrictions are appropriate, describe the restrictions in the practitioner's report.

Knowledge of Matters Outside Procedures

.40 Although the practitioner need not perform procedures beyond the procedures agreed to and acknowledged by the engaging party to be appropriate for the intended purpose of the engagement, if in connection with the application of the procedures, and through the completion of the engagement, matters come to the practitioner's attention by other means that significantly contradict the subject matter referred to in the practitioner's report, the practitioner should discuss the matter with the engaging party and take appropriate action, including determining whether the practitioner's report should be revised to disclose the matter. (Ref: par. .A72–.A73)

Communication Responsibilities

.41 In the event the practitioner encounters known or suspected fraud or noncompliance with laws or regulations in connection with the engagement, the practitioner should consider responsibilities under the AICPA Code of Professional Conduct and applicable law prior to communicating such information either to the responsible party or the engaging party. (Ref: par. .A74)

Documentation

.42 The practitioner should prepare engagement documentation on a timely basis that includes the following: (Ref: par. .A75–.A76)

- a. The written agreement and acknowledgment from the engaging party regarding the appropriateness of the procedures performed for the intended purpose of the engagement, as required by paragraph .22
- b. The nature, timing, and extent of the procedures performed to comply with relevant sections and applicable legal and regulatory requirements, including the following:
 - i. The identifying characteristics of the specific items or matters tested
 - ii. Who performed the engagement work and the date such work was completed
 - iii. When the appropriate party will not provide one or more of the requested written representations pursuant to paragraphs .27–.28 or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or that the written representations are otherwise not reliable, the matters in paragraph .30a–c
 - iv. Who reviewed the engagement work performed and the date and extent of such review
- c. The results of the procedures performed and the evidence obtained

Application and Other Explanatory Material

Scope of This Statement on Standards for Attestation Engagements (Ref: par. .02)

.A1 Reference to "subject matter" in this section encompasses anything on which agreed-upon procedures are performed, including information, documents, measurements, or compliance with laws and regulations.

.A2 The procedures to be performed may be developed by the practitioner, the engaging party, another party, or a combination of these parties. Further, the procedures may be prescribed by law, regulation, or contract.

Objectives (Ref: par. .08a)

.A3 In an agreed-upon procedures engagement, the practitioner applies procedures to the subject matter of the engagement. The requirements and guidance related to the subject matter in section 105 apply.

Conduct of an Agreed-Upon Procedures Engagement (Ref: par. .09)

.A4 If a practitioner were performing an agreed-upon procedures engagement related to an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants, section 105, this section, and section 315, *Compliance Attestation*, would be relevant. In addition, there may be interpretative publications applicable to the subject matter, such as, for example, AICPA Statement of Position 17-1, *Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936*.

Preconditions for an Agreed-Upon Procedures Engagement (Ref: par. .10–.11 and .35)

.A5 The "Agreed-Upon Procedure Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation (ET sec. 1.297.020) of the "Independence Rule" (ET sec. 1.200.001) establishes independence requirements unique to agreed-upon procedures engagements.

.A6 In determining whether procedures can be designed, performed, and reported on in accordance with this section, the practitioner may consider whether such procedures

- are or will be subjective or require judgment to apply,
- will be selected to result only in findings that show the subject matter in a favorable light, and
- will meet the intended purpose of the engagement.

.A7 In determining whether procedures can be designed, performed, and reported on in accordance with this section, the practitioner may need to obtain an understanding of the criteria or measurement framework used in developing the subject matter.

.A8 The intended purpose of the engagement is determined by the engaging party. Consideration of the intended purpose of the engagement and the intended users of the practitioner's agreed-upon procedures report informs the

practitioner's professional judgment about whether it is practical or necessary to obtain the agreement of those intended users and whether to restrict the use of the report as discussed in paragraphs .35–.36.

.A9 The engagement may be required by law, regulation, or contract or may arise as a result of a request by a third party or the engaging party's intent to provide information to a broad class of users, such as customers.

.A10 The restriction to specified parties may or may not include parties that have agreed to the procedures and acknowledged that the procedures performed are appropriate for their purposes.

.A11 Law or regulation may require an agreed-upon procedures engagement to be performed (for example, to demonstrate compliance with requirements of specific laws or regulations). Further, the procedures to be performed may be prescribed by law, regulation, or contract. Regulatory expectations may also be set out as part of a regulatory audit or communications or requests from regulators. Law or regulation may prescribe the nature, timing, and extent of the procedures to be performed and, in some cases, the way the procedures or findings are to be described in the practitioner's report. In other circumstances, law or regulation may prescribe only the nature of the procedures to be performed or may use terms that are unclear about whether an agreed-upon procedures engagement is an acceptable service (for example, terms requiring an audit, review, examination, validation, or certification).

.A12 Based on the practitioner's understanding with the engaging party, the practitioner may consider it necessary to request a regulator to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes.

.A13 A contract may require an agreed-upon procedures engagement to be performed. Given that the procedures are being performed to satisfy the obligations or expectations of the parties to the contract, unless the procedures, or a detailed description of the nature of the procedures, are included in the contract, all users of the practitioner's agreed-upon procedures report ordinarily would agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes.

.A14 For example, a practitioner may be engaged to perform procedures relating to a securitization transaction. In such circumstances, the practitioner and engaging party may identify other parties, such as underwriters, to request to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes.

.A15 Nothing precludes the practitioner and engaging party from agreeing to the type of communication or acknowledgment to be used to obtain the agreement and acknowledgment of parties other than the engaging party that the procedures performed are appropriate for their purposes and who would make the communication. If the practitioner intends to communicate directly with a party other than the engaging party, the rules regarding confidential information as set forth in the AICPA Code of Professional Conduct apply.

Agreeing on the Terms of the Engagement (Ref: par. .14–.15)

.A16 It is in the interests of both the engaging party and the practitioner to document the agreed-upon terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the engagement letter or other suitable form of written agreement will vary with the engagement circumstances.

.A17 The responsibility of the practitioner is to carry out the procedures and report the findings in accordance with the attestation standards. The practitioner assumes the risk that misapplication of the procedures may result in inappropriate findings being reported. Furthermore, the practitioner assumes the risk that appropriate findings may not be reported or may be reported inaccurately. The practitioner's risks can be reduced through adequate planning and supervision and due professional care in performing the procedures, accumulating the findings, and preparing the practitioner's report.

.A18 The practitioner has no responsibility to determine the differences between the procedures to be performed and the procedures that the practitioner would have determined to be necessary had the practitioner been engaged to perform another form of attestation engagement. The procedures that the practitioner performs pursuant to an agreed-upon procedures engagement may be more or less extensive than the procedures that the practitioner would determine to be necessary had the practitioner been engaged to perform another form of engagement.

.A19 There may be circumstances in which the party responsible for the subject matter is not a party to the engagement. For example, the practitioner may be engaged to perform procedures with respect to benchmarking certain information in which multiple entities may be responsible for certain aspects of the information, or the information may be publicly available, such as subject matter that appears on the internet or in a public building, such as a grocery or retail store. If the practitioner is engaged to benchmark the prices of 10 products at 3 different stores on a certain date, each of the stores may be responsible for the source of the subject matter and the price that is published on the shelf.

.A20 If the procedures are prescribed or otherwise developed by parties other than the practitioner, the agreed-upon terms of the engagement may include the procedures to be performed.

Procedures to Be Performed (Ref: par. .16–.17 and .25)

.A21 Mere reading of specified information about the subject matter does not constitute a procedure sufficient to permit a practitioner to report on the results of applying procedures.

.A22 Examples of appropriate procedures include the following:

- Inspection of specified documents evidencing certain types of transactions or detailed attributes thereof
- Confirmation of specific information with third parties
- Comparison of documents, schedules, or analyses with certain specified attributes
- Performance of specific procedures on work performed by others
- Performance of mathematical computations

.A23 Examples of inappropriate procedures include the following:

- Mere reading of the work performed by others solely to describe their findings
- Evaluating the competency or objectivity of another party
- Obtaining an understanding about a particular subject

- Interpreting documents outside the scope of the practitioner's professional expertise

.A24 If the practitioner selects a sample, stating the size of the sample and how the sample was selected contributes to the specificity of the description of procedures performed (for example, 50 items starting at the 8th item and selecting every 15th item thereafter or invoices issued from May 1 to July 31, 20XX).

.A25 In certain circumstances, it may be appropriate for a planned procedure to be modified because the results of applying the procedure indicate that the procedure was not appropriately designed, and the findings would be inconsistent with the intended purpose of the engagement. However, any revisions to the descriptions of procedures performed or findings that are intended to mislead users would be inappropriate.

.A26 Examples of other information the practitioner may include are the date the procedure was performed and the sources of information used in performing the procedure.

.A27 To avoid vague or ambiguous language, the procedures to be performed are characterized by the action to be taken at a level of specificity sufficient for a reader to understand the nature and extent of the procedures performed. Examples of descriptions of acceptable actions are as follows:

- Inspect
- Confirm
- Compare
- Agree
- Trace
- Inquire
- Recalculate
- Observe
- Mathematically check

Conversely, the following descriptions of actions (unless defined to indicate the nature, timing, and extent of the procedures associated with these actions) generally are not acceptable because they are not sufficiently precise or have an uncertain meaning:

- Note
- Review
- General review
- Limited review
- Evaluate
- Analyze
- Check
- Test
- Interpret
- Verify
- Examine

Using the Work of a Practitioner's External Specialist (Ref: par. .19)

.A28 The practitioner's education and experience enable the practitioner to be knowledgeable about business matters in general, but the practitioner is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. In certain circumstances, it may be appropriate to involve a practitioner's external specialist to assist the practitioner in the performance of one or more procedures. The following are examples of such circumstances:

- An attorney who helps with the interpretation of legal terminology in laws, regulations, rules, contracts, or grants
- A medical specialist who assists with understanding the characteristics of diagnosis codes documented in patient medical records
- An environmental engineer who assists with the interpretation of environmental remedial action regulatory directives that may affect the procedures applied to an environmental liabilities account in a financial statement
- A geologist who helps distinguish between the physical characteristics of a generic minerals group related to information to which the procedures are applied

.A29 The agreement regarding the involvement of a practitioner's external specialist may be reached when agreeing upon the terms of the engagement or as part of obtaining the engaging party's agreement to the procedures and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement.

.A30 A practitioner may apply procedures to the report or work product of a practitioner's external specialist that does not constitute assistance by the external specialist to the practitioner in an agreed-upon procedures engagement. For example, the practitioner may reference information contained in a report of a practitioner's external specialist in describing a procedure. However, it is inappropriate for the practitioner to merely read the external specialist's report solely to describe or repeat the findings or to take responsibility for all or a portion of any procedures performed by a practitioner's external specialist or the external specialist's work product.

Using the Work of Internal Auditors or Other Practitioners (Ref: par. .21)

.A31 Internal auditors may prepare schedules and accumulate data or provide other information for the practitioner's use in performing the procedures. Also, internal auditors may perform and report separately on procedures that they have carried out. Such procedures may be similar to those that a practitioner may perform under this section.

.A32 A practitioner may perform procedures on information documented in the working papers of internal auditors. For example, the practitioner may do the following:

- Repeat all or some of the procedures
- Determine whether the internal auditors' documentation indicates procedures performed and whether the findings documented are presented in a report by the internal auditors

.A33 It is inappropriate for the practitioner to do the following:

- Merely read the internal auditors' report solely to describe or repeat their findings
- Take responsibility for all or a portion of any procedures performed by internal auditors by reporting those findings as the practitioner's own
- Report in any manner that implies shared responsibility for the procedures with the internal auditors

Appropriateness of the Procedures Performed (Ref: par. .22 and .27)

.A34 The practitioner's communication with the engaging party enables the engaging party, if not already aware, to be made aware of the specific procedures performed and affords the engaging party an opportunity to suggest alternative or additional procedures that the engaging party may feel are appropriate in order to meet the intended purpose of the engagement.

.A35 The written agreement of the procedures and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement may be documented in the engagement letter, an addendum to the engagement letter, a representation letter, or some other form of written communication.

Findings (Ref: par. .11d, .15n, and .24–.26)

.A36 *Findings* are the factual results of procedures performed. Findings are capable of being objectively verified and objectively described, which means that procedures to be applied to the subject matter are expected to result in reasonably consistent findings. Accordingly, findings exclude opinions or conclusions in any form as well as any recommendations that the practitioner may make.

.A37 A threshold for reporting exceptions does not apply to findings reported in an agreed-upon procedures engagement unless such threshold is established by the engaging party. An example of language that describes a threshold for reporting exceptions is as follows: "For purposes of performing these procedures, no exceptions were reported for differences of \$1,000 or less resulting solely from the rounding of amounts disclosed."

.A38 To avoid vague or ambiguous language, the findings are described at a level of specificity sufficient for a user to understand the nature, timing, and extent of the procedures and findings.

.A39 If, in the practitioner's judgment, certain terms are potentially uncertain in meaning, the practitioner may consider whether a glossary is appropriate in the circumstances.

.A40 An example of language that should not be used in reporting findings is as follows:

Nothing came to our attention that caused us to believe that the subject matter is not in accordance with (or based on) the criteria, in all material respects.

.A41 The following table provides examples of appropriate and inappropriate descriptions of findings resulting from the application of certain procedures.

<i>Appropriate Procedures</i>	<i>Appropriate Description of Findings</i>	<i>Inappropriate Description of Findings</i>
Inspect the shipment dates for a sample (agreed-upon) of specified shipping documents and determine whether any such dates were subsequent to [date].	No shipment dates shown on the sample of shipping documents were subsequent to [date].	Nothing came to my attention as a result of applying that procedure.
Recalculate the number of blocks of streets paved during the year ended [date], shown on contractors' certificates of project completion; compare the resultant number to the number in an identified chart of performance statistics as of [date].	The number of blocks of streets paved in the chart of performance statistics was Y blocks more than the number calculated from the contractors' certificates of project completion.	The number of blocks of streets paved approximated the number of blocks included in the chart of performance statistics.
Recalculate the rate of return on a specified investment (according to an agreed-upon formula) and determine whether the resultant percentage agrees to the percentage in an identified schedule.	No exceptions were found as a result of applying the procedure.	The resultant percentage approximated the predetermined percentage in the identified schedule.
Inspect the quality standards classification codes in identified performance test documents for products produced during [specified period]; compare such codes to those shown in the [identified] computer printout for [specified period] as of [date].	All classification codes inspected in the identified documents were the same as those shown in the computer printout, except for the following: [List all exceptions.]	All classification codes appeared to comply with such performance documents.
Trace all outstanding checks appearing on a bank reconciliation as of [date] to checks cleared in the bank statement of the subsequent month.	All outstanding checks appearing on the bank reconciliation were traced to the list of cleared checks in the subsequent month's bank statement, except for the following: [List all exceptions.]	Nothing came to my attention as a result of applying the procedure.

<i>Appropriate Procedures</i>	<i>Appropriate Description of Findings</i>	<i>Inappropriate Description of Findings</i>
Compare the amounts of the invoices included in the "over 90 days" column shown in an identified schedule of aged accounts receivable of a specific customer as of [date] to the amount and invoice date shown on the corresponding outstanding invoice. Determine whether the dates on the corresponding outstanding invoices precede the date indicated on the schedule by more than 90 days.	All outstanding invoice amounts agreed with the amounts shown on the schedule in the "over 90 days" column, and the dates shown on such outstanding invoices preceded the date indicated on the schedule by more than 90 days.	The outstanding invoice amounts agreed within approximation of the amounts shown on the schedule in the "over 90 days" column, and nothing came to our attention that the dates shown on such outstanding invoices did not precede the date indicated on the schedule by more than 90 days.
Obtain from XYZ Company [personnel specified by management], the [date] bank reconciliations. Confirm with the bank the cash on deposit as of [date]. Compare the balance confirmed by the bank to the amount shown on the bank reconciliations.	Obtained from XYZ Company [personnel specified by management], the [date] bank reconciliations. Obtained bank confirmations of the cash on deposit as of [date]. Compared the balance confirmed by the bank to the amount shown on the bank reconciliations. [List all exceptions.]	No exceptions were identified in the confirmations received, and nothing came to our attention as a result of applying the procedures.

.A42 When a procedure is written in sufficient detail, the finding may be very brief because the practitioner does not need to repeat the procedure in describing the result. When there are no exceptions, common descriptions of results are the following:

- No exceptions were noted.
- No exceptions were [noted / found / identified] as a result of applying the procedure.

It is acceptable to repeat part of the procedure in the finding, such as in the following examples:

- No shipment dates shown on the sample of shipping documents were subsequent to [date].
- All outstanding invoice numbers, dates, and amounts agreed with the corresponding fields on the "over 90 days" column of the schedule.

If the practitioner identifies exceptions in applying the procedures, the report states them and provides some detail about the item or items involved, such as in the following examples:

- We found 14 out of the 15 items to be in agreement; the address on one item on the schedule did not agree to the [source document].
- The amount recalculated as a result of performing the procedure was \$XXX, which did not agree with the amount of \$YYYY on the [describe supporting document].
- Of the 30 selections made, two [insert attribute, such as amounts, dates, names] did not agree from the [describe the supporting documentation] to the [describe the supporting documentation].

A finding written to appear to be a fact or a conclusion would not be appropriate, such as in the following examples:

- A result stating, "We determined the current ratio of X Company at December 31, 20X4, was 2:1," could be considered a fact and is not appropriate. An appropriate description of the result could be stated as, "We recalculated the current ratio of X Company at December 31, 20X4, as 2:1."
- A result stating, "We have [observed / found / determined] the net sales of X Company for the year 20X4 were \$X," could be considered a fact and is not appropriate. An appropriate description of the result could be stated as, "We recalculated the net sales of X Company for the year 20X4 based on totaling the list of invoices in the sales journal as \$X."

Additionally, terms that might be construed as communicating assurance — such as *reasonable* or *adequate*, or that the results of applying the procedure were *close enough* — would not be appropriate. For example, it is inappropriate to state the following:

- The [number of blocks of streets paved] per the [supporting documentation] approximated the [number of blocks of streets paved] included in the chart of performance statistics for the year ended [date].
- All [classification codes] appear to comply with the requirements in the contract.

Terms such as *minor*, *immaterial*, *material*, or *significant*, unless the measures of relevance comprehended by such terms are clearly defined in both the engagement letter and the practitioner's report, are not appropriate for use in expressing results of procedures. It is also inappropriate to word a finding to convey negative assurance. For example, it is inappropriate to state the following:

- Nothing came to our attention as a result of applying the procedure.
- Nothing came to our attention that caused us to believe that [the subject matter] is not presented in accordance with [the criteria].

Written Representations (Ref: par. .27)

.A43 Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the engaging party. The person from whom the practitioner requests written representations is ordinarily a member of senior management or those charged with governance

depending on, for example, the management and governance structure of the engaging party, which may vary by entity, reflecting influences such as size and ownership characteristics.

Requested Written Representations Not Provided or Not Reliable (Ref: par. .30c)

.A44 Circumstances in which the practitioner may be unable to obtain requested written representations include, for example, when

- the engaging party does not have a relationship with the responsible party, and
- the agreed-upon procedures engagement is undertaken against the wishes of the responsible party, for example, when required by law or regulation.

In these or similar circumstances, the practitioner may need to reconsider whether the responsible party is able to take responsibility for the subject matter.

.A45 Although it is expected that the practitioner will be able to obtain all the requested written representations from the engaging party and, if applicable, the responsible party pursuant to paragraphs .27–.28, appropriate actions the practitioner might consider in the circumstances described in paragraph .30c include the following:

- a. Determining the effect on the practitioner's report, including whether to restrict the use of the practitioner's report or whether to disclose in the practitioner's report that the engaging party or the responsible party did not provide one or more of the requested written representations
- b. Withdrawing from the engagement

Preparing the Practitioner's Report (Ref: par. .25, .31, and .33)

.A46 This section does not require a standardized format for reporting on all agreed-upon procedures engagements. Instead, it identifies the basic elements that the report is to include. The report is tailored to the specific engagement circumstances. The practitioner may use headings, separate paragraphs, paragraph numbers, typographical devices (for example, boldface text), and other mechanisms to enhance the clarity and readability of the report.

.A47 Findings may be misleading, for example, if the responsible party revises the subject matter as a result of initial findings from procedures performed, and the findings to be expressed in the report do not indicate that the subject matter was changed. In such instances, the findings may indicate that the subject matter was revised as a result of initial findings from the procedures performed and that there are no findings with respect to the revised subject matter.

.A48 Appropriate actions that the practitioner might consider in the circumstances described in paragraph .33 include

- a. performing revised procedures,
- b. rewording a procedure or a finding, or
- c. withdrawing from the engagement.

Content of the Practitioner's Agreed-Upon Procedures Report

Title (Ref: par. .34a)

.A49 A title indicating that the practitioner's report is the report of an independent practitioner (for example, "Independent Practitioner's Report," "Report of Independent Certified Public Accountant," or "Independent Accountant's Report") affirms that the practitioner has met all the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

Identification of the Subject Matter to Which the Procedures Have Been Applied (Ref: par. .34d)

.A50 In identifying the subject matter to which the procedures have been applied, the practitioner may describe the criteria or measurement framework used by the responsible party to develop the subject matter. For example, the identification of the subject matter may be "the cash and accounts receivable of XYZ Company as of December 31, 20XX in accordance with accounting principles generally accepted in the United States of America." Including additional information in the practitioner's report, particularly a general-use report, about the criteria or measurement framework used by the responsible party to develop the subject matter may assist users in determining whether the procedures are appropriate for their purposes.

.A51 A practitioner may be asked to apply procedures to more than one subject matter. In these engagements, the practitioner may issue one practitioner's report that refers to all subject matter covered. Section 315 contains an example of language that may be used in the introductory paragraph to address such circumstances.⁴

Identification of the Responsible Party (Ref: par. .34e)

.A52 The following is an example of a statement that the practitioner may include in the practitioner's report when the engaging party is not the responsible party, and identification of the responsible party and its responsibility for the subject matter is based solely on representations received from the engaging party: "In performing our agreed-upon procedures engagement, we have relied solely on representations provided by [*the engaging party*] relating to the responsible party and its responsibility for [*the subject matter*]."

Agreement to and Acknowledgment of the Appropriateness of the Procedures (Ref: par. 34f)

.A53 Although not required, the practitioner may consider adding one or more of the following statements to address the risk that a user (particularly of a general-use agreed-upon procedures report) may inappropriately conclude that parties in addition to the engaging party agreed to and acknowledged the appropriateness of the procedures:

- A statement that no other party acknowledged the appropriateness of the procedures
- An identification of any other parties who agreed to and acknowledged the appropriateness of the procedures for their purposes and a statement that these parties have acknowledged that the procedures performed are appropriate for their purposes

⁴ Paragraph .A32 of section 315, *Compliance Attestation*.

- A statement that the procedures are specified in a contract, law, or regulation and a reference to the contract, law, or regulation that clearly indicates that additional parties are parties to the contract, law, or regulation

.A54 Although not required, the practitioner may make an explicit statement that the practitioner makes no representation regarding the appropriateness of the procedures either for the purpose for which the practitioner's report has been requested or for any other purpose. The practitioner might make this statement to address the risk that a user may conclude that the practitioner represents that the procedures performed are appropriate for the intended purpose of the engagement or for any other purpose.

Description of the Intended Purpose of the Agreed-Upon Procedures Engagement (Ref: par. 34g)

.A55 Because the practitioner is precluded from expressing an opinion or conclusion, it would not be appropriate to state that the intended purpose of the engagement was to determine whether the subject matter was prepared or is stated in accordance with specified criteria or that the practitioner performed the engagement to conclude whether the entity complied with specified criteria.

Practitioner's Report Not Suitable for Any Other Purpose (Ref: par. 34h)

.A56 The practitioner may advise users regarding inappropriate uses of the practitioner's agreed-upon procedures report. For example, the practitioner may advise that the report is not intended for making investment decisions or for use by potential lenders or investors.

Statement When the Subject Matter Consists of Elements, Accounts, or Items of a Financial Statement (Ref: par. 34o)

.A57 If the subject matter consists of elements, accounts, or items of a financial statement, the practitioner's report might, instead, state that the procedures do not constitute an audit (or a review) of financial statements or any part thereof, the objective of which is the expression of an opinion (or conclusion) on the financial statements or a part thereof.

Relevant Ethical Requirements (Ref: par. 34r)

.A58 Relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. When the Code of Professional Conduct applies, the practitioner's other ethical responsibilities relate to the "Principles of Professional Conduct" (ET sec. 0.300).

.A59 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the practitioner may choose to name the relevant sources (for example, the name of the code, rule, or applicable regulation, or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or refer to a term that appropriately describes those sources.

Reservations or Restrictions Concerning Procedures or Findings (Ref: par. 34t)

.A60 Examples of reservations or restrictions procedures or findings may include the following:

- Disclosure of stipulated facts, assumptions, or interpretations (including the source thereof) used in the application of procedures
- Description of the condition of records, controls, or data to which the procedures were applied
- Explanation that the practitioner has no responsibility to update the practitioner's report
- Explanation that the sample may not be representative of the population

Signature of the Practitioner (Ref: par. 34u)

.A61 In some cases, law or regulation may allow for the use of electronic signatures in the practitioner's report.

.A62 In certain situations, the practitioner's report may be required by law or regulation to include the personal name and signature of the practitioner, in addition to the practitioner's firm.

.A63 *Considerations Specific to Governmental Entities.* This section would not preclude a governmental practitioner from including the personal name and signature of the practitioner in the practitioner's report when, in certain situations, the governmental practitioner is required by law or regulation or chooses to do so.

Practitioner's Address (Ref: par. .34v)

.A64 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country. The city and state where the practitioner practices may be indicated on letterhead that contains the issuing office's location.

Alert That Restricts the Use of the Practitioner's Agreed-Upon Procedures Report (Ref: par. .35–.36)

.A65 Based on the circumstances of the engagement, the practitioner may consider it appropriate to include an alert, in a separate paragraph, that restricts the use of the practitioner's agreed-upon procedures report. Examples of situations in which the practitioner, using professional judgment, may decide to include an alert, in a separate paragraph, that restricts the use of the practitioner's agreed-upon procedures report include the following:

- When the engaging party requests that the use of the report be restricted.
- When agreed-upon procedures are performed on compliance with aspects of contractual agreements, the practitioner may determine to restrict the use of the report to the parties to the contract or agreement.
- When agreed-upon procedures are performed to comply with regulatory requirements, the practitioner may determine to restrict the use of the report to the engaging party and the regulator.
- When agreed-upon procedures are performed relating to certain subject matter (for example, subject matter addressed in the AT-C section 300 series), the practitioner may determine to restrict the use of the report to parties that are known to understand the subject matter.

- When agreed-upon procedures are performed on subject matter that is intended to be used by or is only available to a limited number of parties, the practitioner may determine to restrict the use of the report to such parties.
- When the procedures that the practitioner is engaged to perform are prescribed and the practitioner does not have the ability to perform or design additional procedures, the practitioner may determine to restrict the use of the report to those parties that prescribed the procedures.

.A66 A practitioner's report that includes an alert that restricts the use of the report may be included in a document that also contains a practitioner's report that is for general use. The inclusion of the separate restricted-use report does not affect the intended use of the general-use report nor does the inclusion of the general-use report affect the intended use of the restricted-use report. The restricted-use report remains restricted as to use, and the general-use report continues to be for general use.

.A67 A practitioner may also issue a single combined practitioner's report that includes (a) a practitioner's report that includes an alert that restricts its use and (b) a report that is for general use. If these two types of reports are clearly differentiated within the combined report, such as through the use of appropriate headings, the alert that restricts the use of the report may be limited to the report that includes the alert that restricts its use. In such circumstances, the use of the general-use report is not affected.

.A68 Law or regulation may require that a practitioner's report be made available to the public as a matter of public record.

.A69 A practitioner is not responsible for controlling, and cannot control, distribution of the practitioner's report after its release. The alert that restricts the use of the practitioner's report is designed to avoid misunderstandings related to the use of the practitioner's report, particularly if the practitioner's report is taken out of the context in which the practitioner's report is intended to be used. A practitioner may consider informing the engaging party or other specified parties that the practitioner's report is not intended for distribution to parties other than those specified in the practitioner's report. The practitioner may, in connection with establishing the terms of the engagement, reach an understanding with the engaging party that the intended use of the practitioner's report will be restricted and may obtain the engaging party's agreement that the engaging party and specified parties will not distribute such practitioner's report to parties other than those identified therein.

.A70 The practitioner may identify the specified parties by naming them, referring to a list of those parties, or identifying the class of parties, for example, "all customers of XYZ Company during some or all of the period January 1, 20XX, to December 31, 20XX." The method of identifying the specified parties is determined by the practitioner.

Adding Other Specified Parties After the Release of the Practitioner's Report (Ref: par. .37)

.A71 When the practitioner is requested to add an additional specified party, the practitioner may agree to add the additional specified party based on the practitioner's consideration of factors such as the identity of the other parties and the intended use of the practitioner's report. The practitioner is not required to reissue the report to identify the additional specified party in the alert that restricts the use of the report, or if applicable, indicate that the

additional specified party agreed to the procedures and acknowledged that the procedures performed are appropriate for their purposes. If the practitioner's report is reissued, the practitioner is not required to change the date of the report.

Knowledge of Matters Outside Procedures (Ref: par. .40)

.A72 For example, if, during the course of applying procedures regarding an entity's internal control, the practitioner becomes aware of a material weakness by means other than performance of the procedures, such matter may be included in the practitioner's report.

.A73 When the practitioner applies procedures to an element, account, or item of a financial statement and has performed an audit or review of the entity's related financial statements, and the practitioner's audit or review report on such financial statements includes a departure from the standard report, the practitioner may include a reference to the audit or review report and the departure from the standard report in the practitioner's agreed-upon procedures report.

Communication Responsibilities (Ref: par. .41)

.A74 Disclosure of confidential information as defined in the Code of Professional Conduct requires the explicit consent of the engaging party or the responsible party, as appropriate. In circumstances in which such matters are identified, the practitioner may consider discussing with legal counsel or others prior to communicating or taking further action.

Documentation (Ref: par. .42)

.A75 Documentation prepared at the time work is performed or shortly thereafter is likely to be more accurate than documentation prepared at a much later time.

.A76 The practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

.A77

Exhibit — Illustrative Practitioner's Agreed-Upon Procedures Reports

The illustrative practitioner's agreed-upon procedures reports in this exhibit meet the applicable reporting requirements in paragraphs .34–.37. A practitioner may use alternative language in drafting an agreed-upon procedures report, provided that the language meets the applicable requirements in paragraphs .34–.37.

Example 1: Practitioner's Agreed-Upon Procedures Report Related to a Statement of Investment Performance Statistics

Circumstances include the following:

- The engaging party is the responsible party.
- The practitioner has assisted in the development of the procedures.
- No party other than the engaging party has agreed to the procedures and acknowledged that the procedures are appropriate for their purposes.

Independent Accountant's Report

[Appropriate Addressee]

We have performed the procedures enumerated below on [identify the subject matter, for example, the accompanying Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]. [The responsible party, for example, XYZ Fund] is responsible for [the subject matter].

[The engaging party, for example, XYZ Fund] has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of [identify the intended purpose of the engagement, for example, assisting users in understanding the Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and the associated findings are as follows:

[Include paragraphs to describe the procedures performed detailing the nature and extent, and if applicable, the timing, of each procedure and to describe the findings from each procedure performed, including sufficient details on exceptions found.]

We were engaged by [the engaging party, for example, XYZ Fund] to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on [identify the subject matter, for example, the accompanying Statement of Investment Performance Statistics of XYZ Fund for the year ended December 31, 20X1]. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Fund and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

[Additional paragraphs may be added to describe other matters.]

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

Example 2: Practitioner's Agreed-Upon Procedures Report Related to Cash and Accounts Receivable

Circumstances include the following:

- The engaging party is not the responsible party.
- Other than the engaging party, no other party has agreed to the procedures and acknowledged that the procedures are appropriate for their purposes.

Independent Accountant's Report

[Appropriate Addressee]

We have performed the procedures enumerated below on *[identify the subject matter, for example, the cash and accounts receivable of XYZ Company as of December 31, 20XX, included in the accompanying information provided to us by management of XYZ Company]*. *[The responsible party, for example, XYZ Company]* is responsible for *[the subject matter]*.

[The engaging party, for example, ABC Company] has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of *[identify the intended purpose of the engagement, for example, assisting users in understanding cash and accounts receivable of XYZ Company as of December 31, 20XX, included in the accompanying information provided to us by management of ABC Company]*. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and the associated findings are as follows:

Cash

1. For the four bank accounts listed below, we obtained from XYZ Company management
 - a. the December 31, 20XX, bank reconciliations and
 - b. the December 31, 20XX, general ledger.
2. We performed the following procedures:
 - a. Obtained a bank confirmation directly from each bank of the cash on deposit as of December 31, 20XX
 - b. Compared the balance confirmed by the bank to the amount shown on the respective bank reconciliations
 - c. Mathematically recomputed the bank reconciliations
 - d. Compared the cash balances per book listed in the reconciliations below to the respective general ledger account balances

Cash December 31, 20XX

<i>Bank</i>	<i>Cash Balance per Book</i>
DEF National Bank, general ledger account 123	\$5,000
LMN State Bank, general ledger account 124	3,776
RST Trust Company regular account, general ledger account 125	86,912
RST Trust Company payroll account, general ledger account 126	5,000
	\$110,688

We found no exceptions as a result of the procedures.

Accounts Receivable

3. We obtained the accounts receivable aged trial balance as of December 31, 20XX, from XYZ Company (attached as exhibit A). We mathematically checked that the individual customer account balance subtotals in the aged trial balance of accounts receivable agreed to the total accounts receivable per the aged trial balance. We compared the total accounts receivable per the accounts receivable aged trial balance to the total accounts receivable per general ledger account 250.

We found no exceptions as a result of the procedures.

4. We obtained the accounts receivable subsidiary ledger as of December 31, 20XX, from XYZ Company. We compared the individual customer account balance subtotals shown in the accounts receivable aged trial balance (exhibit A) as of December 31, 20XX, to the balances shown in the accounts receivable subsidiary ledger.

We found no exceptions as a result of the procedures.

5. We selected 50 customer account balances from exhibit A by starting at the 8th item and selecting every 15th item thereafter until 50 were selected. The sample size selected represents 9.8% of the aggregate amount of the customer account balances. We obtained the corresponding invoices from XYZ Company and traced the aging (according to invoice dates) for the 50 customer account balances shown in exhibit A to the details of outstanding invoices in the accounts receivable subsidiary ledger.

We found no exceptions as a result of the procedures.

6. We mailed confirmations directly to the customers representing the 150 largest customer account balance subtotals selected from the accounts receivable aged trial balance, and we received responses as indicated below. As agreed, any individual differences in a customer account balance of less than \$300 were to be considered minor, and no further procedures were performed.

Of the 150 customer balances confirmed, we received responses from 140 customers; 10 customers did not reply.

No exceptions were identified in 120 of the confirmations received. The differences in the remaining 20 confirmation replies were less than \$300.

For the 10 customers that did not reply, we traced the items constituting the outstanding customer account balance to invoices and supporting shipping documents.

A summary of the confirmation results according to the respective aging categories is as follows.

Accounts Receivable December 31, 20XX			
Aging Categories	Customer Account Balances	Confirmations Requested	Confirmations Received
Current	\$156,000	\$76,000	\$65,000
Past due:			
Less than 1 month	60,000	30,000	19,000
1–3 months	36,000	18,000	10,000
Over 3 months	48,000	48,000	8,000
	\$300,000	\$172,000	\$102,000

We were engaged by [the engaging party, for example, ABC Company] to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on [identify the subject matter]. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

[Additional paragraphs may be added to describe other matters.]

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

Example 3: Practitioner’s Agreed-Upon Procedures Report in Connection With Claims of Creditors

Circumstances include the following:

- The engaging party is the responsible party.
- The engaging party and one specified party have prescribed the procedures for the practitioner to perform. The engaging party and the specified party have both agreed the procedures and have acknowledged that the procedures are appropriate for the intended purpose of the engagement and their purposes, respectively.

- The practitioner has determined to disclose in the agreed-upon procedures report that the specified party has agreed to and acknowledged that the procedures are appropriate for their purposes.
- The practitioner has determined to restrict the use of the agreed-upon procedures report to the parties that prescribed the procedures.

Independent Accountant's Report

[Appropriate Addressee]

We have performed the procedures enumerated below on *[identify the subject matter, for example, the claims of creditors of XYZ Company as of May 31, 20XX, as set forth in the accompanying Schedule A]*. *[The responsible party, for example, XYZ Company]* is responsible for *[the subject matter]*.

[The engaging party, for example, XYZ Company] has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of *[identify the intended purpose of the engagement, for example, assisting users in understanding the claims of creditors of XYZ Company as of May 31, 20XX, as set forth in the accompanying Schedule A]*. Additionally, *[identify the other party or parties that has or have agreed to and acknowledged that the procedures performed are appropriate to meet their purposes, for example, the Trustee of XYZ Company]* has agreed to and acknowledged that the procedures performed are appropriate to meet for their purposes. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and associated findings are as follows:

1. Obtained the general ledger and the accounts payable trial balance as of May 31, 20XX, from XYZ Company. Compared the total of the accounts payable trial balance to the total accounts payable balance in general ledger account 450.
The total of the accounts payable trial balance agreed with the total accounts payable balance in the general ledger account number 450.
2. Obtained the claim form submitted by creditors in support of the amounts claimed from XYZ Company. Compared the creditor name and amounts from the claim form to the respective name and amounts shown in the accounts payable trial balance obtained in procedure 1. For any differences identified, requested XYZ Company to provide supporting detail. Compared such identified differences to the supporting detail provided.
All differences noted are presented in column 3 of Schedule A. Except for those amounts shown in column 4 of Schedule A, all such differences were agreed to *[describe supporting detail]*.
3. Using the claim form obtained in procedure 2, compared the name and amount to invoices, and if applicable, receiving reports, provided by XYZ Company.

No exceptions were found as a result of this procedure.

We were engaged by *[the engaging party, for example, XYZ Company]* to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the

objective of which would be the expression of an opinion or conclusion, respectively, on *[identify the subject matter, for example, the claims of creditors of XYZ Company as of May 31, 20XX, as set forth in the accompanying Schedule A]*. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of *[identify the specified parties, for example, XYZ Company and the Trustee of XYZ Company]*, and is not intended to be, and should not be, used by anyone other than these specified parties.

[Additional paragraphs may be added to describe other matters.]

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

Example 4: Practitioner's Agreed-Up-on Procedures Report in Which Procedures Are Specified in Regulation

Circumstances include the following:

- The engaging party has agreed to the procedures and acknowledged that the procedures are appropriate for the intended purpose of the engagement.
- The procedures are prescribed in regulation.
- The practitioner has determined to restrict the use of the agreed-upon procedures report to the engaging party and the regulator.

Independent Accountant's Report

[Appropriate Addressee]

We have performed the procedures enumerated below on *[identify the subject matter, for example, the financial accounts of the engaging party during the year ended December 31, 20XX]*. *[The responsible party]* is responsible for *[the subject matter]*.

[The engaging party] has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of *[identify the intended purpose of the engagement, for example, assisting users in understanding the financial accounts of the engaging party during the year ended December 31, 20XX]*. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and the associated findings are as follows:

[Include paragraphs to describe the procedures performed detailing the nature and extent, and if applicable, the timing, of each procedure and to describe the findings from each procedure performed, including sufficient details on exceptions found.]

We were engaged by *[the engaging party]* to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not

conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on *[identify the subject matter]*. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of *[the responsible party]* and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of *[identify the specified parties, for example, the engaging party and the State of XXX]*, and is not intended to be, and should not be, used by anyone other than these specified parties.

[Additional paragraphs may be added to describe other matters.]

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

AT-C Section 300

SUBJECT MATTER

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AT-C Section 305

Prospective Financial Information

Source: SSAE No. 18.

Effective for practitioners' examination and agreed-upon procedures reports on prospective financial information dated on or after May 1, 2017.

Introduction

.01 This section contains performance and reporting requirements and application guidance for a practitioner examining or performing agreed-upon procedures on prospective financial information.

.02 Prospective financial information can take the form of prospective financial statements or partial presentations.

.03 The AICPA Guide *Prospective Financial Information* (guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines," chapter 7, "Reasonably Objective Basis," chapter 8, "Presentation Guidelines," and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information and interpretive guidance for applying this section.

.04 In addition to complying with this section, a practitioner is required to comply with section 105, *Concepts Common to All Attestation Engagements*, and either section 205, *Assertion-Based Examination Engagements*, for examinations of prospective financial information, or section 215, *Agreed-Upon Procedures Engagements*, for agreed-upon procedures engagements that address prospective financial information. In some cases, this section repeats or refers to requirements found in sections 105, 205, and 215 when describing those requirements in the context of engagements that address prospective financial information. Although not all the requirements in sections 105, 205, and 215 are repeated or referred to in this section, the practitioner is responsible for complying with all the requirements in sections 105 and 205, or 105 and 215, as applicable. [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.05 Section 210, *Review Engagements*, states that a practitioner should not perform a review of prospective financial information.¹ Section 206, *Direct Examination Engagements*, states that section 206 is not applicable to examination engagements related to subject matter for which other AT-C sections require the application of section 205, which includes section 305, *Prospective Financial Information*. [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹ Paragraph .07 of section 210, *Review Engagements*.

Effective Date

.06 This section is effective for practitioners' examination and agreed-upon procedures reports on prospective financial information dated on or after May 1, 2017.

Objectives of an Examination Engagement²

.07 In conducting an examination of prospective financial information, the objectives of the practitioner are to

- a. obtain reasonable assurance about whether, in all material respects,
 - i. the prospective financial information is presented in accordance with the guidelines for the presentation of prospective financial information established by the AICPA (AICPA presentation guidelines) (Ref: par. .A1) and
 - ii. the assumptions underlying the forecast are suitably supported and provide a reasonable basis for the responsible party's forecast, or the assumptions underlying the projection are suitably supported and provide a reasonable basis for the responsible party's projection, given the hypothetical assumptions. (Ref: par. .A2)
- b. express an opinion in a written report on the matters in paragraph .07a.

Objectives of an Agreed-Upon Procedures Engagement

.08 In conducting an agreed-upon procedures engagement for which the subject matter is prospective financial information, the objectives of the practitioner are to

- a. apply specific procedures to the prospective financial information and
- b. issue a written report that describes the procedures applied and the practitioner's findings without providing an opinion or conclusion on the prospective financial information.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Definitions

.09 For purposes of this section, the following terms have the meanings attributed as follows:^[3]

Entity. Any unit, existing or to be formed, for which financial statements could be prepared in accordance with generally accepted

² Paragraph .18 of this section requires the practitioner to request a written assertion from the responsible party. For that reason, when the term "examination" is used in this section, it refers to an "assertion-based examination" performed under section 205, *Assertion-Based Examination Engagements*, and this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

^[3] [Footnote deleted, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

accounting principles or special purpose frameworks. For example, an entity can be an individual, partnership, corporation, trust, estate, association, or governmental unit. (Ref: par. .A3)

Financial forecast. Prospective financial statements that present, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and cash flows. A financial forecast is based on the responsible party's assumptions reflecting conditions it expects to exist and the course of action it expects to take. A financial forecast may be expressed in specific monetary amounts as a single-point estimate of forecasted results or as a range, when the responsible party selects key assumptions to form a range within which it reasonably expects, to the best of its knowledge and belief, the item or items subject to the assumptions to actually fall. If a forecast contains a range, the range is not selected in a biased or misleading manner (for example, a range in which one end is significantly less expected than the other). (Ref: par. .A4)

Financial projection. Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows. A financial projection is sometimes prepared to present one or more hypothetical courses of action for evaluation, as in response to a question such as, "What would happen if...?" A financial projection is based on the responsible party's assumptions reflecting conditions it expects would exist and the course of action it expects would be taken, given one or more hypothetical assumptions. A projection, like a forecast, may contain a range. (Ref: par. .A5–.A6)

Guide. The AICPA Guide *Prospective Financial Information*.

Hypothetical assumption. An assumption used in a financial projection or in a partial presentation of projected information to present a condition or course of action that is not necessarily expected to occur, but is consistent with the purpose of the projection.

Key factors. The significant matters on which an entity's future results are expected to depend. Such factors are basic to the entity's operations and, thus, encompass matters that affect, among other things, the entity's sales, production, service, and financing activities. Key factors serve as a foundation for prospective financial information and are the bases for the assumptions.

Partial presentation. A presentation of prospective financial information that excludes one or more of the applicable items required for prospective financial statements as described in chapter 8 of the guide. (Ref: par. .A7)

Presentation guidelines. The criteria for the presentation and disclosure of prospective financial information. (Ref: par. .A8)

Prospective financial information. Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Prospective financial statements. Either financial forecasts or financial projections, including the summaries of significant assumptions and accounting policies. Although prospective

financial statements may cover a period that has partially expired, statements for periods that have completely expired are not considered to be prospective financial statements. Pro forma financial statements and partial presentations are not considered to be prospective financial statements. (Ref: par. .A9–.A10)

Requirements

Preconditions for an Examination Engagement

.10 Because a financial projection is not appropriate for general use, a practitioner should not agree to the use of the practitioner's name in conjunction with a financial projection that the practitioner believes will be distributed to those who will not be negotiating directly with the responsible party. (Ref: par. .A4–.A5 and .A11)

.11 Unless required by law or regulation to do so, a practitioner should not accept an engagement to examine

- a. a forecast or projection, unless the responsible party has agreed to disclose the significant assumptions
- b. a projection, unless the responsible party has agreed to identify in the presentation which of the assumptions are hypothetical and to describe the limitations on the usefulness of the projection.
- c. a partial presentation that does not describe the limitations on the usefulness of the presentation.

.12 A practitioner should not examine a forecast or projection that discloses none of the significant assumptions. If after accepting the engagement the practitioner determines that the forecast or projection discloses none of the significant assumptions, the practitioner should withdraw from the engagement, unless required by law or regulation to report on the forecast or projection, in which case, the practitioner should express an adverse opinion in the practitioner's report.

.13 If after accepting the engagement, the practitioner determines that the forecast or projection fails to disclose one or more of the significant assumptions, the practitioner should describe the assumption(s) in the practitioner's report and express an adverse opinion.

.14 If after accepting the engagement the practitioner determines that a projection fails to identify which of the assumptions are hypothetical or describe the limitations on the usefulness of the projection, the practitioner should withdraw from the engagement, unless required by law or regulation to report on the projection, in which case, the practitioner should express an adverse opinion in the practitioner's report.

Training and Proficiency

.15 The practitioner should understand the guidelines for the preparation and presentation of prospective financial information contained in the guide.

.16 The practitioner should possess or obtain a level of knowledge of the industry and the accounting principles and practices of the industry in which the entity operates, or will operate, that will enable the practitioner to examine prospective financial information that is appropriate for an entity operating in that industry.

.17 The practitioner should obtain knowledge of the key factors on which the entity's prospective financial information is based. (Ref: par. .A12)

Requesting a Written Assertion

.18 In performing an examination under this section, the practitioner should request from the responsible party a written assertion. If the responsible party refuses to provide a written assertion, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation. (Ref: par. .A13) [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Planning

.19 In accordance with section 205, the practitioner should establish an overall engagement strategy that sets the scope, timing, and direction of the engagement and guides the development of the engagement plan.⁴ (Ref: par. .A14)

Examination Procedures

.20 The examination procedures should be based on the practitioner's consideration of the following:

- a. The nature and materiality of the information to the prospective financial information taken as a whole
- b. The likelihood of material misstatements
- c. Knowledge obtained during current and previous engagements
- d. The responsible party's competence with respect to prospective financial information
- e. The extent to which the prospective financial information is affected by the responsible party's judgment, for example, its judgment in selecting the significant assumptions used to prepare the prospective financial information
- f. The support for the responsible party's assumptions

.21 The practitioner should evaluate whether the responsible party has a reasonably objective basis for the forecast and should consider whether sufficiently objective assumptions can be developed for each key factor. (Ref: par. .A15)

.22 The practitioner should perform those procedures the practitioner considers necessary in the circumstances to report on whether the assumptions underlying the forecast are suitably supported and provide a reasonable basis for the forecast, or whether the assumptions underlying the projection are suitably supported and provide a reasonable basis for the projection, given the hypothetical assumptions. (Ref: par. .A16–.A17)

.23 The practitioner should evaluate the support for the significant assumptions individually and in the aggregate. Assumptions are suitably supported if the preponderance of the information supports each significant assumption. In an examination of a projection, the practitioner need not obtain support for the hypothetical assumptions, although the practitioner should

⁴ Paragraph .11 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

evaluate whether they are consistent with the purpose of the presentation. (Ref: par. .A18–.A20)

.24 In an evaluation of whether the assumptions provide a reasonable basis for the forecast, the practitioner should evaluate the assumptions in the aggregate. If certain assumptions do not have a material effect on the presentation, they may not have to be individually evaluated. Nonetheless, the practitioner should evaluate the aggregate effect of individually insignificant assumptions in making the practitioner's overall evaluation.

.25 The practitioner should evaluate the assumptions related to an expired portion of the prospective period. (Ref: par. .A21–.A23)

.26 In evaluating the preparation and presentation of the prospective financial information, the practitioner should perform procedures to obtain reasonable assurance about whether the

- a. presentation reflects the identified assumptions,
- b. computations made to translate the assumptions into prospective amounts are mathematically accurate,
- c. assumptions are internally consistent,
- d. accounting principles used in the forecast or projection are appropriate, (Ref: par. .A24)
- e. prospective financial information is presented in accordance with the AICPA presentation guidelines, and
- f. assumptions have been adequately disclosed in accordance with the AICPA presentation guidelines.

.27 The practitioner should conclude whether the prospective financial information, including related disclosures, should be revised because of any of the following: (Ref: par. .A25)

- a. Mathematical errors
- b. Unreasonable or internally inconsistent assumptions
- c. Inappropriate or incomplete presentation
- d. Inadequate disclosure

Written Representations in an Examination Engagement

.28 In an examination of a forecast, in addition to the written representations from the responsible party required by section 205,⁵ the practitioner should request from the responsible party written representations that

- a. the forecast presents the expected financial position, results of operations, and cash flows for the forecast period and that the forecast reflects the responsible party's judgment, based on present circumstances, of the expected conditions and its expected course of action;
- b. the assumptions on which the forecast is based are reasonable and suitably supported; and
- c. if the forecast contains a range, the item or items subject to the assumptions are reasonably expected to fall within the range and that the range was not selected in a biased or misleading manner.

⁵ Paragraph .51 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.29 In an examination of a projection, in addition to the written representations from the responsible party required by section 205,⁶ the practitioner should request from the responsible party written representations that

- a. identify the hypothetical assumptions;
- b. identify which of the hypothetical assumptions, if any, are improbable;
- c. describe the limitations of the usefulness of the presentation;
- d. state that the responsible party is responsible for the projection presenting the expected financial position, results of operations, and cash flows for the projection period given the hypothetical assumptions, and that the projection reflects the responsible party's judgment, based on present circumstances, of expected conditions and its expected course of action given the occurrence of the hypothetical events;
- e. state that the assumptions other than the hypothetical assumptions are reasonable, given the hypothetical assumptions, and are suitably supported; and
- f. state that if the projection contains a range, given the hypothetical assumptions, the item or items subject to the assumption are reasonably expected to actually fall within the range and that the range was not selected in a biased or misleading manner.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.30 In an examination of prospective information, the written representation required by section 205 regarding whether the subject matter is in accordance with (or based on) the criteria should indicate that the forecast (or projection) is presented in accordance with (or based on) the guidelines for the presentation of a forecast (or financial projection) established by the AICPA.^[7] (Ref: par. .A26)

.31 In an examination of prospective financial information, the practitioner should request from the responsible party the written representations required by section 205 and paragraphs .28 or .29 of this section, as applicable, even if the engaging party is not the responsible party.⁸ The alternative to obtaining the required written representations provided for in section 205 is not permitted in an engagement to examine prospective financial information.⁹ The responsible party's refusal to furnish the written representations required by section 205 and paragraphs .28 or .29 of this section, as applicable, constitutes a limitation on the scope of the engagement. Such refusal is often sufficient to preclude an unmodified opinion and particularly with respect to the representations in paragraph .53 of section 205, may cause the practitioner to disclaim an opinion or withdraw from the examination engagement, when withdrawal

⁶ See footnote 5. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

^[7] [Footnote deleted, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁸ See footnote 5. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁹ Paragraph .52 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

is possible under applicable law or regulations.¹⁰ However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate. [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Content of the Practitioner's Examination Report

.32 The practitioner's examination report on prospective financial information should include the following, unless the practitioner is disclaiming an opinion, in which case, items .32*f*, and .32*g* should be omitted: (Ref: par. .A27–.A30)

- a. A title that includes the word *independent*.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification of the prospective financial information being reported on, including the period of time to which the prospective financial information relates.
- d. An indication that the criteria against which the prospective financial information was measured or evaluated are the guidelines for the presentation of a forecast (or projection) established by the AICPA.
- e. A statement that identifies the responsible party and its responsibility for the prospective financial information being prepared and presented in accordance with the guidelines for the presentation of a forecast (or projection) established by the AICPA.
- f. A statement that the practitioner's responsibility is to express an opinion on the prospective financial information, based on the practitioner's examination.
- g. A statement that
 - i. the practitioner's examination was conducted in accordance with attestation standards established by the AICPA. (Ref: par. A31)
 - ii. those standards require that the practitioner plan and perform the examination to obtain reasonable assurance about whether the forecast (or projection) is presented in accordance with the guidelines for the presentation of a forecast (or projection) established by the AICPA, in all material respects.
 - iii. the practitioner believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.
- h. A description of the nature of an examination engagement
- i. A statement that the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement.

¹⁰ Paragraphs .56 and .A68 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- j. The practitioner's opinion about whether the forecast (or projection) is presented, in all material respects, in accordance with the guidelines for the presentation of a forecast (or projection) established by the AICPA, and whether the underlying assumptions are suitably supported and provide a reasonable basis for the forecast or a reasonable basis for the projection given the hypothetical assumptions.
- k. A statement indicating that the prospective results may not be achieved and describing other significant inherent limitations, if any.
- l. A statement that the practitioner has no responsibility to update the report for events and circumstances occurring after the date of the report.
- m. The manual or printed signature of the practitioner's firm.
- n. The city and state where the practitioner's report is issued.
- o. The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate evidence on which to base the practitioner's opinion, including evidence that
 - i. the attestation documentation has been reviewed,
 - ii. the prospective financial information has been prepared, and
 - iii. the responsible party has provided a written assertion.)

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.33 When a practitioner examines a projection, the practitioner's opinion regarding the assumptions should be conditioned on the hypothetical assumptions, that is, the practitioner should express an opinion on whether the assumptions provide a reasonable basis for the projection, given the hypothetical assumptions. In addition to the required elements for a practitioner's report on an examination of a forecast, a report on an examination of a projection should include (Ref: par. .A27 and .A32–.A33)

- a. an identification of the hypothetical assumptions,
- b. a description of the special purpose for which the projection was prepared, and
- c. an alert, in a separate paragraph, that restricts the use of the report. The alert should
 - i. state that the report is intended solely for the information and use of the specified parties,
 - ii. identify the specified parties for whom use is intended, and
 - iii. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.
- d. When the engagement is also performed in accordance with *Government Auditing Standards*, the alert that restricts the use of the report should include the following information, rather than the information required by paragraph .33c:
 - i. a description of the purpose of the report, and
 - ii. a statement that the report is not suitable for any other purpose.

.34 When the prospective financial information contains a range, the practitioner's report should also include a separate paragraph that states that the responsible party has elected to portray the expected results of one or more assumptions as a range. (Ref: par. .A27 and .A34)

Modified Opinions

.35 The following are circumstances that require the practitioner to modify the opinion and the type of modified opinion the practitioner should express in each circumstance: (Ref: par. .A35–.A39)

- a. If, in the practitioner's judgment, the prospective financial information materially departs from AICPA presentation guidelines, the practitioner should express a qualified or adverse opinion. (Ref: par. .A36–.A37)
- b. If the prospective financial information fails to disclose assumptions that, in the practitioner's professional judgment, are significant, or misapplies the accounting principles, the practitioner should express an adverse opinion. (Ref: par. .A38)
- c. If the practitioner believes that one or more significant assumptions are not suitably supported or do not provide a reasonable basis for the forecast, or for the projection given the hypothetical assumptions, the practitioner should express an adverse opinion. (Ref: par. .A38)
- d. If the practitioner is unable to obtain sufficient appropriate evidence, the practitioner should disclaim an opinion and describe the scope limitation in the practitioner's report. (Ref: par. .A39)

Partial Presentations

.36 When examining a partial presentation, the practitioner should give appropriate consideration to whether key factors affecting elements, accounts, or items that are interrelated with those in the partial presentation have been considered, including key factors that may not necessarily be obvious to the user of a partial presentation (for example, production capacity relative to a sales forecast), and whether all significant assumptions have been disclosed. (Ref: par. .A40–.A41 and .A29)

.37 Because partial presentations are generally appropriate only for limited use, practitioners' reports on partial presentations of both forecasted and projected financial information should include a description of any limitations on the usefulness of the presentation.

Preconditions for an Agreed-Upon Procedures Engagement

.38 In addition to determining that the preconditions for accepting or continuing an agreed-upon procedures engagement enumerated in section 105 and section 215 are met, the practitioner should not perform an agreed-upon procedures engagement on a forecast or projection unless the prospective financial information includes a summary of significant assumptions.

Content of the Practitioner's Agreed-Upon Procedures Report

.39 The practitioner's report on the application of agreed-upon procedures to a forecast or projection should include the following: (Ref: par. .A42–.A43)

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification of the engaging party.
- d. An identification of the prospective financial information to which the procedures have been applied.
- e. A statement that identifies the responsible party and its responsibility for preparing and presenting the forecast (or projection) in accordance with the guidelines for the presentation of a forecast (or projection) established by the AICPA. When the engaging party is not the responsible party and identification of the responsible party and its responsibility for the prospective financial information is based solely on representations received from the engaging party, the practitioner's agreed-upon procedures report should include a statement to that effect.
- f. A statement that the engaging party acknowledged that the procedures performed are appropriate to meet the intended purpose of the engagement.
- g. An identification of the intended purpose of the engagement in sufficient detail to enable the user to understand the nature of the work performed.
- h. A statement that the practitioner's report may not be suitable for any other purpose.
- i. A statement that the procedures performed may not address all the items of interest to a user of the report and may not meet the needs of all users of the report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.
- j. A statement that an agreed-upon procedures engagement involves the practitioner performing specific procedures that the engaging party has agreed to and acknowledged to be appropriate for the intended purpose of the engagement and reporting on findings based on the procedures performed.
- k. A description of the procedures performed detailing the nature and extent, and if applicable, the timing of each procedure.
- l. A description of the findings from each procedure performed, including sufficient details on exceptions found. (The practitioner should not provide a conclusion.)
- m. If applicable, a description of any specified threshold established by the engaging party for reporting exceptions.
- n. A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the AICPA.
- o. A statement that the practitioner was not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or a conclusion, respectively, on
 - i. whether the presentation of the forecast (or projection) is in accordance with guidelines for the presentation of a forecast (or projection) established by the AICPA,
 - ii. whether the underlying assumptions are suitably supported, and

- iii. whether the underlying assumptions provide a reasonable basis for the forecast or a reasonable basis for the projection given the hypothetical assumptions.
- p. A statement that the practitioner does not express such an opinion or conclusion.
- q. A statement that had the practitioner performed additional procedures, other matters might have come to the practitioner's attention that would have been reported.
- r. A statement that the practitioner is required to be independent of the responsible party and to meet the practitioner's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the agreed-upon procedures engagement.
- s. If applicable, a description of the nature of the assistance provided by a practitioner's external specialist.
- t. A statement indicating that the prospective results may not be achieved and describing other significant inherent limitations, if any.
- u. A statement that the practitioner has no responsibility to update the report for events and circumstances occurring after the date of the report.
- v. When applicable, reservations or restrictions concerning procedures or findings.
- w. The manual or printed signature of the practitioner's firm.
- x. The city and state where the practitioner's report is issued.
- y. The date of the report. (The report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that
 - i. the attestation documentation has been reviewed, and
 - ii. the prospective financial information has been prepared.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Alert That Restricts the Use of the Practitioner's Agreed-Upon Procedures Report

.40 The practitioner should consider whether to include an alert, in a separate paragraph, that restricts the use of the practitioner's agreed-upon procedures report, taking into account the understanding with the engaging party regarding the nature of the engagement. [Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.41 If the practitioner determines to include an alert, in a separate paragraph, that restricts the use of the practitioner's report, such alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.

[Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Application and Other Explanatory Material

Objectives of an Examination Engagement (Ref: par. .07a)

.A1 The practitioner's objective in an examination of prospective financial information is to obtain sufficient appropriate evidence to reduce attestation risk to a level that is, in the practitioner's professional judgment, acceptably low to express an opinion about whether the prospective financial information is presented in accordance with AICPA presentation guidelines and the assumptions are suitably supported and provide either a reasonable basis for the responsible party's forecast or a reasonable basis for the responsible party's projection, given the hypothetical assumptions. The practitioner's opinion does not address whether the prospective results can be achieved because events and circumstances frequently do not occur as expected, and achievement of the prospective results is dependent on the actions, plans, and assumptions of the responsible party.

.A2 The concept of *suitably supported* is discussed in paragraphs .23 and .A18–.A20.

Definitions

Entity (Ref: par. .09)

.A3 The term *entity* is used elsewhere in the attestation standards. However, the definition of the term *entity* in paragraph .09 is applicable only to this section.

Financial Forecast (Ref: par. .09–.10)

.A4 As indicated in chapter 4, "Types of Prospective Financial Information and Their Uses," of the guide, prospective financial statements are for either general use or limited use. *General use of prospective financial statements* refers to the use of the statements by persons with whom the responsible party is not negotiating directly—for example, in an offering statement of an entity's debt or equity interests. Because recipients of prospective financial statements distributed for general use are unable to ask the responsible party directly about the presentation, the presentation most useful to them is one that portrays, to the best of the responsible party's knowledge and belief, the expected results. Thus, only a financial forecast is appropriate for general use.

Financial Projection (Ref: par. .09–.10)

.A5 *Limited use of prospective financial statements* refers to the use of prospective financial statements by the responsible party alone or by the responsible party and third parties with whom the responsible party is negotiating directly. Examples include use in negotiations for a bank loan, submission to a regulatory agency, and use solely within the entity. Third-party recipients of prospective financial statements intended for limited use can ask questions of the responsible party and negotiate terms directly with it. Any type of prospective financial statements that would be useful in the circumstances would normally be appropriate for limited use. Thus, the presentation may be a financial forecast or a financial projection.

.A6 Generally, as the number or significance of the hypothetical assumptions increases, the less likely that it is appropriate for the responsible party to present a financial projection.

Partial Presentation (Ref: par. .09)

.A7 Paragraphs 8.61–.72 of the guide establishes a limitation on the use of partial presentations. Paragraph 8.59 of the guide states, in part

...partial presentations are not ordinarily appropriate for general use. Accordingly, a partial presentation ordinarily should not be distributed to third parties who will not be *negotiating directly* with the responsible party (for example, in an offering document for an entity's debt or equity interests). In this context, negotiating directly is defined as a third-party user's ability to ask questions of, and negotiate the terms or structure of a transaction directly with, the responsible party.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Presentation Guidelines (Ref: par. .09)

.A8 Chapter 8 of the guide contains the guidelines for the presentation and disclosure of prospective financial information.

Prospective Financial Statements (Ref: par. .09)

.A9 Prospective financial statements may take the form of complete financial statements or may be summarized or condensed, as described in chapter 8 of the guide. Presentations that exclude one or more relevant elements described in that section are defined as *partial presentations*. For the purposes of this section, the term *forecast* used alone means forecasted information, which can be either a full presentation (a financial forecast) or a partial presentation. The term *projection* can refer to either a financial projection or a partial presentation of projected information.

.A10 The objective of pro forma financial information is to show what the significant effects on the historical financial statements might have been had a consummated or proposed transaction or event occurred at an earlier date. Although the transaction in question might be prospective, this section does not apply to such presentations because they are essentially historical financial statements and do not purport to be prospective financial statements. See section 310, *Reporting on Pro Forma Financial Information*.

Preconditions for an Examination Engagement (Ref: par. .10)

.A11 Paragraph .10 indicates that it is not appropriate for a practitioner to agree to the use of the practitioner's name in conjunction with a financial projection that the practitioner believes will be distributed to those who will not be negotiating directly with the responsible party. An example of such a situation is the inclusion of a financial projection in an offering statement of an entity's debt or equity interests, unless the projection is used to supplement a financial forecast for the period covered by the forecast (that is, the financial projection would be presented in the same document as the financial forecast and the period covered by the projection would not begin before, or extend beyond, the period covered by the forecast).

Training and Proficiency (Ref: par. .17)

.A12 In obtaining knowledge of the entity's business, accounting policies, and the key factors upon which its future financial results appear to depend, the practitioner may focus on areas such as the following:

- The availability and cost of resources needed to operate, for example, raw materials, labor, short-term and long-term financing, and plant and equipment.
- The nature and condition of markets in which the entity sells its goods or services, including final consumer markets if the entity sells to intermediate markets
- Factors specific to the industry, including competitive conditions, sensitivity to economic conditions, accounting policies, specific regulatory requirements, and technology
- Patterns of past performance for the entity or comparable entities, including trends in revenue and costs, turnover of assets, uses and capacities of physical facilities, and management policies

Requesting a Written Assertion (Ref: par. .18)

.A13 Paragraph .18 applies regardless of whether the responsible party is the engaging party.

Planning (Ref: par. .19)

.A14 Factors that may be considered by the practitioner in planning the examination of prospective financial information include the following:

- The financial reporting framework to be used and the type of presentation
- Preliminary judgments about materiality levels
- Items within the prospective financial information that are subject to risk of material misstatement
- Conditions that may require extension or modification of the practitioner's examination procedures
- Knowledge of the entity's business and its industry
- The responsible party's experience in preparing prospective financial information
- The length of the period covered by the prospective financial information
- The process by which the responsible party develops its prospective financial information

Examination Procedures (Ref: par. .21–.23, .25, .26d, and .27)

.A15 Chapter 7 of the guide indicates that a reasonably objective basis for a forecast cannot exist if the premise on which the assumptions are based is too subjective. A forecast has to be based on a realistic premise, which has to be supportable. In contrast, the basic premise for a projection does not have to be supportable, although the hypothetical assumptions should be consistent with the purpose of the presentation. Accordingly, in a projection, the responsible party need not have a reasonably objective basis for the hypothetical assumptions.

.A16 Forecast. The practitioner can form an opinion that the assumptions provide a reasonable basis for the financial forecast if the responsible party represents that the presentation reflects, to the best of its knowledge and belief, its estimate of expected financial position, results of operations, and cash flows

for the prospective period, and the practitioner concludes that, based on the practitioner's examination, (a) the responsible party has explicitly identified all key factors expected to materially affect the operations of the entity during the prospective period and has developed appropriate assumptions with respect to such factors, and (b) the assumptions are suitably supported.

.A17 Projection. The practitioner can form an opinion that the assumptions provide a reasonable basis for the financial projection given the hypothetical assumptions if the responsible party represents that the presentation reflects, to the best of its knowledge and belief, expected financial position, results of operations, and cash flows for the prospective period given the hypothetical assumptions, and the practitioner concludes, based on the practitioner's examination, that

- a. the responsible party has explicitly identified all key factors that would materially affect the operations of the entity during the prospective period if the hypothetical assumptions were to materialize and has developed appropriate assumptions with respect to such factors, and
- b. the other assumptions are suitably supported given the hypothetical assumptions. However, as the number and significance of the hypothetical assumptions increase, the practitioner may not be able to be satisfied about the presentation as a whole by obtaining support for the remaining assumptions.

.A18 A preponderance of information exists for an assumption if the weight of available information supports that assumption. Furthermore, because of the judgments involved in developing assumptions, different people may arrive at somewhat different, but equally reasonable, assumptions based on the same information.

.A19 In evaluating support for assumptions other than hypothetical assumptions in a projection, the practitioner can conclude that they are suitably supported if the preponderance of information supports each significant assumption given the hypothetical assumptions.

.A20 Appropriate considerations for forecasts and projections include whether

- a. sufficient pertinent sources of information about the assumptions have been considered. Examples of external sources the practitioner might consider are government publications, industry publications, economic forecasts, existing or proposed legislation, and reports of changing technology. Examples of internal sources are budgets, labor agreements, patents, royalty agreements and records, sales backlog records, debt agreements, and actions of the board of directors involving entity plans.
- b. the assumptions are consistent with the sources from which they are derived.
- c. the assumptions are consistent with each other.
- d. the historical financial information and other data used in developing the assumptions are sufficiently reliable for that purpose. Reliability can be assessed by inquiry and analytical or other procedures, some of which may have been completed in past audits or reviews of the historical financial statements.
- e. the historical financial information and other data used in developing the assumptions are comparable over the periods specified

or whether the effects of any lack of comparability were considered in developing the assumptions.

- f. the logical arguments or theory, considered with the data supporting the assumptions, are reasonable.

.A21 The procedures the practitioner performs to evaluate these assumptions depends on

- the significance of the period,
- whether financial statements have been prepared for the expired period, and
- whether the forecast or projection incorporates the historical results.

.A22 The practitioner may obtain evidence regarding the actual results by applying audit or review procedures to the historical results.

.A23 At some point the historical results become such a large portion of the prospective results that the practitioner might consider it inappropriate to examine the prospective financial information.

.A24 Under the AICPA presentation guidelines, the accounting principles used in a projection need not be those expected to be used in the historical financial statements for the prospective period if use of a different principle is consistent with the purpose of the presentation.

.A25 The practitioner's consideration of materiality is discussed in section 205.¹¹ Materiality is a concept that is judged in light of the expected range of reasonableness of the information; therefore, users would not expect prospective financial information (information about events that have not yet occurred) to be as precise as historical information.

Written Representations in an Examination Engagement (Ref: par. .30)

.A26 Section 205 requires the practitioner to request written representations from the responsible party, including a representation that it has disclosed to the practitioner all known matters contradicting the subject matter.¹² Because no one can know the future, "known matters," in the context of prospective financial information, refers to what the responsible party expects. The required disclosure in the written representations relates to assumptions that are not consistent with the responsible party's expectations, or in the case of a projection, not consistent with the responsible party's expectations given the occurrence of the hypothetical assumptions.

Content of the Practitioner's Examination Report (Ref: par. .32–.34, and .36)

.A27 The list of elements in paragraphs .32–.34 constitutes all the required elements for a practitioner's report on an examination of prospective

¹¹ Paragraph .17 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹² Paragraph .51c of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

financial information, including the elements required by section 205.¹³ Application guidance regarding the elements of an examination report is included in section 205.¹⁴

.A28 Example 1 in the exhibit, "Illustrative Practitioner's Examination and Agreed-Upon Procedures Reports Related to Prospective Financial Information," to this section provides an illustration of a practitioner's report on an examination of a financial forecast.

.A29 The requirements in paragraph .32 are applicable to practitioners' reports on prospective financial statements and on partial presentations.

.A30 When the practitioner's examination of prospective financial information is part of a larger engagement, for example, a financial feasibility study or business acquisition study, the practitioner may expand the practitioner's report on the examination of the prospective financial information to describe the entire engagement. Chapter 17, "The Practitioner's Examination Report," of the guide addresses reporting when the examination engagement is part of a larger engagement.

.A31 In identifying the standards under which the engagement was performed, the practitioner may specify the AT-C section under which the engagement was performed, for example: AT-C section 305, *Prospective Financial Information*, of the attestation standards established by the AICPA. [Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A32 Section 205 notes that the specified parties may be identified by naming them, referring to a list of them, or identifying them as a class.¹⁵ [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A33 Example 2 in the exhibit to this section provides an illustration of a practitioner's examination report on a financial projection. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A34 The following is an example of a separate paragraph to be added to the practitioner's report when the practitioner examines prospective financial statements, in this case, a forecast that contains a range:

As described in the summary of significant assumptions, management of XYZ Company has elected to portray forecasted [*describe the financial statement element or elements for which the expected results of one or more assumptions fall within a range, and identify assumptions expected to fall within a range, for example, revenue in the amounts of \$X,XXX and \$Y,YYY, which is predicated upon occupancy rates of XX percent and YY percent of available apartments*] rather than as a single point estimate. Accordingly, the accompanying forecast presents forecasted financial position, results of operations, and cash flows [*describe one or more assumptions expected to fall within a range, for example, "at such occupancy rates"*]. However, there is no assurance that the actual results will fall within the range of [*describe one or more assumptions expected to fall within a range, for example, occupancy rates*] presented.

¹³ Paragraphs .63–.66 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁴ Paragraphs .A85–.A111 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁵ Paragraph .A108 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Modified Opinions (Ref: par. .35)

.A35 Because of the nature, sensitivity, and interrelationship of prospective financial information, a user of a practitioner's report may find it difficult to interpret a practitioner's opinion that is qualified because of a misapplication of accounting principles, the failure to disclose a significant assumption, the unreasonableness of the underlying assumptions, an assumption that is not suitably supported, or a scope limitation. Using language such as "except for . . ." in the practitioner's opinion about these items may result in misunderstanding by users of the report. For that reason, when a misapplication of accounting principles, a failure to disclose a significant assumption, an unreasonable assumption, an assumption that is not suitably supported, or a limitation on the scope of the practitioner's examination has led the practitioner to conclude that the practitioner cannot express an unmodified opinion, paragraph .35 identifies the type of modified opinion to be expressed. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A36 A qualified opinion may result from the failure to disclose matters (other than the significant assumptions) required by AICPA presentation guidelines, for example, the failure to disclose significant accounting policies, which is required by chapter 8 of the guide. (As indicated in paragraph .35*b*, the failure to disclose significant assumptions would result in an adverse opinion.) [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A37 Section 205 indicates that a qualified opinion is expressed as being "except for" the effects of the matter to which the qualification relates.¹⁶ Section 205 also requires that the practitioner's opinion be separated from any paragraphs emphasizing matters related to the subject matter or any other reporting responsibilities.¹⁷ Accordingly, the opinion paragraph would refer to a separate paragraph that describes the matter giving rise to the qualification. The following is an illustration of the separate paragraph that describes the matter giving rise to the qualification and the opinion paragraph when a financial forecast contains a departure from AICPA presentation guidelines:

The forecast does not disclose significant accounting policies. Disclosure of such policies is required by guidelines for the presentation of a forecast established by the AICPA.

In our opinion, except for the omission of the disclosures related to significant accounting policies as discussed in the preceding paragraph, the accompanying forecast is presented, in all material respects, in accordance with the guidelines for the presentation of a forecast established by the AICPA, and the underlying assumptions are suitably supported and provide a reasonable basis for management's forecast.

[Paragraph renumbered and revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

¹⁶ Paragraph .73 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁷ Paragraph .82 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

A38 In an adverse opinion, the practitioner's opinion states that the presentation is not in accordance with the AICPA presentation guidelines and, when applicable, also states that in the practitioner's opinion, the assumptions are not suitably supported and do not provide a reasonable basis for the prospective financial statements. The following are illustrative paragraphs for use when the practitioner expresses an adverse opinion because the financial forecast contains a significant assumption that is unreasonable:

As discussed under the caption "Sales" in the summary of significant forecast assumptions, the forecasted sales include, among other things, revenue from the Company's federal defense contracts continuing at the current level. The Company's present federal defense contracts will expire in March 20XX. No new contracts have been signed, and no negotiations are underway for new federal defense contracts. Furthermore, the federal government has entered into contracts with another company to supply the items being manufactured under the Company's present contracts.

In our opinion, the accompanying forecast is not presented in accordance with the guidelines for the presentation of a forecast established by the AICPA because management's assumptions, as discussed in the preceding paragraph, are not suitably supported and do not provide a reasonable basis for management's forecast.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

A39 In a disclaimer of opinion, the paragraph of the practitioner's report that describes the matters giving rise to the opinion modification describes the respects in which the examination did not comply with attestation standards applicable to an examination engagement. The practitioner states that because of the respects in which the examination did not comply with such standards, the scope of the examination was not sufficient to enable the practitioner to express, and the practitioner does not express, an opinion on the presentation of or the assumptions underlying the forecast or projection. The following is an illustrative report on an examination of prospective financial statements, in this case, a financial forecast, for which a significant assumption could not be evaluated.

We were engaged to examine the accompanying forecast of XYZ Company, which comprises the forecasted balance sheet as of December 31, 20XX, and the related forecasted statements of income, stockholders' equity, and cash flows for the year then ending. XYZ Company's management is responsible for preparing and presenting the forecast in accordance with the guidelines for the presentation of a forecast established by the AICPA.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

As discussed under the caption, "Income From Investee" in the summary of significant forecast assumptions, the forecast includes income from an equity investee constituting 23 percent of forecasted net income, which is management's estimate of the Company's share of the investee's income to be accrued for 20XX. The investee has not prepared a forecast for the year ending December 31, 20XX, and we were, therefore, unable to obtain suitable support for this assumption.

Our responsibility is to express an opinion on the subject matter or assertion based on conducting the examination in accordance with attestation standards established by the AICPA. Because, as described in the preceding paragraph, we are unable to evaluate management's assumption regarding income from an equity investee and other assumptions that depend thereon, the scope of

our work was not sufficient to express, and we do not express, an opinion with respect to the presentation of or the assumptions underlying the accompanying forecast.

We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Partial Presentations (Ref: par. .36)

.A40 Paragraphs 8.57–.72 of the guide addresses partial presentations. [Paragraph renumbered and revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A41 The practitioner's procedures on a partial presentation may be affected by the nature of the information presented. Many elements of prospective financial statements are interrelated. The nature and extent of the procedures performed in an examination of some partial presentations may need to be similar to the procedures performed in an examination of a full presentation of prospective financial statements. For example, the scope of a practitioner's procedures when the practitioner examines forecasted results of operations (a partial presentation) would likely be similar to that of procedures used for the examination of prospective financial statements because the practitioner would most likely need to consider the interrelationships of all accounts in the examination of results of operations. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Content of the Practitioner's Agreed-Upon Procedures Report (Ref: par. .39)

.A42 The list of elements in paragraph .39 constitutes all the required elements for a practitioner's report on the application of agreed-upon procedures to a forecast or projection, including the elements required by section 215.¹⁸ Application guidance regarding the elements of an agreed-upon procedures report is included in section 215.¹⁹ [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A43 Example 3 in the exhibit to this section provides an illustration of a practitioner's agreed-upon procedures report. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

¹⁸ Paragraph .34 of section 215, *Agreed-Upon Procedures Engagements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁹ Paragraphs .A49–.A64 of section 215. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.A44

Exhibit — Illustrative Practitioner's Examination and Agreed-Upon Procedures Reports Related to Prospective Financial Information

Example 1: Practitioner's Examination Report on a Financial Forecast

The following is an illustrative practitioner's report for an examination of a financial forecast that does not contain a range.

Independent Accountant's Report

[Appropriate Addressee]

We have examined the accompanying forecast of XYZ Company, which comprises *[identify the statements, for example, the forecasted balance sheet as of December 31, 20XX, and the related forecasted statements of income, stockholders' equity, and cash flows for the year then ending]*, based on the guidelines for the presentation of a forecast established by the AICPA. XYZ Company's management¹ is responsible for preparing and presenting the forecast in accordance with the guidelines for the presentation of a forecast established by the AICPA.² Our responsibility is to express an opinion on the forecast based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the forecast is presented in accordance with the guidelines for the presentation of a forecast established by the AICPA, in all material respects. An examination involves performing procedures to obtain evidence about the forecast. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the forecast, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

In our opinion, the accompanying forecast is presented, in all material respects, in accordance with the guidelines for the presentation of a forecast established by the AICPA, and the underlying assumptions are suitably supported and provide a reasonable basis for management's forecast.

There will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

¹ If the responsible party is other than management, the references to management in this illustrative practitioner's report would be changed to refer to the party who has responsibility for the assumptions.

² When the presentation is summarized as illustrated in exhibit 9-2 of the AICPA Guide *Prospective Financial Information*, this sentence might read, "We have examined the accompanying summarized forecast of XYZ Company as of December 31, 20XX, and for the year then ending..."

Example 2: Practitioner's Examination Report on a Financial Projection

The following is an illustrative practitioner's report for an examination of a financial projection that does not contain a range.

Independent Accountant's Report

[Appropriate Addressee]

We have examined the accompanying projection of XYZ Company, which comprises *[identify the statements, for example, the projected balance sheet as of December 31, 20XX, and the related projected statements of income, stockholders' equity, and cash flows for the year then ending]* based on the guidelines for the presentation of a projection established by the AICPA.³ XYZ Company's management⁴ is responsible for preparing and presenting the projection based on *[identify the hypothetical assumption, for example, the granting of the requested loan as described in the summary of significant assumptions]* in accordance with the guidelines for the presentation of a projection established by the AICPA. The projection was prepared for *[describe the special purpose, for example, the purpose of negotiating a loan to expand XYZ Company's plant]*. Our responsibility is to express an opinion on the projection based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the projection is presented in accordance with the guidelines for the presentation of a projection established by the AICPA, in all material respects. An examination involves performing procedures to obtain evidence about the projection. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the projection, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

In our opinion, *[describe the hypothetical assumption(s), for example, assuming the granting of the requested loan for the purpose of expanding XYZ Company's plant as described in the summary of significant assumptions]* the projection referred to above is presented, in all material respects, in accordance with the guidelines for the presentation of a projection established by the AICPA, and the underlying assumptions are suitably supported and provide a reasonable basis for management's projection given the hypothetical assumption(s).

Even if *[identify the hypothetical assumption, for example, the loan is granted and the plant is expanded,]* there will usually be differences between the projected and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

³ When the presentation is summarized as illustrated in exhibit 9-2 of the AICPA Guide *Prospective Financial Information*, this sentence might read, "We have examined the accompanying summarized projection of XYZ Company as of December 31, 20XX, and for the year then ending..."

⁴ If the responsible party is other than management, the references to management in this illustrative practitioner's report would be changed to refer to the party who has responsibility for the assumptions.

The accompanying projection and this report are intended solely for the information and use of *[identify specified parties, for example, XYZ Company and DEF National Bank]*, and are not intended to be and should not be used by anyone other than these specified parties.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 3: Practitioner's Agreed-Upon Procedures Report Related to a Financial Forecast

The following is an illustrative practitioner's report for an engagement to apply agreed-upon procedures to a financial forecast.

Independent Accountant's Agreed-Upon Procedures Report

[Appropriate Addressee]

We have performed the procedures enumerated below on *[identify the statements, for example, the forecasted balance sheet as of December 31, 20XX and the related forecasted statements of income, stockholders' equity, and cash flows of DEF Company, a subsidiary of ABC Company, for the year then ending]*. DEF Company's management⁵ is responsible for preparing and presenting the forecast in accordance with the guidelines for the presentation of a forecast established by the AICPA.

XYZ Corporation's management has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of *[identify the intended purpose of the engagement]*. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and the associated findings are as follows:

[Include paragraphs to describe the procedures performed detailing the nature and extent, and if applicable, the timing of each procedure and to describe the findings from each procedure performed, including sufficient details on exceptions found.]

We were engaged by XYZ Corporation to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, about whether the forecast is presented in accordance with the guidelines for the presentation of a forecast established by the AICPA or whether the underlying assumptions are suitably supported or provide a reasonable basis for management's forecast. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

There will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

⁵ If the responsible party is other than management, the references to management in this illustrative report would be changed to refer to the party who has responsibility for the assumptions.

We are required to be independent of XYZ Corporation and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our agreed-upon procedures engagement.

[Additional paragraphs may be added to describe other matters]

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

[Paragraph renumbered and revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

AT-C Section 310

Reporting on Pro Forma Financial Information

Source: SSAE No. 18.

Effective for practitioners' examination and review reports on pro forma financial information dated on or after May 1, 2017.

Introduction

.01 This section contains performance and reporting requirements and application guidance for a practitioner examining or reviewing pro forma financial information.

.02 This section does not apply when

- a practitioner is performing agreed-upon procedures related to pro forma financial information. Section 105, *Concepts Common to All Attestation Engagements*, and section 215, *Agreed-Upon Procedures Engagements*, are applicable to such engagements.
- certain requesting parties request a comfort letter or ask a practitioner to perform procedures on pro forma financial information in connection with an offering. AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, is applicable to such engagements.
- pro forma financial information is presented outside the basic financial statements but within the same document, and the practitioner is not engaged to report on the pro forma financial information. AU-C section 720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*, and AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, may be applicable to such engagements.
- for purposes of a more meaningful presentation, a transaction consummated after the balance sheet date is reflected in the historical financial statements (such as a revision of debt maturities or a revision of earnings per share calculations for a stock split).
- the applicable financial reporting framework requires the presentation of pro forma financial information in the financial statements or the accompanying notes. For example, generally accepted accounting principles require pro forma financial information in FASB *Accounting Standards Codification* (ASC) 805, *Business Combinations*, FASB ASC 250, *Accounting Changes and Error Corrections*, or, in some cases, pro forma financial information relating to subsequent events.

.03 In addition to complying with this section, a practitioner is required to comply with section 105 and either section 205, *Assertion-Based Examination Engagements*, for examinations of pro forma financial information or section 210, *Review Engagements*, for reviews of pro forma financial information. In some cases, this section repeats or refers to requirements found in sections 105, 205, and 210 when describing those requirements in the context of an examination or review of pro forma financial information. Although not all the

requirements in sections 105, 205, and 210 are repeated or referred to in this section, the practitioner is responsible for complying with all the requirements in sections 105, 205, and 210, as applicable.¹ [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Effective Date

.04 This section is effective for practitioners' examination and review reports on pro forma financial information dated on or after May 1, 2017.

Objectives of an Examination Engagement²

.05 In conducting an examination of pro forma financial information, the objectives of the practitioner are to

- a. obtain reasonable assurance about whether, in accordance with (or based on) the criteria
 - i. management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), (Ref: par. .A1)
 - ii. and, in all material respects
 - (1) the related pro forma adjustments give appropriate effect to those assumptions, and
 - (2) the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts.
- b. express an opinion in a written report on the matters in paragraph .05a.

Objectives of a Review Engagement

.06 In conducting a review of pro forma financial information, the objectives of the practitioner are to

- a. obtain limited assurance about whether, in accordance with (or based on) the criteria, any material modifications should be made to
 - i. management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event),
 - ii. the related pro forma adjustments in order for them to give appropriate effect to those assumptions, or
 - iii. the pro forma amounts in order for them to reflect the proper application of those adjustments to the historical financial statement amounts.

¹ Section 206, *Direct Examination Engagements*, states that section 206 is not applicable to examination engagements related to subject matter for which other AT-C sections require the application of section 205, *Assertion-Based Examination Engagements*, which includes this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

² Paragraph .10 of this section requires the practitioner to request a written assertion from the responsible party. For that reason, when the term "examination" is used in this section, it refers to an "assertion-based examination" performed under section 205 and this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- b. express a conclusion in a written report on the matters in paragraph .06a.

Definitions

.07 For the purposes of this section, the following terms have the meanings attributed as follows: (Ref: par. .A2–.A5)

Criteria for the preparation of pro forma financial information. The basis disclosed in the pro forma financial information that management used to develop the pro forma financial information, including the assumptions underlying the pro forma financial information. Paragraph .11 contains the attributes of suitable criteria for an examination or review of pro forma financial information.

Pro forma financial information. A presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date.

Requirements

Preconditions for an Examination or Review Engagement

.08 In order to accept an attestation engagement to examine or review pro forma financial information, in addition to the preconditions for an attestation engagement included in sections 105 and 205, the practitioner³

- a. should determine that the document that contains the pro forma financial information includes historical financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or that such financial statements are readily available and, if pro forma financial information is presented for an interim period, the document also either includes historical interim financial information for that period (which may be presented in condensed form) or such interim information is readily available. In the case of a business combination, the document includes the relevant historical financial information for the significant constituent parts of the combined entity. (Ref: par. .A6–.A7)
- b. should determine that the historical financial statements of the entity (or in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based, in the case of (Ref: par. .A7–.A8)
 - i. an examination of pro forma financial information, have been audited, or
 - ii. a review of pro forma financial information, have been audited or reviewed, (Ref: par. .A8)and the audit report (or the review report, if issued) is included in the document containing the pro forma financial information (or is readily available) to the extent that the historical financial information is included in the document pursuant to paragraph .08a.

³ Paragraphs .26–.30 of section 105, *Concepts Common to All Attestation Engagements*, and paragraph .06 of section 205, *Examination Engagements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- c. will be able to obtain an appropriate level of knowledge of the accounting and financial reporting practices of the entity (or in the case of a business combination, of each significant constituent part of the combined entity) that will enable the practitioner to perform the procedures necessary to report on the pro forma financial information.

.09 The level of service provided by the practitioner on the pro forma financial information should not exceed that provided on the related historical financial statements. An examination can be performed on pro forma financial information only if the related historical financial statements were audited. A review can be performed on pro forma financial information only if the related historical financial statements were audited or reviewed. In the case of a business combination, the level of service provided by the practitioner on the pro forma financial information should not exceed the lowest level of service provided on the underlying historical financial statements of any significant constituent part of the combined entity. (Ref: par. .A9)

Requesting a Written Assertion

.10 The practitioner should request from management a written assertion. If management refuses to provide a written assertion, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation (Ref: par. .A10)

Assessing the Suitability of the Criteria

.11 As required by section 105, the practitioner should determine whether management has used suitable criteria in preparing and presenting the pro forma financial information.⁴ In assessing the suitability of the criteria, the practitioner should determine whether the criteria include, at a minimum, that

- a. the financial information be extracted from audited or reviewed historical financial statements;
- b. the pro forma adjustments be
 - i. directly attributable to the transaction (or event),
 - ii. factually supportable (Ref: par. .A11),
 - iii. consistent with the entity's applicable financial reporting framework and its accounting policies under that framework; and
- c. the pro forma financial information be appropriately presented and include disclosures that enable intended users to understand the information conveyed.

Understanding the Entity's Accounting and Financial Reporting Policies

.12 The practitioner who is reporting on the pro forma financial information should have or obtain an appropriate level of knowledge of the accounting and financial reporting practices of the entity (or, in the case of a business combination, each significant constituent part of the combined entity). (Ref: par. .A12)

⁴ Paragraph .27b(ii) of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Examination and Review Procedures

.13 The procedures the practitioner should apply to the assumptions and pro forma adjustments for either an examination or a review engagement are as follows:

- a.* Obtain an understanding of the underlying transaction (or event). (Ref: par. .A13)
- b.* Obtain an understanding of the accounting and financial reporting practices of each significant constituent part of the combined entity in a business combination that will enable the practitioner to perform the required procedures. If another practitioner has performed an audit or a review of the most recent annual or interim period for which the pro forma financial information is presented (or the most recent annual or interim period of a significant constituent part of the combined entity), the need, by a practitioner reporting on the pro forma financial information, for an understanding of such entity's accounting and financial reporting practices is not diminished. In such circumstances, the practitioner should consider whether the practitioner can acquire sufficient knowledge of these matters to perform the procedures necessary to report on the pro forma financial information.
- c.* Discuss with management their assumptions regarding the effects of the transaction (or event).
- d.* Evaluate whether pro forma adjustments are included for all significant effects directly attributable to the transaction (or event).
- e.* Obtain sufficient evidence in support of such adjustments. (Ref: par. .A14)
- f.* Evaluate whether management's assumptions that underlie the pro forma adjustments are presented in a sufficiently clear and comprehensive manner.
- g.* Evaluate whether the pro forma adjustments are consistent with each other and with the data used to develop them.
- h.* Evaluate whether computations of pro forma adjustments are mathematically correct and whether the pro forma column reflects the proper application of those adjustments to the historical financial statements.
- i.* Read the pro forma financial information and evaluate whether
 - i.* the underlying transaction (or event), the pro forma adjustments, the significant assumptions, and the significant uncertainties, if any, about those assumptions have been appropriately described.
 - ii.* the source of the historical financial information on which the pro forma financial information is based has been appropriately identified.

Written Representations in an Examination and Review Engagement

.14 In addition to the written representations from management required by section 205 for an examination engagement or by section 210 for a review

engagement, the practitioner should request written representations from management that⁵

- a. it is responsible for the assumptions used in determining the pro forma adjustments;
- b. the assumptions are factually supportable;
- c. the assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event); the related pro forma adjustments give appropriate effect to those assumptions; and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts
- d. the pro forma adjustments are consistent with the entity's applicable financial reporting framework and its accounting policies under that framework
- e. the pro forma financial information is appropriately presented and discloses the significant effects directly attributable to the transaction (or event). (See paragraph .11c.)

.15 In an examination or a review engagement, the practitioner should request from management the written representations required by section 205 or section 210, as applicable, and paragraph .14 of this section, even if the engaging party is not management. The alternative to obtaining the required written representations provided for in sections 205 and 210 is not permitted in an engagement to examine or review pro forma financial information.⁶ Management's refusal to furnish the written representations required by section 205 and paragraph .14 of this section constitutes a limitation on the scope of the examination engagement. Such refusal is often sufficient to preclude an unmodified opinion and, particularly with respect to the representations in paragraph .53 of section 205, may cause the practitioner to disclaim an opinion or withdraw from the examination engagement, when withdrawal is possible under applicable law or regulation.⁷ Management's refusal to furnish the written representations required by section 210 and paragraph .14 of this section constitutes a limitation on the scope of the review engagement sufficient to cause the practitioner to withdraw from the review engagement.⁸ However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate. [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Reporting

.16 The practitioner's report on pro forma financial information may be added to the practitioner's report on historical financial information, or it may appear separately. If the reports are combined and the date of completion of the procedures for the examination or review of the pro forma financial information

⁵ Paragraph .51 of section 205 and paragraph .33 of section 210, *Review Engagements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁶ Paragraph .52 of section 205 and paragraph .34 of section 210. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁷ Paragraphs .51, .56, and .A68 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁸ Paragraphs .33–.38c of section 210. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

is after the date the practitioner obtained the evidence necessary to issue a report on the audit or review of the historical financial information, the combined report should be dual-dated. (Ref: par. .A15)

Content of the Practitioner's Examination Report

.17 The practitioner's examination report on pro forma financial information should include the following, unless the practitioner is disclaiming an opinion, in which case, items .17j and .17k should be omitted: (Ref: par. .A16)

- a. A title that includes the word *independent*.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. A reference to the pro forma adjustments included in the pro forma financial information.
- d. A reference to management's description of the transaction (or event) to which the pro forma adjustments give effect. (The description is included in the pro forma financial information.)
- e. An identification or description of the pro forma financial information being reported on, including the point in time or period of time to which the measurement or evaluation of the pro forma financial information relates.
- f. An identification of the criteria against which the pro forma financial information was measured or evaluated.
- g. A reference to the financial statements from which the historical financial information is derived, a statement that such financial statements were audited, and, if applicable, whether the financial statements were audited by another auditor. (The report on pro forma financial information should refer to any modification in the auditor's report on the historical financial statements. In the case of a business combination, this paragraph applies to each significant constituent part of the combined entity.) (Ref: par. .A17)
- h. A statement that the pro forma adjustments are based on management's assumptions.
- i. A statement that identifies management and its responsibility for the pro forma financial information.
- j. A statement that the practitioner's responsibility is to express an opinion on the pro forma financial information based on the practitioner's examination.
- k. A statement that
 - i. the practitioner's examination was conducted in accordance with attestation standards established by the AICPA.
 - ii. those standards require that the practitioner plan and perform the examination to obtain reasonable assurance about whether, in accordance with (or based on) the criteria
 - (1) management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event),
 - (2) and, in all material respects,

- (a) the related pro forma adjustments give appropriate effect to those assumptions, and
 - (b) the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts.
 - iii. the practitioner believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.
- l.* An examination of pro-forma financial information involves performing procedures to obtain evidence about
 - i. management's assumptions, (Ref: par. .A18)
 - ii. the related pro forma adjustments, and
 - iii. the pro forma amounts.
- m.* A statement that the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement.
- n.* A description of the objectives and limitations of pro forma financial information.
- o.* The practitioner's opinion about whether, in accordance with (or based on) the criteria
 - i. management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), (Ref: par. .A19)
 - ii. and, in all material respects
 - (1) the related pro forma adjustments give appropriate effect to those assumptions, and
 - (2) the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts.
- p.* When the circumstances identified in section 205 are applicable, an alert, in a separate paragraph, that restricts the use of the report or describes the purpose of the report, as applicable.⁹
- q.* The manual or printed signature of the practitioner's firm.
- r.* The city and state where the practitioner's report is issued.
- s.* The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate evidence on which to base the practitioner's opinion, including evidence that
 - i. the attestation documentation has been reviewed,
 - ii. the pro forma financial information has been prepared, and
 - iii. management has provided a written assertion.)

⁹ Paragraph .64 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Content of the Practitioner's Review Report

.18 The practitioner's review report on pro forma financial information should include the following: (Ref: par. .A20)

- a. A title that includes the word *independent*.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. A reference to the pro forma adjustments included in the pro forma financial information.
- d. A reference to management's description of the transaction (or event) to which the pro forma adjustments give effect. (The description is included in the pro forma financial information.)
- e. An identification or description of the pro forma financial information being reported on, including the point in time or period of time to which the measurement or evaluation of the pro forma financial information relates.
- f. An identification of the criteria against which the pro forma financial information was measured or evaluated.
- g. A reference to the financial statements from which the historical financial information is derived and (Ref: par. .A21)
 - i. a statement that such financial statements were audited or reviewed, as applicable.
 - ii. if the practitioner issued a review report on the historical financial statements, a statement that a review report was issued, and, if applicable, whether the financial statements were reviewed by another accountant. (The report on pro forma financial information should refer to any modification in the accountant's report on the historical financial information. In the case of a business combination, this paragraph applies to each significant constituent part of the combined entity.)
- h. A statement that the pro forma adjustments are based on management's assumptions.
- i. A statement that identifies
 - i. management and its responsibility for the pro forma financial information.
 - ii. the practitioner's responsibility to express a conclusion on the pro forma financial information based on the practitioner's review.
- j. A statement that
 - i. the practitioner's review was conducted in accordance with attestation standards established by the AICPA.
 - ii. those standards require that the practitioner plan and perform the review to obtain limited assurance about whether, in accordance with (or based on) the criteria, any material modifications should be made to

- (1) management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), (Ref: par. .A22)
 - (2) the related pro forma adjustments in order for them to give appropriate effect to those assumptions, or
 - (3) the pro forma amounts in order for them to reflect the proper application of those adjustments to the historical financial statement amounts.
- iii. the practitioner believes the review evidence the practitioner obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's conclusion.
- iv. the procedures performed in a review vary in nature and timing from, and are substantially less in extent than, an examination, the objective of which is to obtain reasonable assurance about whether, in accordance with (or based on) the criteria, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts in order to express an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed.
- v. the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements relating to the review engagement.
- k. a description of the objectives and limitations of pro forma financial information.
- l. a description of the work performed as a basis for the practitioner's conclusion.
- m. the practitioner's conclusion about whether, based on the review and in accordance with (or based on) the criteria, the practitioner is aware of any material modifications that should be made to
 - i. management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), (Ref: par. .A23)
 - ii. the related pro forma adjustments in order for them to give appropriate effect to those assumptions, or
 - iii. the pro forma amounts in order for them to reflect the proper application of those adjustments to the historical financial statement amounts.

- n.* When the circumstances identified in section 210 are applicable, an alert, in a separate paragraph, that restricts the use of the report or describes the purpose of the report, as applicable.¹⁰
- o.* The manual or printed signature of the practitioner's firm.
- p.* The city and state where the practitioner's report is issued.
- q.* The date of the report. The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate review evidence on which to base the practitioner's conclusion, including evidence that
 - i.* the attestation documentation has been reviewed,
 - ii.* the pro forma financial information has been prepared, and
 - iii.* management has provided a written assertion.

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Application and Other Explanatory Material

Objectives of an Examination Engagement (Ref: par. .05a[i])

.A1 For the purposes of this section, the responsible party is management of the entity for which the practitioner is reporting on pro forma financial information.

Definitions (Ref: par. .07)

Pro Forma Financial Information

.A2 Pro forma financial information is developed by applying pro forma adjustments to historical financial information. Appropriate pro forma adjustments are based on management's assumptions, give effect to all significant effects directly attributable to the transaction (or event), and are stated on a basis consistent with the financial reporting framework of the reporting entity and its accounting policies under that framework.

.A3 Pro forma financial information is commonly used to show the effects of transactions such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

.A4 Adequately disclosed pro forma financial information

- is labeled as such to distinguish it from historical financial information.

¹⁰ Paragraph .47c of section 210. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- describes the transaction (or event) that is reflected in the pro forma financial information, the date on which the transaction (or event) is assumed to occur, the financial reporting framework of the historical financial statements, the source of the historical financial information on which it is based, the significant assumptions used to develop the pro forma adjustments, and any significant uncertainties about those assumptions.
- indicates that the pro forma financial information should be read in conjunction with related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

.A5 Article 11 of Regulation S-X provides further guidance on the presentation of pro forma financial information included in filings with the SEC.

Preconditions for an Examination or Review Engagement (Ref: par. .08–.09)

.A6 For pro forma financial information included in an SEC Form 8-K, historical financial information previously included in an SEC filing would meet this requirement. Interim historical financial information may be presented as a column in the pro forma financial information.

.A7 Historical financial statements, historical interim financial information, and audit reports are deemed to be *readily available* if they are obtainable by a third-party user without any further action by the entity. (For example, historical interim financial information on an entity's website may be considered readily available, but being available upon request is not considered readily available.)

.A8 For entities within the PCAOB's jurisdiction as defined by the Sarbanes-Oxley Act of 2002, as amended, the review may be as defined in AS 4105, *Reviews of Interim Financial Information*, of the PCAOB's auditing standards. For nonissuers, the review may be an interim or annual review as described in AR-C section 90, *Review of Financial Statements*, or an interim review as discussed in AU-C section 930, *Interim Financial Information*, when the review of interim financial information meets the provisions of that section.¹¹ Although AS 4105 does not require an accountant to issue a written report on a review of interim financial information, the SEC requires the report to be filed if, in any filing, the entity states that the interim financial information has been reviewed by an independent public accountant.¹² [Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

.A9 If the underlying historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) have been audited at year-end and reviewed at an interim date, the practitioner may perform an examination or a review of the pro forma

¹¹ Paragraph .04 of AR-C section 90, *Review of Financial Statements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹² Paragraph .03 of AS 4105, *Reviews of Interim Financial Information*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

financial information at year-end, but is limited to performing a review of the pro forma financial information at the interim date.

Requesting a Written Assertion (Ref: par. .10)

.A10 Paragraph .10 applies regardless of whether the responsible party is the engaging party.

Assessing the Suitability of the Criteria (Ref: par. .11b(ii))

.A11 Management is responsible for having factually supportable pro forma adjustments. The pro forma adjustments are factually supportable if the preponderance of the information supports each significant assumption underlying the adjustments.

Understanding the Entity's Accounting and Financial Reporting Policies (Ref: par. .12)

.A12 Procedures to obtain knowledge of each significant constituent part of the combined entity in a business combination may include communicating with other practitioners who have audited or reviewed the historical financial information on which the pro forma financial information is based. Matters that may be considered include

- accounting principles and financial reporting practices followed;
- transactions between the entities;
- material contingencies; and
- relevant industry, legal and regulatory, and other external factors pertaining to the entity and any acquiree or divestee.

Examination and Review Procedures (Ref: par. .13a and e)

.A13 An understanding of the underlying transaction (or event) may be obtained, for example, by reading relevant contracts and minutes of meetings of the board of directors and by making inquiries of appropriate officials of the entity, and, if considered necessary in the circumstances, of the entity acquired or to be acquired.

.A14 The evidence required to support the level of assurance obtained is a matter of professional judgment. Sections 205 and 210 provide guidance about the evidence to be obtained in examination and review engagements, respectively. Examples of evidence that the practitioner might consider obtaining are purchase, merger or exchange agreements, appraisal reports, debt agreements, employment agreements, actions of the board of directors, and existing or proposed legislation or regulatory actions.

Reporting (Ref: par. .16)

.A15 The following is an example of how the report would be dual dated:

February 15, 20X2, except for the paragraphs regarding pro forma financial information for which the date is March 20, 20X2.

Content of the Practitioner's Examination Report (Ref: par. .17)

.A16 The list of elements in paragraph .17 constitutes all the required elements for a practitioner's examination report on pro forma financial information, including the elements required by section 205.¹³ Application guidance regarding the elements of an examination report is included in section 205.¹⁴

Reference to Financial Statements From Which Historical Financial Information is Derived (Ref: par. .17g)

.A17 If the historical financial information was previously included in an SEC filing, the practitioner's report would be modified to indicate that the historical financial statements are "incorporated by reference."

Statement That Examination Involves Performing Procedures to Obtain Evidence About Management's Assumptions (Ref: par. .17[iii][1])

.A18 Because a business combination accounted for in a manner similar to a pooling-of-interests combines the historical amounts of the combined entities retroactively, pro forma adjustments for a transaction that is not yet reflected in the historical financial statements or a proposed transaction generally affect only the equity section of the pro forma condensed balance sheet. Such business combinations would not ordinarily involve a choice of assumptions by management. Accordingly, a practitioner's report on a business combination that will be accounted for in a manner similar to a pooling-of-interests need not address management's assumptions unless the pro forma financial information includes adjustments to conform the accounting principles of the combining entities or gives effect to other transactions (for example, a new contractual arrangement or reduction in interest expense attributable to repayment of debt).

Opinion About Management's Assumptions (Ref: par. .17[i])

.A19 Uncertainty about whether the transaction (or event) will be consummated would not ordinarily require a modification of the practitioner's report.

Content of the Practitioner's Review Report (Ref: par. .18)

.A20 The list of elements in paragraph .18 constitutes all the required elements for a practitioner's report on a review of pro forma financial information, including the elements required by section 210.¹⁵ Application guidance regarding the elements of a review report is included in section 210.¹⁶

Reference to Financial Statements From Which Historical Financial Information is Derived (Ref: par. .18g)

.A21 If the historical financial information was previously included in an SEC filing, the practitioner's report would be modified to indicate that the historical financial statements are "incorporated by reference."

¹³ Paragraphs .63–.66 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁴ Paragraphs .A85–.A111 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁵ Paragraphs .46–.49 of section 210. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁶ Paragraphs .A61–.A80 of section 210. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Statement That the Practitioner Plans and Performs Review to Obtain Limited Assurance About Management's Assumptions (Ref: par. .18[iii][1])

.A22 Because a business combination accounted for in a manner similar to a pooling-of-interests combines the historical amounts of the combined entities retroactively, pro forma adjustments for a transaction that is not yet reflected in the historical financial statements or a proposed transaction generally affect only the equity section of the pro forma condensed balance sheet. Such business combinations would not ordinarily involve a choice of assumptions by management. Accordingly, a practitioner's report on a business combination that will be accounted for in a manner similar to a pooling-of-interests need not address management's assumptions unless the pro forma financial information includes adjustments to conform the accounting principles of the combining entities or gives effect to other transactions (for example, a new contractual arrangement or reduction in interest expense attributable to a repayment of debt).

Conclusion About Management's Assumptions (Ref: par. .18m[i])

.A23 Uncertainty about whether the transaction (or event) will be consummated would not ordinarily require a modification of the practitioner's report.

.A24

Exhibit—Illustrative Practitioner's Reports for Examinations and Reviews of Pro Forma Financial Information

The illustrative practitioner's examination reports in this exhibit (examples 1, 3, 4, 5, and 6) meet the reporting requirements of section 205, *Assertion-Based Examination Engagements*, and of paragraph .17 of this section.¹ A practitioner may use alternative language in drafting an examination report, provided that the language meets the applicable requirements of section 205 and paragraph .17 of this section.²

The illustrative practitioner's review reports in this exhibit (examples 2 and 3) meet the applicable reporting requirements of section 210, *Review Engagements*, and of paragraph .18 of this section.³ A practitioner may use alternative language in drafting a review report, provided that the language meets the applicable requirements of section 210 and paragraph .18 of this section.⁴

The language in these illustrative examination and review reports assume that one column of pro forma financial information is presented without presenting separate columns of historical financial information and pro forma adjustments.

Example 1: Practitioner's Examination Report on Pro Forma Financial Information: Unmodified Opinion

Independent Accountant's Report

[Appropriate Addressee]

We have examined the pro forma adjustments giving effect to the underlying transaction (or event) described in Note 1 and the application of those adjustments to the historical amounts in the accompanying pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended (pro forma financial information), based on the criteria in Note 1. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants, appearing elsewhere herein [or "*and are readily available*"]. The pro forma adjustments are based on management's assumptions described in Note 1. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, based on the criteria in Note 1, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts

¹ Paragraphs .62–.86 of section 205, *Examination Engagements*.

² Paragraphs .62–.86 of section 205.

³ Paragraphs .44–.60 of section 210, *Review Engagements*.

⁴ See footnote 3.

reflect the proper application of those adjustments to the historical financial statement amounts. An examination involves performing procedures to obtain evidence about management's assumptions, the related pro forma adjustments, and the pro forma amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the pro forma financial information, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the underlying transaction (or event) occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction (or event) actually occurred at such earlier date.

In our opinion, based on the criteria in Note 1, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 2: Practitioner's Review Report on Pro Forma Financial Information: Unmodified Conclusion

Independent Accountant's Report

[Appropriate Addressee]

We have reviewed the pro forma adjustments giving effect to the transaction (or event) described in Note 1 and the application of those adjustments to the historical amounts in the accompanying pro forma condensed balance sheet of X Company as of March 31, 20X2, and the related pro forma condensed statement of income for the three months then ended (pro forma financial information), based on the criteria in Note 1. These historical condensed financial statements are derived from the historical unaudited financial statements of X Company, which were reviewed by us, and of Y Company, which were reviewed by other accountants,⁵ appearing elsewhere herein [or "and are readily available"]. The pro forma adjustments are based on management's assumptions as described

⁵ When one set of historical financial statements is audited and the other set is reviewed, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were reviewed by other accountants, appearing elsewhere herein [or "and are readily available"].

in Note 1. X Company's management is responsible for the pro forma financial information. Our responsibility is to express a conclusion based on our review.

Our review was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform our review to obtain limited assurance about whether, based on the criteria in Note 1, any material modifications should be made to management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event); the related pro forma adjustments, in order for them to give appropriate effect to those assumptions; or the pro forma amounts, in order for them to reflect the proper application of those adjustments to the historical financial statement amounts. The procedures performed in a review vary in nature and timing from, and are substantially less in extent than an examination, the objective of which is to obtain reasonable assurance about whether, based on the criteria, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts, in order to express an opinion. Accordingly, we do not express such an opinion. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the underlying transaction (or event) occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction (or event) actually occurred at such earlier date.

[Include a description of the work performed as a basis for the practitioner's conclusion.]

Based on our review, we are not aware of any material modifications that should be made to management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, the related pro forma adjustments in order for them to give appropriate effect to those assumptions, or the pro forma amounts, in order for them to reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet of X Company as of March 31, 20X2, and the related pro forma condensed statement of income for the three months then ended, based on the criteria in Note 1.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

**Example 3: Practitioner's Examination Report on Pro Forma Financial Information at Year-End With a Review of Pro Forma Financial Information for a Subsequent Interim Date:
Unmodified Opinion and Unmodified Conclusion**

Independent Accountant's Report

[Appropriate Addressee]

We have examined the pro forma adjustments giving effect to the transaction (or event) described in Note 1 and the application of those adjustments to the historical amounts in the accompanying pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended (pro forma financial information) based on the criteria in Note 1. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants, appearing elsewhere herein *[or "and are readily available"]*. The pro forma adjustments are based on management's assumptions described in Note 1. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, based on the criteria in Note 1, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts. An examination involves performing procedures to obtain evidence about management's assumptions, the related pro forma adjustments, and the pro forma amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the pro forma financial information, whether due to fraud or error. We believe that the evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements related to the engagement.

In addition, we have reviewed the pro forma adjustments and the application of those adjustments to the historical amounts in the accompanying pro forma condensed balance sheet of X Company as of March 31, 20X2, and the related pro forma condensed statement of income for the three months then ended (pro forma financial information), based on the criteria in Note 1. The historical condensed financial statements are derived from the historical financial statements of X Company, which were reviewed by us, and of Y Company, which were reviewed by other accountants,⁶ appearing elsewhere herein *[or "and are*

⁶ When one set of historical financial statements is audited and the other set is reviewed, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were reviewed by other accountants, appearing elsewhere herein *[or "and are readily available"]*.

readily available"]. The pro forma adjustments are based on management's assumptions as described in Note 1. X Company's management is responsible for the pro forma financial information. Our responsibility is to express a conclusion based on our review.

Our review was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform our review to obtain limited assurance about whether, based on the criteria in Note 1, any material modifications should be made to management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event); the related pro forma adjustments, in order for them to give appropriate effect to those assumptions; or the pro forma amounts, in order for them to reflect the proper application of those adjustments to the historical financial statement amounts. The procedures performed in a review vary in nature and timing from, and are substantially less in extent than an examination, the objective of which is to obtain reasonable assurance about whether, based on the criteria, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts, in order to express an opinion. Accordingly, we do not express such an opinion on the pro forma adjustments or on the application of such adjustments to the pro forma condensed balance sheet as of March 31, 20X2, and the pro forma condensed statement of income for the three months then ended. Because of the limited nature of the engagement, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed. We believe that the review evidence obtained is sufficient and appropriate to provide a reasonable basis for our conclusion.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the underlying transactions (or event) occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction (or event) actually occurred at such earlier date.

[Include a description of the work performed as a basis for the practitioner's conclusion.]

In our opinion, based on the criteria in Note 1, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended.

Based on our review, we are not aware of any material modifications that should be made to management's assumptions in order for them to provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, the related pro forma adjustments in order for them to give appropriate effect to those assumptions, or the pro forma amounts in order for them to reflect the proper application of those adjustments to the historical financial statement amounts

in the pro forma condensed balance sheet of X Company as of March 31, 20X2, and the related pro forma condensed statement of income for the three months then ended based on the criteria in Note 1.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 4: Practitioner's Examination Report: Qualified Opinion Because of a Scope Limitation

Independent Accountant's Report

[Appropriate Addressee]

We have examined the pro forma adjustments giving effect to the transaction (or event) described in Note 1 and the application of those adjustments to the historical amounts in the accompanying pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended (pro forma financial information), based on the criteria in Note 1. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants, appearing elsewhere herein *[or "and are readily available"]*. The pro forma adjustments are based upon management's assumptions described in Note 1. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Except as discussed below, our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, based on the criteria in Note 1, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event), and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts. An examination involves performing procedures to obtain evidence about management's assumptions, the related pro forma adjustments, and the pro forma amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the pro forma financial information, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent of *[identify the responsible party, for example, X Company]* and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

We were unable to perform the examination procedures we considered necessary with respect to the assumptions relating to the proposed loan described in Adjustment E in Note 1.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the underlying transaction (or event) occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been

attained had the above-mentioned transaction (or event) actually occurred at such earlier date.

In our opinion, based on the criteria in Note 1, except for the effects of such changes, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the assumptions relating to the proposed loan, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 5: Practitioner's Examination Report: Qualified Opinion Because of Reservations About the Propriety of the Assumptions

Independent Accountant's Report

[Appropriate Addressee]

[Same first four paragraphs as examination report in example 1.]

As discussed in Note 1 to the pro forma financial statements, the pro forma adjustments reflect management's assumption that X Division of the acquired company will be sold. The net assets of this division are reflected at their historical carrying amount; generally accepted accounting principles require these net assets to be recorded at fair value less cost to sell.

In our opinion, based on the criteria in Note 1, except for inappropriate valuation of the net assets of X Division, management's assumptions described in Note 1 provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, and, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

Example 6: Practitioner's Examination Report: Disclaimer of Opinion Because of a Scope Limitation

Independent Accountant's Report

[Appropriate Addressee]

We were engaged to examine the pro forma adjustments giving effect to the transaction (or event) described in Note 1 and the application of those adjustments to the historical amounts in the accompanying pro forma financial condensed balance sheet of X Company as of December 31, 20X1, and the related

pro forma condensed statement of income for the year then ended (pro forma financial information), based on the criteria in Note 1. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants, appearing elsewhere herein [or "*and are readily available*"]. The pro forma adjustments are based on management's assumptions described in Note 1. X Company's management is responsible for the pro forma financial information.

[The second paragraph in the practitioner's examination report in example 1 is intentionally omitted from the report with a disclaimer of opinion.]

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

[The fourth paragraph in the practitioner's examination report in example 1 is intentionally omitted from the report with a disclaimer of opinion.]

As discussed in Note 1 to the pro forma financial statements, the pro forma adjustments reflect management's assumptions that the elimination of duplicate facilities would have resulted in a 30 percent reduction in operating costs. Management could not supply us with sufficient evidence to support this assertion.

Our responsibility is to express an opinion on the pro forma financial information based on conducting the examination in accordance with attestation standards established by the AICPA. Because we were unable to evaluate management's assumptions regarding the reduction in operating costs and other assumptions related thereto, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether, based on the criteria in Note 1, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction (or event) described in Note 1, or on whether, in all material respects, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma amounts reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet of X Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE Nos. 21 and 22.]

AT-C Section 315

Compliance Attestation

Source: SSAE No. 18.

Effective for practitioners' examination reports on compliance with specified requirements and for practitioners' agreed-upon procedures reports related to compliance or internal control over compliance with specified requirements dated on or after May 1, 2017.

Introduction

.01 This section contains performance and reporting requirements and application guidance for a practitioner (Ref: par. .A1–.A3)

- a. examining an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants (specified requirements) or an assertion about compliance with specified requirements.
- b. performing agreed-upon procedures related to an entity's compliance with specified requirements.
- c. performing agreed-upon procedures related to an entity's internal control over compliance with specified requirements.

.02 This section does not apply to

- a. reviews that address compliance with specified requirements or an entity's internal control over compliance or an assertion thereon because section 210, *Review Engagements*, states that such engagements should not be performed.¹
- b. examination engagements in which a practitioner is reporting on an entity's internal control over compliance with specified requirements. (Ref: par. .A4)
- c. situations in which an auditor reports on specified requirements based solely on an audit of financial statements, as addressed in AU-C section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*.
- d. engagements in which a governmental audit requirement requires an auditor to express an opinion on compliance in accordance with AU-C section 935, *Compliance Audits*.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.03 A practitioner's report issued in accordance with the provisions of this section does not provide a legal determination of an entity's compliance with specified requirements. However, such a report may be useful to legal counsel or others in making such determinations.

.04 In addition to complying with this section, a practitioner is required to comply with section 105, *Concepts Common to All Attestation Engagements*, and

¹ Paragraph .07 of section 210, *Review Engagements*.

either section 205, *Assertion-Based Examination Engagements*, for examinations of compliance, or section 215, *Agreed-Upon Procedures Engagements*, for agreed-upon procedures engagements that address compliance. In some cases, this section repeats or refers to requirements found in sections 105, 205, and 215 when describing those requirements in the context of engagements that address compliance. Although not all the requirements in sections 105, 205, and 215 are repeated or referred to in this section, the practitioner is responsible for complying with all the requirements in sections 105 and either 205 or 215, as applicable.² [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Effective Date³

.05 This section is effective for practitioners' examination reports on compliance with specified requirements and for practitioners' agreed-upon procedures reports related to compliance or internal control over compliance with specified requirements dated on or after May 1, 2017.

Objectives of an Examination Engagement

.06 In conducting an examination of an entity's compliance with specified requirements, the objectives of the practitioner are to (Ref: par. .A5)

- a. obtain reasonable assurance about whether the entity complied with the specified requirements, in all material respects,
- b. express an opinion in a written report about whether
 - i. the entity complied with the specified requirements, in all material respects, or
 - ii. management's assertion about its compliance with the specified requirements is fairly stated, in all material respects.

Objectives of an Agreed-Upon Procedures Engagement

.07 In conducting an agreed-upon procedures engagement for which the subject matter is compliance or internal control over compliance with specified requirements, the objectives of the practitioner are to (Ref: par. .A5)

- a. apply specific procedures to an entity's compliance with specified requirements or an entity's internal control over compliance with specified requirements and
- b. issue a written report that describes the procedures applied and the practitioner's findings without providing an opinion or conclusion on an entity's compliance with specified requirements or an entity's internal control over compliance with specified requirements.

² Section 206, *Direct Examination Engagements*, states that section 206 is not applicable to examination engagements related to subject matter for which other AT-C sections require the application of section 205, *Assertion-Based Examination Engagements*, which includes this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

³ Paragraph .10 of this section requires the practitioner to request a written assertion from the responsible party. For that reason, when the term "examination" is used in this section, it refers to an "assertion-based examination" performed under section 205 and this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Definitions

.08 For the purposes of this section, the following terms have the meanings attributed as follows:

Compliance with specified requirements. An entity's compliance with specified laws, regulations, rules, contracts, or grants.

Internal control over compliance. An entity's internal control over compliance with specified requirements. The internal control addressed in this section may include part of, but is not the same as, internal control over financial reporting. (Ref: par. .A6)

Material noncompliance. A failure to follow compliance requirements or a violation of prohibitions included in the specified requirements that results in noncompliance that is quantitatively or qualitatively material, either individually or when aggregated with other noncompliance. (Ref: par. .A7)

Requirements

Preconditions for Examination Engagements

.09 In order to accept an attestation engagement to examine compliance with specified requirements, in addition to the preconditions for an examination engagement in sections 105 and 205, the practitioner should determine that⁴ (Ref: par. .A8–.A9)

- a. management accepts responsibility for the entity's compliance with specified requirements and the entity's internal control over compliance. (Ref: par. .A8–.A9)
- b. management evaluates the entity's compliance with specified requirements. (Ref: par. .A9)

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.10 In performing an examination under this section, the practitioner should request from management a written assertion. If management refuses to provide a written assertion, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation. (Ref: par. .A10–.A11)

Reasonable Assurance

.11 In an engagement to examine compliance with specified requirements, the practitioner should seek to obtain reasonable assurance that the entity complied with the specified requirements, in all material respects, including designing the examination to detect both intentional and unintentional material noncompliance.

⁴ Paragraphs .26–.30 of section 105, *Concepts Common to All Attestation Engagements*, and paragraph .06 of section 205, *Examination Engagements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Materiality

.12 As required by section 205, the practitioner should consider materiality when establishing the overall engagement strategy.⁵ (Ref: par. .A12–.A13)

Examination Procedures

.13 The practitioner should obtain an understanding of the specified requirements. The practitioner's procedures to obtain that understanding should include the following: (Ref: par. .A14)

- a. Consideration of laws, regulations, rules, contracts, and grants that pertain to the specified requirements, including published requirements
- b. Consideration of knowledge about the specified requirements obtained through prior engagements and regulatory reports
- c. Discussion with appropriate individuals within the entity (for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators)

.14 In an engagement to examine an entity's compliance with specified requirements when the entity has operations in several components (for example, locations, branches, subsidiaries, or programs), the practitioner should determine the nature, timing, and extent of testing to be performed at individual components. In making such a determination and in selecting the components to be tested, the practitioner should evaluate factors such as the following:

- a. The degree to which the specified requirements apply at the component level
- b. Judgments about materiality
- c. The degree of centralization of records
- d. The effectiveness of the control environment, particularly management's direct control over the exercise of authority delegated to others and its ability to supervise activities at various locations effectively
- e. The nature and extent of operations conducted at the various components
- f. The similarity of operations over compliance for different components

.15 The practitioner should obtain an understanding of relevant portions of internal control over compliance sufficient to plan the engagement and to assess control risk for compliance with specified requirements. In planning the examination, such knowledge should be used to identify types of potential noncompliance, to consider factors that affect the risk of material noncompliance, and to design appropriate tests of compliance. (Ref: par. .A15–.A16)

.16 For engagements involving compliance with regulatory requirements, the practitioner's procedures should include reviewing reports of relevant examinations and related communications between regulatory agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.

⁵ Paragraph .17 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Written Representations in an Examination Engagement

.17 In an examination engagement, in addition to the written representations from management required by section 205,⁶ the practitioner should request written representations from management that (Ref: par. .A17)

- a. acknowledge management's responsibility for establishing and maintaining effective internal control over compliance.
- b. state that management has performed an evaluation of the entity's compliance with specified requirements.
- c. state management's interpretation of any compliance requirements that have varying interpretations.
- d. state that management has disclosed any known noncompliance occurring during or subsequent to the period covered by the practitioner's report.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.18 In an examination of compliance, the practitioner should request from management the written representations required by section 205 and paragraph .17 of this section, even if the engaging party is not management.⁷ The alternative to obtaining the required written representations provided for in section 205 is not permitted in an engagement to examine compliance.⁸ Management's refusal to furnish the written representations required by section 205 and paragraph .17 of this section constitutes a limitation on the scope of the engagement. Such refusal is often sufficient to preclude an unmodified opinion and particularly with respect to the representations in paragraph .53 of section 205, may cause the practitioner to disclaim an opinion or withdraw from the examination engagement, when withdrawal is possible under applicable law or and regulation.⁹ However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate. [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Forming the Opinion

.19 In evaluating whether the entity has complied with the specified requirements, in all material respects, (or whether management's assertion about its compliance with the specified requirements is fairly stated, in all material respects), the practitioner should evaluate (a) the nature and frequency of the noncompliance identified and (b) whether such noncompliance is material relative to the nature of the compliance requirements.

⁶ Paragraph .51 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁷ See footnote 6. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁸ Paragraph .52 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁹ Paragraphs .56 and .A68 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Content of the Practitioner's Examination Report

.20 The practitioner's examination report on compliance should include the following, unless the practitioner is disclaiming an opinion, in which case, items .20g and .20h should be omitted: (Ref: par. .A18–.A20)

- a. A title that includes the word *independent*.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. An identification of the compliance matters that are being reported on or the assertion about such matters, including the point in time or period of time to which the measurement or evaluation of compliance relates.
- d. An identification of the specified requirements against which compliance was measured or evaluated. (Ref: par. .A21)
- e. A statement that identifies
 - i. management and its responsibility for compliance with the specified requirements (when reporting on the subject matter) or for its assertion about compliance with the specified requirements (when reporting on the assertion).
- f. A statement that the practitioner's responsibility is to express an opinion on the entity's compliance with the specified requirements or on management's assertion about the entity's compliance with the specified requirements, based on the practitioner's examination.
- g. A statement that
 - i. the practitioner's examination was conducted in accordance with attestation standards established by the AICPA. (Ref: par. .A22)
 - ii. those standards require that the practitioner plan and perform the examination to obtain reasonable assurance about whether
 - (1) the entity complied with the specified requirements, in all material respects, or
 - (2) management's assertion about compliance with the specified requirements is fairly stated, in all material respects.
 - iii. the practitioner believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the practitioner's opinion.
- h. A description of the nature of an examination engagement.
- i. A statement that the practitioner is required to be independent and to meet the practitioner's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement.
- j. A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the entity's compliance with specified requirements or its assertion thereon.
- k. A statement that the examination does not provide a legal determination on the entity's compliance with specified requirements.
- l. The practitioner's opinion about whether, in all material respects

- i. the entity complied with the specified requirements or
 - ii. management's assertion about the entity's compliance with specified requirements is fairly stated.
- m. When the circumstances identified in section 205 are applicable, an alert in a separate paragraph that restricts the use of the report or describes the purpose of the report, as applicable.¹⁰
- n. The manual or printed signature of the practitioner's firm.
- o. The city and state where the practitioner's report is issued.
- p. The date of the report. (The report should be dated no earlier than the date on which the practitioner has obtained sufficient appropriate evidence on which to base the practitioner's opinion, including evidence that
 - i. the attestation documentation has been reviewed, and
 - ii. management has provided a written assertion.)

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.21 Frequently, criteria will be contained in the compliance requirements, in which case, it is not necessary to repeat the criteria in the practitioner's report; however, if the criteria are not included in the compliance requirement, the report should identify the criteria. (Ref: par. .A21 and .A23–.A24)

Modified Opinions

.22 If the practitioner determines that there is material noncompliance, the practitioner's report should describe the material noncompliance, and the opinion should be modified in accordance with section 205.¹¹ (Ref: par. .A25–.A29)

Preconditions for an Agreed-Upon Procedures Engagement

.23 In order to accept an attestation engagement to apply agreed-upon procedures related to compliance with specified requirements or internal control over compliance with specified requirements, in addition to the preconditions for an agreed-upon procedures engagement in sections 105 and 215, the practitioner should determine that management accepts responsibility for the entity's compliance with specified requirements and the entity's internal control over compliance.¹² (Ref: par. .A30) [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.24 The practitioner should obtain an understanding of the specified requirements. The practitioner's procedures to obtain that understanding should include the following:

- a. Consideration of laws, regulations, rules, contracts, and grants that pertain to the specified requirements, including published requirements

¹⁰ Paragraph .64 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹¹ Paragraphs .70–.83 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹² Paragraphs .26–.30 of section 105 and paragraphs .10–.13 of section 215, *Agreed-Upon Procedures Engagements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- b. Consideration of knowledge about the specified requirements obtained through prior engagements and regulatory reports
- c. Discussion with appropriate individuals within the entity (for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators)

Written Representations in an Agreed-Upon Procedures Engagement

.25 In an agreed-upon procedures engagement, in addition to the written representations from management required by section 215, the practitioner should request written representations from management that¹³

- a. acknowledge management's responsibility for establishing and maintaining effective internal control over compliance.
- b. state management's interpretation of any compliance requirements that have varying interpretations.
- c. state that management has disclosed any known noncompliance occurring during or subsequent to the period covered by the practitioner's report.

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Content of the Practitioner's Agreed-Upon Procedures Report

.26 The practitioner's agreed-upon procedures report on compliance (or internal control over compliance) should include the following: (Ref: par. .A32–.A35)

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. Identification of the engaging party.
- d. Indication that the subject matter to which the procedures have been applied is the entity's compliance (or internal control over compliance) during a period or as of a point in time.
- e. Identification of the specified requirements against which the entity's compliance (or internal control over compliance) was measured or evaluated.
- f. An indication that management of the entity is responsible for the entity's compliance (or internal control over compliance) with the specified requirements.
- g. A statement that the engaging party acknowledged that the procedures performed are appropriate to meet the intended purpose of the engagement.
- h. A statement that the purpose of the engagement is to assist users in determining whether the entity complied with the specified requirements (or internal control over compliance with specified requirements)

¹³ Paragraph .27 of section 215. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- i.* A statement that the practitioner's report may not be suitable for any other purpose.
- j.* A statement that the procedures performed may not address all the items of interest to a user of the report and may not meet the needs of all users of the report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.
- k.* A statement that an agreed-upon procedures engagement involves the practitioner performing specific procedures that the engaging party has agreed to and acknowledged to be appropriate for the intended purpose of the engagement and reporting on findings based on the procedures performed.
- l.* A description of the procedures performed detailing the nature and extent, and if applicable, the timing of each procedure.
- m.* A description of the findings from each procedure performed, including sufficient details on exceptions found. (The practitioner should not provide a conclusion.)
- n.* If applicable, a description of any specified threshold established by management for reporting exceptions.
- o.* A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the AICPA.
- p.* A statement that the practitioner was not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on compliance with specified requirements (or internal control over compliance with specified requirements).
- q.* A statement that the practitioner does not express such an opinion or conclusion.
- r.* A statement that had the practitioner performed additional procedures, other matters might have come to the practitioner's attention that would have been reported.
- s.* A statement that the practitioner is required to be independent of the entity and to meet the practitioner's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the agreed-upon procedures engagement.
- t.* If applicable, a description of the nature of the assistance provided by a practitioner's external specialist.
- u.* When applicable, reservations or restrictions concerning procedures or findings.
- v.* The manual or printed signature of the practitioner's firm.
- w.* The city and state where the practitioner's report is issued.
- x.* The date of the report. (The report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that the attestation documentation has been reviewed.)

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Alert That Restricts the Use of the Practitioner's Agreed-Upon Procedures Report

.27 The practitioner should consider whether to include an alert, in a separate paragraph, that restricts the use of the practitioner's agreed-upon procedures report, taking into account the understanding with the engaging party regarding the nature of the engagement. [Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.28 If the practitioner determines to include an alert, in a separate paragraph, that restricts the use of the practitioner's report, such alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.

[Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.29 When the engagement is also performed in accordance with *Government Auditing Standards*, and the practitioner determines to include an alert, in a separate paragraph that restricts the use of the practitioner's report, such alert should include the following information, rather than the information required by paragraph .28:

- a. A description of the purpose of the report
- b. A statement indicating that the report is not suitable for any other purpose

[Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Application and Other Explanatory Material

Introduction (Ref: par. .01 and .02b)

.A1 Compliance requirements may be either financial or nonfinancial in nature.

.A2 The criteria for evaluating or measuring compliance with specified requirements ordinarily are included in the specified requirements but may be otherwise identified.

.A3 A practitioner may be engaged to provide other types of services in connection with an entity's compliance with specified requirements or its internal control over compliance with specified requirements. For example, the practitioner may be engaged to provide recommendations on how to improve the entity's compliance or related internal control. Such an engagement is governed by the guidance in CS section 100, *Consulting Services: Definitions and Standards*.

.A4 An engagement to examine internal control over compliance is governed by sections 105 and 205. Additionally, AU-C section 940, *An Audit of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, may be helpful to a practitioner in such an engagement.

Objectives of an Examination Engagement (Ref: par. .06–.07)

.A5 For the purposes of this section, the responsible party is management of the entity for which the practitioner is reporting on compliance.

Definitions

Internal Control Over Compliance

.A6 An entity's internal control over compliance is the process by which management obtains reasonable assurance of compliance with specified requirements. Although management's internal control may include a wide variety of objectives and related policies and procedures, only some of these may be relevant to an entity's compliance with specified requirements. An entity's internal control over compliance may vary based on the nature of the compliance requirements. For example, internal control over compliance with a capital requirement would generally include accounting procedures, whereas internal control over compliance with a requirement to practice nondiscriminatory hiring may not include accounting procedures.

Material Noncompliance

.A7 Government requirements or other requirements may define material noncompliance for the purpose of the engagement.

Preconditions for Examination Engagements (Ref: par. .09–.10)

.A8 Management is responsible for ensuring that the entity complies with the requirements applicable to its activities. That responsibility encompasses the following:

- a. Identifying and complying with the specified requirements
- b. Designing, implementing, and maintaining internal control to provide reasonable assurance that the entity complies with those requirements
- c. Specifying reports that satisfy legal, regulatory, or contractual requirements

[Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A9 In carrying out its responsibilities, management will ordinarily have documentation regarding its compliance such as accounting or statistical data, entity policy manuals, accounting manuals, narrative memoranda, procedural write-ups, flowcharts, completed questionnaires, or internal auditors' reports. The form and extent of documentation will vary depending on the nature of the compliance requirements and the size and complexity of the entity. [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A10 Management's written assertion about compliance with specified requirements may take many forms. Throughout this section, for example, the phrase "management's assertion that W Company complied with [*specify compliance requirement*] as of [*date*]," illustrates such an assertion. Other phrases may also be used. A statement that is so subjective (for example, *substantially complied*) that people having competence in and using the same or similar criteria would not ordinarily be able to arrive at similar conclusions is not an appropriate written assertion.

.A11 Paragraph .10 applies regardless of whether management is the engaging party. [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Materiality (Ref: par. .12)

.A12 The terms of an engagement may provide for a supplemental practitioner's report of all or certain noncompliance discovered. Such terms would not affect the practitioner's judgments about materiality in establishing the overall engagement strategy or in forming an opinion on an entity's compliance with specified requirements or on management's assertion about such compliance.

.A13 In an examination of an entity's compliance with specified requirements, the practitioner's consideration of materiality is affected by (a) the nature of the compliance requirements, which may or may not be quantifiable in monetary terms, (b) the nature and frequency of noncompliance identified with appropriate consideration of sampling risk, and (c) qualitative considerations, including the needs and expectations of the users of the practitioner's report.

Examination Procedures (Ref: par. .13 and .15)

.A14 In certain circumstances, the practitioner may determine that it is necessary to discuss the specified requirements with appropriate individuals outside the entity (for example, a regulator or specialist).

.A15 A practitioner generally obtains an understanding of the design of specific controls by performing the following:

- a. Inquiries of appropriate management, supervisory, and staff personnel
- b. Inspection of the entity's documents
- c. Observation of the entity's activities and operations

.A16 The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the following:

- The newness and complexity of the specified requirements
- The practitioner's knowledge of internal control over compliance obtained in previous professional engagements
- The nature of the specified requirements
- An understanding of the industry in which the entity operates
- Judgments about materiality

Written Representations in an Examination Engagement (Ref: par. .17)

.A17 At the beginning of the engagement, the practitioner may want to consider discussing with management the need for management to provide the practitioner with a written representation letter at the conclusion of the engagement.

Content of the Practitioner's Examination Report (Ref: par. .20–.21)

.A18 The list of elements in paragraph .20 constitutes all the required elements for a practitioner's report on an examination of compliance with specified requirements, including the elements required by section 205.¹⁴ Application guidance regarding the elements of an examination report is included in section 205.¹⁵

.A19 Examples 1 and 2 in the exhibit to this section provide illustrations of practitioner's examination reports on compliance.

.A20 Paragraph .20*d* represents the criteria for measuring or evaluating compliance with the specified requirements.

.A21 Ordinarily, the criteria are included in the specified requirements. In that case, the identification may say, "We have examined management of XYZ Company's compliance with *[identify the specified requirements...]*."

.A22 In identifying the standards under which the engagement was performed, the practitioner may specify the AT-C section under which the engagement was performed, for example: AT-C section 315, *Compliance Attestation*, of the attestation standards established by the AICPA. [Paragraph added, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A23 If a compliance requirement is to "maintain \$25,000 in capital," it would not be necessary to identify the \$25,000 in the practitioner's report; however, if the requirement is subjectively worded, for example, to "maintain adequate capital," the criteria used to define *adequate* would be included in the report. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A24 When evaluating compliance with certain requirements requires interpretation of the laws, regulations, rules, contracts, or grants that establish those requirements, the practitioner evaluates whether the criteria are suitable for evaluating compliance. If these interpretations are significant, the practitioner may include a paragraph describing the interpretations and identifying the source of the interpretations made by the entity's management. The following is an example of such a paragraph:

We have been informed that, under *[name of entity]*'s interpretation of *[identify the compliance requirement]*, *[explain the source and nature of the relevant interpretation]*.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Modified Opinions (Ref: par. .22)

Qualified Opinion

.A25 The following is an example of

¹⁴ Paragraph .63 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁵ Paragraphs .A85–.A111 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- a. a paragraph that would be added to the practitioner's report to describe the matter giving rise to the qualified opinion, and
- b. an opinion paragraph of a report containing the qualified opinion:

Our examination disclosed the following material noncompliance with *[type of compliance requirement]* applicable to *[name of entity]* during the *[period]* ended *[date]*. *[Describe noncompliance.]*

In our opinion, except for the material noncompliance described in the preceding paragraph, *[name of entity]* complied, in all material respects, with the aforementioned requirements for the *[period]* ended *[date]*.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Adverse Opinion

.A26 The following is an example of

- a. a paragraph that would be added to the practitioner's report to describe the matter(s) giving rise to the adverse opinion, and
- b. an opinion paragraph of a report containing an adverse opinion:

Our examination disclosed the following material noncompliance with *[type of compliance requirement]* applicable to *[name of entity]* during the *[period]* ended *[date]*. *[Describe noncompliance.]*

In our opinion, because of the effect of the noncompliance described in the preceding paragraph, *[name of entity]* has not complied with the aforementioned requirements for the *[period]* ended *[date]*.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A27 If the practitioner's report containing a qualified or adverse opinion on the entity's compliance with specified requirements is included in a document that also includes the practitioner's audit report on the entity's financial statements, the compliance report may indicate that the noncompliance was considered during the audit. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A28 The following is an example of an additional sentence that may be included in the opinion paragraph of a practitioner's examination report that describes material noncompliance:

We considered the effect of these conditions on our audit of the 20XX financial statements. This report on XYZ Company's compliance with *[identify the specified requirements]* does not affect our audit report dated *[date of report]* on those financial statements.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A29 The practitioner also may include the preceding sentence when the two practitioner's reports are not included in the same document. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Preconditions for an Agreed-Upon Procedures Engagement (Ref: par. .23)

.A30 Management is responsible for ensuring that the entity complies with the requirements applicable to its activities. That responsibility encompasses the following:

- a. Identifying and complying with the specified requirements
- b. Designing, implementing, and maintaining internal control to provide reasonable assurance that the entity complies with those requirements
- c. Specifying reports that satisfy legal, regulatory, or contractual requirements

[Paragraph renumbered and revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.A31] [Paragraph renumbered and deleted, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Content of the Practitioner's Agreed-Upon Procedures Report (Ref: par. .26)

.A32 The list of elements in paragraph .26 of this section constitutes all the required elements for a practitioner's report on the application of agreed-upon procedures related to an entity's compliance with specified requirements, including the elements required by section 215.¹⁶ Application guidance regarding the elements of an agreed-upon procedures report is included in section 215.¹⁷ [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A33 In some agreed-upon procedures engagements, procedures may relate to both compliance with specified requirements and the entity's internal control over compliance. In these engagements, the practitioner may issue one practitioner's report that addresses both. For example, the first sentence of the introductory paragraph may state the following:

We have performed the procedures enumerated below, related to *[name of entity]*'s compliance with *[identify the specified requirements]* during the *[period]* ended *[date]* and *[name of entity]*'s internal control over compliance with the aforementioned compliance requirements as of *[date]*.

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A34 When performing agreed-upon procedures related to an entity's compliance with specified requirements, or an entity's internal control over compliance with certain requirements requires interpretation of the laws, regulations, rules, contracts, or grants that establish those requirements, the practitioner evaluates whether the criteria are suitable for performing such agreed-upon procedures and reporting findings. If these interpretations are significant, the practitioner may include a paragraph describing the interpretations made by

¹⁶ Paragraph .34 of section 215. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁷ Paragraphs .A49–.A64 of section 215. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

management and the source of the interpretations. An example of such a paragraph, which would precede the procedures and findings paragraph(s), follows:

We have been informed that, under *[name of entity]*'s interpretation of *[identify the compliance requirement]*, *[explain the nature and source of the relevant interpretation.]*

[Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A35 Example 3 in the exhibit to this section provides an illustration of a practitioner's agreed-upon procedures report related to compliance with specified requirements. Example 4 in the exhibit to this section provides an illustration of an agreed-upon procedures report related to internal control over compliance with specified requirements. [Paragraph renumbered, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.A36

Exhibit — Illustrative Practitioner's Examination and Agreed-Upon Procedures Reports Related to Compliance, and Agreed-Upon Procedures Report Related to Internal Control Over Compliance

The illustrative practitioner's examination reports in this exhibit (examples 1 and 2) meet the reporting requirements of section 205, *Assertion-Based Examination Engagements*,¹ and of paragraphs .20–.22 of this section. A practitioner may use alternative language in drafting an examination report, provided that the language meets the applicable requirements of section 205² and paragraphs .20–.22 of this section.

The illustrative practitioner's agreed-upon procedures reports in this exhibit (examples 3 and 4) meet the applicable reporting requirements of section 215, *Agreed-Upon Procedures Engagements*,³ and paragraph .26 of this section. A practitioner may use alternative language in drafting an agreed-upon procedures report, provided that the language meets the applicable requirements of section 215⁴ and paragraph .26 of this section.

Example 1: Practitioner's Examination Report on Compliance; Unmodified Opinion

The following is an illustrative practitioner's examination report for an engagement in which the practitioner is reporting on subject matter (an entity's compliance with specified requirements during a period of time).

Independent Accountant's Report

[Appropriate addressee]

We have examined XYZ Company's compliance with [identify the specified requirements, for example, the requirements listed in Attachment 1] during the period January 1, 20X1, to December 31, 20X1. Management of XYZ Company is responsible for XYZ Company's compliance with the specified requirements. Our responsibility is to express an opinion on XYZ Company's compliance with the specified requirements based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether XYZ Company complied, in all material respects, with the specified requirements referenced above. An examination involves performing procedures to obtain evidence about whether XYZ Company complied with the specified requirements. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material noncompliance, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

¹ Paragraphs .62–.83 of section 205.

² See footnote 1.

³ Paragraphs .31–.38 of section 215.

⁴ See footnote 3.

Our examination does not provide a legal determination on XYZ Company's compliance with specified requirements.

In our opinion, XYZ Company complied, in all material respects, with *[identify the specified requirements, for example, the requirements listed in Attachment 1]* during the period January 1, 20X1 to December 31, 20X1.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

Example 2: Practitioner's Examination Report on an Assertion About Compliance; Unmodified Opinion

The following is an illustrative practitioner's examination report for an engagement in which the practitioner is reporting on the management's assertion about compliance with specified requirements and management's assertion accompanies the report.

Independent Accountant's Report

[Appropriate Addressee]

We have examined management of XYZ Company's assertion that XYZ Company complied with *[identify the specified requirements, for example, the requirements listed in Attachment 1]* during the period January 1, 20X1 to December 31, 20X1.⁵ XYZ Company's management is responsible for its assertion. Our responsibility is to express an opinion on management's assertion about XYZ Company's compliance with the specified requirements based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion about compliance with the specified requirements is fairly stated, in all material respects. An examination involves performing procedures to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

Our examination does not provide a legal determination on XYZ Company's compliance with the specified requirements.

In our opinion, management's assertion that XYZ Company complied with *[identify the specified requirements, for example, the requirements listed in Attachment 1]*, is fairly stated, in all material respects.

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

⁵ If management's assertion accompanies the practitioner's report, the practitioner would refer to management's assertion by using the same title as management used for its assertion. The report also would use the same description of the specified requirements that management used in its assertion. If management's assertion is stated in the report, rather than accompanying the report, the word *accompanying* would be omitted.

Example 3: Practitioner's Agreed-Upon Procedures Report Related to Compliance

The following is an illustrative practitioner's agreed-upon procedures report related to an entity's compliance with specified requirements in which the procedures and findings are described in the report, rather than referenced.

Independent Accountant's Report on Applying Agreed-Upon Procedures

[Appropriate Addressee]

We have performed the procedures enumerated below related to XYZ Company's compliance with *[identify the specified requirements, for example, the requirements listed in Attachment I]* during the period January 1, 20X1 to December 31, 20X1.⁶ XYZ Company's management is responsible for its compliance with those requirements.

XYZ Company's management has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of assisting users in determining whether the entity complied with the specified requirements. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and the associated findings are as follows:

[Include paragraphs to describe the procedures performed detailing the nature and extent, and if applicable, the timing, of each procedure and to describe the findings from each procedure performed, including sufficient details on exceptions found.]

We were engaged by XYZ Company's management to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on compliance with specified requirements. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our agreed-upon procedures engagement.

[Additional paragraphs may be added to describe other matters]

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

⁶ If the agreed-upon procedures have been published by a third-party (for example, a regulator in regulatory policies or a lender in a debt agreement), this sentence might begin as follows: "We have performed the procedures included in [title of publication or other document] and enumerated below..." [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Example 4: Practitioner's Agreed-Upon Procedures Report Related to Internal Control Over Compliance

The following is an illustrative practitioner's agreed-upon procedures report related to an entity's internal control over compliance in which the procedures and findings are described in the report rather than referenced.

Independent Accountant's Report on Applying Agreed-Upon Procedures

[Appropriate Addressee]

We have performed the procedures enumerated below related to XYZ Company's internal control over compliance with *[identify the specified requirements for example, the requirements listed in Attachment 1]*, as of December 31, 20X1.⁷ XYZ Company's management is responsible for its internal control over compliance with those requirements.

XYZ Company's management has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of assisting users in determining whether the entity complied with the specified requirements. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures and the associated findings are as follows:

[Include paragraphs to describe the procedures performed detailing the nature and extent, and if applicable, the timing, of each procedure and to describe the findings from each procedure performed, including sufficient details on exceptions found.]

We were engaged by XYZ Company's management to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on internal control over compliance with specified requirements. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our agreed-upon procedures engagement.

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

[Paragraph renumbered and revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19. Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁷ If the agreed-upon procedures have been published by a third-party (for example, a regulator in regulatory policies or a lender in a debt agreement), this sentence might begin as follows: "We have performed the procedures included in [title of publication or other documents] and enumerated below..." [Revised, July 2021, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

AT-C Section 320

Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting

Source: SSAE No. 18.

Effective for service auditors' reports dated on or after May 1, 2017.

Introduction

.01 This section contains performance and reporting requirements and application guidance for a service auditor examining controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities' internal control over financial reporting. It complements AU-C section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, in that a service auditor's report prepared in accordance with this section may provide appropriate evidence under AU-C section 402. (Ref: par. .A1)

.02 In addition to complying with this section, a practitioner is required to comply with section 105, *Concepts Common to All Attestation Engagements*, and section 205, *Assertion-Based Examination Engagements*. In some cases, this section repeats or refers to requirements in sections 105 and 205 when describing those requirements in the context of examinations that address controls at a service organization likely to be relevant to user entities' internal control over financial reporting. Although not all the requirements in sections 105 and 205 are repeated or referred to in this section, the practitioner is responsible for complying with all the requirements in sections 105 and 205.^{1, 2} (Ref: par. .A2) [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.03 Section 205 indicates that when performing an attestation engagement, a practitioner should report on a written assertion or should report directly on the subject matter.³ For engagements conducted under this section, the service auditor reports directly on the subject matter.

¹ Section 206, *Direct Examination Engagements*, states that section 206 is not applicable to examination engagements related to subject matter for which other AT-C sections require the application of section 205, *Assertion-Based Examination Engagements*, which includes this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

² Paragraph .13 of this section requires the service auditor to request a written assertion from management of the service organization. For that reason, when the term "examination" is used in this section, it refers to an "assertion-based examination" performed under section 205 and this section. [Footnote added, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

³ Paragraph .67 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.04 The focus of this section is on controls at service organizations likely to be relevant to user entities' internal control over financial reporting. The guidance herein also may be helpful to a practitioner performing an engagement under section 205 to report on controls at a service organization

- a. other than those that are likely to be relevant to user entities' internal control over financial reporting (for example, controls that affect user entities' compliance with specified requirements of laws, regulations, rules, contracts, or grants or controls that affect user entities' production or quality control). Section 315, *Compliance Attestation*, is applicable if a practitioner is performing agreed-upon procedures related to an entity's internal control over compliance with specified requirements. Section 205 is applicable if a practitioner is examining an entity's controls over compliance with specified requirements. (Ref: par. .A3–.A4)
- b. when management of the service organization does not provide an assertion about the suitability of the design of controls because it is not responsible for the design of the controls (for example, when the controls have been designed by the user entity or the design is stipulated in a contract between the user entity and the service organization). (Ref: par. .A5)

.05 In addition to performing an examination of a service organization's controls, a service auditor may be engaged to (a) examine and report on a user entity's transactions or balances maintained by a service organization, or (b) perform and report under section 215, *Agreed-Upon Procedures Engagements*, the results of agreed-upon procedures related to the controls of a service organization or to transactions or balances of a user entity maintained by a service organization. However, these engagements are not addressed in this section.

Effective Date

.06 This section is effective for service auditors' reports dated on or after May 1, 2017.

Objectives

.07 The objectives of the service auditor are to

- a. obtain reasonable assurance about whether, in all material respects, based on the criteria
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period (or in the case of a type 1 report, as of a specified date)
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the specified period (or in the case of a type 1 report, as of a specified date).
 - iii. when included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in management's

description of the service organization's system were achieved throughout the specified period.

- b. express an opinion in a written report about the matters in paragraph .07a.

Definitions

.08 For the purposes of this section, the following definitions apply:

Carve-out method. Method of addressing the services provided by a subservice organization, whereby management's description of the service organization's system identifies the nature of the services performed by the subservice organization and excludes from the description and from the scope of the service auditor's engagement the subservice organization's relevant control objectives and related controls.

Complementary subservice organization controls. Controls that management of the service organization assumes, in the design of the service organization's system, will be implemented by the subservice organizations and are necessary to achieve the control objectives stated in management's description of the service organization's system.

Complementary user entity controls. Controls that management of the service organization assumes, in the design of the service organization's system, will be implemented by user entities and are necessary to achieve the control objectives stated in management's description of the service organization's system. (Ref: par. .A6)

Control objectives. The aim or purpose of specified controls at the service organization. Control objectives address the risks that controls are intended to mitigate.

Controls at a service organization. The policies and procedures at a service organization likely to be relevant to user entities' internal control over financial reporting. These policies and procedures are designed, implemented, and documented by the service organization to provide reasonable assurance about the achievement of the control objectives relevant to the services covered by the service auditor's report. (Ref: par. .A7)

Inclusive method. Method of addressing the services provided by a subservice organization whereby management's description of the service organization's system includes a description of the nature of the services provided by the subservice organization as well as the subservice organization's relevant control objectives and related controls.

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls (referred to in this section as a *type 1 report*). A service auditor's report that comprises the following:

- a. Management's description of the service organization's system
- b. A written assertion by management of the service organization about whether, based on the criteria

- i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date
- ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to achieve those control objectives as of the specified date
- c. A report that expresses an opinion on the matters in b(i)–(ii)

Management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls (referred to in this section as a *type 2 report*). A service auditor's report that comprises the following:

- a. Management's description of the service organization's system
- b. A written assertion by management of the service organization about whether, based on the criteria
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period to achieve those control objectives
 - iii. the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period to achieve those control objectives
- c. A report that
 - i. expresses an opinion on the matters in b(i)–(iii)
 - ii. includes a description of the tests of controls and the results thereof

Service auditor. A practitioner who reports on controls at a service organization.

Service organization. An organization or segment of an organization that provides services to user entities, which are likely to be relevant to those user entities' internal control over financial reporting.

Service organization's assertion. A written assertion about the matters referred to in part (b) of the definition of **management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls**, for a type 2 report, and, for a type 1 report, the matters referred to in part (b) of the definition of **management's description of a service organization's system and a service**

auditor's report on that description and on the suitability of the design of controls.

Service organization's system. The policies and procedures designed, implemented, and documented by management of the service organization to provide user entities with the services covered by the service auditor's report. Management's description of the service organization's system identifies the services covered, the period to which the description relates (or in the case of a type 1 report, the date to which the description relates), the control objectives specified by management or an outside party, the party specifying the control objectives (if not specified by management), and the related controls. (Ref: par. .A8)

Subservice organization. A service organization used by another service organization to perform some of the services provided to user entities that are likely to be relevant to those user entities' internal control over financial reporting. (Ref: par. .A9)

Test of controls. A procedure designed to evaluate the operating effectiveness of controls in achieving the control objectives stated in management's description of the service organization's system.

Type 1 report. See **management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design of controls.**

Type 2 report. See **management's description of a service organization's system and a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls.**

User auditor. An auditor who audits and reports on the financial statements of a user entity.

User entity. An entity that uses a service organization for which controls at the service organization are likely to be relevant to that entity's internal control over financial reporting.

Requirements

Management and Those Charged With Governance

.09 When this section requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with management of the service organization, the service auditor should determine the appropriate person(s) within the service organization's management or governance structure with whom to interact. This should include consideration of which person(s) has the appropriate responsibilities for and knowledge of the matters concerned. (Ref: par. .A10–.A11)

Preconditions

.10 A service auditor should accept or continue an engagement to report on controls at a service organization pursuant to this section only if the preconditions for an attestation engagement identified in section 105 and the following conditions are met:⁴ (Ref: par. .A12–.A13)

⁴ Paragraphs .26–.30 of section 105, *Concepts Common to All Attestation Engagements*. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- a. The service auditor's preliminary knowledge of the engagement circumstances indicates that the scope of the engagement and management's description of the service organization's system will not be so limited that they are unlikely to be useful to user entities and their auditors.
- b. Management acknowledges and accepts its responsibility for the following:
 - i. Preparing its description of the service organization's system and its assertion, including the completeness, accuracy, and method of presentation of the description and assertion (Ref: par. .A14)
 - ii. Having a reasonable basis for its assertion (Ref: par. .A15)
 - iii. Selecting the criteria to be used and stating them in the assertion
 - iv. Specifying the control objectives, stating them in the description of the service organization's system, and, if the control objectives are specified by law, regulation, or another party (for example, a user group or a professional body), identifying in the description the party specifying the control objectives (Ref: par. .A16)
 - v. Identifying the risks that threaten the achievement of the control objectives stated in the description and designing, implementing, and documenting controls that are suitably designed and operating effectively to provide reasonable assurance that the control objectives stated in the description of the service organization's system will be achieved (Ref: par. .A17)
 - vi. Providing a written assertion that accompanies management's description of the service organization's system, both of which will be provided to user entities (Ref: par. .A18)

.11 When the inclusive method is used, the service auditor should apply the requirements in sections 105, 205, and this section to the services provided by the subservice organization, as applicable, including the requirement to obtain management of the service organization's acknowledgement and acceptance of responsibility for the matters in paragraph .10b of this section as they relate to the subservice organization. (Ref: par. .A19–.A20)

Request to Change the Scope of the Engagement

.12 As required by section 105, if management requests a change in the scope of the engagement before the completion of the engagement, the service auditor should not agree to a change in the terms of the engagement when no reasonable justification for doing so exists.⁵ (Ref: par. .A21–.A22 and .A57)

Requesting a Written Assertion

.13 The practitioner should request from management of the service organization a written assertion. If management refuses to provide a written assertion, the practitioner should withdraw from the engagement when withdrawal is possible under applicable law or regulation. (Ref: par. .A23)

⁵ Paragraph .31 of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Assessing the Suitability of the Criteria

.14 As required by section 105, the service auditor should assess whether management has used suitable criteria in⁶ (Ref: par. .A25–.A26)

- a. preparing its description of the service organization's system,
- b. evaluating whether controls were suitably designed to achieve the control objectives stated in the description, and
- c. evaluating whether controls operated effectively throughout the specified period to achieve the control objectives stated in the description of the service organization's system, in the case of a type 2 report.

.15 In assessing the suitability of the criteria to evaluate whether management's description of the service organization's system is fairly presented, the service auditor should determine if the criteria include, at a minimum

- a. whether management's description of the service organization's system presents how the service organization's system was designed and implemented, including the following information about the service organization's system, if applicable:
 - i. The types of services provided, including, as appropriate, the classes of transactions processed.
 - ii. The procedures, within both automated and manual systems, by which services are provided, including, as appropriate, procedures by which transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities.
 - iii. The information used in the performance of the procedures, including, if applicable, related accounting records, whether electronic or manual, and supporting information involved in initiating, authorizing, recording, processing, and reporting transactions. This includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities.
 - iv. How the service organization's system captures and addresses significant events and conditions other than transactions.
 - v. The process used to prepare reports and other information for user entities.
 - vi. Services performed by a subservice organization, if any, including whether the carve-out method or the inclusive method has been used in relation to them. (Ref: par. .A37)
 - vii. The specified control objectives and controls designed to achieve those objectives, including, as applicable, complementary user entity controls and complementary subservice organization controls assumed in the design of the service organization's controls.

⁶ Paragraph .27b(ii) of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- viii. Other aspects of the service organization's control environment, risk assessment process, information and communications (including the related business processes), control activities, and monitoring activities that are relevant to the services provided. (Ref: par. .A15 and .A27)
- b. in the case of a type 2 report, whether management's description of the service organization's system includes relevant details of changes to the service organization's system during the period covered by the description. (Ref: par. .A50)
- c. whether management's description of the service organization's system does not omit or distort information relevant to the service organization's system, while acknowledging that management's description of the service organization's system is prepared to meet the common needs of a broad range of user entities and their user auditors, and may not, therefore, include every aspect of the service organization's system that each individual user entity and its user auditor may consider important in its own particular environment.

.16 In assessing the suitability of the criteria to evaluate whether the controls are suitably designed, the service auditor should determine if the criteria include, at a minimum, whether

- a. the risks that threaten the achievement of the control objectives stated in management's description of the service organization's system have been identified by management.
- b. the controls identified in management's description of the service organization's system would, if operating effectively, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.

.17 In assessing the suitability of the criteria to evaluate whether controls operated effectively to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved, the service auditor should determine if the criteria include, at a minimum, whether the controls were consistently applied as designed throughout the specified period, including whether manual controls were applied by individuals who have the appropriate competence and authority.

.18 Section 205 requires a practitioner to request from the responsible party a written assertion about the measurement or evaluation of the underlying subject matter against the criteria.⁷ The practitioner should determine that management's assertion addresses all the criteria management used to evaluate the fairness of the presentation of the description, the suitability of the design of the controls, and in a type 2 engagement, the operating effectiveness of the controls. (Ref: par. .A24) [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Materiality

.19 The service auditor's consideration of materiality should include the fair presentation of management's description of the service organization's system, the suitability of the design of controls to achieve the related control objectives stated in the description and, in the case of a type 2 report, the operating

⁷ Paragraph .10 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

effectiveness of the controls to achieve the related control objectives stated in the description. (Ref: par. .A28–.A30)

Obtaining an Understanding of the Service Organization's System and Assessing the Risk of Material Misstatement

.20 The service auditor should obtain an understanding of the service organization's system, including controls that are included in the scope of the engagement. That understanding should include service organization processes used to (Ref: par. .A31–.A33)

- a.* prepare the description of the service organization's system, including the determination of control objectives,
- b.* identify controls designed to achieve the control objectives,
- c.* assess the suitability of the design of the controls, and
- d.* in a type 2 report, assess the operating effectiveness of controls.

.21 If the service organization has an internal audit function, part of the service auditor's understanding of the service organization's system should include the following:

- a.* The nature of the internal audit function's responsibilities and how the internal audit function fits in the service organization's organizational structure
- b.* The activities performed, or to be performed, by the internal audit function as it relates to the service organization

.22 As required by section 205, the service auditor should identify and assess the risks of material misstatement.⁸ (Ref: par. .A34–.A35) [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.23 The service auditor should read the reports of the internal audit function and regulatory examinations that relate to the services provided to user entities and the scope of the engagement, if any, to obtain an understanding of the nature and extent of the procedures performed and the related findings. The findings should be taken into consideration as part of the risk assessment and in determining the nature, timing, and extent of the tests.

Responding to Assessed Risks and Further Procedures

.24 As required by paragraphs .25–.39 of this section and section 205, the service auditor should⁹

- a.* design and implement overall responses to address the assessed risks of material misstatement for the subject matter and
- b.* design and perform further procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement.

⁸ Paragraph .19 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

⁹ Paragraphs .21–.22 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Obtaining Evidence Regarding Management's Description of the Service Organization's System

.25 The service auditor should obtain and read management's description of the service organization's system and should evaluate whether those aspects of the description that are included in the scope of the engagement are presented fairly, in all material respects, based on the criteria in management's assertion, including whether (Ref: par. .A28–.A29 and .A36–.A40)

- a. the control objectives stated in management's description of the service organization's system are reasonable in the circumstances;
- b. controls identified in management's description of the service organization's system were implemented;
- c. complementary user entity controls and complementary subservice organization controls, if any, are adequately described; and
- d. services performed by a subservice organization, if any, are adequately described, including whether the carve-out method or the inclusive method has been used in relation to them.

.26 The service auditor should determine through inquiries made in combination with other procedures whether the service organization's system has been implemented. (Ref: par. .A40)

Obtaining Evidence Regarding the Design of Controls

.27 The service auditor should assess whether the controls that management identified in its description of the service organization's system as the controls that achieve the control objectives were suitably designed to achieve those control objectives by (Ref: par. .A28–.A29, .A36, and .A41–.A45)

- a. obtaining an understanding of management's process for identifying and evaluating the risks that threaten the achievement of the control objectives and assessing the completeness and accuracy of management's identification of those risks,
- b. evaluating the linkage of the controls identified in management's description of the service organization's system with those risks, including risks arising from each of the described classes of transactions and risks that IT poses to the user entity's internal control over financial reporting, and
- c. determining that the controls have been implemented.

Obtaining Evidence Regarding the Operating Effectiveness of Controls

.28 When performing a type 2 engagement, the service auditor should test those controls that management has identified in its description of the service organization's system as the controls that achieve the control objectives and should assess the operating effectiveness of those controls throughout the period. Evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period. (Ref: par. .A28–.A30, .A36, and .A46–.A51)

.29 When performing a type 2 engagement, the service auditor should obtain an understanding of changes in the service organization's system that were

implemented during the period covered by the service auditor's report. If the service auditor believes the changes would be considered significant by user entities and their auditors, the service auditor should determine whether those changes are included in management's description of the service organization's system. If such changes are not included in the description, the service auditor should describe the changes in the report and determine the effect on the report. If superseded controls are relevant to the achievement of the control objectives stated in the description, the service auditor should, if possible, test the superseded controls before the change. If the service auditor cannot test superseded controls relevant to the achievement of the control objectives stated in the description, the service auditor should determine the effect on the report. (Ref: par. .A50–.A51)

Evaluating the Reliability of Information Produced by the Service Organization

.30 When using information produced by the service organization, section 205 requires the service auditor to evaluate whether such information is sufficiently reliable for the service auditor's purposes by obtaining evidence about its accuracy and completeness and evaluating whether the information is sufficiently precise and detailed.¹⁰ (Ref: par. .A52)

.31 When designing and performing tests of controls, the service auditor should

- a. perform other procedures such as inspection, observation, or reperformance in combination with inquiry to obtain evidence about the following:
 - i. How the control was applied
 - ii. The consistency with which the control was applied
 - iii. By whom or by what means the control was applied
- b. determine whether the controls to be tested depend on other controls, and if so, whether it is necessary to obtain evidence supporting the operating effectiveness of those other controls.
- c. determine an effective method for selecting the items to be tested to meet the objectives of the procedure.

Nature and Cause of Deviations

.32 The service auditor should investigate the nature and cause of any deviations identified and should determine whether

- a. identified deviations are within the expected rate of deviation and are acceptable. If so, the testing that has been performed provides an appropriate basis for concluding that the control operated effectively throughout the specified period.
- b. additional testing of the control or other controls is necessary to reach a conclusion about whether the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period.
- c. the testing that has been performed provides an appropriate basis for concluding that the control did not operate effectively throughout the specified period.

¹⁰ Paragraph .36 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.33 If, as a result of performing the procedures in paragraph .32, the service auditor becomes aware that any identified deviations have resulted from fraud by service organization personnel, the service auditor should assess the risk that management's description of the service organization's system is not fairly presented, the controls are not suitably designed and, in a type 2 engagement, the controls are not operating effectively. (Ref: par. .A36)

.34 If the service auditor becomes aware of incidents of noncompliance with laws or regulations, fraud or uncorrected misstatements attributable to management or other service organization personnel that are not clearly trivial and that may affect one or more user entities, the service auditor should determine the effect of such incidents on management's assertion, management's description of the service organization's system, the achievement of the control objectives, and the service auditor's report.

Subsequent Events

.35 In performing subsequent events procedures as required by section 205, if the service auditor becomes aware of an event that is of such a nature and significance that its disclosure is necessary to prevent users of a type 1 or type 2 report from being misled, and information about that event is not disclosed by management in its description, the service auditor should disclose such event in the service auditor's report.¹¹

Written Representations

.36 In addition to the written representations from management required by section 205, the service auditor should request written representations indicating that it has disclosed to the service auditor any of the following of which it is aware:¹² (Ref: par. .A53–.A56)

- a. Instances of noncompliance with laws and regulations or uncorrected misstatements attributable to the service organization that may affect one or more user entities
- b. Knowledge of any actual, suspected, or alleged fraud by management or the service organization's employees that could adversely affect the fairness of the presentation of management's description of the service organization's system or the completeness or achievement of the control objectives stated in the description

.37 If a service organization uses a subservice organization and management's description of the service organization's system uses the inclusive method, the service auditor should also obtain the written representations identified in section 205 and paragraph .36 of this section from management of the subservice organization.¹³ (Ref: par. .A53–.A56)

.38 In a type 1 or type 2 engagement, the practitioner should request from the responsible party (in this case, management of the service organization), the written representations required by section 205 and paragraph .36 of this section, even if the engaging party is not the responsible party. The alternative to obtaining the required written representations provided for in section 205 is

¹¹ Paragraph .49 and .A60 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹² Paragraph .51 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹³ See footnote 12. [Footnote revised and renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

not permitted in a type 1 or type 2 engagement.¹⁴ The refusal by management of the service organization (or by management of a subservice organization that is being presented using the inclusive method) to furnish the written representations required by section 205 and paragraph .36 of this section constitutes a limitation on the scope of the engagement. Such refusal is often sufficient to preclude an unmodified opinion and particularly with respect to the representations in paragraph .53 of section 205, may cause the service auditor to disclaim an opinion or withdraw from the examination engagement when withdrawal is possible under applicable law or regulation.^[15] However, based on the nature of the representations not obtained or the circumstances of the refusal, the service auditor may conclude that a qualified opinion is appropriate. (Ref: par. .A53–.A57) [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Other Information

.39 Section 205 contains requirements for situations in which prior to or after the release of the practitioner's report on subject matter or an assertion, the practitioner is willing to permit the inclusion of the report in a document that contains the subject matter or assertion on which the service auditor reported and other information.¹⁶ (Ref: par. .A58)

Content of the Service Auditor's Report

.40 A service auditor's type 2 report should include the following: (Ref: par. .A59–.A60)

- a. A title that includes the word *independent*.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. Identification of the following:
 - i. Management's description of the service organization's system, the function performed by the system, and the period to which the description relates
 - ii. The criteria identified in management's assertion against which the fairness of the presentation of the description and the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description were evaluated
 - iii. Any information included in a document containing the report that is not covered by the report (Ref: par. .A58)
 - iv. Any services performed by a subservice organization and whether the carve-out method or the inclusive method was used in relation to them. Depending on which method is used, the following should be included:
 - (1) If the carve-out method was used, a statement indicating that (Ref: par. .A61)

¹⁴ Paragraph .52 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

^[15] [Footnote renumbered and deleted, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

¹⁶ Paragraph .58 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- (a) management's description of the service organization's system excludes the control objectives and related controls of the relevant subservice organizations
 - (b) certain control objectives specified by the service organization can be achieved only if complementary subservice organization controls assumed in the design of the service organization's controls are suitably designed and operating effectively
 - (c) the service auditor's procedures do not extend to such complementary subservice organization controls
- (2) If the inclusive method was used, a statement that management's description of the service organization's system includes the subservice organization's specified control objectives and related controls, and that the service auditor's procedures included procedures related to the subservice organization
- d. A statement that the controls and control objectives included in the description are those that management believes are likely to be relevant to user entities' internal control over financial reporting, and the description does not include those aspects of the system that are not likely to be relevant to user entities' internal control over financial reporting.
- e. If management's description of the service organization's system refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of the design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization.
- f. A reference to management's assertion and a statement that management is responsible for
 - i. preparing the description of the service organization's system and the assertion, including the completeness, accuracy, and method of presentation of the description and assertion.
 - ii. providing the services covered by the description of the service organization's system.
 - iii. specifying the control objectives and stating them in the description of the service organization's system.
 - iv. identifying the risks that threaten the achievement of the control objectives.
 - v. selecting the criteria.
 - vi. designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description of the service organization's system.

- g.* A statement that the service auditor is responsible for expressing an opinion on the fairness of the presentation of management's description of the service organization's system and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description based on the service auditor's examination.
- h.* A statement that
 - i. the examination was conducted in accordance with attestation standards established by the AICPA.
 - ii. those standards require that the service auditor plan and perform the examination to obtain reasonable assurance about whether, in all material respects, based on the criteria in management's assertion, management's description of the service organization's system is fairly presented and the controls are suitably designed and operating effectively throughout the specified period to achieve the related control objectives.
 - iii. the service auditor believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the service auditor's opinion.
- i.* A statement that an examination of management's description of a service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve the related control objectives stated in the description involves
 - i. performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description based on the criteria in management's assertion.
 - ii. assessing the risks that management's description of the service organization's system is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives.
 - iii. testing the operating effectiveness of those controls that management considers necessary to provide reasonable assurance that the related control objectives stated in management's description of the service organization's system were achieved.
 - iv. evaluating the overall presentation of management's description of the service organization's system, suitability of the control objectives stated in the description, and suitability of the criteria specified by the service organization in its assertion.
- j.* A statement that the service auditor is required to be independent and to meet the service auditor's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement
- k.* A description of the inherent limitations of controls, including that projecting to the future any evaluation of the fairness of the presentation of management's description of the service organization's system or conclusions about the suitability of the design or operating effectiveness of the controls to achieve the related

control objectives is subject to the risk that controls at a service organization may become ineffective.

- l.* A reference to a description of the service auditor's tests of controls and the results thereof that includes (Ref: par. .A62)
 - i. an identification of the controls that were tested.
 - ii. whether the items tested represent all or a selection of the items in the population.
 - iii. the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk assessments.
 - iv. any identified deviations in the operation of controls included in the description, the extent of testing performed by the service auditor that led to the identification of the deviations (including the number of items tested), and the number and nature of the deviations noted (even if, on the basis of tests performed, the service auditor concludes that the related control objective was achieved). (Ref: par. .A63)
 - v. if the work of the internal audit function has been used in tests of controls to obtain evidence, a description of the internal auditor's work and of the service auditor's procedures with respect to that work. (Ref: par. .A64–.A66)
- m.* The service auditor's opinion on whether, in all material respects, based on the criteria described in management's assertion
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period.
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the specified period.
 - iii. the controls operated effectively to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved throughout the specified period.
 - iv. if the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a statement to that effect.
 - v. if the application of complementary subservice organization controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a statement to that effect.
- n.* An alert, in a separate paragraph, that restricts the use of the report. The alert should (Ref: par. .A67–.A72)
 - i. state that the report, including the description of tests of controls and results thereof, is intended solely for the information and use of management of the service organization, user entities of the service organization's system during some or all of the period covered by the report, and the auditors who audit and report on such user entities'

financial statements or internal control over financial reporting.

- ii. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.¹⁷
- o. The manual or printed signature of the service auditor's firm.
- p. The city and state where the service auditor's report is issued.
- q. The date of the report. (The report should be dated no earlier than the date on which the service auditor has obtained sufficient appropriate evidence on which to base the service auditor's opinion, including evidence that
 - i. management's description of the service organization system has been prepared,
 - ii. management has provided a written assertion, and
 - iii. the attestation documentation has been reviewed.)

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.41 A service auditor's type 1 report should include the following: (Ref: par. .A59 and .A72)

- a. A title that includes the word *independent*.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. Identification of the following:
 - i. Management's description of the service organization's system, the function performed by the system, and the specified date to which the description relates.
 - ii. The criteria identified in management's assertion against which the fairness of the presentation of the description and the suitability of the design of the controls to achieve the related control objectives stated in the description were evaluated.
 - iii. Any information included in a document containing the report that is not covered by the report. (Ref: par. .A58)
 - iv. Any services performed by a subservice organization and whether the carve-out method or the inclusive method was used in relation to them. Depending on which method is used, the following should be included:
 - (1) If the carve-out method was used, a statement indicating that (Ref: par. .A61)
 - (a) management's description of the service organization's system excludes the control objectives and related controls of the relevant subservice organizations.
 - (b) certain control objectives specified by the service organization can be achieved only if complementary subservice organization controls assumed in the design of the service organization's controls are

¹⁷ Paragraph .65 or .66 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- suitably designed and operating effectively.
 - (c) the service auditor's procedures do not extend to such complementary subservice organization controls.
- (2) If the inclusive method was used, a statement that management's description of the service organization's system includes the subservice organization's specified control objectives and related controls, and that the service auditor's procedures included procedures related to the subservice organization.
- d. A statement that the controls and control objectives included in the description are those that management believes are likely to be relevant to user entities' internal control over financial reporting, and the description does not include those aspects of the system that are not likely to be relevant to user entities' internal control over financial reporting.
- e. If management's description of the service organization's system refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of the design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization.
- f. A reference to management's assertion and a statement that management is responsible for
 - i. preparing the description of the service organization's system and the assertion, including the completeness, accuracy, and method of presentation of the description and assertion.
 - ii. providing the services covered by the description of the service organization's system.
 - iii. specifying the control objectives and stating them in the description of the service organization's system.
 - iv. identifying the risks that threaten the achievement of the control objectives.
 - v. selecting the criteria.
 - vi. designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description of the service organization's system.
- g. A statement that the service auditor is responsible for expressing an opinion on the fairness of the presentation of management's description of the service organization's system and on the suitability of the design of the controls to achieve the related control objectives stated in the description, based on the service auditor's examination.
- h. A statement that
 - i. the examination was conducted in accordance with attestation standards established by the AICPA.

- ii. those standards require that the service auditor plan and perform the examination to obtain reasonable assurance about whether, in all material respects, based on the criteria in management's assertion, management's description of the service organization's system is fairly presented, and the controls are suitably designed as of the specified date to achieve the related control objectives.
 - iii. the service auditor believes the evidence obtained is sufficient and appropriate to provide a reasonable basis for the service auditor's opinion.
- i. A statement that an examination of management's description of a service organization's system and the suitability of the design of the service organization's controls to achieve the related control objectives stated in the description involves
 - i. performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design of the controls to achieve the related control objectives stated in the description, based on the criteria in management's assertion.
 - ii. assessing the risks that management's description of the service organization's system is not fairly presented and that the controls were not suitably designed to achieve the related control objectives.
 - iii. evaluating the overall presentation of management's description of the service organization's system, suitability of the control objectives stated in the description, and suitability of the criteria specified by the service organization in its assertion.
- j. A statement that the service auditor is required to be independent and to meet the service auditor's other ethical responsibilities in accordance with relevant ethical requirements related to the examination engagement.
- k. A description of the inherent limitations of controls, including that projecting to the future any evaluation of the fairness of the presentation of management's description of the service organization's system or conclusions about the suitability of the design of the controls to achieve the related control objectives is subject to the risk that controls at a service organization may become ineffective.
- l. A statement the service auditor has not performed any procedures regarding the operating effectiveness of controls and, therefore, expresses no opinion thereon.
- m. The service auditor's opinion on whether, in all material respects, based on the criteria described in management's assertion
 - i. management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of the specified date.
 - ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively as of the specified date.

- iii. if the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a statement to that effect.
 - iv. if the application of complementary subservice organization controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a statement to that effect.
 - n. An alert, in a separate paragraph, that restricts the use of the report. The alert should (Ref: par. .A67–.A72)
 - i. state that the report is intended solely for the information and use of management of the service organization, user entities of the service organization's system as of the specified date, and the auditors who audit and report on such user entities' financial statements or internal control over financial reporting.
 - ii. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.¹⁸
 - o. The manual or printed signature of the service auditor's firm.
 - p. The city and state where the service auditor's report is issued.
 - q. The date of the report. (The report should be dated no earlier than the date on which the service auditor has obtained sufficient appropriate evidence on which to base the service auditor's opinion, including evidence that
 - i. management's description of the service organization system has been prepared,
 - ii. management has provided a written assertion, and
 - iii. the attestation documentation has been reviewed.)

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Modified Opinions

.42 The service auditor's opinion should be modified, and the service auditor's report should contain a clear description of all the reasons for the modification, if the service auditor concludes that, based on the criteria in management's assertion (Ref. par. .A73)

- a. management's description of the service organization's system is not fairly presented, in all material respects;
- b. the controls are not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated effectively, in all material respects;
- c. in the case of a type 2 report, the controls did not operate effectively throughout the specified period to achieve the related control objectives stated in management's description of the service organization's system, in all material respects; or

¹⁸ Paragraph .65 or .66 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- d. the service auditor is unable to obtain sufficient appropriate evidence.

.43 If the service auditor plans to disclaim an opinion because of the inability to obtain sufficient appropriate evidence, and, based on the limited procedures performed, has concluded that, in all material respects, based on the criteria in management's assertion

- a. certain aspects of management's description of the service organization's system are not fairly presented,
- b. certain controls were not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated effectively, or
- c. in the case of a type 2 report, certain controls did not operate effectively throughout the specified period to achieve the related control objectives stated in management's description of the service organization's system, then

the service auditor should identify these findings in the service auditor's report.

.44 If the service auditor plans to disclaim an opinion, the service auditor *should not* identify the procedures that were performed nor include statements describing the characteristics of a service auditor's engagement in the service auditor's report—to do so might overshadow the disclaimer.

Other Communication Responsibilities

.45 In addition to the communication responsibilities in section 205, if the service auditor becomes aware of the matters identified in paragraph .34, the service auditor should determine whether this information has been communicated appropriately to affected user entities.¹⁹ If the information has not been so communicated, and management of the service organization refuses to do so, the service auditor should take appropriate action. (Ref: par. .A74)

Application and Other Explanatory Material

Introduction (Ref: par. .01–.02 and .04)

.A1 Controls related to a service organization's operations and compliance objectives may be relevant to a user entity's internal control over financial reporting. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions or disclosures, or may pertain to evidence that the user auditor evaluates or uses in applying auditing procedures. For example, a payroll processing service organization's controls related to the timely remittance of payroll deductions to government authorities may be relevant to a user entity because late remittances could incur interest and penalties that would result in a liability to the user entity. Similarly, a service organization's controls over the acceptability of investment transactions from a regulatory perspective may be considered relevant to a user entity's presentation and disclosure of transactions and account balances in its financial statements.

¹⁹ Paragraphs .85–.86 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.A2 Section 105 requires the practitioner to consider applicable interpretive publications when planning and performing an attestation engagement.²⁰ Additional interpretive guidance for a practitioner examining controls at a service organization relevant to user entities' internal control over financial reporting is provided in the AICPA Guide *Service Organizations: Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*.

.A3 Paragraph .04 of this section refers to other engagements the practitioner may perform and report on under section 205 when reporting on controls at a service organization. Paragraph .04 is not, however, intended to

- alter the definitions of a *service organization* and *service organization's system* in paragraph .08 to permit reports issued under this section to include in the description of the service organization's system aspects of their services (including relevant control objectives and related controls) not likely to be relevant to user entities' internal control over financial reporting, or
- permit a practitioner's report to be issued that combines reporting under this section on a service organization's controls that are likely to be relevant to user entities' internal control over financial reporting, with reporting under section 205 on controls that are not likely to be relevant to user entities' internal control over financial reporting.

.A4 When a service auditor conducts an engagement under section 205 to report on controls at a service organization other than those controls likely to be relevant to user entities' internal control over financial reporting, and the service auditor intends to use the guidance in this section in planning and performing that engagement, the service auditor may encounter matters that differ significantly from those associated with engagements to report on a service organization's controls likely to be relevant to user entities' internal control over financial reporting. The following are examples of such matters:

- Identification of suitable and available criteria, as prescribed in section 105, for evaluating the fairness of presentation of management's description of the service organization's system and the suitability of the design and the operating effectiveness of the controls²¹
- Identification of appropriate control objectives, and the basis for evaluating the reasonableness of the control objectives in the circumstances of the particular engagement
- Identification of the intended users of the report and the manner in which they intend to use the report
- Relevance and appropriateness of the definitions in paragraph .08, many of which specifically relate to internal control over financial reporting
- Application of references to auditing standards (AU-C sections) that are intended to provide the service auditor with guidance relevant to internal control over financial reporting

²⁰ Paragraph .23 of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

²¹ Paragraph .27b(ii) of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- Application of the concept of materiality in the circumstances of the particular engagement
- Developing the language to be used and identifying the elements to be included in a practitioner's examination report, as discussed in section 205²²

.A5 In some circumstances, management of the service organization may not be in a position to assert that the controls are suitably designed, for example, because the controls have been designed by management of the user entity. If management is unable to assert that the controls are suitably designed, management would also be precluded from asserting that the controls are operating effectively because of the inextricable link between the suitability of the design of controls and their operating effectiveness. The absence of an assertion with respect to the suitability of design of controls would preclude the service auditor from expressing an opinion on the operating effectiveness of controls. As an alternative, the practitioner may report under section 205 on whether the controls were operating as described or may perform agreed-upon procedures under section 215.

Definitions (Ref: par. .08)

Complementary User Entity Controls

.A6 Complementary user entity controls are specific and relevant to the services provided by the service organization applicable to user entities' internal control over financial reporting.

Controls at a Service Organization

.A7 The policies and procedures referred to in the definition of *controls at a service organization* in paragraph .08 include aspects of the information and communications component of user entities' internal control maintained by the service organization and control activities related to the information and communications component and may also include aspects of one or more of the other components of internal control at a service organization. For example, the definition of *controls at a service organization* may include aspects of the service organization's control environment, risk assessment, monitoring activities, and control activities when they relate to the services provided. Such definition does not, however, include controls at a service organization that are not related to the achievement of the control objectives stated in management's description of the service organization's system, for example, controls related to the preparation of the service organization's own financial statements.

Service Organization's System

.A8 The policies and procedures referred to in the definition of *service organization's system* refer to the guidelines and activities for providing transaction processing and other services to user entities and include the infrastructure, software, people, and data that support the policies and procedures.

Subservice Organization

.A9 There may be instances in which a subservice organization uses the services of another service organization to perform services that are likely to be relevant to user entities' internal control over financial reporting. In those

²² Paragraphs .63–.66 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

circumstances, the service organization that provides services to the subservice organization is also a subservice organization.

Management and Those Charged With Governance (Ref: par. .09)

.A10 For the purposes of this section, the responsible party is management of the service organization.

.A11 Management and governance structures vary by entity, reflecting influences such as size and ownership characteristics. Such diversity means that it is not possible for this section to specify for all engagements the person(s) with whom the service auditor is to interact regarding particular matters. For example, the service organization may be a segment of an organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance from whom to request written representations may require the exercise of professional judgment.

Preconditions

Service Auditor Need Not Be Independent of User Entities (Ref: par. .10)

.A12 In performing a service auditor's engagement, the service auditor need not be independent of each user entity.

Law or Regulation Requires Acceptance or Continuance of Engagement (Ref: par. .10)

.A13 If one or more of the conditions in paragraph .10 of this section or in section 105 are not met and the service auditor is, nevertheless, required by law or regulation to accept or continue an engagement to report on controls at a service organization, the service auditor is required, in accordance with paragraphs .42–.44, to determine the effect on the service auditor's report of one or more of such conditions not being met.²³

Management's Responsibility for Documenting the Service Organization's System (Ref: par. .10b[i])

.A14 Management of the service organization is responsible for documenting the service organization's system. No one particular form of documentation is prescribed, and the extent of documentation may vary depending on the size and complexity of the service organization and its monitoring activities.

Reasonable Basis for Management's Assertion (Ref: par. .10b[ii] and .15a[viii])

.A15 Management's monitoring activities may provide evidence of the design and operating effectiveness of controls in support of management's assertion. *Monitoring of controls* is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the service organization, and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring

²³ Paragraphs .26–.30 of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities. Internal auditors or personnel performing similar functions may contribute to the monitoring of a service organization's activities. Monitoring activities may also include using information communicated by external parties, such as customer complaints, which may indicate problems or highlight areas in need of improvement. The greater the degree and effectiveness of ongoing monitoring, the less need for separate evaluations. Usually, some combination of ongoing monitoring and separate evaluations will ensure that internal control maintains its effectiveness over time. The service auditor's report on controls is not a substitute for the service organization's own processes to provide a reasonable basis for its assertion.

Management's Responsibility for Control Objectives (Ref. par. 10b[iv])

.A16 The control objectives stated in management's description of the service organization's system relate to the types of financial statement assertions commonly embodied in the broad range of user entities' financial statements to which controls at the service organization could reasonably be expected to relate.

Management's Responsibility for Identifying Risks (Ref: par. . 10b[v])

.A17 Control objectives relate to risks that controls seek to mitigate. For example, the risk that a transaction is recorded at the wrong amount or in the wrong period can be expressed as a control objective that transactions are recorded at the correct amount and in the correct period. Management is responsible for identifying the risks that threaten achievement of the control objectives stated in management's description of the service organization's system. A service organization's controls may be designed with the assumption that user entities will have implemented complementary user entity controls or that subservice organizations will have implemented complementary subservice organization controls that are necessary to achieve the control objectives. The risks that management identifies also include the risk that such controls were not implemented by user entities or subservice organizations or that those controls were not operating effectively. Management may have a formal or informal process for identifying relevant risks. A formal process may include estimating the significance of identified risks, assessing the likelihood of their occurrence, and deciding about actions to address them. However, because control objectives relate to risks that controls seek to mitigate, thoughtful identification by management of control objectives when designing, implementing, and documenting the service organization's system may itself comprise an informal process for identifying relevant risks.

Providing a Written Assertion (Ref: par. . 10b[vi])

.A18 The service organization's assertion may be attached to the description of the service organization's system or may be included in the description if clearly segregated from the description, for example, through the use of headings. Segregating the assertion from the description clarifies that the assertion is not part of the description. (See subparagraph (b) of the definitions of *management's description of a service organization's system* and *a service auditor's report on that description and on the suitability of the design of controls* and *management's description of a service organization's system* and *a service auditor's report on that description and on the suitability of the design and operating effectiveness of controls* in paragraph .08.)

Inclusive Method (Ref: par. . 11)

.A19 The inclusive method is generally feasible if, for example, the service organization and the subservice organization are related, or if the contract between the service organization and the subservice organization provides for the use of the inclusive method. In such circumstances, the service organization is the engaging party, and the requirements relative to agreeing on the terms of the engagement may not be applicable.

.A20 If the inclusive method is used, matters to be agreed upon or coordinated by the service organization and the subservice organization include

- the scope of the examination and the period to be covered by the service auditor's report.
- acknowledgment from management of the subservice organization that it will provide the service auditor with a written assertion and representation letter. (Both management of the service organization and management of the subservice organization are responsible for providing the service auditor with a written assertion and representation letter.)
- the planned content and format of the inclusive description.
- the representatives of the subservice organization and the service organization who will be responsible for
 - providing each entity's description.
 - integrating the descriptions.
- for a type 2 report, the timing of the tests of controls.

Request to Change the Scope of the Engagement (Ref: par. .12)

.A21 A request to change the scope of the engagement may not have a reasonable justification if, for example, the request is made

- to exclude certain control objectives at the service organization from the scope of the engagement because of the likelihood that the service auditor's opinion would be modified with respect to those control objectives.
- to prevent the disclosure of deviations identified at a subservice organization by requesting a change from the inclusive method to the carve-out method.

.A22 A request to change the scope of the engagement may have a reasonable justification when, for example, the request is made because the service organization, a transfer agent, after providing the description of its system to the service auditor, decides that it would like to remove a control objective related to new fund setup because only one fund was set up during the reporting period, and management of the fund had performed its own testing. The service auditor concluded that the removal of the control objective related to new fund setup was reasonable in the circumstances because the objective was not relevant to a broad range of user entities during the examination period.

Requesting a Written Assertion (Ref: par. .13 and .18)

.A23 Paragraph .13 applies regardless of whether the responsible party is the engaging party.

.A24 Exhibit B, "Illustrative Assertions by Management of a Service Organization," contains illustrative management assertions for type 1 and type 2 engagements.

Assessing the Suitability of the Criteria (Ref: par. .14)

.A25 Section 105 requires a practitioner, among other things, to determine whether the criteria to be applied in the preparation and evaluation of the underlying subject matter are suitable and will be available to the intended users, and the subject matter is appropriate.²⁴ Section 105 also indicates that one of the attributes of an appropriate subject matter is that it is identifiable and capable of consistent measurement or evaluation against the criteria.²⁵ As indicated in section 105, the responsible party (in this case, management of the service organization) or the engaging party is responsible for selecting the criteria, and the engaging party is responsible for determining that such criteria are appropriate for its purposes.²⁶ For an examination or review engagement, section 105 defines the *underlying subject matter* as the phenomenon that is measured or evaluated by applying criteria.²⁷ [Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.A26 For the purposes of engagements performed in accordance with this section, criteria need to be available to user entities and their auditors to enable them to understand the basis for the service organization's assertion about the fair presentation of management's description of the service organization's system, the suitability of the design of controls that address control objectives stated in the description of the system and, in the case of a type 2 report, the operating effectiveness of such controls. Information about suitable criteria is provided in section 105.²⁸ Paragraphs .15–.17 discuss the criteria for evaluating the fairness of the presentation of management's description of the service organization's system and the suitability of the design and operating effectiveness of the controls.

Monitoring the Effectiveness of Controls at Subservice Organizations (Ref: par. .15a[viii])

.A27 Management's description of the service organization's system and the scope of the service auditor's engagement includes controls at the service organization that monitor the effectiveness of controls at the subservice organization, which may include some combination of ongoing monitoring to determine that potential issues are identified timely and separate evaluations to determine that the effectiveness of internal control is maintained over time. Such monitoring activities may include

- reviewing and reconciling output reports,
- holding periodic discussions with the subservice organization,
- making regular site visits to the subservice organization,
- testing controls at the subservice organization by members of the service organization's internal audit function,
- reviewing type 1 or type 2 reports on the subservice organization's system prepared pursuant to this section or section 205, and

²⁴ Paragraph .27b(ii) of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

²⁵ Paragraph .A39a of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

²⁶ Paragraph .A47 of section 105. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

²⁷ Definition of *underlying subject matter* in paragraph .12 of section 105. [Footnote revised and renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

²⁸ See footnote 24. [Footnote revised and renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- monitoring external communications, such as customer complaints relevant to the services by the subservice organization.

Materiality (Ref: par. .19, .25, and .27–.28)

.A28 In an engagement to report on controls at a service organization, the concept of materiality relates to the information being reported on, not the financial statements of user entities. The service auditor plans and performs procedures to determine whether, in all material respects, based on the criteria in management's assertion, management's description of the service organization's system is fairly presented; controls at the service organization are suitably designed to achieve the control objectives stated in the description; and, in the case of a type 2 report, controls at the service organization operated effectively throughout the specified period to achieve the control objectives stated in the description. The concept of materiality takes into account that the service auditor's report provides information about the service organization's system to meet the common information needs of a broad range of user entities and their auditors who have an understanding of the manner in which the system is being used by a particular user entity for financial reporting.

.A29 Materiality with respect to the fair presentation of management's description of the service organization's system and with respect to the design of controls primarily includes the consideration of qualitative factors, for example, whether

- management's description of the service organization's system includes the significant aspects of the processing of transactions.
- management's description of the service organization's system omits or distorts relevant information.
- the controls have the ability, as designed, to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved.

Materiality with respect to the operating effectiveness of controls includes the consideration of both quantitative and qualitative factors, for example, the tolerable rate and observed rate of deviation (a quantitative matter) and the nature and cause of any observed deviations (a qualitative matter).

.A30 The concept of materiality is not applied when disclosing, in the description of the tests of controls, the results of those tests when deviations have been identified. This is because in the particular circumstances of a specific user entity or user auditor, a deviation may have significance beyond whether or not, in the opinion of the service auditor, it prevents a control from operating effectively. For example, the control to which the deviation relates may be particularly significant in preventing a certain type of error that may be material in the particular circumstances of a user entity's financial statements.

Obtaining an Understanding of the Service Organization's System and Assessing the Risk of Material Misstatement (Ref: par. .20 and .22)

.A31 Obtaining an understanding of the service organization's system, including related controls, assists the service auditor in the following:

- Identifying the boundaries of the system and how it interfaces with other systems

- Assessing whether management's description of the service organization's system fairly presents the service organization's system that has been designed and implemented
- Understanding which controls are necessary to achieve the control objectives stated in management's description of the service organization's system, whether controls were suitably designed to achieve those control objectives, and, in the case of a type 2 report, whether controls were operating effectively throughout the specified period to achieve those control objectives.
- When a separate type 1 or type 2 report exists for a subservice organization, whether management has identified controls that are necessary, either at the service organization or at user entities, to address relevant complementary user entity controls identified in the carved-out subservice organization's description of its system.

.A32 Paragraph .15a(viii) indicates that the criteria for assessing whether management's description of the service organization's system is fairly presented should include other aspects of the service organization's control environment, risk assessment process, information and communications (including relevant business processes), control activities, and monitoring activities that are relevant to the services provided. Although aspects of the service organization's control environment, risk assessment process, and monitoring activities may not be presented in the description in the context of control objectives, they may, nevertheless, be necessary to achieve the specified control objectives stated in the description. Likewise, deficiencies in these controls may have an effect on the service auditor's assessment of whether the controls, taken as a whole, were suitably designed or operating effectively to achieve the specified control objectives.

.A33 The service auditor's procedures to obtain the understanding may include the following:

- Inquiring of management and others within the service organization who, in the service auditor's judgment, may have relevant information
- Observing operations and inspecting documents, reports, and printed and electronic records of transaction processing
- Inspecting a selection of agreements between the service organization and user entities to identify their common terms
- Reperforming the application of a control

One or more of the preceding procedures may be accomplished through the performance of a walkthrough.

.A34 In a type 1 or type 2 engagement, the risk of material misstatement relates to the risk that, in all material respects, based on the criteria in management's assertion

- a. management's description of the service organization's system is not fairly presented;
- b. the controls are not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated effectively; and
- c. in the case of a type 2 report, the controls did not operate effectively throughout the specified period to achieve the related

control objectives stated in management's description of the service organization's system.

.A35 The risks identified in paragraph .A34 may include those related to new or changed controls, system changes, significant changes in processing volume, new personnel or significant changes in key management or personnel, new types of transactions, new products or technologies, or modifications to the service auditor's opinion in the service auditor's report for the prior year.

Reasonable Assurance (Ref: par. .25, .27-.28, and .33)

.A36 In a service auditor's examination engagement, the service auditor plans and performs the engagement to obtain reasonable assurance of detecting misstatements in management's description of the service organization's system and instances in which control objectives were not achieved. Absolute assurance is not attainable because of factors such as the need for judgment, the use of sampling, and the inherent limitations of controls at the service organization that affect whether the description is fairly presented and the controls are suitably designed and operating effectively to achieve the control objectives, and because much of the evidence available to the service auditor is persuasive, rather than conclusive, in nature. Also, procedures that are effective for detecting unintentional misstatements in the description, and instances in which control objectives were not achieved, may be ineffective for detecting misstatements in the description resulting from fraud and instances in which the control objectives were not achieved that are concealed through collusion between service organization personnel and a third party or among management or employees of the service organization. Therefore, the subsequent discovery of the existence of material misstatements in the description or instances in which control objectives were not achieved does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the service auditor.

Obtaining Evidence Regarding Management's Description of the Service Organization's System (Ref: par. .15a[vi] and .25-.26)

.A37 Considering the following questions may assist the service auditor in determining whether management's description of the service organization's system is fairly presented, in all material respects, based on the criteria in management's assertion:

- Is the description prepared at a level of detail that could reasonably be expected to provide a broad range of user auditors with sufficient information to obtain an understanding of internal control in accordance with AU-C section 402? The description need not address every aspect of the service organization's processing or the services provided to user entities and need not be so detailed that it would potentially enable a reader to compromise security or other controls at the service organization.
- Is the description prepared in a manner that does not omit or distort information that might affect the decisions of a broad range of user auditors, for example, does the description contain any significant omissions or inaccuracies regarding processing of which the service auditor is aware?
- Does the description include relevant details of changes to the service organization's system during the period covered by the description when the description covers a period of time?

- Have the controls identified in the description actually been implemented?
- If the inclusive method has been used, does the description separately identify controls at the service organization and controls at the subservice organization? Does the description include activities at the service organization that monitor the effectiveness of controls at the subservice organization?
- Are complementary user entity controls, if any, adequately described? In most cases, the control objectives stated in the description are worded so that they are capable of being achieved through the effective operation of controls implemented by the service organization alone. In some cases, however, the control objectives stated in the description cannot be achieved by the service organization alone because their achievement requires particular controls to be implemented by user entities. For example, to achieve the specified control objectives, a user entity may need to review the completeness and accuracy of input provided to the service organization before submitting it to the service organization or the completeness and accuracy of reports provided to the user entity subsequent to processing. When the description does include complementary user entity controls, the description separately identifies those controls, along with the specific control objectives that cannot be achieved by the service organization alone.
- If the carve-out method has been used, does the description identify the functions that are performed by the subservice organization? (When the carve-out method has been used, the description does not describe the detailed processing or controls at the subservice organization.) Does the description include activities at the service organization that monitor the effectiveness of controls at the subservice organization as well as complementary subservice organization controls?

.A38 The service auditor's procedures to evaluate the fair presentation of management's description of the service organization's system may include the following:

- Considering the nature of the user entities and how the services provided by the service organization are likely to affect them, for example, the predominant types of user entities, and whether the user entities are regulated by government agencies
- Reading contracts with user entities to gain an understanding of the service organization's contractual obligations
- Observing procedures performed by service organization personnel
- Reviewing the service organization's policy and procedure manuals and other documentation of the system, for example, flowcharts and narratives
- Performing walkthroughs of transactions through the service organization's system

.A39 Paragraph .25a requires the service auditor to evaluate whether the control objectives stated in management's description of the service organization's system are reasonable in the circumstances. Considering the following questions may assist the service auditor in this evaluation:

- Do the control objectives stated in the description relate to the types of assertions commonly embodied in the broad range of user entities' financial statements to which controls at the service organization could reasonably be expected to relate (for example, assertions about existence and accuracy that are affected by access controls that prevent or detect unauthorized access to the system)? Although the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements, the service auditor considers matters, such as the following, when identifying the types of assertions to which the controls are likely to relate:
 - The types of services provided by the service organization, including the classes of transactions processed
 - The contents of reports and other information prepared for user entities
 - The information used in the performance of procedures
 - The types of significant events other than transactions that occur in providing the services
 - Services performed by a subservice organization, if any
 - The responsibility of the service organization to implement controls, including responsibilities established in contracts and agreements with user entities
 - The risks to a user entity's internal control over financial reporting arising from information technology used or provided by the service organization
- Are the control objectives stated in the description complete? Although a complete set of control objectives can provide a broad range of user auditors with a framework to assess the effect of controls at the service organization on assertions commonly embodied in user entities' financial statements, the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements and cannot, therefore, determine whether control objectives are complete from the viewpoint of individual user entities or user auditors. It is the responsibility of individual user entities or user auditors to assess whether the service organization's description addresses the particular control objectives that are relevant to their needs. If the control objectives are specified by an outside party, including control objectives specified by law or regulation, the outside party is responsible for their completeness and reasonableness.

.A40 The service auditor's procedures to determine whether the system described by the service organization has been implemented may be similar to, and performed in conjunction with, procedures to obtain an understanding of that system. Other procedures that the service auditor may use in combination with inquiry of management and other service organization personnel include observation, inspection of records and other documentation, and reperformance of the manner in which transactions are processed through the system and controls are applied.

Obtaining Evidence Regarding the Design of Controls (Ref: par. .27)

.A41 The risks and control objectives identified in paragraph .27 encompass fraud and unintentional acts that threaten the achievement of the control objectives.

.A42 From the viewpoint of a user auditor, a control is suitably designed to achieve the control objectives stated in management's description of the service organization's system if individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that material misstatements are prevented, or detected and corrected. A service auditor, however, is not aware of the circumstances at individual user entities that would affect whether or not a misstatement is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is suitably designed if individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that the control objective(s) stated in the description of the service organization's system are achieved.

.A43 A service auditor may consider using flowcharts, questionnaires, or decision tables to facilitate understanding the design of the controls.

.A44 Controls may consist of a number of activities directed at the achievement of various control objectives. Consequently, if the service auditor evaluates certain activities as being ineffective in achieving a particular control objective, the existence of other activities may allow the service auditor to conclude that controls related to the control objective are suitably designed to achieve the control objective. (Ref: par. .27)

.A45 The service organization may have different controls in place to address each of the risks associated with the control objective; therefore, multiple controls may be needed in order for the service auditor to conclude on the design of controls relating to each of the risks associated with the control objective.

Obtaining Evidence Regarding the Operating Effectiveness of Controls (Ref: par. .15*b* and .28–.29)

.A46 From the viewpoint of a user auditor, a control is operating effectively if individually or in combination with other controls, it provides reasonable assurance that material misstatements are prevented, or detected and corrected. A service auditor, however, is not aware of the circumstances at individual user entities that would affect whether or not a misstatement resulting from a control deviation is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is operating effectively if, individually or in combination with other controls, it provides reasonable assurance that the control objectives stated in management's description of the service organization's system are achieved. Similarly, a service auditor is not in a position to determine whether any observed control deviation would result in a material misstatement from the viewpoint of an individual user entity.

.A47 Obtaining an understanding of controls sufficient to opine on the suitability of their design is not sufficient evidence regarding their operating effectiveness unless some automation provides for the consistent operation of the controls as they were designed and implemented. For example, obtaining information about the implementation of a manual control at a point in time does not provide evidence about operation of the control at other times. However, because of the inherent consistency of IT processing, performing procedures to determine the design of an automated application control and whether it has

been implemented may serve as evidence of that control's operating effectiveness, depending on the service auditor's assessment and testing of IT general controls such as those over program changes.

.A48 Evidence about the satisfactory operation of controls in prior periods does not provide evidence of the operating effectiveness of controls during the current period. The service auditor expresses an opinion on the effectiveness of controls throughout each period; therefore, sufficient appropriate evidence about the operating effectiveness of controls throughout the current period is required for the service auditor to express that opinion for the current period. Knowledge of modifications to the service auditor's report or deviations observed in prior engagements may, however, be considered in assessing risk and lead the service auditor to increase the extent of testing during the current period.

.A49 Generally, a type 2 report(s) is most useful to user entities and their auditors when it covers a substantial portion of the period covered by the user entity's financial statements being audited.

.A50 Determining the effect of changes in the service organization's controls that were implemented during the period covered by the service auditor's report involves gathering information about the nature and extent of such changes, how they affect processing at the service organization, and how they might affect assertions in the user entities' financial statements.

.A51 Certain controls may not leave evidence of their operation that can be tested at a later date and, accordingly, the service auditor may find it appropriate to test the operating effectiveness of such controls at various times throughout the reporting period.

Evaluating the Reliability of Information Produced by the Service Organization (Ref: par. .30)

.A52 The following are examples of information produced by a service organization that are commonly used by a service auditor:

- Population lists the service auditor uses to select a sample of items for testing
- Lists of data that have specific characteristics
- Exception reports
- Transaction reconciliations
- Documentation that provides evidence of the operating effectiveness of controls, such as user access lists
- System-generated reports
- Other system-generated data

Written Representations (Ref: par. .12 and .36–.38)

.A53 Written representations reaffirming the service organization's assertion about the effective operation of controls may be based on ongoing monitoring activities, separate evaluations, or a combination of the two.

.A54 In certain circumstances, a service auditor may obtain written representations from parties in addition to management of the service organization, such as those charged with governance.

.A55 The written representations required by paragraph .36 are separate from and in addition to the assertion that accompanies management's description of the service organization's system.

.A56 In addition to the written representations required by paragraph .36, the service auditor may consider it necessary to request other written representations.

.A57 If the service auditor is unable to obtain written representations regarding relevant control objectives and related controls at the subservice organization, management of the service organization may be able to use the carve-out method.

Other Information (Ref: par. .39, .40[iii], and .41[iii])

.A58 The other information referred to in paragraph .39 may include

- information provided by the service organization and included in a separate section of the type 1 or type 2 report, or
- information outside the type 1 or type 2 report included in a document that contains the service auditor's report. This other information may be provided by the service organization or another party.

Content of the Service Auditor's Report (Ref: par. .40 and .41)

.A59 Examples of service auditors' reports are presented in exhibit A of this section, and illustrative assertions by management of the service organization are presented in exhibit B.

.A60 The list of report elements in paragraphs .40 and .41 constitutes all the required report elements for a service auditor's type 2 and type 1 engagement, respectively, including the elements required by section 205.²⁹ Application guidance regarding the elements of a practitioner's examination report is included in section 205.³⁰ (Ref: par. .40)

.A61 The following is an example of the information required by paragraphs .40c(iv)(1) and .41c(iv)(1):

As indicated in the description, XYZ Service Organization uses a subservice organization for all of its computerized application processing. The description includes only the control objectives and related controls of XYZ Service Organization and excludes the control objectives and related controls of the subservice organization. The description also indicates that certain control objectives specified by XYZ Service Organization can be achieved only if complementary subservice organization controls assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with related controls at XYZ Service Organization. Our examination did not extend to controls of the subservice organization, and we have not evaluated the suitability of the design or operating effectiveness of such complementary subservice organization controls.

²⁹ Paragraphs .63–.66 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

³⁰ Paragraphs .A85–.A111 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

Description of the Service Auditor's Tests of Controls and the Results Thereof (Ref: par. .40k)

.A62 The service auditor may include in the description of tests of controls and results the procedures the service auditor performed to verify the completeness and accuracy of information provided by the service organization.

.A63 In describing the service auditor's tests of controls and results thereof for a type 2 report, it is helpful to readers if the service auditor's report includes information about causative factors for identified deviations, to the extent the service auditor has identified such factors.

.A64 When the work of the internal audit function has been used in performing tests of controls, the service auditor's description of that work and of the service auditor's procedures with respect to that work may be presented in a number of ways, for example

- by including introductory material to the description of tests of controls indicating that certain work of the internal audit function was used in performing tests of controls and describing the service auditor's procedures with regard to that work.
- by attributing individual tests to internal audit and describing the service auditor's procedures with regard to that work.

.A65 The work of the internal audit function referred to in paragraph .40k(v) does not include tests of controls performed by internal auditors as a part of direct assistance.

.A66 Other than the description of the work of the internal auditors referred to in paragraph .40k(v), the service auditor's report does not make any reference to the use of the work of the internal audit function to obtain evidence or to the use of internal auditors to provide direct assistance.

Use of the Service Auditor's Report (Ref: par. .40m and .41m)

.A67 Section 205 requires that the use of a practitioner's report be restricted to specified parties when the criteria used to evaluate or measure the subject matter are available only to specified parties or appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.³¹ The criteria used for engagements to report on controls at a service organization are relevant only for the purpose of providing information about the service organization's system, including controls, to those who have an understanding of how the system is used for financial reporting by user entities and, accordingly, the service auditor's report states that the report and the description of tests of controls are intended only for use by management of the service organization, user entities of the service organization ("during some or all of the period covered by the service auditor's report" for a type 2 report, and "as of the specified date" for a type 1 report), and their user auditors. (The illustrative reports in exhibit A of this section illustrate language for a paragraph restricting the use of the report.)

.A68 Section 205 indicates that the need for restriction on the use of a practitioner's report may result from a number of circumstances, including the potential for the report to be misunderstood when taken out of the context in

³¹ Paragraph .64b of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

which it was intended to be used, and the extent to which the procedures performed are known or understood.³²

.A69 Although the alert language in the service auditor's report restricts the use of the report, a service auditor is not responsible for controlling a service organization's distribution of a report. A service auditor may inform the service organization of the following:

- A service auditor's type 1 report is not intended for distribution to parties other than the service organization, user entities of the service organization's system as of the end of the period covered by the report, and their user auditors.
- A service auditor's type 2 report is not intended for distribution to parties other than the service organization, user entities of the service organization's system during some or all of the period covered by the report, and their user auditors.

.A70 A user entity is also considered a user entity of the service organization's subservice organizations if controls at subservice organizations are relevant to internal control over financial reporting of the user entity. In such case, the user entity is referred to as an *indirect* or *downstream* user entity of the subservice organization. Consequently, an indirect or downstream user entity may be included in the group to whom use of the service auditor's report is restricted if controls at the service organization are relevant to internal control over financial reporting of such indirect or downstream user entity.

.A71 In engagements in which the inclusive method is used, the users of a subservice organization's system that are not users of the service organization's system, are not *user entities*, as defined in paragraph .08.

.A72 In engagements in which the inclusive method is used, management of a subservice organization may be identified as a specified party and, if so, would be included in the alert language described in paragraphs .40m and .41m.

Modified Opinions (Ref: par. .42)

.A73 The AICPA Guide *Service Organizations: Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting* contains examples of elements of modified service auditor's reports.

Other Communication Responsibilities (Ref: par. .45)

.A74 Actions that a service auditor may take when the service auditor becomes aware of noncompliance with laws or regulations, fraud, or uncorrected misstatements at the service organization (after giving additional consideration to instances in which the service organization has not appropriately communicated this information to affected user entities, and the service organization refuses to do so) include the following:

- Obtaining legal advice about the consequences of different courses of action
- Communicating with those charged with governance of the service organization

³² Paragraph .A110 of section 205. [Footnote renumbered, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

- Disclaiming an opinion, modifying the service auditor's opinion, or adding a separate paragraph to the practitioner's report that describes the matter
- Communicating with third parties, for example, a regulator, when required to do so
- Withdrawing from the engagement
- Considering the nature of the user entities and how the services provided by the service organization are likely to affect them, for example, the predominant types of user entities, and whether the user entities are regulated by government agencies
- Reading contracts with user entities to gain an understanding of the service organization's contractual obligations
- Observing procedures performed by service organization personnel
- Reviewing the service organization's policy and procedure manuals and other documentation of the system, for example, flowcharts and narratives
- Performing walkthroughs of transactions through the service organization's system

.A75

Exhibit A — Illustrative Service Auditor's Reports

The following illustrative service auditor's reports contain text in **boldface italics** that would be added to the report if the situation described in the text is applicable. These illustrative reports are for guidance only and are not intended to be exhaustive or applicable to all situations. The inclusion of headings in the report may be useful but is not required by this section or section 205.¹ The AICPA Guide *Service Organizations: Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting* includes additional illustrative reports, including reports with modified opinions.

Example 1: Type 2 Service Auditor's Report

Independent Service Auditor's Report² on XYZ Service Organization's Description of Its [type or name of] System and the Suitability of the Design and Operating Effectiveness of Controls

To: XYZ Service Organization

Scope

We have examined XYZ Service Organization's description of its [type or name of] system entitled "XYZ Service Organization's Description of Its [type or name of] System" for processing user entities' transactions [or identification of the function performed by the system] throughout the period [date] to [date] (description) and the suitability of the design and operating effectiveness of the controls included in the description to achieve the related control objectives stated in the description, based on the criteria identified in "XYZ Service Organization's Assertion" (assertion). The controls and control objectives included in the description are those that management of XYZ Service Organization believes are likely to be relevant to user entities' internal control over financial reporting, and the description does not include those aspects of the [type or name of] system that are not likely to be relevant to user entities' internal control over financial reporting.

[A statement such as the following is added to the service auditor's report when information that is not covered by the report is included in the description of the service organization's system.]

The information included in [section number where the other information is presented], "Other Information Provided by XYZ Service Organization" is presented by management of XYZ Service Organization to provide additional information and is not a part of XYZ Service Organization's description of its [name or type of] system made available to user entities during the period [date] to [date]. Information about XYZ Service Organization's [describe the nature of the information, for example, business continuity planning, privacy practices, and so on] has not been subjected to the procedures applied in the examination of the description of the [name or type of] system and of the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description of the [name or type of] system.

¹ Paragraph .A82 of section 205.

² May also be "Report of Independent Service Auditors."

[A statement such as the following is added to the service auditor's report when the service organization uses a subservice organization, the carve-out method is used to present the subservice organization, and complementary subservice organization controls are required to meet the control objectives.]

XYZ Service Organization uses a subservice organization to [identify the function or service provided by the subservice organization]. The description includes only the control objectives and related controls of XYZ Service Organization and excludes the control objectives and related controls of the subservice organization. The description also indicates that certain control objectives specified by XYZ Service Organization can be achieved only if complementary subservice organization controls assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with the related controls at XYZ Service Organization. Our examination did not extend to controls of the subservice organization, and we have not evaluated the suitability of the design or operating effectiveness of such complementary subservice organization controls.

[A statement such as the following is added to the assertion when complementary user entity controls are required to meet the control objectives.]

The description indicates that certain control objectives specified in the description can be achieved only if complementary user entity controls assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with related controls at the service organization. Our examination did not extend to such complementary user entity controls, and we have not evaluated the suitability of the design or operating effectiveness of such complementary user entity controls.

Service Organization's Responsibilities

In [section number where the assertion is presented], XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and assertion, including the completeness, accuracy, and method of presentation of the description and assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria stated in the assertion, and designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description.

Service Auditor's Responsibilities

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description, based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, based on the criteria in management's assertion, the description is fairly presented and the controls were suitably designed and operating effectively to achieve the related control objectives stated in the description throughout the period [date] to [date]. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

An examination of a description of a service organization's system and the suitability of the design and operating effectiveness of controls involves

- performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description, based on the criteria in management's assertion.
- assessing the risks that the description is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives stated in the description.
- testing the operating effectiveness of those controls that management considers necessary to provide reasonable assurance that the related control objectives stated in the description were achieved.
- evaluating the overall presentation of the description, suitability of the control objectives stated in the description, and suitability of the criteria specified by the service organization in its assertion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

Inherent Limitations

The description is prepared to meet the common needs of a broad range of user entities and their auditors who audit and report on user entities' financial statements and may not, therefore, include every aspect of the system that each individual user entity may consider important in its own particular environment. Because of their nature, controls at a service organization may not prevent, or detect and correct, all misstatements in processing or reporting transactions [*or identification of the function performed by the system*]. Also, the projection to the future of any evaluation of the fairness of the presentation of the description, or conclusions about the suitability of the design or operating effectiveness of the controls to achieve the related control objectives, is subject to the risk that controls at a service organization may become ineffective.

Description of Tests of Controls

The specific controls tested and the nature, timing, and results of those tests are listed in [*section number where the description of tests of controls is presented*].

Opinion

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion

- a. the description fairly presents the [*type or name of*] system that was designed and implemented throughout the period [*date*] to [*date*].
- b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period [*date*] to [*date*] **and subservice organizations and user entities applied the complementary controls assumed in the design of XYZ Service Organization's controls throughout the period [*date*] to [*date*].**
- c. the controls operated effectively to provide reasonable assurance that the control objectives stated in the description were achieved

throughout the period [date] to [date] ***if complementary subservice organization and user entity controls assumed in the design of XYZ Service Organization's controls operated effectively throughout the period [date] to [date].***

Restricted Use

This report, including the description of tests of controls and results thereof in [section number where the description of tests of controls is presented], is intended solely for the information and use of management of XYZ Service Organization, user entities of XYZ Service Organization's [type or name of] system during some or all of the period [date] to [date], and their auditors who audit and report on such user entities' financial statements or internal control over financial reporting and have a sufficient understanding to consider it, along with other information, including information about controls implemented by user entities themselves, when assessing the risks of material misstatement of user entities' financial statements. This report is not intended to be, and should not be, used by anyone other than the specified parties.

[Service auditor's signature]

[City and state where the service auditor's report is issued]

[Date of the service auditor's report]

Example 2: Type 1 Service Auditor's Report

Independent Service Auditor's Report³ on XYZ Service Organization's Description of Its [type or name of] System and the Suitability of the Design of Controls

To: XYZ Service Organization

We have examined XYZ Service Organization's description of its [type or name of] system entitled, "XYZ Service Organization's Description of Its [type or name of] System," for processing user entities' transactions [or identification of the function performed by the system] as of [date] (description) and the suitability of the design of the controls included in the description to achieve the related control objectives stated in the description, based on the criteria identified in "XYZ Service Organization's Assertion" (assertion). The controls and control objectives included in the description are those that management of XYZ Service Organization believes are likely to be relevant to user entities' internal control over financial reporting, and the description does not include those aspects of the [type or name of] system that are not likely to be relevant to user entities' internal control over financial reporting.

[A statement such as the following is added to the service auditor's report when information that is not covered by the report is included in the description of the service organization's system.]

The information included in [section number where the other information is presented], "Other Information Provided by XYZ Service Organization," is presented by management of XYZ Service Organization to provide additional information and is not a part of XYZ Service Organization's description of its [name or type of] system made available to user entities as of [date]. Information about XYZ Service Organization's [describe the nature of the information, for example, business continuity planning, privacy practices, and so on] has not been subjected to the procedures applied in the examination of the description

³ May also be "Report of Independent Service Auditors."

of the [name or type of] system and of the suitability of the design of controls to achieve the related control objectives stated in the description of the [name or type of] system.

[A statement such as the following is added to the report when the service organization uses a subservice organization, the carve-out method is used to present the subservice organization, and complementary subservice organization controls are required to meet the control objectives.]

XYZ Service Organization uses a subservice organization to [identify the function or service provided by the subservice organization]. The description includes only the control objectives and related controls of XYZ Service Organization and excludes the control objectives and related controls of the subservice organization. The description also indicates that certain control objectives specified by XYZ Service Organization can be achieved only if complementary subservice organization controls assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with the related controls at XYZ Service Organization. Our examination did not extend to controls of the subservice organization, and we have not evaluated the design or operating effectiveness of such complementary subservice organization controls.

[A statement such as the following is added to the assertion when complementary user entity controls are required to meet the control objectives.]

The description indicates that certain control objectives specified in the description can be achieved only if complementary user entity controls assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with related controls at the service organization. Our examination did not extend to such complementary user entity controls, and we have not evaluated the suitability of the design or operating effectiveness of such complementary user entity controls.

Service Organization's Responsibilities

In [section number where assertion is presented], XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and its assertion, including the completeness, accuracy, and method of presentation of the description and assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria stated in the assertion, and designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description.

Service Auditor's Responsibilities

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design of the controls to achieve the related control objectives stated in the description, based on our examination.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, based on the criteria in management's assertion, the description is fairly presented and the controls were suitably designed to achieve the related

control objectives stated in the description as of [date]. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

An examination of a description of a service organization's system and the suitability of the design of controls involves

- performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design of the controls to achieve the related control objectives stated in the description, based on the criteria in management's assertion.
- assessing the risks that the description is not fairly presented and that the controls were not suitably designed to achieve the related control objectives stated in the description.
- evaluating the overall presentation of the description, suitability of the control objectives stated in the description, and suitability of the criteria specified by the service organization in its assertion.

We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

Inherent Limitations

The description is prepared to meet the common needs of a broad range of user entities and their auditors who audit and report on user entities' financial statements and may not, therefore, include every aspect of the system that each individual user entity may consider important in its own particular environment. Because of their nature, controls at a service organization may not prevent, or detect and correct, all misstatements in processing or reporting transactions [or *identification of the function performed by the system*]. Also, the projection to the future of any evaluation of the fairness of the presentation of the description, or conclusions about the suitability of the design of the controls to achieve the related control objectives, is subject to the risk that controls at a service organization may become ineffective.

Other Matter

We did not perform any procedures regarding the operating effectiveness of controls stated in the description and, accordingly, do not express an opinion thereon.

Opinion

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion

- a. the description fairly presents the [type or name of] system that was designed and implemented as of [date].
- b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively as of [date] **and subservice organizations and user entities applied the complementary controls assumed in the design of XYZ Service Organization's controls as of [date].**

Restricted Use

This report is intended solely for the information and use of management of XYZ Service Organization, user entities of XYZ Service Organization's [type or name of] system as of [date], and their auditors who audit and report on such user entities' financial statements or internal control over financial reporting and have a sufficient understanding to consider it, along with other

information, including information about controls implemented by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements. This report is not intended to be, and should not be, used by anyone other than the specified parties.

[Service auditor's signature]

[City and state where the service auditor's report is issued]

[Date of the service auditor's report]

[Revised, June 2022, to reflect conforming changes necessary due to the issuance of SSAE No. 21.]

.A76

Exhibit B — Illustrative Assertions by Management of a Service Organization

Paragraph .10b(vi) indicates that one of the preconditions for a service auditor to accept or continue an engagement is that management acknowledge and accept responsibility for providing a written assertion that accompanies management's description of the service organization's system. Paragraph .A18 indicates that the service organization has the option of attaching the assertion to the description of the service organization's system or including it in the description and clearly segregating the assertion from the description, for example, through the use of headings. Segregating the assertion from the description clarifies that the assertion is not part of the description.

The following illustrative management assertions contain text in boldface italics that would be added to management's assertion if the situation described in the text is applicable. These illustrative assertions are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Assertion by Management of a Service Organization for a Type 2 Report

XYZ Service Organization's Assertion

We have prepared the description of XYZ Service Organization's *[type or name of]* system entitled, "XYZ Service Organization's Description of Its *[type or name of]* System," for processing user entities' transactions *[or identification of the function performed by the system]* throughout the period *[date]* to *[date]* (description) for user entities of the system during some or all of the period *[date]* to *[date]*, and their auditors who audit and report on such user entities' financial statements or internal control over financial reporting and have a sufficient understanding to consider it, along with other information, ***including information about controls implemented by subservice organizations and user entities of the system themselves***, when assessing the risks of material misstatement of user entities' financial statements.

[A statement such as the following is added to the assertion when the service organization uses a subservice organization, the carve-out method is used to present the subservice organization, and complementary subservice organization controls are required to meet the control objectives.]

XYZ Service Organization uses a subservice organization to [identify the function or service provided by the subservice organization]. The description includes only the control objectives and related controls of XYZ Service Organization and excludes the control objectives and related controls of the subservice organization. The description also indicates that certain control objectives specified in the description can be achieved only if complementary subservice organization controls assumed in the design of our controls are suitably designed and operating effectively, along with the related controls at the service organization. The description does not extend to controls of the subservice organization.

[A statement such as the following is added to the service auditor's report when complementary user entity controls are required to meet the control objectives.]

The description indicates that certain control objectives specified in the description can be achieved only if complementary user entity controls

assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with related controls at the service organization. The description does not extend to controls of the user entities.

We confirm, to the best of our knowledge and belief, that

- a. the description fairly presents the [type or name of] system made available to user entities of the system during some or all of the period [date] to [date] for processing their transactions [or identification of the function performed by the system] as it relates to controls that are likely to be relevant to user entities' internal control over financial reporting. The criteria we used in making this assertion were that the description
 - i. presents how the system made available to user entities of the system was designed and implemented to process relevant user entity transactions, including, if applicable,
 - (1) the types of services provided, including, as appropriate, the classes of transactions processed.
 - (2) the procedures, within both automated and manual systems, by which those services are provided, including, as appropriate, procedures by which transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities of the system.
 - (3) the information used in the performance of the procedures including, if applicable, related accounting records, whether electronic or manual, and supporting information involved in initiating, authorizing, recording, processing, and reporting transactions; this includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities.
 - (4) how the system captures and addresses significant events and conditions other than transactions.
 - (5) the process used to prepare reports and other information for user entities.
 - (6) services performed by a subservice organization, if any, including whether the carve-out method or the inclusive method has been used in relation to them.
 - (7) the specified control objectives and controls designed to achieve those objectives, including, as applicable, complementary user entity controls and complementary subservice organization controls assumed in the design of the service organization's controls.
 - (8) other aspects of our control environment, risk assessment process, information and communications (including the related business processes), control activities, and monitoring activities that are relevant to the services provided.

- ii. includes relevant details of changes to the service organization's system during the period covered by the description.
 - iii. does not omit or distort information relevant to the service organization's system, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities of the system and their user auditors, and may not, therefore, include every aspect of the [type or name of] system that each individual user entity of the system and its auditor may consider important in its own particular environment.
- b. the controls related to the control objectives stated in the description were suitably designed and operating effectively throughout the period [date] to [date] to achieve those control objectives ***if subservice organizations and user entities applied the complementary controls assumed in the design of XYZ Service Organization's controls throughout the period [date] to [date].*** The criteria we used in making this assertion were that
- i. the risks that threaten the achievement of the control objectives stated in the description have been identified by management of the service organization.
 - ii. the controls identified in the description would, if operating effectively, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.
 - iii. the controls were consistently applied as designed, including whether manual controls were applied by individuals who have the appropriate competence and authority.

Example 2: Assertion by Management of a Service Organization for a Type 1 Report

XYZ Service Organization's Assertion

We have prepared the description of XYZ Service Organization's [type or name of] system entitled, "XYZ Service Organization's Description of Its [type or name of] System," for processing user entities' transactions [or identification of the function performed by the system] as of [date] (description) for user entities of the system as of [date], and their auditors who audit and report on such user entities' financial statements or internal control over financial reporting and have a sufficient understanding to consider it, along with other information, including information about controls ***implemented by subservice organizations and user entities themselves***, when obtaining an understanding of user entities' information and communication systems relevant to financial reporting.

[A statement such as the following is added to the assertion when the service organization uses a subservice organization, the carve-out method is used to present the subservice organization, and complementary subservice organization controls are required to meet the control objectives.]

XYZ Service Organization uses a subservice organization to [identify the function or service provided by the subservice organization]. The description includes only the control objectives and related controls of XYZ Service Organization and excludes the control objectives and related controls of the subservice organization(s). The description also indicates that certain control objectives specified in the description can

be achieved only if complementary subservice organization controls assumed in the design of our controls are suitably designed and operating effectively, along with the related controls at the service organization. The description does not extend to controls of the subservice organization.

[A statement such as the following is added to the service auditor's report when complementary user entity controls are required to meet the control objectives.]

The description indicates that certain control objectives specified in the description can be achieved only if complementary user entity controls assumed in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with related controls at the service organization. The description does not extend to controls of the user entities.

We confirm, to the best of our knowledge and belief, that

- a. the description fairly presents the [type or name of] system made available to user entities of the system as of [date] for processing their transactions [or identification of the function performed by the system] as it relates to controls that are likely to be relevant to user entities' internal control over financial reporting. The criteria we used in making this assertion were that the description
 - i. presents how the system made available to user entities of the system was designed and implemented to process relevant transactions, including, if applicable
 - (1) the types of services provided, including, as appropriate, the classes of transactions processed.
 - (2) the procedures, within both automated and manual systems, by which those services are provided, including, as appropriate, procedures by which transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities of the system.
 - (3) the information used in the performance of the procedures including, if applicable, related accounting records, whether electronic or manual, and supporting information involved in initiating, authorizing, recording, processing, and reporting transactions; this includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities.
 - (4) how the system captures and addresses significant events and conditions other than transactions.
 - (5) the process used to prepare reports and other information for user entities.
 - (6) services performed by a subservice organization, if any, including whether the carve-out method or the inclusive method has been used in relation to them.
 - (7) the specified control objectives and controls designed to achieve those objectives, including, as

applicable, complementary user entity controls and complementary subservice organization controls assumed in the design of the service organization's controls.

- (8) other aspects of our control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring activities that are relevant to the services provided.
 - ii. does not omit or distort information relevant to the service organization's system, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities of the system and their user auditors, and may not, therefore, include every aspect of the [type or name of] system that each individual user entity of the system and its auditor may consider important in its own particular environment.
 - b. the controls related to the control objectives stated in the description were suitably designed as of [date] to achieve those control objectives ***if subservice organizations and user entities applied the complementary controls assumed in the design of XYZ Service Organization's controls as of [date].*** The criteria we used in making this assertion were that
 - i. the risks that threaten the achievement of the control objectives stated in the description have been identified by management of the service organization.
 - ii. the controls identified in the description would, if operating effectively, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.
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AT-C Section 395****[Designated for AT Section 701,
Management's Discussion and Analysis]*****NOTE**

SSAE No. 18 does not supersede chapter 7, "Management's Discussion and Analysis," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, which is currently codified as AT section 701.

The Auditing Standards Board (ASB) has not clarified AT section 701 because practitioners rarely perform attest engagements to report on management's discussion and analysis prepared pursuant to the rules and regulations adopted by the U.S. Securities and Exchange Commission. Therefore, the ASB decided that it would retain AT section 701 in its current unclarified format as section 395 until further notice.

AT Section 701—Management's Discussion and Analysis

Source: SSAE No. 10.

Effective when management's discussion and analysis is for a period ending on or after June 1, 2001. Earlier application is permitted.

General

.01 This section sets forth attestation standards and provides guidance to a practitioner concerning the performance of an attest engagement¹ with respect to management's discussion and analysis (MD&A) prepared pursuant to the rules and regulations adopted by the Securities and Exchange Commission (SEC), which are presented in annual reports to shareholders and in other documents.²

Applicability

.02 This section is applicable to the following levels of service when a practitioner is engaged by (a) a public³ entity that prepares MD&A in accordance

* This section contains an "AT-C" identifier, instead of an "AT" identifier, to avoid confusion with references to existing "AT" sections, which remain effective through April 2017.

¹ Paragraph .01 of section 101, *Attest Engagements*, defines an attest engagement as one in which a practitioner "is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter (hereafter referred to as the *assertion*), that is the responsibility of another party."

² Because this section provides guidance specific to attest engagements concerning MD&A presentations, a practitioner should not perform a compliance attestation engagement under section 601, *Compliance Attestation*, with respect to an MD&A presentation.

³ For purposes of this section, a public entity is any entity (a) whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter (OTC) market, including securities quoted only locally or regionally, (b) that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b).

with the rules and regulations adopted by the SEC (see paragraph .04) or (b) a nonpublic entity that prepares an MD&A presentation and whose management provides a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC:⁴

- An examination of an MD&A presentation
- A review of an MD&A presentation for an annual period, an interim period, or a combined annual and interim period⁵

A practitioner⁶ engaged to examine or review MD&A and report thereon should comply with the general, fieldwork, and reporting standards established in section 50, *SSAE Hierarchy*, and the specific standards set forth in this section. A practitioner engaged to perform agreed-upon procedures on MD&A should follow the guidance set forth in section 201, *Agreed-Upon Procedures Engagements*.⁷ [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

.03 This section does not—

- a. Change the auditor's responsibility in an audit of financial statements performed in accordance with generally accepted auditing standards (GAAS).
- b. Apply to situations in which the practitioner is requested to provide management with recommendations to improve the MD&A rather than to provide assurance. A practitioner engaged to provide such nonattest services should refer to CS section 100, *Consulting Services: Definitions and Standards*.
- c. Apply to situations in which the practitioner is engaged to provide attest services with respect to an MD&A presentation that is prepared based on criteria other than the rules and regulations adopted by the SEC. A practitioner engaged to perform an examination or a review based upon such criteria should refer to the guidance in section 101, or to section 201 if engaged to perform an agreed-upon procedures engagement.⁸

⁴ Such assertion may be made by any of the following:

- (a) Including a statement in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC.
- (b) Providing a separate written assertion to accompany the MD&A presentation.
- (c) Providing a written assertion in a representation letter to the practitioner.

⁵ As discussed in paragraph .85*k*, a review report is not intended to be filed with the SEC as a report under the Securities Act of 1933 (the 1993 Act) or the Securities Exchange Act of 1934 (the 1934 Act) and, accordingly, the review report should contain a statement of restrictions on the use of the report to specified parties if the entity is (a) a public entity or (b) a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency.

⁶ In this section, the terms *practitioner* or *accountant* generally refer to a person engaged to perform an attest service on MD&A. The term *accountant* may also refer to a person engaged to review financial statements. The term *auditor* refers to a person engaged to audit financial statements. As this section includes certain requirements for the practitioner to have audited or performed a review of financial statements in accordance with AU-C section 930, *Interim Financial Information*, the terms *auditor*, *practitioner*, or *accountant* may refer, in this section, to the same person. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

⁷ Practitioners should follow guidance in AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, when requested to perform agreed-upon procedures on MD&A and report thereon in a letter for an underwriter. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

⁸ The guidance in this section may be helpful when performing an engagement to provide attest services with respect to an MD&A presentation that is based on criteria other than the rules and regulations adopted by the SEC. Such other criteria would have to be suitable and available as discussed in paragraphs .23–.33 of section 101.

.04 The requirements for MD&A have changed periodically since the first requirement was adopted by the SEC in 1974. As of the date of issuance of this SSAE, the rules and regulations for MD&A adopted by the SEC are found in Item 303 of Regulation S-K, as interpreted by Financial Reporting Release (FRR) No. 36, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures* (Chapter 5 of the "Codification of Financial Reporting Policies"); Item 303 of Regulation S-B for small business issuers; and Item 9 of Form 20-F for Foreign Private Issuers.⁹ Item 303 of Regulation S-K, as interpreted by FRR No. 36, Item 303 of Regulation S-B for small business issuers, and Item 9 of Form 20-F for Foreign Private Issuers, provide the relevant rules and regulations adopted by the SEC that meet the definition of suitable criteria in paragraphs .23–.32 of section 101. The practitioner should consider whether the SEC has adopted additional rules and regulations with respect to MD&A subsequent to the issuance of this section.

Conditions for Engagement Performance

Examination

.05 The practitioner's objective in an engagement to examine MD&A is to express an opinion on the MD&A presentation taken as a whole by reporting whether—

- a. The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC.¹⁰
- b. The historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements.¹¹
- c. The underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.¹²

.06 A practitioner may accept an engagement to examine MD&A of a public or nonpublic entity, provided the practitioner audits, in accordance with GAAS,¹³ the financial statements for at least the latest period to which the

⁹ The SEC staff from time to time issues guidance related to the SEC's adopted requirements; for example, Staff Accounting Bulletins (SABs), Staff Legal Bulletins, and speeches. Although such guidance may provide additional information with respect to the adopted requirements for MD&A, the practitioner should not be expected to attest to assertions on compliance with such guidance. The practitioner may find it helpful to also familiarize himself or herself with material contained on the SEC's website www.sec.gov that provides further information with respect to the SEC's views concerning MD&A disclosures.

¹⁰ The required elements as of the date of issuance of this SSAE include a discussion of the entity's financial condition, changes in financial condition, and results of operations, including a discussion of liquidity and capital resources.

¹¹ Whether historical financial amounts are accurately derived from the financial statements includes both amounts that are derived from the face of the financial statements (which includes the notes to the financial statements) and financial statement schedules and those that are derived from underlying records supporting elements, accounts, or items included in the financial statements.

¹² Whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein requires consideration of management's interpretation of the disclosure criteria for MD&A, management's determinations as to the relevancy of information to be included, and estimates and assumptions made by management that affect reported information.

¹³ Restrictions on the scope of the audit of the financial statements will not necessarily preclude the practitioner from accepting an engagement to examine MD&A. Note that the SEC will generally not accept an auditor's report that is modified for a scope limitation. The practitioner should consider the nature and magnitude of the scope limitation and the form of the auditor's report in assessing whether an examination of MD&A could be performed.

MD&A presentation relates and the financial statements for the other periods covered by the MD&A presentation have been audited by the practitioner or a predecessor auditor. A base knowledge of the entity and its operations gained through an audit of the historical financial statements and knowledge about the industry and the environment is necessary to provide the practitioner with sufficient knowledge to properly evaluate the results of the procedures performed in connection with the examination.

.07 If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A presentation, the practitioner (the successor auditor) should also consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for such period so that he or she would be able to—

- a. Identify types of potential material misstatements in MD&A and consider the likelihood of their occurrence.
- b. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the MD&A presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC.
- c. Perform the procedures that will provide the practitioner with a basis for expressing an opinion on the MD&A presentation with respect to whether the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements for such period.
- d. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.

Refer to paragraphs .99–.101 for guidance regarding the review of the predecessor auditor's working papers.

Review

.08 The objective of a review of MD&A is to report whether any information came to the practitioner's attention to cause him or her to believe that—

- a. The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.
- b. The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.
- c. The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

A review consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. A review ordinarily does not contemplate (a) tests of accounting records through inspection, observation, or confirmation, (b) obtaining corroborating evidential matter in response to inquiries, or (c) the application of certain other procedures ordinarily performed during an examination of MD&A. A review may bring to the practitioner's attention significant matters affecting the

MD&A, but it does not provide assurance that the practitioner will become aware of all significant matters that would be disclosed in an examination.

.09 A practitioner may accept an engagement to review the MD&A presentation of a public entity for an annual period provided the practitioner has audited, in accordance with GAAS, the financial statements for at least the latest annual period to which the MD&A presentation relates and the financial statements for the other periods covered by the MD&A presentation have been audited by the practitioner or a predecessor auditor.¹⁴ A base knowledge of the entity and its operations gained through an audit of the historical financial statements and knowledge about the industry and the environment is necessary to provide the practitioner with sufficient knowledge to properly evaluate the results of the procedures performed in connection with the review.

.10 If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A presentation, the practitioner should also consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for such period so he or she would be able to—

- a. Identify types of potential material misstatements in the MD&A and consider the likelihood of their occurrence.
- b. Perform the procedures that will provide the practitioner with a basis for reporting whether any information has come to the practitioner's attention to cause him or her to believe any of the following.
 - (1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.
 - (2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements for such period.
 - (3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

.11 A practitioner may accept an engagement to review the MD&A presentation of a public entity for an interim period provided that both of the following conditions are met.

- a. The practitioner performs either (1) a review of the historical financial statements for the related comparative interim periods and issues a review report thereon in accordance with AU-C section 930, *Interim Financial Information*, or (2) an audit of the interim financial statements.
- b. The MD&A presentation for the most recent fiscal year has been or will be examined or reviewed by either the practitioner or a predecessor auditor.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

¹⁴ As discussed in paragraph .85*k*, a review report is not intended to be filed with the SEC as a report under the 1933 Act or the 1934 Act and, accordingly, the review report should contain a statement of restrictions on the use of the report to specified parties if the entity is (a) a public entity or (b) a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency.

.12 If a predecessor auditor examined or reviewed the MD&A presentation of a public entity for the most recent fiscal year, the practitioner should not accept an engagement to review the MD&A presentation for an interim period unless he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for the interim period to perform the procedures described in paragraph .10.

.13 If a nonpublic entity chooses to prepare MD&A, the practitioner should not accept an engagement to perform a review of such MD&A for an annual period under this section unless both of the following conditions are met.

- a. The annual financial statements for the periods covered by the MD&A presentation have been or will be audited and the practitioner has audited or will audit the most recent year (refer to paragraph .07 if the financial statements for prior years were audited by a predecessor auditor).
- b. Management will provide a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC as the criteria. (See paragraph .02.)

.14 A practitioner may accept an engagement to review the MD&A presentation of a nonpublic entity for an interim period provided that all of the following conditions are met.

- a. The practitioner performs one of the following:
 - (1) A review of the historical financial statements for the related interim periods under the Statements on Standards for Accounting and Review Services (SSARs) and issues a review report thereon
 - (2) A review of the condensed interim financial information for the related interim periods under AU-C section 930 and issues a review report thereon, and such interim financial information is accompanied by complete annual financial statements for the most recent fiscal year that have been audited
 - (3) An audit of the interim financial statements
- b. The MD&A presentation for the most recent fiscal year has been or will be examined or reviewed.
- c. Management will provide a written assertion stating that the presentation has been prepared using the rules and regulations adopted by the SEC as the criteria. (See paragraph .02.)

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Engagement Acceptance Considerations

.15 In determining whether to accept an engagement, the practitioner should consider whether management (and others engaged by management to assist them, such as legal counsel) has the appropriate knowledge of the rules and regulations adopted by the SEC to prepare MD&A.

Responsibilities of Management

.16 Management is responsible for the preparation of the entity's MD&A pursuant to the rules and regulations adopted by the SEC. The preparation of MD&A in conformity with the rules and regulations adopted by the SEC

requires management to interpret the criteria, accurately derive the historical amounts from the entity's books and records, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information.

.17 An entity should not name the practitioner in a client-prepared document as having examined or reviewed MD&A unless the MD&A presentation and related practitioner's report and the related financial statements and auditor's (or accountant's review) report are included in the document (or, in the case of a public entity, incorporated by reference to such information filed with a regulatory agency). If such a statement is made in a document that does not include (or incorporate by reference) such information, the practitioner should request that neither his or her name nor reference to the practitioner be made with respect to the MD&A information, or that such document be revised to include the required presentations and reports. If the client does not comply, the practitioner should advise the client that he or she does not consent to either the use of his or her name or the reference to the practitioner, and he or she should consider what other actions might be appropriate.¹⁵

Obtaining an Understanding of the SEC Rules and Regulations and Management's Methodology for the Preparation of MD&A

.18 The practitioner should obtain an understanding of the rules and regulations adopted by the SEC for MD&A. (Refer to paragraph .04.)

.19 The practitioner should inquire of management regarding the method of preparing MD&A, including matters such as the sources of the information, how the information is gathered, how management evaluates the types of factors having a material effect on financial condition (including liquidity and capital resources), results of operations, and cash flows, and whether there have been any changes in the procedures from the prior year.

Timing of Procedures

.20 Proper planning by the practitioner contributes to the effectiveness of the attest procedures in an examination or a review of MD&A. Performing some of the work in conjunction with the audit of the historical financial statements or the review of interim financial statements may permit the work to be carried out in a more efficient manner and to be completed at an earlier date. When performing an examination or a review of MD&A, the practitioner may consider the results of tests of controls, analytical procedures,¹⁶ and substantive tests performed in a financial statement audit or analytical procedures and inquiries made in a review of financial statements or interim financial information.

¹⁵ In considering what other actions, if any, may be appropriate in these circumstances, the practitioner may wish to consult his or her legal counsel.

¹⁶ AU-C section 520, *Analytical Procedures*, defines analytical procedures as "evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount." In applying analytical procedures to MD&A, the practitioner develops expectations of matters that would be discussed in MD&A by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the client and of the industry in which the client operates, and the knowledge of relationships among the various financial elements gained through the audit of financial statements or review of interim financial information. Refer to AU-C section 520 for further discussion of analytical procedures. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Materiality

.21 The practitioner should consider the concept of materiality in planning and performing the engagement. The objective of an examination or a review is to report on the MD&A presentation taken as a whole and not on the individual amounts and disclosures contained therein. In the context of an MD&A presentation, the concept of materiality encompasses both material omissions (for example, the omission of trends, events, and uncertainties that are currently known to management that are reasonably likely to have material effects on the entity's financial condition, results of operations, liquidity, or capital resources) and material misstatements in MD&A, both of which are referred to herein as a misstatement. Assessing the significance of a misstatement of some items in MD&A may be more dependent upon qualitative than quantitative considerations. Qualitative aspects of materiality relate to the relevance and reliability of the information presented (for example, qualitative aspects of materiality are considered in assessing whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures in the MD&A). Furthermore, quantitative information is often more meaningful when accompanied by qualitative disclosures. For example, quantitative information about market risk-sensitive instruments is more meaningful when accompanied by qualitative information about an entity's market risk exposures and how those exposures are managed. Materiality is also a concept that is judged in light of the expected range of reasonableness of the information; therefore, users should not expect prospective information (information about events that have not yet occurred) to be as precise as historical information.

.22 In expressing an opinion, or providing the limited assurance of a review engagement, on the presentation, the practitioner should consider the omission or misstatement of an individual assertion (see paragraph .34) to be material if the magnitude of the omission or misstatement—individually or when aggregated with other omissions or misstatements—is such that a reasonable person using the MD&A presentation would be influenced by the inclusion or correction of the individual assertion. The relative rather than absolute size of an omission or misstatement may determine whether it is material in a given situation.

Inclusion of Pro Forma Financial Information

.23 Management may include pro forma financial information with respect to a business combination or other transactions in MD&A. The practitioner should consider the guidance in paragraph .10 of section 401, *Reporting on Pro Forma Financial Information*, when performing procedures with respect to such information, even if management indicates in MD&A that certain information has been derived from unaudited financial statements. For example, in an examination of MD&A, the practitioner's procedures would ordinarily include obtaining an understanding of the underlying transaction or event, discussing with management their assumptions, obtaining sufficient evidence in support of the adjustments, and other procedures for the purpose of expressing an opinion on the MD&A presentation taken as a whole and not for expressing an opinion on (or providing the limited assurance of a review of) the pro forma financial information included therein under section 401.

Inclusion of External Information

.24 An entity may also include in its MD&A information external to the entity, such as the rating of its debt by certain rating agencies or comparisons

with statistics from a trade association. Such external information should also be subjected to the practitioner's examination or review procedures. For example, in an examination, the practitioner might compare information concerning the statistics of a trade organization to a published source; however, the practitioner would not be expected to test the underlying support for the trade association's calculation of such statistics.

Inclusion of Forward-Looking Information

.25 An entity may include certain forward-looking disclosures in the MD&A presentation, including cautionary language concerning the achievability of the matters disclosed. Although any forward-looking disclosures that are included in the MD&A presentation should be subjected to the practitioner's examination or review, such information is subjected to testing only for the purpose of expressing an opinion that the underlying information, determinations, estimates, and assumptions provide a reasonable basis for the disclosures contained therein or providing the limited assurance of a review on the MD&A presentation taken as a whole. The practitioner may consider the guidance in section 301, *Financial Forecasts and Projections*, when performing procedures with respect to forward-looking information. The practitioner may also consider whether meaningful cautionary language has been included with the forward-looking information.

.26 Section 27A of the Securities Act of 1933 (the 1933 Act) and Section 21E of the Securities Exchange Act of 1934 (the 1934 Act) provide a safe harbor from liability in private litigation with respect to forward-looking statements that include or make reference to meaningful cautionary language. However, such sections also include exclusions from safe harbor protection in certain situations. Whether an entity's forward-looking statements and the practitioner's report thereon qualify for safe harbor protection is a legal matter.

Inclusion of Voluntary Information

.27 An entity may voluntarily include other information in the MD&A presentation that is not required by the rules and regulations adopted by the SEC for MD&A. When the entity includes in MD&A additional information required by other rules and regulations of the SEC (for example, Item 305 of Regulation S-K, *Quantitative and Qualitative Disclosures About Market Risk*), the practitioner should also consider such other rules and regulations in subjecting such information to his or her examination or review procedures.¹⁷

Examination Engagement

.28 To express an opinion about whether (a) the presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC, (b) the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements, and (c) the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein, the practitioner seeks to obtain reasonable assurance by accumulating sufficient evidence in support of the disclosures and assumptions, thereby restricting attestation risk to an appropriately low level.

¹⁷ To the extent that the voluntary information includes forward-looking information, refer to paragraphs .25–.26.

Attestation Risk

.29 In an engagement to examine MD&A, the practitioner plans and performs the examination to obtain reasonable assurance of detecting both intentional and unintentional misstatements that are material to the MD&A presentation taken as a whole. Absolute assurance is not attainable because of factors such as the need for judgment regarding the areas to be tested and the nature, timing, and extent of tests to be performed; the concept of selective testing of the data; and the inherent limitations of the controls applicable to the preparation of MD&A. The practitioner exercises professional judgment in assessing the significant determinations made by management as to the relevancy of information to be included, and the estimates and assumptions that affect reported information. As a result of these factors, in the great majority of cases, the practitioner has to rely on evidence that is persuasive rather than convincing. Also, procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery that a material misstatement exists in the MD&A does not, in and of itself, evidence (a) failure to obtain reasonable assurance; (b) inadequate planning, performance, or judgment on the part of the practitioner; (c) the absence of due professional care; or (d) a failure to comply with this section.

.30 Factors to be considered by the practitioner in planning an examination of MD&A include (a) the anticipated level of attestation risk related to assertions embodied in the MD&A presentation, (b) preliminary judgments about materiality for attest purposes, (c) the items within the MD&A presentation that are likely to require revision or adjustment, and (d) conditions that may require extension or modification of attest procedures. For purposes of an engagement to examine MD&A, the components of attestation risk are defined as follows.

- a. *Inherent risk* is the susceptibility of an assertion within MD&A to a material misstatement, assuming that there are no related controls. (See paragraphs .34–.38.)
- b. *Control risk* is the risk that a material misstatement that could occur in an assertion within MD&A will not be prevented or detected on a timely basis by the entity's controls; some control risk will always exist because of the inherent limitations of any internal control.
- c. *Detection risk* is the risk that the practitioner will not detect a material misstatement that exists in an assertion within MD&A.

Inherent Risk

.31 The level of inherent risk varies with the nature of the assertion. For example, the inherent risk concerning financial information included in the MD&A presentation may be low, whereas the inherent risk concerning the completeness of the disclosure of the entity's risks or liquidity may be high.

Control Risk

.32 The practitioner should assess control risk as discussed in paragraphs .53–.57. Assessing control risk contributes to the practitioner's evaluation of the risk that material misstatement in the MD&A exists. In the process of assessing control risk (together with assessing inherent risk), the practitioner may obtain evidential matter about the risk that such misstatement may exist. The practitioner uses this evidential matter as part of the reasonable basis for his or her opinion on the MD&A presentation taken as a whole.

Detection Risk

.33 In determining an acceptable level of detection risk, the practitioner assesses inherent risk and control risk, and considers the extent to which he or she seeks to restrict attestation risk. As assessed inherent risk or control risk decreases, the acceptable level of detection risk increases. Accordingly, the practitioner may alter the nature, timing, and extent of tests performed based on the assessments of inherent risk and control risk.

Nature of Assertions

.34 Assertions are representations by management that are embodied in the MD&A presentation. They can be either explicit or implicit and can be classified according to the following broad categories:

- a. Occurrence
- b. Consistency with the financial statements
- c. Completeness
- d. Presentation and disclosure

.35 Assertions about occurrence address whether reported transactions or events have occurred during a given period. Assertions about consistency with the financial statements address whether—

- a. Reported transactions, events, and explanations are consistent with the financial statements.
- b. Historical financial amounts have been accurately derived from the financial statements and related records.
- c. Nonfinancial data have been accurately derived from related records.

.36 Assertions about completeness address whether descriptions of transactions and events necessary to obtain an understanding of the entity's financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources are included in MD&A; and whether known events, transactions, conditions, trends, demands, commitments, or uncertainties that will result in or are reasonably likely to result in material changes to these items are appropriately described in the MD&A presentation.

.37 For example, if management asserts that the reason for an increase in revenues is a price increase in the current year, they are explicitly asserting that both an increase in revenues and a price increase have occurred in the current year, and implicitly asserting that any historical financial amounts included are consistent with the financial statements for such period. They are also implicitly asserting that the explanation for the increase in revenues is complete; that there are no other significant reasons for the increase in revenues.

.38 Assertions about presentation and disclosure address whether information included in the MD&A presentation is properly classified, described, and disclosed. For example, management asserts that any forward-looking information included in MD&A is properly classified as being based on management's present assessment and includes an appropriate description of the expected results. To further disclose the nature of such information, management may also include a statement that actual results in the future may differ materially from management's present assessment. (See paragraphs .25–.26.)

.39 The auditor of the underlying financial statements is responsible for designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion, as discussed in AU-C section 500, *Audit Evidence*. Although procedures designed to achieve the practitioner's objective of forming an opinion on the MD&A presentation taken as a whole may test certain assertions embodied in the underlying financial statements, the practitioner is not expected to test the underlying financial statement assertions in an examination of MD&A. For example, the practitioner is not expected to test the completeness of revenues or the existence of inventory when testing the assertions in MD&A concerning an increase in revenues or an increase in inventory levels; assurance related to completeness of revenues or for existence of inventory would be obtained as part of the audit. The practitioner is, however, responsible for testing the completeness of the explanation for the increase in revenues or the increase in inventory levels. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Performing an Examination Engagement

.40 The practitioner should exercise (a) due professional care in planning, performing, and evaluating the results of his or her examination procedures and (b) the proper degree of professional skepticism to obtain reasonable assurance that material misstatements will be detected.

.41 In an examination of MD&A, the practitioner should perform the following.

- a. Obtain an understanding of the rules and regulations adopted by the SEC for MD&A and management's method of preparing MD&A. (See paragraphs .18–.19.)
- b. Plan the engagement. (See paragraphs .42–.48.)
- c. Consider relevant portions of the entity's internal control applicable to the preparation of MD&A. (See paragraphs .49–.58.)
- d. Obtain sufficient evidence, including testing completeness. (See paragraphs .59–.64.)
- e. Consider the effect of events subsequent to the balance-sheet date. (See paragraphs .65–.66.)
- f. Obtain written representations from management concerning its responsibility for MD&A, completeness of minutes, events subsequent to the balance-sheet date, and other matters about which the practitioner believes written representations are appropriate. (See paragraphs .110–.112.)
- g. Form an opinion about whether the MD&A presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC, whether the historical financial amounts included therein have been accurately derived, in all material respects, from the entity's financial statements, and whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained in the MD&A. (See paragraph .67.)

Planning the Engagement

General Considerations

.42 Planning an engagement to examine MD&A involves developing an overall strategy for the expected scope and performance of the engagement.

When developing an overall strategy for the engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Knowledge of the entity's internal control applicable to the preparation of MD&A obtained during the audit of the financial statements and the extent of recent changes, if any
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The types of relevant information that management reports to external analysts (for example, press releases and presentations to lenders and rating agencies, if any, concerning past and future performance)
- How the entity analyzes actual performance compared to budgets and the types of information provided in documents submitted to the board of directors for purposes of the entity's day-to-day operations and long-range planning
- The extent of management's knowledge of and experience with the rules and regulations adopted by the SEC for MD&A
- If the entity is a nonpublic entity, the intended use of the MD&A presentation
- Preliminary judgments about (a) materiality, (b) inherent risk at the individual assertion level, and (c) factors (for example, matters identified during the audit or review of the historical financial statements) relating to significant deficiencies in internal control applicable to the preparation of MD&A (See paragraph .58.)
- The fraud risk factors or other conditions identified during the audit of the most recent annual financial statements and the practitioner's response to such risk factors
- The type and extent of evidential matter supporting management's assertions and disclosures in the MD&A presentation
- The nature of complex or subjective matters potentially material to the MD&A presentation that may require special skill or knowledge and whether such matters may require using the work of a specialist to obtain sufficient evidential matter (See paragraph .47.)
- The presence of an internal audit function (See paragraph .48.)

.43 In planning an engagement when MD&A has not previously been examined, the practitioner should consider the degree to which the entity has information available for such prior periods and the continuity of the entity's personnel and their ability to respond to inquiries with respect to such periods. In addition, the practitioner should obtain an understanding of the entity's internal control in prior years applicable to the preparation of MD&A.

Consideration of Audit Results

.44 The practitioner should also consider the results of the audits of the financial statements for the periods covered by the MD&A presentation on the examination engagement, such as matters relating to the following:

- The availability and condition of the entity's records
- The nature and magnitude of audit adjustments
- Misstatements¹⁸ that were not corrected in the financial statements that may affect MD&A disclosures (for example, misclassifications between financial statement line items)

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.45 The practitioner should also consider the possible impact on the scope of the examination engagement of any modification or contemplated modification of the auditor's report, including matters addressed in explanatory language. For example, if the auditor has modified the auditor's report to include a going-concern uncertainty explanatory paragraph, the practitioner would consider such a matter in assessing attestation risk.

Multiple Components

.46 In an engagement to examine MD&A, if the entity has operations in several components (for example, locations, branches, subsidiaries, or programs), the practitioner examining the group's MD&A should determine the components to which procedures should be applied. In making such a determination and in selecting the components to be tested, the practitioner examining the group's MD&A should consider factors such as the following:

- The relative importance of each component to the applicable disclosure in the group's MD&A
- The degree of centralization of records
- The effectiveness of controls, particularly those that affect group management's direct control over the exercise of authority delegated to others and its ability to supervise activities at various locations effectively
- The nature and extent of operations conducted at the various components
- The similarity of operations and internal control for different components

The practitioner examining the group's MD&A should consider whether the audit base of the components is consistent with the components that are disclosed in MD&A. Accordingly, it may be desirable for the practitioner examining the group's MD&A to coordinate the audit work with the components that will be disclosed. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Using the Work of a Specialist

.47 In some engagements to examine MD&A, the nature of complex or subjective matters potentially material to the MD&A presentation may require specialized skill or knowledge in a particular field other than accounting or auditing. For example, the entity may include information concerning plant production capacity, which would ordinarily be determined by an engineer. In

¹⁸ Refer to paragraphs .05–.06 and .11–.13 of AU-C section 320, *Materiality in Planning and Performing an Audit*, and paragraph .10 of AU-C section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

such cases, the practitioner may use the work of a specialist and should consider the relevant guidance in AU-C section 620, *Using the Work of an Auditor's Specialist*. An auditor's specialist may be either an auditor's internal specialist (for example, a partner of the auditor's firm) or an external specialist. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Internal Audit Function

.48 Another factor the practitioner should consider when planning the engagement is whether the entity has an internal audit function and the extent to which internal auditors are involved in directly testing the MD&A presentation, in monitoring the entity's internal control applicable to the preparation of MD&A, or in testing the underlying records supporting disclosures in the MD&A. A practitioner should consider the guidance in AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, when addressing the competence and objectivity of internal auditors; the nature, timing, and extent of work to be performed; and other related matters. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Consideration of Internal Control Applicable to the Preparation of MD&A

.49 The practitioner should obtain an understanding of the entity's internal control applicable to the preparation of MD&A sufficient to plan the engagement and to assess control risk. Generally, controls that are relevant to an examination pertain to the entity's objective of preparing MD&A in conformity with the rules and regulations adopted by the SEC, and may include controls within the control environment, risk assessment, information and communication, control activities, and monitoring components.

.50 The controls relating to operations and compliance objectives may be relevant to an examination if they pertain to data the practitioner evaluates or uses in applying examination procedures. For example, controls over the gathering of information, which are different from financial statement controls, and controls relating to nonfinancial data that are included in the MD&A presentation, may be relevant to an examination engagement.

.51 In planning the examination, knowledge of such controls should be used to identify types of potential misstatement (including types of potential material omissions), to consider factors that affect the risk of material misstatement and to design appropriate tests.

.52 A practitioner generally obtains an understanding of the design of the entity's internal control applicable to the preparation of MD&A by making inquiries of appropriate management, supervisory, and staff personnel; by inspection of the entity's documents; and by observation of the entity's relevant activities, including controls over matters discussed, nonfinancial data included, and management evaluation of the reasonableness of information included. The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the entity's complexity, the length of time that the entity has prepared MD&A pursuant to the rules and regulations adopted by the SEC, the practitioner's knowledge of the entity's controls obtained in audits and previous professional engagements, and judgments about materiality.

.53 After obtaining an understanding of the entity's internal control applicable to the preparation of MD&A, the practitioner assesses control risk for the assertions embodied in the MD&A presentation. (Refer to paragraphs .34–.39.) The practitioner may assess control risk at the maximum level (the greatest probability that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by an entity's controls) because the practitioner believes controls are unlikely to pertain to an assertion, are unlikely to be effective, or because evaluating their effectiveness would be inefficient. Alternatively, the practitioner may obtain evidential matter about the effectiveness of both the design and operation of a control that supports a lower assessed level of control risk. Such evidential matter may be obtained from tests of controls planned and performed concurrently with obtaining the understanding of the internal control or from procedures performed to obtain the understanding that were not specifically planned as tests of controls.

.54 After obtaining the understanding and assessing control risk, the practitioner may desire to seek a further reduction in the assessed level of control risk for certain assertions. In such cases, the practitioner considers whether evidential matter sufficient to support a further reduction is likely to be available and whether performing additional tests of controls to obtain such evidential matter would be efficient.

.55 When seeking to assess control risk below the maximum for controls over financial and nonfinancial data, the practitioner should perform tests of controls to obtain evidence to support the assessed level of control risk. For example, the practitioner may perform tests of controls directed toward the effectiveness of the design or operation of internal control over the accumulation of the number of units sold for a manufacturing company, average interest rates earned and paid for a financial institution, or average net sales per square foot for a retail entity.

.56 The practitioner uses the knowledge provided by the understanding of internal control applicable to the preparation of MD&A and the assessed level of control risk in determining the nature, timing, and extent of substantive tests for the MD&A assertions.

.57 The practitioner should document the understanding of the internal control components obtained to plan the examination and the assessment of control risk. The form and extent of this documentation is influenced by the size and complexity of the entity, as well as the nature of the entity's controls applicable to the preparation of MD&A.

.58 During the course of an engagement to examine MD&A, the practitioner may become aware of control deficiencies in the design or operation of controls applicable to the preparation of MD&A that could adversely affect the entity's ability to prepare MD&A in accordance with the rules and regulations adopted by the SEC. The practitioner should consider the implications of such control deficiencies on his or her ability to rely on management's explanations and on comparisons to summary accounting records. A practitioner's responsibility to communicate these control deficiencies in an examination of MD&A is similar to the auditor's responsibility described in AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*, and AU-C section 260, *The Auditor's Communication With Those Charged With Governance*. [Revised, March 2006, to reflect conforming changes necessary due to the issuance of SAS No. 112. Revised, January 2010, to reflect conforming changes necessary due to the issuance of SAS No. 115. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Obtaining Sufficient Evidence

.59 The practitioner should apply procedures to obtain reasonable assurance of detecting material misstatements. In an audit of historical financial statements, the practitioner will have applied audit procedures to some of the information included in the MD&A. However, because the objective of those audit procedures is to have a reasonable basis for expressing an opinion on the financial statements taken as a whole rather than on the MD&A, certain additional examination procedures should be performed as discussed in paragraphs .60–.64. Determining these procedures and evaluating the sufficiency of the evidence obtained are matters of professional judgment.

.60 The practitioner ordinarily should apply the following procedures.

- a. Read the MD&A and compare the content for consistency with the audited financial statements; compare financial amounts to the audited financial statements or related accounting records and analyses; recompute the increases, decreases, and percentages disclosed.
- b. Compare nonfinancial amounts to the audited financial statements, if applicable, or to other records. (Refer to paragraphs .62–.64.)
- c. Consider whether the explanations in MD&A are consistent with the information obtained during the audit; investigate further those explanations that cannot be substantiated by information in the audit working papers through inquiry (including inquiry of officers and other executives having responsibility for operational areas) and inspection of client records.
- d. Examine internally generated documents (for example, variance analyses, sales analyses, wage cost analyses, sales or service pricing sheets, and business plans or programs) and externally generated documents (for example, correspondence, contracts, or loan agreements) in support of the existence, occurrence, or expected occurrence of events, transactions, conditions, trends, demands, commitments, and uncertainties disclosed in the MD&A.
- e. Obtain available prospective financial information (for example, budgets; sales forecasts; forecasts of labor, overhead, and materials costs; capital expenditure requests; and financial forecasts and projections) and compare such information to forward-looking MD&A disclosures. Inquire of management as to the procedures used to prepare the prospective financial information. Evaluate whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the MD&A disclosures of events, transactions, conditions, trends, demands, commitments, or uncertainties.¹⁹
- f. Consider obtaining available prospective financial information relating to prior periods and comparing actual results with forecasted and projected amounts.
- g. Make inquiries of officers and other executives having responsibility for operational areas (such as sales, marketing, and production) and financial and accounting matters, as to their plans and

¹⁹ Refer to paragraph .26 for a discussion concerning the safe harbor rules for forward-looking statements.

expectations for the future that could affect the entity's liquidity and capital resources.

- h.* Consider obtaining external information concerning industry trends, inflation, and changing prices and comparing the related MD&A disclosures to such information.
- i.* Compare the information in MD&A with the rules and regulations adopted by the SEC and consider whether the presentation includes the required elements of such rules and regulations.
- j.* Read the minutes of meetings to date of the board of directors and other significant committees to identify matters that may affect MD&A; consider whether such matters are appropriately addressed in MD&A.
- k.* Inquire of officers as to the entity's prior experience with the SEC and the extent of comments received upon review of documents by the SEC; read correspondence between the entity and the SEC with respect to such review, if any.
- l.* Obtain public communications (for example, press releases and quarterly reports) and the related supporting documentation dealing with historical and future results; consider whether MD&A is consistent with such communications.
- m.* Consider obtaining other types of publicly available information (for example, analyst reports and news articles); compare the MD&A presentation with such information.

Testing Completeness

.61 The practitioner should design procedures to test the presentation for completeness, including tests of the completeness of explanations that relate to historical disclosures as discussed in paragraphs .36–.37. The practitioner should also consider whether the MD&A discloses matters that could significantly impact future financial condition and results of operations of the entity by considering information that he or she obtained through the following:

- a.* Audit of the financial statements
- b.* Inquiries of the entity's officers and other executives directed to current events, conditions, economic changes, commitments and uncertainties, within both the entity and its industry
- c.* Other information obtained through procedures such as those listed in paragraphs .60 and .65–.66

As discussed in paragraph .31, the inherent risk concerning the completeness of disclosures may be high; if it is, the practitioner may extend the procedures (for example, by making additional inquiries of management or by examining additional internally generated documents).

Nonfinancial Data

.62 Management may include nonfinancial data (such as units produced; the number of units sold, locations, or customers; plant utilization; or square footage) in the MD&A. The practitioner should consider whether the definitions used by management for such nonfinancial data are reasonable for the particular disclosure in the MD&A and whether there are suitable criteria (for example, industry standards with respect to square footage for retail operations), as discussed in paragraphs .23–.32 of section 101.

.63 In some situations, the nonfinancial data or the controls over the nonfinancial data may have been tested by the practitioner in conjunction with

the financial statement audit; however, the practitioner's consideration of the nature of the procedures to apply to nonfinancial data in an examination of MD&A is based on the concept of materiality with respect to the MD&A presentation. The practitioner should consider whether industry standards exist for the nonfinancial data or whether there are different methods of measurement that may be used, and, if such methods could result in significantly different results, whether the method of measurement selected by management is reasonable and consistent between periods covered by the MD&A presentation. For example, the number of customers reported by management could vary depending on whether management defines a customer as a subsidiary or "ship to" location of a company rather than the company itself.

.64 In testing nonfinancial data included in the MD&A, the practitioner may seek to assess control risk below the maximum for controls over such nonfinancial data, as discussed in paragraph .55. The practitioner weighs the increase in effort of the examination associated with the additional tests of controls that is necessary to obtain evidential matter against the resulting decrease in examination effort associated with the reduced substantive tests. For those nonfinancial assertions for which the practitioner performs additional tests of controls, the practitioner determines the assessed level of control risk that the results of those tests will support. This assessed level of control risk is used in determining the appropriate detection risk to accept for those nonfinancial assertions and, accordingly, in determining the nature, timing, and extent of substantive tests for such assertions.

Consideration of the Effect of Events Subsequent to the Balance-Sheet Date

.65 As there is an expectation by the SEC that MD&A considers events through a date at or near the filing date,²⁰ the practitioner should consider information about events²¹ that comes to his or her attention after the end of the period addressed by MD&A and prior to the issuance of his or her report that may have a material effect on the entity's financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources. Events or matters that should be disclosed in MD&A include those that—²²

- Are reasonably expected to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.
- Are reasonably likely to result in the entity's liquidity increasing or decreasing in any material way.
- Will have a material effect on the entity's capital resources.
- Would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.

²⁰ A registration statement under the 1933 Act speaks as of its effective date.

²¹ Such events are only referred to as *subsequent events* in relation to an MD&A presentation if they occur after the MD&A presentation has been issued. The annual MD&A presentation ordinarily would not be updated for subsequent events if an MD&A presentation for a subsequent interim period has been issued or the event has been reported through a filing on Form 8-K.

²² The practitioner should refer to the rules and regulations adopted by the SEC for other examples of events that should be disclosed.

The practitioner should consider whether events identified during the examination of the MD&A presentation or the audit of the related financial statements require adjustment to or disclosure in the MD&A presentation. When MD&A will be included or incorporated by reference in a 1933 Act document that is filed with the SEC, the practitioner's procedures should extend up to the filing date or as close to it as is reasonable and practicable in the circumstances.²³ If a public entity's MD&A presentation is to be included only in a filing under the 1934 Act (for example, Forms 10-K or 10-KSB), the practitioner's responsibility to consider subsequent events does not extend beyond the date of the report on MD&A. Paragraphs .94–.98 provide guidance when the practitioner is engaged subsequent to the filing of the MD&A presentation.

.66 In an examination of MD&A, the practitioner's fieldwork ordinarily extends beyond the date of the auditor's report on the related financial statements.²⁴ Accordingly, the practitioner generally should—

- a. Read available minutes of meetings of stockholders, the board of directors, and other appropriate committees; as to meetings for which minutes are not available, inquire about matters dealt with at such meetings.
- b. Read the latest available interim financial statements for periods subsequent to the date of the auditor's report, compare them with the financial statements for the periods covered by the MD&A, and inquire of and discuss with officers and other executives having responsibility for operational, financial, and accounting matters (limited where appropriate to major locations) matters such as the following:
 - Whether interim financial statements have been prepared on the same basis as the audited financial statements
 - Whether there were any significant changes in the entity's operations, liquidity, or capital resources in the subsequent period
 - The current status of items in the financial statements for which the MD&A has been prepared that were accounted for on the basis of tentative, preliminary, or inconclusive data
 - Whether any unusual adjustments were made during the period from the balance-sheet date to the date of inquiry
- c. Make inquiries of members of senior management as to the current status of matters concerning litigation, claims, and assessments identified during the audit of the financial statements and

²³ Additionally, if the practitioner's report on MD&A is included or incorporated by reference in a 1933 Act document, the practitioner should extend his or her procedures with respect to subsequent events from the date of his or her report on MD&A up to the effective date or as close thereto as is reasonable and practicable in the circumstances.

²⁴ Undertaking an engagement to examine MD&A does not extend the auditor's responsibility to update the subsequent events review procedures for the financial statements beyond the date of the auditor's report. However, see AU-C section 560, *Events and Subsequently Discovered Facts*. Also, see AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, as to an auditor's responsibility when his or her report is included in a registration statement filed under the 1933 Act. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

of any new matters or unfavorable developments. Consider obtaining updated legal letters from legal counsel.²⁵

- d. Consider whether there have been any changes in economic conditions or in the industry that could have a significant effect on the entity.
- e. Obtain written representations from appropriate officials as to whether any events occurred subsequent to the latest balance-sheet date that would require disclosure in the MD&A. (See paragraphs .110–.112.)
- f. Make such additional inquiries or perform such other procedures as considered necessary and appropriate to address questions that arise in carrying out the foregoing procedures, inquiries, and discussions.

Forming an Opinion

.67 The practitioner should consider the concept of materiality discussed in paragraphs .21–.22, and the impact of any modification of the auditor's report on the historical financial statements in forming an opinion on the examination of MD&A, including the practitioner's ability to evaluate the results of inquiries and other procedures.

Reporting

.68 In order for the practitioner to issue a report on an examination of MD&A, the financial statements for the periods covered by the MD&A presentation and the related auditor's report(s) should accompany the MD&A presentation (or, with respect to a public entity, be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency). In addition, if the entity is a nonpublic entity, one of the following conditions should be met.

- a. A statement should be included in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC.
- b. A separate written assertion should accompany the MD&A presentation or such assertion should be included in a representation letter obtained from the entity.

.69 The practitioner's report on an examination of MD&A should include the following:

- a. A title that includes the word *independent*
- b. An identification of the MD&A presentation, including the period covered
- c. A statement that management is responsible for the preparation of the MD&A pursuant to the rules and regulations adopted by the SEC, and a statement that the practitioner's responsibility is to express an opinion on the presentation based on his or her examination

²⁵ See paragraphs .16–.24 of AU-C section 501, *Audit Evidence—Specific Considerations for Selected Items*, for guidance concerning obtaining legal letters. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

- d. A reference to the auditor's report on the related financial statements, and if the report was other than a standard report, the substantive reasons therefor
- e. A statement that the examination was conducted in accordance with attestation standards established by the AICPA and a description of the scope of an examination of MD&A
- f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion
- g. A paragraph stating that—
 - (1) The preparation of MD&A requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information
 - (2) Actual results in the future may differ materially from management's present assessment of information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties
- h. If the entity is a nonpublic entity, a statement that, although the entity is not subject to the rules and regulations of the SEC, the MD&A presentation is intended to be a presentation in accordance with the rules and regulations adopted by the SEC
- i. The practitioner's opinion on whether—
 - (1) The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC
 - (2) The historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements
 - (3) The underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein
- j. The manual or printed signature of the practitioner's firm
- k. The date of the examination report

Appendix A [paragraph .114], "Examination Reports," includes a standard examination report. (See Example 1.)

Dating

.70 The practitioner's report on the examination of MD&A should be dated as of the completion of the practitioner's examination procedures. That date should not precede the date of the auditor's report on the latest historical financial statements covered by the MD&A.

Report Modifications

.71 The practitioner should modify the standard report described in paragraph .69, if any of the following conditions exist.

- The presentation excludes a material required element under the rules and regulations adopted by the SEC. (See paragraph .72.)

- The historical financial amounts have not been accurately derived, in all material respects, from the entity's financial statements. (See paragraph .72.)
- The underlying information, determinations, estimates, and assumptions used by management do not provide the entity with a reasonable basis for the disclosure in the MD&A. (See paragraph .72.)
- There is a restriction on the scope of the engagement. (See paragraph .73.)
- The practitioner decides to refer to the report of another practitioner as the basis in part for his or her report. (See paragraph .74.)
- The practitioner is engaged to examine the MD&A presentation after it has been filed with the SEC or other regulatory agency. (See paragraphs .94–.98.)

.72 The practitioner should express a qualified or an adverse opinion if (a) the MD&A presentation excludes a material required element, (b) historical financial amounts have not been accurately derived in all material respects, or (c) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures; for example, if there is a lack of consistency between management's method of measuring nonfinancial data between periods covered by the MD&A presentation. The basis for such opinion should be stated in the practitioner's report. Appendix A [paragraph .114] includes several examples of such modifications. (See Example 2.) Also refer to paragraph .107 for required communications with the audit committee.

.73 If the practitioner is unable to perform the procedures he or she considers necessary in the circumstances, the practitioner should modify the report or withdraw from the engagement. If the practitioner modifies the report, he or she should describe the limitation on the scope of the examination in an explanatory paragraph and qualify his or her opinion, or disclaim an opinion. However, limitations on the ability of the practitioner to perform necessary procedures could also arise because of the lack of adequate support for a significant representation in the MD&A. That circumstance may result in a conclusion that the unsupported representation constitutes a material misstatement of fact and, accordingly, the practitioner may qualify his or her opinion or express an adverse opinion, as described in paragraph .72.

Reference to Report of Another Practitioner

.74 If another practitioner examined the MD&A presentation of a component (refer to paragraph .46), the practitioner examining the group's MD&A may decide to make reference to such report of the component practitioner as a basis for his or her opinion on the group's consolidated MD&A presentation. The practitioner examining the group's MD&A should disclose this fact in the introductory paragraph of the report and should refer to the report of the component practitioner in expressing an opinion on the group's consolidated MD&A presentation. These references indicate (1) that the practitioner examining the group's MD&A is not taking responsibility for the work of the component practitioner, and (2) the source of the examination evidence with respect to those components for which reference to the examination of component practitioners is made. Appendix A [paragraph .114] provides an example of a report for such a situation. (See example 3.) Refer to paragraph .105 for guidance when the

other practitioner does not issue a report. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Emphasis of a Matter

.75 In a number of circumstances, the practitioner may wish to emphasize a matter regarding the MD&A presentation. For example, he or she may wish to emphasize that the entity has included information beyond the required elements of the rules and regulations adopted by the SEC. Such explanatory comments should be presented in a separate paragraph of the practitioner's report.

Review Engagement

.76 The objective of a review engagement, including a review of MD&A for an interim period, is to accumulate sufficient evidence to provide the practitioner with a basis for reporting whether any information came to the practitioner's attention to cause him or her to believe that (a) the MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, (b) the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements, or (c) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein. MD&A for an interim period may be a free-standing presentation or it may be combined with the MD&A presentation for the most recent fiscal year. Procedures for conducting a review of MD&A generally are limited to inquiries and analytical procedures, rather than also including search and verification procedures, concerning factors that have a material effect on financial condition, including liquidity and capital resources, results of operations, and cash flows. In a review engagement, the practitioner should—

- a. Obtain an understanding of the rules and regulations adopted by the SEC for MD&A and management's method of preparing MD&A. (See paragraphs .18–.19.)
- b. Plan the engagement. (See paragraph .77.)
- c. Consider relevant portions of the entity's internal control applicable to the preparation of the MD&A. (See paragraph .78.)
- d. Apply analytical procedures and make inquiries of management and others. (See paragraphs .79–.80.)
- e. Consider the effect of events subsequent to the balance-sheet date. The practitioner's consideration of such events in a review of MD&A is similar to the practitioner's consideration in an examination. (See paragraphs .65–.66.)
- f. Obtain written representations from management concerning its responsibility for MD&A, completeness of minutes, events subsequent to the balance-sheet date, and other matters about which the practitioner believes written representations are appropriate. (See paragraph .110.)
- g. Form a conclusion as to whether any information came to the practitioner's attention that causes him or her to believe any of the following.
 - (1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.

- (2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.
- (3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

Planning the Engagement

.77 Planning an engagement to review MD&A involves developing an overall strategy for the analytical procedures and inquiries to be performed. When developing an overall strategy for the review engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The types of relevant information that management reports to external analysts (for example, press releases or presentations to lenders and rating agencies concerning past and future performance)
- The extent of management's knowledge of and experience with the rules and regulations adopted by the SEC for MD&A
- If the entity is a nonpublic entity, the intended use of the MD&A presentation
- Matters identified during the audit or review of the historical financial statements relating to MD&A reporting, including knowledge of the entity's internal control applicable to the preparation of MD&A and the extent of recent changes, if any
- Matters identified during prior engagements to examine or review MD&A
- Preliminary judgments about materiality
- The nature of complex or subjective matters potentially material to the MD&A that may require special skill or knowledge
- The presence of an internal audit function and the extent to which internal auditors are involved in directly testing the MD&A presentation or underlying records

Consideration of Internal Control Applicable to the Preparation of MD&A

.78 To perform a review of MD&A, the practitioner needs to have sufficient knowledge of the entity's internal control applicable to the preparation of MD&A to—

- Identify types of potential misstatements in MD&A, including types of material omissions, and consider the likelihood of their occurrence.

- Select the inquiries and analytical procedures that will provide a basis for reporting whether any information causes the practitioner to believe the following.
 - The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, or the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.
 - The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

Application of Analytical Procedures and Inquiries

.79 The practitioner ordinarily would not obtain corroborating evidential matter of management's responses to the practitioner's inquiries in performing a review of MD&A. The practitioner should, however, consider the consistency of management's responses in light of the results of other inquiries and the application of analytical procedures. The practitioner ordinarily should apply the following analytical procedures and inquiries.

- a. Read the MD&A presentation and compare the content for consistency with the audited financial statements (or reviewed interim financial information if MD&A includes interim information); compare financial amounts to the audited or reviewed financial statements or related accounting records and analyses; recompute the increases, decreases, and percentages disclosed.
- b. Compare nonfinancial amounts to the audited (or reviewed) financial statements, if applicable, or to other records. (Refer to paragraph .80.)
- c. Consider whether the explanations in MD&A are consistent with the information obtained during the audit or the review of interim financial information; make further inquiries of officers and other executives having responsibility for operational areas as necessary.
- d. Obtain available prospective financial information (for example, budgets; sales forecasts; forecasts of labor, overhead, and materials costs; capital expenditure requests; and financial forecasts and projections) and compare such information to forward-looking MD&A disclosures. Inquire of management as to the procedures used to prepare the prospective financial information. Consider whether information came to the practitioner's attention that causes him or her to believe that the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures of trends, demands, commitments, events, or uncertainties.²⁶
- e. Make inquiries of officers and other executives having responsibility for operational areas (such as sales, marketing, and production) and financial and accounting matters, as to any plans and

²⁶ Refer to paragraph .26 for a discussion concerning the safe harbor rules for forward-looking statements.

expectations for the future that could affect the entity's liquidity and capital resources.

- f.* Compare the information in MD&A with the rules and regulations adopted by the SEC and consider whether the presentation includes the required elements of such rules and regulations.
- g.* Read the minutes of meetings to date of the board of directors and other significant committees to identify actions that may affect MD&A; consider whether such matters are appropriately addressed in the MD&A presentation.
- h.* Inquire of officers as to the entity's prior experience with the SEC and the extent of comments received upon review of documents by the SEC; read correspondence between the entity and the SEC with respect to such review, if any.
- i.* Inquire of management regarding the nature of public communications (for example, press releases and quarterly reports) dealing with historical and future results and consider whether the MD&A presentation is consistent with such communications.

.80 If nonfinancial data are included in the MD&A presentation, the practitioner should inquire as to the nature of the records from which such information was derived and observe the existence of such records, but need not perform other tests of such records beyond analytical procedures and inquiries of individuals responsible for maintaining them. The practitioner should consider whether such nonfinancial data are relevant to users of the MD&A presentation and whether such data are clearly defined in the MD&A presentation. The practitioner should make inquiries regarding whether the definition of the nonfinancial data was consistently applied during the periods reported.

.81 However, if the practitioner becomes aware that the presentation may be incomplete or contain inaccuracies, or is otherwise unsatisfactory, the practitioner should perform the additional procedures he or she deems necessary to achieve the limited assurance contemplated by a review engagement.

Reporting

.82 In order for the practitioner to issue a report on a review of MD&A for an annual period, the financial statements for the periods covered by the MD&A presentation and the related auditor's report(s) should accompany the MD&A presentation (or with respect to a public entity be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency).

.83 If the MD&A presentation relates to an interim period and the entity is a public entity, the financial statements for the interim periods covered by the MD&A presentation and the related accountant's review report(s) should accompany the MD&A presentation, or be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency. The comparative financial statements for the most recent annual period and the related MD&A should accompany the MD&A presentation for the interim period, or be incorporated by reference to information filed with a regulatory agency. Generally, the requirement for inclusion of the annual financial statements and related MD&A is satisfied by a public entity that has met its reporting responsibility for filing its annual financial statements and MD&A in its annual report on Form 10-K.

.84 If the MD&A presentation relates to an interim period and the entity is a nonpublic entity, the following documents should accompany the interim MD&A presentation in order for the practitioner to issue a review report:

- a. The MD&A presentation for the most recent fiscal year and related accountant's examination or review report(s)
- b. The financial statements for the periods covered by the respective MD&A presentations (most recent fiscal year and interim periods and the related auditor's report(s) and accountant's review report(s))

In addition, one of the following conditions should be met.

- A statement should be included in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC.
- A separate written assertion should accompany the MD&A presentation or such assertion should be included in a representation letter obtained from the entity.

.85 The practitioner's report on a review of MD&A should include the following:

- a. A title that includes the word *independent*
- b. An identification of the MD&A presentation, including the period covered
- c. A statement that management is responsible for the preparation of the MD&A pursuant to the rules and regulations adopted by the SEC
- d. A reference to the auditor's report on the related financial statements, and, if the report was other than a standard report, the substantive reasons therefor
- e. A statement that the review was conducted in accordance with attestation standards established by the AICPA
- f. A description of the procedures for a review of MD&A
- g. A statement that a review of MD&A is substantially less in scope than an examination, the objective of which is an expression of opinion regarding the MD&A presentation, and accordingly, no such opinion is expressed
- h. A paragraph stating that—
 - (1) The preparation of MD&A requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information
 - (2) Actual results in the future may differ materially from management's present assessment of information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties
- i. If the entity is a nonpublic entity, a statement that although the entity is not subject to the rules and regulations of the SEC, the MD&A presentation is intended to be a presentation in accordance with the rules and regulations adopted by the SEC

- j. A statement about whether any information came to the practitioner's attention that caused him or her to believe that—
 - (1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC
 - (2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements
 - (3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein
- k. If the entity is a public entity as defined in paragraph .02, or a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency (for example, certain offerings of securities under Rule 144A of the 1933 Act that purport to conform to Regulation S-K), a statement of restrictions on the use of the report to specified parties, because it is not intended to be filed with the SEC as a report under the 1933 Act or the 1934 Act.
- l. The manual or printed signature of the practitioner's firm
- m. The date of the review report

Appendix B [paragraph .115], "Review Reports," provides examples of a standard review report for an annual and interim period.

Dating

.86 The practitioner's report on the review of MD&A should be dated as of the completion of the practitioner's review procedures. That date should not precede the date of the accountant's report on the latest historical financial statements covered by the MD&A.

Report Modifications

.87 The practitioner should modify the standard review report described in paragraph .86 if any of the following conditions exist.

- The presentation excludes a material required element of the rules and regulations adopted by the SEC. (See paragraph .89.)
- The historical financial amounts have not been accurately derived, in all material respects, from the entity's financial statements. (See paragraph .89.)
- The underlying information, determinations, estimates, and assumptions used by management do not provide the entity with a reasonable basis for the disclosures in the MD&A. (See paragraph .89.)
- The practitioner decides to refer to the report of another practitioner as the basis, in part, for his or her report. (See paragraph .90.)
- The practitioner is engaged to review the MD&A presentation after it has been filed with the SEC or other regulatory agency. (See paragraphs .94–.98.)

.88 When the practitioner is unable to perform the inquiry and analytical procedures he or she considers necessary to achieve the limited assurance

provided by a review, or the client does not provide the practitioner with a representation letter, the review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report. If the practitioner is unable to complete a review because of a scope limitation, the practitioner should consider the implications of that limitation with respect to possible misstatements of the MD&A presentation. In those circumstances, the practitioner should also refer to paragraphs .107–.109 for guidance concerning communications with the audit committee.

.89 If the practitioner becomes aware that the MD&A is materially misstated, the practitioner should modify the review report to describe the nature of the misstatement. Appendix B [paragraph .115] contains an example of such a modification of the accountant's report. (See Example 3.)

.90 If another practitioner reviewed or examined the MD&A for a material component, the practitioner may decide to make reference to such report of the other practitioner in reporting on the consolidated MD&A presentation. Such reference indicates a division of responsibility for performance of the review.

Emphasis of a Matter

.91 In some circumstances, the practitioner may wish to emphasize a matter regarding the MD&A presentation. For example, he or she may wish to emphasize that the entity has included information beyond the required elements of the rules and regulations adopted by the SEC. Such explanatory comments should be presented in a separate paragraph of the practitioner's report.

Combined Examination and Review Report on MD&A

.92 A practitioner may be engaged both to examine an MD&A presentation as of the most recent fiscal year-end and to review a separate MD&A presentation for a subsequent interim period. If the examination and review are completed at the same time, a combined report may be issued. Appendix C [paragraph .116], "Combined Reports," contains an example of a combined report on an examination of an annual MD&A presentation and the review of a separate MD&A presentation for an interim period. (See Example 1.)

.93 If an entity prepares a combined MD&A presentation for annual and interim periods in which there is a discussion of liquidity and capital resources only as of the most recent interim period but not as of the most recent annual period, the practitioner is limited to performing the highest level of service that is provided with respect to the historical financial statements for any of the periods covered by the MD&A presentation. For example, if the annual financial statements have been audited and the interim financial statements have been reviewed, the practitioner may be engaged to perform a review of the combined MD&A presentation. Appendix C [paragraph .116] contains an example of a review report on a combined MD&A presentation for annual and interim periods. (See Example 2.)

When Practitioner Is Engaged Subsequent to the Filing of MD&A

.94 Management's responsibility for updating an MD&A presentation for events occurring subsequent to the issuance of MD&A depends on whether the entity is a public or nonpublic entity. A public entity is required to report significant subsequent events in a Form 8-K or Form 10-Q, or in a registration

statement; therefore, a public company would ordinarily not modify its MD&A presentation once it is filed with the SEC (or other regulatory agency).

.95 Therefore, if the practitioner is engaged to examine (or review) an MD&A presentation of a public entity that has already been filed with the SEC (or other regulatory agency), the practitioner should consider whether material subsequent events are appropriately disclosed in a Form 8-K or 10-Q, or a registration statement that includes or incorporates by reference such MD&A presentation. Refer to paragraphs .65–.66 for guidance concerning consideration of events up to the filing date when the practitioner's report on MD&A will be included (or incorporated by reference) in a 1933 Act document filed with the SEC that will require a consent.

.96 If subsequent events of a public entity are appropriately disclosed in a Form 8-K or 10-Q, or in a registration statement, or if there have been no material subsequent events, the practitioner should add the following paragraph to his or her examination or review report following the opinion or concluding paragraph, respectively.

The accompanying Management's Discussion and Analysis does not consider events that have occurred subsequent to Month XX, 20X6, the date as of which it was filed with the Securities and Exchange Commission.

.97 If there has been a material subsequent event that has not been disclosed in a manner described in paragraph .95 and if the practitioner determines that it is appropriate to issue a report even though the MD&A presentation has not been updated for such material subsequent event (for example, because the filing of the Form 10-Q that will disclose such events has not yet occurred), the practitioner should express a qualified or an adverse opinion (or appropriately modify the review report) on the MD&A presentation. As discussed in paragraph .107, if such material subsequent event is not appropriately disclosed, the practitioner should evaluate (a) whether to resign from the engagement related to the MD&A presentation and (b) whether to remain as the entity's auditor or stand for re-election to audit the entity's financial statements.

.98 Because a nonpublic entity is not subject to the filing requirements of the SEC, an MD&A presentation of a nonpublic entity should be updated for material subsequent events through the date of the practitioner's report.

When a Predecessor Auditor Has Audited Prior Period Financial Statements

.99 If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A, the need by the practitioner reporting on the MD&A for an understanding of the business and the entity's accounting and financial reporting practices for such prior period, as discussed in paragraph .07, is not diminished and the practitioner should apply the appropriate procedures. In applying the appropriate procedures, the practitioner may consider reviewing the predecessor auditor's working papers with respect to audits of financial statements and examinations or reviews of MD&A presentations for such prior periods.

.100 Information that may be obtained from the audit or attest working papers of the predecessor auditor will not provide a sufficient basis in itself for the practitioner to express an opinion with respect to the MD&A disclosures for such prior periods. If the practitioner has audited the current year, the results of such audit may be considered in planning and performing the examination

of MD&A and may provide evidential matter that is useful in performing the examination, including with respect to matters disclosed for prior periods. For example, an increase in salaries expense may be the result of an acquisition in the last half of the prior year. Auditing procedures applied to payroll expense in the current year that validate the increase as a result of the acquisition may provide evidential matter with respect to the increase in salaries expense in the prior year attributed to the acquisition.

.101 In addition to the procedures described in paragraphs .49–.66, the practitioner will need to make inquiries of the predecessor auditor and management as to audit adjustments proposed by the predecessor auditor that were not recorded in the financial statements.

Communications Between Predecessor and Successor Auditors

.102 If the practitioner is appointed as the successor auditor, he or she follows the guidance AU-C section 210A, *Terms of Engagement*, in considering whether or not to accept the engagement. If, at the time of the appointment as auditor, the practitioner is also being engaged to examine or review MD&A, the practitioner should also make specific inquiries of the predecessor auditor regarding MD&A. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.103 The practitioner's examination may be facilitated by (a) making specific inquiries of the predecessor regarding matters that the successor believes may affect the conduct of the examination (or review), such as areas that required an inordinate amount of time or problems that arose from the condition of the records, and (b) if the predecessor previously examined or reviewed MD&A, reviewing the predecessor's working papers for the predecessor's examination or review engagement.

.104 If, subsequent to his or her engagement to audit the financial statements, the practitioner is requested to examine MD&A, the practitioner should request the client to authorize the predecessor auditor to allow a review of the predecessor's audit working papers related to the financial statement periods included in the MD&A presentation. Although the practitioner may previously have had access to the predecessor auditor's working papers in connection with the successor's audit of the financial statements, ordinarily the predecessor auditor should permit the practitioner to review those audit working papers relating to matters that are disclosed or that would likely be disclosed in MD&A.

Another Auditor Audits a Significant Part of the Financial Statements

.105 When one or more component auditors audits a significant part of a group's financial statements, the practitioner²⁷ may request that the component auditor perform procedures with respect to the MD&A or the practitioner may perform the procedures directly with respect to such component(s).²⁸

²⁷ The practitioner serving as auditor of the group's financial statements is presumed to have an audit base for purposes of examining or reviewing the consolidated MD&A presentation. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

²⁸ The practitioner should consider whether he or she has sufficient industry expertise with respect to a subsidiary audited by a component auditor to take sole responsibility for the group's consolidated MD&A presentation. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Unless the component auditor issues an examination or review report on a separate MD&A presentation of such component(s) (see paragraph .74), the practitioner examining the group's MD&A should not make reference to the work of the component practitioner on MD&A in his or her report on MD&A.²⁹ Accordingly, if the practitioner examining the group's MD&A has requested such component auditor to perform procedures, the practitioner examining the group's MD&A should perform those procedures that he or she considers necessary to take responsibility for the work of the other auditor. Such procedures may include one or more of the following:

- a. Visiting the component auditor and discussing the procedures followed and the results thereof.
- b. Reviewing the working papers of the component auditor with respect to the component.
- c. Participating in discussions with the component's management regarding matters that may affect the preparation of the component's MD&A.
- d. Making supplemental tests with respect to such component.

The determination of the extent of the procedures to be applied by the practitioner examining the group's MD&A rests with that practitioner alone in the exercise of his or her professional judgment and in no way constitutes a reflection on the adequacy of the component auditor's work. Because the practitioner examining the group's MD&A in this case assumes responsibility for his or her opinion on the MD&A presentation without making reference to the procedures performed by the other auditor, the judgment of the practitioner examining the group's MD&A should govern as to the extent of procedures to be undertaken. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Responsibility for Other Information in Documents Containing MD&A

.106 A client may publish annual reports containing MD&A and other documents to which the practitioner, at the client's request, devotes attention. See paragraphs .91–.94 of section 101 for pertinent guidance in these circumstances. See Appendix D of this section [paragraph .117], "Comparison of Activities Performed Under SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, Versus a Review or an Examination Attest Engagement." The guidance in AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, is pertinent when the practitioner's report on MD&A is included in a registration statement, proxy statement, or periodic report filed under the federal securities statutes. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Communications With the Audit Committee

.107 If the practitioner concludes that the MD&A presentation contains material inconsistencies with other information included in the document

²⁹ This does not preclude the practitioner from referring to the component auditor's report on the financial statements in his or her report on the group's MD&A. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

containing the MD&A presentation or with the historical financial statements,³⁰ material omissions, or material misstatements of fact, and management refuses to take corrective action, the practitioner should inform the audit committee or others with equivalent authority and responsibility. If the MD&A is not revised, the practitioner should evaluate (a) whether to resign from the engagement related to the MD&A, and (b) whether to remain as the entity's auditor or stand for re-election to audit the entity's financial statements. The practitioner may wish to consult with his or her attorney when making these evaluations.

.108 If the practitioner is engaged after the MD&A presentation has been filed with the SEC (or other regulatory agency), and becomes aware that such MD&A presentation on file with the SEC (or other regulatory agency) has not been revised for a matter for which the practitioner has or would qualify his or her opinion, the practitioner should discuss such matter with the audit committee and request that the MD&A presentation be revised. If the audit committee fails to take appropriate action, the practitioner should consider whether to resign as the independent auditor of the company. The practitioner may consider paragraphs .21–.23 and .27 of AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, concerning communication with the audit committee and other considerations. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.109 If, as a result of performing an examination or a review of MD&A, the practitioner has determined that there is evidence that fraud may exist, that matter should be brought to the attention of an appropriate level of management. This is generally appropriate even if the matter might be considered clearly inconsequential. If the matter relates to the audited financial statements, the practitioner should consider the guidance in AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, concerning communication responsibilities, and the effect on the auditor's report on the financial statements. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Obtaining Written Representations

.110 In an examination or a review engagement, the practitioner should obtain written representations from management.³¹ The specific written representations obtained by the practitioner will depend on the circumstances of the engagement and the nature of the MD&A presentation. Specific representations should relate to the following matters:

- a. Management's acknowledgment of its responsibility for the preparation of MD&A and management's assertion that the

³⁰ See AU-C section 720B, *Other Information in Documents Containing Audited Financial Statements*, for guidance on the impact of material inconsistencies or material misstatements of fact on the auditor's report on the related historical financial statements. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

³¹ Paragraph .21 of AU-C section 580, *Written Representations*, requires that written representations be in the form of a representation letter addressed to the auditor. Paragraph .09b of AU-C section 925 requires the auditor to obtain updated written representations from management at or shortly before the effective date of the registration statement, about (a) whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified, and (b) whether any events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements. (See paragraph .65.) [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

MD&A presentation has been prepared in accordance with the rules and regulations adopted by the SEC for MD&A³²

- b. A statement that the historical financial amounts included in MD&A have been accurately derived from the entity's financial statements
- c. Management's belief that the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained in the MD&A
- d. A statement that management has made available all significant documentation related to compliance with SEC rules and regulations for MD&A
- e. Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors
- f. For a public entity, whether any communications from the SEC were received concerning noncompliance with or deficiencies in MD&A reporting practices
- g. Whether any events occurred subsequent to the latest balance-sheet date that would require disclosure in the MD&A
- h. If forward-looking information is included, a statement that—
 - The forward-looking information is based on management's best estimate of expected events and operations, and is consistent with budgets, forecasts, or operating plans prepared for such periods
 - The accounting principles expected to be used for the forward-looking information are consistent with the principles used in preparing the historical financial statements
 - Management has provided the latest version of such budgets, forecasts, or operating plans, and has informed the practitioner of any anticipated changes or modifications to such information that could affect the disclosures contained in the MD&A presentation
- i. If voluntary information is included that is subject to the rules and regulations adopted by the SEC (for example, information required by Item 305, *Quantitative and Qualitative Disclosures About Market Risk*), a statement that such voluntary information has been prepared in accordance with the related rules and regulations adopted by the SEC for such information
- j. If pro forma information is included, a statement that—
 - Management is responsible for the assumptions used in determining the pro forma adjustments
 - Management believes that the assumptions provide a reasonable basis for presenting all the significant effects directly attributable to the transaction or event, that the related pro forma adjustments give appropriate effect to those assumptions, and that the pro forma column reflects

³² Management should specify the SEC rules (for example, Item 303 of Regulation S-K, Item 303 of Regulation S-B, or Item 9 of Form 20-F). For nonpublic entities, the practitioner also obtains a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC. (See paragraph .02.)

the proper application of those adjustments to the historical financial statements

- Management believes that the significant effects directly attributable to the transaction or event are appropriately disclosed in the pro forma financial information

.111 In an examination, management's refusal to furnish written representations constitutes a limitation on the scope of the engagement sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause a practitioner to disclaim an opinion or withdraw from the examination engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate in an examination engagement. In a review engagement, management's refusal to furnish written representations constitutes a limitation of the scope of the engagement sufficient to require withdrawal from the review engagement. Further, the practitioner should consider the effects of the refusal on his or her ability to rely on other management representations.

.112 If the practitioner is precluded from performing procedures he or she considers necessary in the circumstances with respect to a matter that is material to the MD&A presentation, even though management has given representations concerning the matter, there is a limitation on the scope of the engagement, and the practitioner should qualify his or her opinion or disclaim an opinion in an examination engagement, or withdraw from a review engagement.

Effective Date

.113 This section is effective when management's discussion and analysis is for a period ending on or after June 1, 2001. Early application is permitted.

.114

Appendix A—Examination Reports

Example 1: Standard Examination Report

1. The following is an illustration of a standard examination report.

Independent Accountant's Report

[Introductory paragraph]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]*. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X5 and 20X4, and the related statements of income, changes in stockholder's equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the financial statements. In our report dated *[Month]* XX, 20X6, we expressed an unmodified opinion on those financial statements.³³

[Scope paragraph]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

³³ If prior financial statements were audited by other auditors, this sentence would be replaced by the following:

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X5, and the related statement of income, changes in stockholder's equity, and cash flows for the year then ended, and the related notes to the financial statements. In our report dated *[Month]* XX, 20X6, we expressed an unmodified opinion on those financial statements. The financial statements of XYZ Company; which comprise the balance sheet as of December 31, 20X4, and the related statement of income, changes in stockholder's equity, and cash flows for each of the years in the two-year period then ended, and the notes to the financial statements; were audited by other auditors, whose report dated *[Month]* XX, 20X5, expressed an unmodified opinion on those financial statements.

If the practitioner's opinion on the financial statements is based on the report of component auditors, this sentence would be replaced by the following:

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company which comprise the balance sheets as of December 31, 20X5 and 20X4, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the notes to the financial statements. In our report dated *[Month]* XX, 20X6, we expressed an unmodified opinion on those financial statements based on our audits and the report of component auditors.

Refer to Example 3 if the practitioner's opinion on MD&A is based on the report of another practitioner on a component of the entity. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[Explanatory paragraph] ³⁴

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraph]

In our opinion, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Signature]

[Date]

Example 2: Modifications to Examination Report for a Qualified Opinion

2. An example of a modification of an examination report for a qualified opinion due to a material omission described in paragraph .72 follows.

[Additional explanatory paragraph preceding the opinion paragraph]

Based on information furnished to us by management, we believe that the Company has excluded a discussion of the significant capital outlay required for its plans to expand into the telecommunications industry and the possible effects on the Company's financial condition, liquidity, and capital resources.

[Opinion paragraph]

In our opinion, except for the omission of the matter described in the preceding paragraph, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

3. An example of a modification of an examination report for a qualified opinion when overly subjective assertions are included in MD&A follows.

³⁴ The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69h:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

[Additional explanatory paragraph preceding the opinion paragraph]

Based on information furnished to us by management, we believe that the underlying information, determinations, estimates, and assumptions used by management do not provide the Company with a reasonable basis for the disclosure concerning *[describe]* in the Company's Management's Discussion and Analysis.

[Opinion paragraph]

In our opinion, except for the disclosure regarding *[describe]* discussed in the preceding paragraph, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

Example 3: Examination Report With Reference to the Report of Another Practitioner

4. The following is an illustration of an examination report indicating a division of responsibility with another practitioner, who has examined a separate MD&A presentation of a wholly-owned subsidiary, when the practitioner reporting is serving as the auditor of the related group's consolidated financial statements.

Independent Accountant's Report

[Introductory paragraphs]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]*. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We did not examine Management's Discussion and Analysis of ABC Corporation, a wholly-owned subsidiary, included in ABC Corporation's *[insert description of registration statement or document]*. Such Management's Discussion and Analysis was examined by other accountants, whose report has been furnished to us, and our opinion, insofar as it relates to information included for ABC Corporation, is based solely on the report of the other accountants.

We have audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated financial statements of XYZ Company, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows, for each of the years in the three-year period ended December 31, 20X5. In our report dated *[Month]* XX, 20X6, we expressed an unmodified opinion on those financial statements based on our audits and the report of other auditors.

[Scope paragraph]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test

basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination and the report of other accountants provide a reasonable basis for our opinion.

[Explanatory paragraph] ³⁵

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraph]

In our opinion, based on our examination and the report of other accountants, the Company's presentation of Management's Discussion and Analysis included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]* includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Signature]

[Date]

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

³⁵ The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

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Appendix B—Review Reports

Example 1: Standard Review Report on an Annual MD&A Presentation

1. The following is an illustration of a standard review report on an annual MD&A presentation.

Independent Accountant's Report

[Introductory paragraph]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X5 and 20X4, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5. In our report dated [*Month*] XX, 20X6, we expressed an unqualified opinion on those financial statements.

[Scope paragraph]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[Explanatory paragraph] ³⁶

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Concluding paragraph]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis

³⁶ The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .85i.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

*[Restricted use paragraph]*³⁷

This report is intended solely for the information and use of *[list or refer to specified parties]* and is not intended to be and should not be used by anyone other than the specified parties.

[Signature]

[Date]

Example 2: Standard Review Report on an Interim MD&A Presentation

2. The following is an illustration of a standard review report on an MD&A presentation for an interim period.

Independent Accountant's Report

[Introductory paragraph]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole included in the Company's *[insert description of registration statement or document]*. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 20X6 and 20X5, and for the three-month and six-month periods then ended, and have issued our report thereon dated July XX, 20X6.

[Scope paragraph]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

*[Explanatory paragraph]*³⁸

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of

³⁷ This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

³⁸ The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .85*i*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Concluding paragraph]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

*[Restricted use paragraph]*³⁹

This report is intended solely for the information and use of *[list or refer to specified parties]* and is not intended to be and should not be used by anyone other than the specified parties.

[Signature]

[Date]

Example 3: Modification to Review Report for a Material Misstatement

3. An example of a modification of the accountant's report when MD&A is materially misstated, as discussed in paragraph .89, follows.

[Additional explanatory paragraph preceding the concluding paragraph]

Based on information furnished to us by management, we believe that the Company has excluded a discussion of the significant capital outlay required for its plans to expand into the telecommunications industry and the possible effects on the Company's financial condition, liquidity, and capital resources.

[Concluding paragraph]

Based on our review, with the exception of the matter described in the preceding paragraph, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

³⁹ This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

Appendix C—Combined Reports

Example 1: Combined Examination and Review Report on MD&A

1. An example of a combined report on an examination of an annual MD&A presentation and the review of MD&A for an interim period discussed in paragraph .92 follows.

Independent Accountant's Report

[Introductory paragraph]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole for the three-year period ended December 31, 20X5, included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]*. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the annual presentation based on our examination. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company as of December 31, 20X5 and 20X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated *[Month]* XX, 20X6, we expressed an unqualified opinion on those financial statements.

[Scope paragraph]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

*[Explanatory paragraph]*⁴⁰

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

⁴⁰ The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

[Opinion paragraph]

In our opinion, the Company's presentation of Management's Discussion and Analysis for the three-year period ended December 31, 20X5, includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Paragraphs on interims]

We have also reviewed XYZ Company's Management's Discussion and Analysis taken as a whole for the six-month period ended June 30, 20X6 included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]*. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 20X6 and 20X5, and for the six-month periods then ended, and have issued our report thereon dated July XX, 20X6.

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis for the six-month period ended June 30, 20X6, does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's unaudited interim financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[Restricted use paragraph] ⁴¹

This report is intended solely for the information and use of *[list or refer to specified parties]* and is not intended to be and should not be used by anyone other than the specified parties.

[Signature]

[Date]

Example 2: Review Report on a Combined Annual and Interim MD&A Presentation

2. An example of a review report on a combined MD&A presentation for annual and interim periods follows.

⁴¹ This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

Independent Accountant's Report*[Introductory paragraph]*

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]*. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company as of December 31, 20X5 and 20X4, and for each of the years in the three-year period ended December 31, 20X5, and in our report dated *[Month]* XX, 20X6, we expressed an unqualified opinion on those financial statements. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 20X6 and 20X5, and for the six-month periods then ended, and have issued our report thereon dated July XX, 20X6.

[Scope paragraph]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[Explanatory paragraph] ⁴²

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Concluding paragraph]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in

⁴² The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

*[Restricted use paragraph]*⁴³

This report is intended solely for the information and use of *[list or refer to specified parties]* and is not intended to be and should not be used by anyone other than the specified parties.

[Signature]

[Date]

⁴³ This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

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Appendix D—Comparison of Activities Performed Under SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* [AU-C Section 720B], Versus a Review or an Examination Attest Engagement *

<i>Activities</i>	<i>SAS No. 118 (AU-C Section 720B)</i>	<i>Review</i>	<i>Examination</i>
Obtain an understanding of SEC rules and regulations and management's methodology for the preparation of Management's Discussion and Analysis (MD&A).	Not applicable (N/A)—Auditor is only required to read the information in the MD&A in order to identify material inconsistencies, if any, with the audited financial statements.	Obtain an understanding of the rules and regulations adopted by the SEC for MD&A. Inquire of management regarding the method of preparing MD&A.	Same as for a review.
Plan the engagement.	N/A	Develop an overall strategy for the analytical procedures and inquiries to be performed to provide negative assurance.	Develop an overall strategy for the expected scope and performance of the engagement to obtain reasonable assurance to express an opinion.
Consider internal control.	N/A	Consider relevant portions of the entity's internal control applicable to the preparation of MD&A to identify the types of potential misstatements and to select the inquiries and analytical procedures; no testing of controls would be performed.	Obtain an understanding of internal control applicable to the preparation of MD&A sufficient to plan the engagement and to assess control risk; controls may be tested by performing inquiries of client personnel, inspection of documents, and observation of relevant activities.

* Refer to AU-C section 720B, *Other Information in Documents Containing Audited Financial Statements*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

<i>Activities</i>	<i>SAS No. 118 (AU-C Section 720B)</i>	<i>Review</i>	<i>Examination</i>
Test assertions.	N/A	Apply the following analytical procedures and make inquiries of management and others; no corroborating evidential matter is obtained: ● Read the MD&A and compare the content for consistency with the financial statements; compare financial amounts to the financial statements or related accounting records and analyses; recompute increases, decreases and percentages disclosed. ● Compare nonfinancial amounts to the financial statements or other records. ● Consider whether MD&A explanations are consistent with information obtained during the audit or review of financial statements; make further inquiries, as necessary. (Note: Such additional inquiries may result in a decision to perform other procedures or detail tests.)	Apply the following analytical and corroborative procedures to obtain reasonable assurance of detecting material misstatements: ● Read the MD&A and compare the content for consistency with the financial statements; compare financial amounts to the financial statements or related accounting records and analyses; recompute increases, decreases and percentages disclosed. ● Compare nonfinancial amounts to the financial statements or other records; perform tests on other records based on the concept of materiality. ● Consider whether explanations are consistent with the information obtained during the audit of financial statements; investigate further explanations that cannot be substantiated by information in the audit working papers through inquiry and inspection of client records.

(continued)

Activities	SAS No. 118 (AU-C Section 720B)	Review	Examination
		● Compare information in MD&A with the rules and regulations adopted by the SEC. ● Obtain and read available prospective financial information; inquire of management as to the procedures used to prepare such information; consider whether information came to the practitioner's attention that causes him or her to believe that the underlying information, determinations, estimates, and assumptions do not provide a reasonable basis for the MD&A disclosures. ● Obtain public communications and minutes of meetings for comparison with disclosures in MD&A. ● Make inquiries of the officers or executives with responsibility for operational areas and financial and accounting matters as to their plans and expectations for the future.	● Examine internally and externally generated documents in support of the existence, occurrence, or expected occurrence of events, transactions, conditions, trends, demands, commitments, and uncertainties disclosed in MD&A. ● Compare information in MD&A with the rules and regulations adopted by the SEC. ● Obtain and read available prospective financial information; inquire of management as to the procedures used to prepare such information; evaluate whether the underlying information, determinations, estimates, and assumptions provide a reasonable basis for the MD&A disclosures.

<i>Activities</i>	<i>SAS No. 118 (AU-C Section 720B)</i>	<i>Review</i>	<i>Examination</i>
		● Inquire as to prior experience with the SEC and the extent of comments received; read correspondence. ● Consider whether there are any additional matters that should be disclosed in the MD&A based on the results of the preceding procedures and knowledge obtained during the audit or review of the financial statements.	● Obtain public communications and minutes of meetings; consider obtaining other types of publicly available information for comparison with the disclosures in MD&A. ● Make inquiries of the officers or executives with responsibility for operational areas and financial and accounting matters as to their plans and expectations for the future. ● Inquire as to prior experience with the SEC and the extent of comments received; read correspondence. ● Test completeness by considering the results of the preceding procedures and knowledge obtained during the audit of the financial statements, and whether such matters are appropriately disclosed in the MD&A; extend procedures if the inherent risk relating to completeness of disclosures is high.

(continued)

<i>Activities</i>	<i>SAS No. 118 (AU-C Section 720B)</i>	<i>Review</i>	<i>Examination</i>
Consider the effect of events subsequent to the balance-sheet date.	Yes	Yes	Yes
Obtain written representations from management.	Yes	Yes	Yes
Form a conclusion and report.	The auditor has no reporting responsibility with respect to MD&A unless the auditor concludes that there is a material inconsistency in the MD&A that has not been eliminated. In such a situation, the auditor may add an other matter paragraph to the auditor's report on the audited financial statements describing the material inconsistency or withhold the auditor's report. If, while reading the MD&A, the auditor becomes aware of an apparent material misstatement of fact, the auditor should discuss such matter with management and take other actions based on management's response.	Form a conclusion based on the results of the preceding procedures and report in the form of negative assurance.	Form an opinion based on the results of the preceding procedures and report conclusion by expressing an opinion.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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Exhibit

List of AT-C Sections Designated by Statement on Standards for Attestation Engagements No. 18, Attestation Standards: Clarification and Recodification, Cross Referenced to List of AT Sections

Part I—AT-C Section to AT Section Cross References

<i>AT-C Sections Designated by SSAE No. 18¹</i>		<i>AT Sections Superseded by SSAE No. 18</i>	
<i>AT-C Section</i>	<i>Title</i>	<i>AT Section</i>	<i>Title</i>
Preface	<i>Preface to the Attestation Standards</i>	Introduction	<i>Attestation Standards—Introduction</i>
100	Common Concepts		
105	<i>Concepts Common to All Attestation Engagements</i>	20	<i>Defining Professional Requirements in Statements on Standards for Attestation Engagements</i>
		50	<i>SSAE Hierarchy</i>
		101	<i>Attest Engagements</i>
200	Level of Service		
205	<i>Examination Engagements</i>	101	<i>Attest Engagements</i>
210	<i>Review Engagements</i>		
215	<i>Agreed-Upon Procedures Engagements</i>	201	<i>Agreed-Upon Procedures Engagements</i>

(continued)

¹ Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*, contains "AT-C" section numbers instead of "AT" section numbers to avoid confusion with references to existing "AT" sections, which remain effective through April 2017.

AT-C Sections Designated by SSAE No. 18		AT Sections Superseded by SSAE No. 18	
AT-C Section	Title	AT Section	Title
300	Subject Matter		
305 ²	Prospective Financial Information	301	Financial Forecasts and Projections
310	Reporting on Pro Forma Financial Information	401	Reporting on Pro Forma Financial Information
315	Compliance Attestation	601	Compliance Attestation
320	Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting	801	Reporting on Controls at a Service Organization
395	Management's Discussion and Analysis	701 ³	Management's Discussion and Analysis

² AT-C section 305, *Prospective Financial Information*, does not address compilations of prospective financial information—a service that is included in AT section 301, *Financial Forecasts and Projections*. Paragraph .01 of AR-C section 80A, *Compilation Engagements*, states that AR-C section 80A (which is applicable to compilations of historical financial statements) also may be applied, adapted as necessary in the circumstances, to other historical or prospective financial information. Footnote 1 of AR-C section 80A states that the Accounting and Review Services Committee plans to expose for public comment separate proposed Statements on Standards for Accounting and Review Services that would provide requirements and guidance to accountants with respect to compilation engagements on pro forma or prospective financial information.

³ The Auditing Standards Board did not clarify AT section 701, *Management's Discussion and Analysis*, because practitioners rarely perform attestation engagements to report on management's discussion and analysis prepared pursuant to the rules and regulations adopted by the SEC. AT section 701 will be retained in its current unclarified format as AT-C section 395, *Management's Discussion and Analysis*, until further notice.

Part II—AT Section to AT-C Section Cross References

<i>AT Sections Superseded by SSAE No. 18</i>		<i>AT-C Sections Designated by SSAE No. 18¹</i>	
<i>AT Section</i>	<i>Title</i>	<i>AT-C Section</i>	<i>Title</i>
20	<i>Defining Professional Requirements in Statements on Standards for Attestation Engagements</i>	105	<i>Concepts Common to All Attestation Engagements</i>
50	<i>SSAE Hierarchy</i>	105	<i>Concepts Common to All Attestation Engagements</i>
101	<i>Attest Engagements</i>	105	<i>Concepts Common to All Attestation Engagements</i>
		205	<i>Examination Engagements</i>
		210	<i>Review Engagements</i>
201	<i>Agreed-Upon Procedures Engagements</i>	215	<i>Agreed-Upon Procedures Engagements</i>
301	<i>Financial Forecasts and Projections</i>	305 ²	<i>Prospective Financial Information</i>
401	<i>Reporting on Pro Forma Financial Information</i>	310	<i>Reporting on Pro Forma Financial Information</i>
501	<i>An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements</i>		<i>Statement on Auditing Standards No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements, withdraws AT section 501³</i>

¹ Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*, contains "AT-C" section numbers instead of "AT" section numbers to avoid confusion with references to existing "AT" sections, which remain effective through April 2017.

² AT-C section 305, *Prospective Financial Information*, does not address compilations of prospective financial information—a service that is included in AT section 301, *Financial Forecasts and Projections*. Paragraph .01 of AR-C section 80A, *Compilation Engagements*, states that AR-C section 80A (which is applicable to compilations of historical financial statements) also may be applied, adapted as necessary in the circumstances, to other historical or prospective financial information. Footnote 1 of AR-C section 80A states that the Accounting and Review Services Committee plans to expose for public comment separate proposed Statements on Standards for Accounting and Review Services that would provide requirements and guidance to accountants with respect to compilation engagements on pro forma or prospective financial information.

³ The issuance of Statement on Auditing Standards (SAS) No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (AU-C sec. 940),

(continued)

AT Sections Superseded by SSAE No. 18		AT-C Sections Designated by SSAE No. 18	
AT Section	Title	AT-C Section	Title
601	Compliance Attestation	315	Compliance Attestation
701 ⁴	Management's Discussion and Analysis	395	Management's Discussion and Analysis
801	Reporting on Controls at a Service Organization	320	Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting

(footnote continued)

moves the content of AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, from the SSAEs to the SASs. SAS No. 130 was issued in October 2015 and becomes effective for integrated audits (audits of internal control over financial reporting that are integrated with audits of financial statements) for periods ending on or after December 15, 2016. Upon its effective date, SAS No. 130 withdraws SSAE No. 15, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, and related Attestation Interpretation No. 1, "Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act" (AT sec. 501 and 9501).

⁴ The Auditing Standards Board did not clarify AT section 701, *Management's Discussion and Analysis*, because practitioners rarely perform attestation engagements to report on management's discussion and analysis prepared pursuant to the rules and regulations adopted by the SEC. AT section 701 will be retained in its current unclarified format as AT-C section 395, *Management's Discussion and Analysis*, until further notice.

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AICPA Guides and Statements of Position

AICPA Guides

Attestation Engagements on Sustainability Information (Including Greenhouse Gas Emissions Information)

Prospective Financial Information

Reporting on an Entity's Cybersecurity Risk Management Program and Controls

Reporting on Controls at a Service Organization: Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy (SOC 2®)

Service Organizations: Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting

Statements of Position — Attestation

<i>Guidance to Practitioners in Conducting and Reporting on an Agreed-Upon Procedures Engagement to Assist Management in Evaluating the Effectiveness of Its Corporate Compliance Program</i>	5/99
<i>Performing Agreed-Upon Procedures Engagements That Address Internal Control Over Derivative Transactions as Required by the New York State Insurance Law</i>	6/01
<i>Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code</i>	5/02
<i>Attestation Engagements That Address Specified Compliance Control Objectives and Related Controls at Entities That Provide Services to Investment Companies, Investment Advisers, or Other Service Providers</i>	10/07
<i>Reporting Pursuant to the 2010 Edition of the Global Investment Performance Standards</i>	10/12
<i>Performing Agreed-Upon Procedures Engagements That Address the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information</i>	9/13
<i>Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936</i>	10/17
<i>Reporting Pursuant to the 2020 Global Investment Performance Standards</i>	1/20

AT-C Appendix B

Other Attestation Publications

This list identifies *other attestation publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate, as indicated in paragraph .A32 of section 105, *Concepts Common to All Attestation Engagements*. These publications may be obtained at <https://www.aicpa.org/cpe-learning>.

Technical Questions and Answers

Q&A section 9500, *Attestation Engagements*

AICPA Whitepapers

Whitepaper: *Materiality considerations for attestation engagements involving aspects of subject matters that cannot be quantitatively measured*¹

¹ This publication is available on the AICPA website at <https://us.aicpa.org/content/dam/aicpa/interestareas/frc/assuranceadvisoryservices/downloadabledocuments/auditdatastandards/materiality-considerations-for-attestation-engagements.pdf>.

AT-C Appendix C

*Schedule of Changes in Statements on Standards for Attestation Engagements**

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
105	.01	Amended by SSAE No. 21.	October 2020
105	.02–.03	Amended by SSAE No. 19.	December 2019
105	.02–.03	Added by SSAE No. 21.	October 2020
105	.04	Amended by SSAE No. 21.	October 2020
105	.09–.10	Amended by SSAE No. 19.	December 2019
105	.11–.14	Amended by SSAE No. 21.	October 2020
105	.25	Amended by SSAE No. 19.	December 2019
105	.26–.30	Amended by SSAE No. 21.	October 2020
105	.34	Amended by SSAE No. 21.	October 2020
105	.36	Added by SSAE No. 21.	October 2020
105	.45–.46	Amended by SSAE No. 21.	October 2020
105	.A1	Amended by SSAE No. 21.	October 2020
105	.A2–.A3	Amended by SSAE No. 19.	December 2019
105	.A7	Amended by SSAE No. 21.	October 2020
105	.A9–.A11	Amended by SSAE No. 21.	October 2020
105	.A13	Amended by SSAE No. 21.	October 2020
105	.A15–.A16	Amended by SSAE No. 21.	October 2020
105	.A27–.A31	Amended by SSAE No. 21.	October 2020
105	.A34	Amended by SSAE No. 21.	October 2020
105	.A35	Added by SSAE No. 19.	December 2019
105	.A37	Added by SSAE No. 19.	December 2019
105	.A39	Amended by SSAE No. 19.	December 2019
105	.A41	Amended by SSAE No. 19.	December 2019
105	.A36–.A45	Amended by SSAE No. 21.	October 2020
105	.A51–.A53	Amended by SSAE No. 21.	October 2020
105	.A56	Amended by SSAE No. 19.	December 2019
105	.A56–.A57	Amended by SSAE No. 21.	October 2020
105	.A59	Amended by SSAE No. 21.	October 2020
105	.A61–.A63	Amended by SSAE No. 21.	October 2020
105	.A66	Amended by SSAE No. 21.	October 2020
105	.A72	Amended by SSAE No. 21.	October 2020
105	.A76	Amended by SSAE No. 21.	October 2020

(continued)

* This table lists changes resulting from Statements on Standards for Attestation Engagements (SSAEs) issued subsequent to SSAE No. 18, *Attestation Standards: Clarification and Recodification*, which was issued in April 2016.

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
205	.A17	Amended by SSAE No. 20.	December 2019
205		Superseded by SSAE No. 21.	October 2020
206		Added by SSAE No. 21.	October 2020
210	.A16	Amended by SSAE No. 20.	December 2019
215		Superseded by SSAE No. 19	December 2019

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AUD Section

STATEMENTS OF POSITION—AUDITING AND ATTESTATION

Introduction

Auditing and Attestation Statements of Position (SOPs) are issued to achieve one or more of several objectives: to revise, clarify, or supplement guidance in previously issued Audit and Accounting Guides; to describe and provide implementation guidance for specific types of audit and attestation engagements; or to provide guidance on specialized areas in audit and attestation engagements.

Auditing SOPs

An auditing SOP is recognized as an interpretive publication as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Interpretive publications are recommendations on the application of generally accepted auditing standards (GAAS) in specific circumstances, including engagements for entities in specialized industries.

An interpretive publication is issued under the authority of the AICPA Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. The members of the ASB have found this SOP to be consistent with existing GAAS.

Although interpretive publications are not auditing standards, AU-C section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

Attestation SOPs

An attestation SOP is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of Statements on Standards for Attestation Engagements (SSAEs) in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive

publications are relevant to the proper application of the attestation standards in specific circumstances. If the practitioner does not apply the guidance included in this SOP, the practitioner should be prepared to explain how he or she complied with the SSAE provisions of this SOP.

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AUD Section 10***Statement of Position 92-8 Auditing
Property/Casualty Insurance Entities'
Statutory Financial Statements—Applying
Certain Requirements of the NAIC Annual
Statement Instructions*****October 1992****NOTE**

This AICPA Statement of Position (SOP) has been developed by the AICPA Insurance Companies Committee to provide guidance regarding the audit of property/casualty insurance entities' statutory financial statements in applying certain requirements of the National Association of Insurance Commissioners' Annual Statement Instructions.

This SOP is recognized as an interpretive publication as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Interpretive publications are recommendations on the application of generally accepted auditing standards (GAAS) in specific circumstances, including engagements for entities in specialized industries.

An interpretive publication is issued under the authority of the AICPA Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. The members of the ASB have found this SOP to be consistent with existing GAAS.

Although interpretive publications are not auditing standards, AU-C section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

Applicability

.01 This statement of position (SOP) provides guidance on the impact of certain requirements of the National Association of Insurance Commissioners' (NAIC's) Annual Statement Instructions—Property and Casualty on the auditor's procedures in the audit of statutory financial statements of property/casualty insurance entities.

Introduction

.02 The NAIC's Annual Statement Instructions direct property/casualty insurers to require their independent certified public accountants to subject the current Schedule P-Part 1 (excluding those amounts related to bulk and incurred-but-not-reported [IBNR] reserves and claim counts) to the auditing procedures applied in the audit of the current statutory financial statements to determine whether Schedule P-Part 1 is fairly stated in all material respects in relation to the basic statutory financial statements taken as a whole. Schedule P-Part 1 includes Part 1-Summary and Part 1A-1R.

.03 Although no separate report on Schedule P-Part 1 is required by the NAIC, the provisions of AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, and the provisions of this SOP apply when information in Schedule P-Part 1 is subjected to auditing procedures applied in the audit of the basic statutory financial statements. The requirements of this SOP do not preclude an auditor from issuing a report similar to those illustrated in paragraph .A17 of AU-C section 725. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Auditing Procedures

.04 Certain of the information in Schedule P-Part 1 is typically subjected to auditing procedures applied in the audit of the basic statutory financial statements (for example, premiums earned and losses paid). Other information not directly related to the basic statutory financial statements is also presented (for example, lines of business classifications for immaterial lines). Although such information may not have been subjected to auditing procedures applied in the audit of the basic statutory financial statements in all instances, such information may have been derived from accounting records that have been tested by the auditor.

.05 Paragraph .A5 of AU-C section 725 states that although an auditor has no obligation to apply auditing procedures to supplementary information presented outside the basic financial statements, the auditor may choose to modify or redirect certain of the procedures to be applied in the audit of the basic financial statements so that the auditor may express an opinion on the supplementary information in relation to the financial statements as a whole. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.06 Chapter 4, "The Loss Reserving and Claims Cycle," of the AICPA Audit and Accounting Guide *Property and Liability Insurance Entities* (the guide), addresses auditing the claims data base, and is applicable when applying auditing procedures to the information presented in Schedule P-Part 1. Chapter 4 also provides a comprehensive discussion of auditing loss reserves and the claims cycle. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.07 As stated in chapter 4 of the guide, because claim data and characteristics such as dates and types of loss can significantly influence reserve estimation, the auditor should test the completeness, accuracy, and classification of the claim loss data during the audit of the statutory financial statements. In

extending those procedures to Schedule P-Part 1, the auditor should determine that

- a. The data presented on Schedule P-Part 1 is properly reconciled to the statistical records of the company.
- b. Changes between the prior-year and current-year Schedule P-Part 1 are properly reconciled to the current-year audited statutory financial statements.
- c. The source of the data for the auditing procedures applied to the claim loss and loss adjustment expense data during the current calendar year (for example, tests of payments on claims for all accident years that were paid during the current calendar year) is the same as (or reconciles to) the statistical records that support the data presented on Schedule P-Part 1.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.08 If, as a result of the procedures performed during the audit of the statutory financial statements, the auditor concludes, on the basis of facts known to the auditor, that Schedule P-Part 1 is materially misstated in relation to the basic financial statements as a whole, the auditor should communicate to the company's management and the opining actuary that Schedule P-Part 1 is not fairly stated and should describe the misstatement. If the company will not agree to revise Schedule P-Part 1, the auditor should issue a report on Schedule P-Part 1 and should include a description of the misstatement in that report. (The auditor should refer to AU-C section 725 when a report will be issued.) The auditor should consider the impact of a misstatement in Schedule P-Part 1 on the auditor's report on the statutory financial statements. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Effective Date

.09 This SOP is effective for audits of statutory-basis financial statements of property/casualty insurance entities for periods ending after December 15, 1992.

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AUD Section 15

Statement of Position 99-1 Guidance to Practitioners in Conducting and Reporting on an Agreed-Upon Procedures Engagement to Assist Management in Evaluating the Effectiveness of Its Corporate Compliance Program

May 21, 1999

NOTE

This AICPA Statement of Position (SOP) has been developed by the AICPA Health Care Pilot Task Force of the AICPA Auditing Standards Board (ASB) to provide guidance regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to agreed-upon procedures attestation engagements performed to assist a health care provider in evaluating the effectiveness of its corporate compliance program consistent with the requirements of a Corporate Integrity Agreement entered into with the Office of Inspector General of the U.S. Department of Health and Human Services.

An attestation SOP is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive publications are relevant to the proper application of the attestation standards in specific circumstances.

Summary

This Statement of Position (SOP) provides guidance to practitioners in conducting and reporting on an agreed-upon procedures engagement performed pursuant to the AICPA Statements on Standards for Attestation Engagements (SSAEs) to assist a health care provider in evaluating the effectiveness of its corporate compliance program consistent with the requirements of a Corporate

Integrity Agreement (CIA) entered into with the Office of Inspector General (OIG) of the U.S. Department of Health and Human Services. CIAs are specific to the entity involved; consequently, users of this SOP should be familiar with the specific requirements of the entity's CIA.

Introduction and Background

.01 The health care industry has historically experienced a significant number and magnitude of allegations of fraud and abuse involving federal health care programs (for example, Medicare and Medicaid) and private health care insurance. Such allegations trigger regulatory scrutiny, litigation, significant monetary settlements, and negative publicity related to — among other things — coding and billing practices, patient referrals, cost reporting, quality of care, and clinical practices. Typically, as part of the global resolution of these allegations, the entity enters into a CIA with the OIG of the U.S. Department of Health and Human Services. Such agreements require that management annually report on its compliance with the terms of the CIA and that there be an assessment of the entity's compliance with the CIA. This assessment includes a billing analysis, which may be performed by an independent review organization (such as a practitioner or consultant) or the provider (if permitted by the OIG), and an agreed-upon procedures engagement. [Paragraph revised, June 2020, for clarity.]

.02 This SOP provides guidance to practitioners in conducting and reporting on an agreed-upon procedures engagement performed pursuant to the AICPA Statements on Standards for Attestation Engagements to assist an entity in evaluating the effectiveness of its corporate compliance program consistent with the requirements of a CIA.¹ The terms of a CIA are unique to the entity; consequently, users of this SOP need to be familiar with the actual CIA and its requirements.

.03 This SOP applies to agreed-upon procedures engagements to assist in evaluating an entity's compliance for a specified period. The practitioner should perform such engagements in accordance with the paragraphs in AT-C section 315, *Compliance Attestation*, that address agreed-upon procedures engagements related to compliance (applicable paragraphs in AT-C section 315). The engagement should be conducted in accordance with standards established by the AICPA, including the criteria set forth in this SOP. However, this SOP is not intended to provide all the required criteria set forth in individual CIAs, nor all the applicable standards established by the AICPA. Additionally, the SOP contains some guidance that may be applied in evaluating an organization's corporate compliance program, even though the program was not imposed by a CIA. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Overview of a Typical Corporate Integrity Agreement

.04 A CIA is an agreement between a health care provider and the OIG in conjunction with a global settlement of a fraud investigation. Such an

¹ The practitioner also might be engaged to assist in other areas beyond an agreed-upon procedures engagement such as providing consulting services in connection with evaluating the company's billing practices, policies, and procedures as required by the CIA or in implementing, assessing, and reporting on voluntarily adopted compliance programs. In addition, the practitioner may assist in preparing an entity's self-disclosure reports to federal health agencies related to billing errors and other compliance matters. Similarly, practitioners may be involved in an entity's preparation of government-required (but not CIA-imposed) compliance reporting (for example, contract requirements for Medicare part C) beyond an agreed-upon procedures engagement.

agreement typically seeks to establish a compliance program within the health care provider (for example, hospital, clinical lab, physician group) that will promote compliance with the requirements of Medicare, Medicaid, and all other federal health care programs.

.05 CIAs are case-specific. Their terms are tailored to address the organizational and operating deficiencies related to providing and billing for health care services that have been identified by the OIG, the entity, or others. Detailed compliance requirements are imposed as a condition for continued participation in federal health care programs. A sample CIA, provided by the OIG and intended to identify potential requirements, is included in appendix A (paragraph .33), "Sample Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and [Provider]." Typical agreements cover five years and require the entity to address the following areas:

- Appointment of a compliance officer and establishment of a compliance committee
- Establishment of a code of conduct
- Establishment of policies and procedures regarding the compliance program
- Development of an information and education program as to the CIA requirements, compliance program, and code of conduct
- Annual assessment of billing policies, procedures, and practices
- Establishment of a confidential disclosure program
- Prohibition of employment of excluded or convicted persons
- Notification to OIG of investigation or legal proceedings
- Reporting of credible evidence of misconduct
- Notifications to OIG of new provider locations
- Provision of implementation and annual reports
- Proper notification and submission of required reports
- Granting of OIG access to documents and individuals to conduct assessments
- Documentation of record retention requirements
- Awareness of disclosure criteria
- Agreement to comply with certain default provisions, penalties, and remedies
- Review of rights as to dispute resolution
- Review of effective and binding agreement clauses

Conditions for Engagement Performance

.06 A practitioner may perform an agreed-upon procedures engagement related to management's compliance with a CIA if all of the conditions specified in AT-C section 105, *Concepts Common to all Attestation Engagements*, AT-C section 215, *Agreed-Upon Procedures Engagements*, and AT-C section 315 are met. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, for clarity.]

.07 For the purposes of this SOP, the responsible party is management of the entity. Management is responsible for ensuring that the entity complies with the requirements of the CIA. That responsibility encompasses (a) identifying applicable compliance requirements, (b) establishing and maintaining internal control policies and procedures to provide reasonable assurance that the entity complies with those requirements, (c) evaluating and monitoring the entity's compliance, and (d) preparing reports that satisfy legal, regulatory, or contractual requirements. Management's evaluation may include documentation such as accounting or statistical data, policy manuals, accounting manuals, narrative memoranda, procedural write-ups, flowcharts, completed questionnaires, internal auditors' reports, and other special studies or analyses. The form and extent of documentation will vary depending on the nature of the compliance requirements and the size and complexity of the entity. Management may engage the practitioner to gather information to assist it in evaluating the entity's compliance. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Agreeing on the Terms of the Engagement

.08 Paragraph .14 of AT-C section 215 requires the practitioner to agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. The agreement should include the following items:

- a. The nature of the engagement
- b. Identification of the subject matter and the responsible party
- c. The responsibilities of the practitioner
- d. A statement that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants
- e. A statement that management of the entity is responsible for the subject matter
- f. A statement that the engaging party agrees to provide the practitioner, prior to the completion of the engagement, with a written agreement and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement
- g. A statement that the engaging party agrees to provide, at the conclusion of the engagement, a representation letter
- h. Reference to the expected form and content of the practitioner's agreed-upon procedures report, including any use restrictions, if applicable
- i. Disclaimers expected to be included in the practitioner's report, if applicable
- j. Assistance to be provided to the practitioner, if applicable
- k. Involvement of a practitioner's external specialist, if applicable
- l. Specified thresholds for reporting exceptions, if applicable

Appendix C (paragraph .35), "Sample Engagement Letter," contains a sample engagement letter that may be used for this kind of engagement. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE

No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.09] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.10] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Practitioner's Responsibilities

.11 The objective of the practitioner's agreed-upon procedures engagement is to apply specific procedures to the entity's compliance with the requirements specified in the CIA and issue a written agreed-upon procedures report that describes the procedures applied and the practitioner's findings without providing an opinion or conclusion on the entity's compliance with the requirements specified in the CIA. (See appendix D [paragraph .36], "Sample Procedures.") [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.12 The practitioner's procedures may be as limited or extensive as the engaging party agrees to and acknowledges are appropriate to assist management and the OIG in evaluating the entity's compliance with the requirements specified in the CIA. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.13] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.14] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Using the Work of a Practitioner's External Specialist²

.15 The practitioner's education and experience enable the practitioner to be knowledgeable about business matters in general, but a practitioner is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. In certain circumstances, it may be appropriate to involve a specialist to assist the practitioner in the performance of one or more procedures. The following are examples:

- An attorney might provide assistance concerning the application of legal terminology in laws, regulations, rules, contracts, or grants to a client's situation.
- A medical specialist might provide assistance in understanding the characteristics of diagnosis codes documented in patient medical records.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

² A *practitioner's specialist* is an individual or organization possessing expertise in a field other than accounting or attestation, whose work in that field is used by the practitioner to assist the practitioner in obtaining evidence for the service being provided. A practitioner's specialist may be either a practitioner's internal specialist (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm) or a practitioner's external specialist. *Partner* and *firm* refer to their governmental equivalents when relevant. [Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.16 The practitioner and the engaging party should explicitly agree to the involvement of a practitioner's external specialist if assisting a practitioner in the performance of an agreed-upon procedures engagement. This agreement may be reached when agreeing upon the terms of the engagement or as part of obtaining the engaging party's agreement to the procedures and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement. The practitioner's report should describe the nature of the assistance provided by the practitioner's external specialist as discussed in paragraphs .19–.20 of AT-C section 215. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.17 A practitioner may apply procedures to the report or work product of a practitioner's external specialist that does not constitute assistance by the external specialist to the practitioner in an agreed-upon procedures engagement. For example, the practitioner may reference information contained in a report of a practitioner's external specialist in describing a procedure. However, it is inappropriate for the practitioner to merely read the external specialist's report solely to describe or repeat the findings, or to take responsibility for all or a portion of any procedures performed by a practitioner's external specialist or the external specialist's work product. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Using the Work of Internal Auditors and Other Practitioners³

.18 The procedures to be enumerated or referred to in the practitioner's report should be performed by the engagement team or other practitioners and not by internal auditors. However, internal auditors may prepare schedules, accumulate data, perform an internal assessment of management's compliance, or provide other information for the practitioner's use in performing the procedures. Also, internal auditors may perform and report separately on procedures that they have carried out. Such procedures may be similar to those that a practitioner may perform in the agreed-upon procedures engagement. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.19 A practitioner may perform procedures on information documented in the working papers of internal auditors. For example, the practitioner may do the following:

- repeat all or some of the procedures.
- determine whether the internal auditors' documentation indicates procedures performed and whether the findings documented are presented in a report by the internal auditors.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

³ AU-C section 610, *Using the Work of Internal Auditors*, does not apply to agreed-upon procedures engagements. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.20 However, it is inappropriate for the practitioner to

- merely read the internal auditor's report solely to describe or repeat their findings.
- take responsibility for all or a portion of any procedures performed by internal auditors by reporting those findings as the practitioner's own.
- report in any manner that implies shared responsibility for the procedures with the internal auditors.

[Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Planning the Engagement

.21 Paragraph .33b of AT-C section 105 requires the engagement partner to take responsibility for the overall quality on each attestation engagement, including responsibility for the engagement being planned and performed (including appropriate direction and supervision) to comply with professional standards and applicable legal and regulatory requirements. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.22 Paragraph .32a of AT-C section 105 requires the engagement partner to be satisfied that the engagement team, and any practitioner's external specialists, collectively, have the appropriate competence, including knowledge of the subject matter, and capabilities to comply with professional standards and applicable legal and regulatory requirements and enable the issuance of a practitioner's report that is appropriate in the circumstances. Relevant matters the engagement partner may consider with respect to appropriate competence and capabilities of those persons involved in the engagement collectively include the following:

- Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation
- Understanding of professional standards and applicable legal and regulatory requirements, for example the attestation standards.
- Technical expertise, including expertise with relevant IT and specialized areas relevant to the subject matter, for example, knowledge of health care regulatory matters to enable them to sufficiently understand the events, transactions, and practices that, in their judgment, have a significant effect on the presentation of the assertions
- Knowledge of relevant industries in which the entity operates
- Ability to apply professional judgment
- Understanding of the firm's quality control policies and procedures

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Documentation

.23 The practitioner should prepare engagement documentation on a timely basis. In an agreed-upon procedures engagement, documentation includes the record of procedures performed, relevant evidence obtained, and findings of the practitioner. The sufficiency of engagement documentation is discussed in paragraphs .34–.41 of AT-C section 105 and in paragraph .42 of AT-C section 215. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.24 Concern over access to the practitioner's documentation might cause some clients to inquire about documentation requirements. In situations where the practitioner is requested to not maintain copies of certain client documentation, or to not prepare and maintain documentation similar to client documents, the practitioner may refer to Interpretation No. 1, "The Effect of an Inability to Obtain Audit Evidence Relating to Income Tax Accruals" (AU-C sec. 9500 par. .01–.22), of AU-C section 500, *Audit Evidence*, for guidance. See Interpretation No. 3, "Providing Access to or Copies of Engagement Documentation to a Regulator," (AT-C sec. 9105 par. .15–.30), of AT-C section 105 for guidance related to providing access to or copies of engagement documentation to a regulator in connection with work performed on an attestation engagement.⁴ [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Written Representations

.25 The practitioner should request from the engaging party written representations in the form of a letter addressed to the practitioner. The representations should include the following:

- a. A statement that management is responsible for compliance with the terms of the CIA⁵
- b. An acknowledgement of management's responsibility for establishing and maintaining effective internal control over compliance

⁴ Paragraph .10 of AT-C section 105, *Concepts Common to All Attest Engagements*, indicates that engagement documentation may also be referred to as working papers. [Footnote added, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

⁵ Depending on the circumstances, representations in the following areas might be appropriate:

- Violations or possible violations of laws or regulations, such as those related to the Medicare and Medicaid antifraud and abuse statutes
- Compliance of third-party billings with applicable coding guidelines (for example, ICD-9-CM, CPT) and laws and regulations (including medical necessity, proper approvals, and proper rendering of care)
- Proper filing of all required Medicare, Medicaid, and similar reports under the applicable reimbursement rules and regulations (including nature of costs — allowable, patient-related, properly allocated, in accordance with applicable rules and regulations, properly adjusted to reflect prior audit adjustments) and adequacy of disclosures (including disputed costs)

[Footnote renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

- c. A statement that management has provided the practitioner with all relevant information and access, as applicable, as agreed upon in the terms of the engagement
- d. A statement that all known matters contradicting the entity's compliance with the CIA and any communication from regulatory agencies or others affecting the entity's compliance with the CIA have been disclosed to the practitioner, including communications received between the end of the reporting period and the date of the practitioner's report
- e. A description of any related material fraud or abuse, other fraud, abuse or illegal acts that, whether or not material, involve management or other employees who have a significant role in the entity's design, implementation, and monitoring of the policies and procedures in place upon which compliance is based
- f. A statement that management has disclosed to the practitioners, orally or in writing, information about past noncompliance issues covered in the settlement agreement that gave rise to the CIA and the related corrective measures taken to support compliance in those areas
- g. A statement that management has disclosed to the practitioner all known events subsequent to the period (or point in time) of the entity's compliance with the CIA being reported on that would have a material effect on the entity's compliance with the CIA
- h. Any additional representations that the practitioner determines are appropriate

When one or more of the written representations that the practitioner has requested are not provided or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should (a) discuss the matter with management; (b) reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general; and (c) if any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's report.⁶ [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Reporting Considerations

.26 A practitioner should present the results of applying agreed-upon procedures to the specific subject matter in the form of findings. The practitioner's report should not express an opinion or conclusion on the subject matter. For example, the report should not include a statement that "nothing came to our attention that caused us to believe that the subject matter is not fairly stated in

⁶ See paragraphs .30 and .A44–.A45 of AT-C section 215, *Agreed-Upon Procedures Engagements*. [Footnote added, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

accordance with the criteria." [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.27 The practitioner should report all findings from the application of the agreed-upon procedures. Any specified threshold established by the engaging party for reporting exceptions should be described in the practitioner's report. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.28 Although the practitioner need not perform procedures beyond the procedures agreed to and acknowledged by the engaging party to be appropriate for the intended purpose of the engagement, if in connection with the application of the procedures, and through the completion of the engagement, matters related to the entity's noncompliance come to the practitioner's attention by other means that significantly contradict the entity's compliance with the CIA, the practitioner should discuss the matter with the engaging party and take appropriate action, including determining whether the practitioner's report should be revised to disclose the matter. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.29] [Paragraph renumbered and deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.30 The practitioner should follow the reporting requirements in paragraphs .31–.37 of AT-C section 215 and paragraph .26 of AT-C section 315. A sample report is included in appendix E (paragraph .37), "Sample Report." [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.31 When evaluating compliance with certain requirements of a CIA requires interpretation of the laws, regulations, rules, contracts, or grants that establish those requirements, the practitioner evaluates whether the criteria (the specified requirements of the CIA) are suitable for performing such agreed-upon procedures and reporting findings. If these interpretations are significant, the practitioner may include a paragraph describing the interpretations made by management and the source of the interpretations. An example of such a paragraph, which would precede the procedures and findings paragraph(s), follows:

We have been informed that, under *[name of entity's]* interpretation of *[identify the compliance requirement]*, *[explain the nature and source of the relevant interpretation]*.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.32 The report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that

- a. the attestation documentation has been reviewed, and

- b.* if applicable, the written presentation of the subject matter has been prepared.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph revised, April 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix A — Sample Corporate Integrity Agreement Between the Office of Inspector General of the Department of Health and Human Services and [Provider]

I. Preamble

[Provider] ("[Provider]") hereby enters into this Corporate Integrity Agreement ("CIA") with the Office of Inspector General ("OIG") of the United States Department of Health and Human Services ("HHS") to ensure compliance by its employees with the requirements of Medicare, Medicaid and all other Federal health care programs (as defined in 42 U.S.C. 1320a-7b(f)) (hereinafter collectively referred to as the "Federal health care programs"). [Provider's] compliance with the terms and conditions in this CIA shall constitute an element of [Provider's] present responsibility with regard to participation in the Federal health care programs. Contemporaneously with this CIA, [Provider] is entering into a Settlement Agreement with the United States, and this CIA is incorporated by reference into the Settlement Agreement.

II. Term of the CIA

The period of the compliance obligations assumed by [Provider] under this CIA shall be 5 years from the effective date of this CIA (unless otherwise specified). The effective date of this CIA will be the date on which the final signatory of this CIA executes this CIA (the "effective date").*

III. Corporate Integrity Obligations

[Provider] shall establish a compliance program that includes the following elements:

A. Compliance Officer

Within ninety (90) days after the effective date of this CIA, [Provider] shall appoint an individual to serve as Compliance Officer, who shall be responsible for developing and implementing policies, procedures, and practices designed to ensure compliance with the requirements set forth in this CIA and with the requirements of the Federal health care programs. The Compliance Officer shall be a member of senior management of [Provider], shall make regular (at least quarterly) reports regarding compliance matters directly to the CEO and/or to the Board of Directors of [Provider] and shall be authorized to report to the Board of Directors at any time. The Compliance Officer shall be responsible for monitoring the day-to-day activities engaged in by [Provider] to further its compliance objectives as well as any reporting obligations created under this CIA. In the event a new Compliance Officer is appointed during the term of this CIA, [Provider] shall notify the OIG, in writing, within fifteen (15) days of such a change.

[Provider] shall also appoint a Compliance Committee within ninety (90) days after the effective date of this CIA. The Compliance Committee shall, at a minimum, include the Compliance Officer and any other appropriate officers as necessary to meet the requirements of this CIA within the provider's

* Source: Office of the Inspector General of the United States Department of Health and Human Services.

corporate structure (e.g., senior executives of each major department, such as billing, clinical, human resources, audit, and operations). The Compliance Officer shall chair the Compliance Committee and the Committee shall support the Compliance Officer in fulfilling his/her responsibilities.

B. Written Standards

1. *Code of Conduct.* Within ninety (90) days of the effective date of this CIA, [Provider] shall establish a Code of Conduct. The Code of Conduct shall be distributed to all employees within ninety (90) days of the effective date of this CIA. [Provider] shall make the promotion of, and adherence to, the Code of Conduct an element in evaluating the performance of managers, supervisors, and all other employees. The Code of Conduct shall, at a minimum, set forth:
 - a. [Provider's] commitment to full compliance with all statutes, regulations, and guidelines applicable to Federal health care programs, including its commitment to prepare and submit accurate billings consistent with Federal health care program regulations and procedures or instructions otherwise communicated by the Health Care Financing Administration ("HCFA") (or other appropriate regulatory agencies) and/or its agents;
 - b. [Provider's] requirement that all of its employees shall be expected to comply with all statutes, regulations, and guidelines applicable to Federal health care programs and with [Provider's] own policies and procedures (including the requirements of this CIA);
 - c. the requirement that all of [Provider's] employees shall be expected to report suspected violations of any statute, regulation, or guideline applicable to Federal health care programs or with [Provider's] own policies and procedures;
 - d. the possible consequences to both [Provider] and to any employee of failure to comply with all statutes, regulations, and guidelines applicable to Federal health care programs and with [Provider's] own policies and procedures or of failure to report such non-compliance; and
 - e. the right of all employees to use the confidential disclosure program, as well as [Provider's] commitment to confidentiality and non-retaliation with respect to disclosures.

Within ninety (90) days of the effective date of the CIA, each employee shall certify, in writing, that he or she has received, read, understands, and will abide by [Provider's] Code of Conduct. New employees shall receive the Code of Conduct and shall complete the required certification within two (2) weeks after the commencement of their employment or within ninety (90) days of the effective date of the CIA, whichever is later.

[Provider] will annually review the Code of Conduct and will make any necessary revisions. These revisions shall be distributed within thirty (30) days of initiating such a change. Employees shall certify on an annual basis that they have received, read, understand and will abide by the Code of Conduct.

2. *Policies and Procedures.* Within ninety (90) days of the effective date of this CIA, [Provider] shall develop and initiate implementation of written Policies and Procedures regarding the operation of

[*Provider's*] compliance program and its compliance with all federal and state health care statutes, regulations, and guidelines, including the requirements of the Federal health care programs. At a minimum, the Policies and Procedures shall specifically address [*insert language relevant to allegations in the case*]. In addition, the Policies and Procedures shall include disciplinary guidelines and methods for employees to make disclosures or otherwise report on compliance issues to [*Provider*] management through the Confidential Disclosure Program required by section III.E. [*Provider*] shall assess and update as necessary the Policies and Procedures at least annually and more frequently, as appropriate. A summary of the Policies and Procedures will be provided to OIG in the Implementation Report. The Policies and Procedures will be available to OIG upon request.

Within ninety (90) days of the effective date of the CIA, the relevant portions of the Policies and Procedures shall be distributed to all appropriate employees. Compliance staff or supervisors should be available to explain any and all policies and procedures.

C. Training and Education

1. *General Training.* Within ninety (90) days of the effective date of this CIA, [*Provider*] shall provide at least two (2) hours of training to each employee. This general training shall explain [*Provider's*]:
 - a. Corporate Integrity Agreement requirements;
 - b. Compliance Program (including the Policies and Procedures as they pertain to general compliance issues); and
 - c. Code of Conduct.

These training materials shall be made available to the OIG, upon request.

New employees shall receive the general training described above within thirty (30) days of the beginning of their employment or within ninety (90) days after the effective date of this CIA, whichever is later. Each year, every employee shall receive such general training on an annual basis.

2. *Specific Training.* Within ninety (90) days of the effective date of this CIA, each employee who is involved directly or indirectly in the delivery of patient care and/or in the preparation or submission of claims for reimbursement for such care (including, but not limited to, coding and billing) for any Federal health care programs shall receive at least [*insert number of training hours*] hours of training in addition to the general training required above. This training shall include a discussion of:
 - a. the submission of accurate bills for services rendered to Medicare and/or Medicaid patients;
 - b. policies, procedures and other requirements applicable to the documentation of medical records;
 - c. the personal obligation of each individual involved in the billing process to ensure that such billings are accurate;
 - d. applicable reimbursement rules and statutes;
 - e. the legal sanctions for improper billings; and
 - f. examples of proper and improper billing practices.

These training materials shall be made available to OIG, upon request. Persons providing the training must be knowledgeable about the subject area.

Affected new employees shall receive this training within thirty (30) days of the beginning of their employment or within ninety (90) days of the effective date of this CIA, whichever is later. If a new employee has any responsibility for the delivery of patient care, the preparation or submission of claims and/or the assignment of procedure codes prior to completing this specific training, a [Provider] employee who has completed the substantive training shall review all of the untrained person's work regarding the assignment of billing codes.

Each year, every employee shall receive such specific training on an annual basis.

3. *Certification.* Each employee shall certify, in writing, that he or she has attended the required training. The certification shall specify the type of training received and the date received. The Compliance Officer shall retain the certifications, along with specific course materials. These shall be made available to OIG upon request.

D. Review Procedures

[Provider] shall retain an entity, such as an accounting, auditing or consulting firm (hereinafter "Independent Review Organization"), to perform review procedures to assist [Provider] in assessing the adequacy of its billing and compliance practices pursuant to this CIA. This shall be an annual requirement and shall cover a twelve (12) month period. The Independent Review Organization must have expertise in the billing, coding, reporting and other requirements of the Federal health care programs from which [Provider] seeks reimbursement. The Independent Review Organization must be retained to conduct the assessment of the first year within ninety (90) days of the effective date of this CIA. For purposes of complying with this review procedures requirement, the OIG at its discretion, may permit the [Provider] to utilize internal auditors to perform the review(s). In such case, the [Provider] will engage the Independent Review Organization to verify the propriety of the internal auditors' methods and accuracy of their results. The [Provider] will request the Independent Review Organization to produce a report on its findings which report shall be included in the Annual Report to the OIG.

The Independent Review Organization (or the [Provider], if permitted by the OIG, as set forth above) will conduct two separate engagements. One will be an analysis of [Provider's] billing to the Federal health care programs to assist the [Provider] and OIG in determining compliance with all applicable statutes, regulations, and directives/guidance ("billing engagement"). The second engagement will assist the [Provider] and OIG in determining whether [Provider] is in compliance with this CIA ("compliance engagement").

1. *Billing Engagement.* The billing engagement shall consist of a review of a statistically valid sample of claims for the relevant period. The sample size shall be determined through the use of a probe sample.¹ At a minimum, the full sample must be within a ninety (90) percent confidence level and a precision of twenty-five (25) percent. The probe sample must contain at least thirty (30) sample units and cannot be used as part of the full sample.

¹ Probe sample is defined as a small, random preliminary sample.

Both the probe sample and the sample must be selected through random numbers. [Provider] shall use OIG's Office of Audit Services Statistical Sampling Software, also known as "RAT-STATS", which is available through the Internet at <https://oig.hhs.gov/compliance/rat-stats/index.asp>.

Each annual billing engagement analysis shall include the following components in its methodology:

- a. **Billing Engagement Objective:** Provide a statement stating clearly the objective intended to be achieved by the billing engagement and the procedure or combination of procedures that will be applied to achieve the objective.
- b. **Billing Engagement Population:** Identify the population, which is the group about which information is needed. Explain the methodology used to develop the population and provide the basis for this determination.
- c. **Sources of Data:** Provide a full description of the source of the information upon which the billing engagement conclusions will be based, including the legal or other standards applied, documents relied upon, payment data, and/or any contractual obligations.
- d. **Sampling Unit:** Define the sampling unit, which is any of the designated elements that comprise the population of interest.
- e. **Sampling Frame:** Identify the sampling frame, which is the totality of the sampling units from which the sample will be selected.

As part of the billing engagement:

- a. Inquire of management as to the procedures and controls affecting the billing process subject to the annual assessment as specified in the CIA. Document that aspect of the billing process (e.g., flow of documents, processing activities), and those controls that will be tested in the sample. The documentation may consist of flow charts, excerpts from policies and procedures manuals, control questionnaires, etc.
 - b. Report the sample results, including the overall error rate and the nature of the errors found (e.g., no documentation, inadequate documentation, assignment of incorrect code).
 - c. Document findings related to [Provider's] procedures to correct inaccurate billings and codings to the Federal health care programs and findings regarding the steps [Provider] is taking to bring its operations into compliance or to correct problems identified by the audit.
2. **Agreed-upon Procedures or Compliance Engagement.** An Independent Review Organization (or the [Provider], if permitted by the OIG) shall also conduct an agreed-upon procedures or compliance engagement, which shall assist the users in determining whether [Provider's] program, policies, procedures, and operations comply with the terms of this CIA. This engagement shall include a section by section analysis of the requirements of this CIA.

A complete copy of the Independent Review Organization's billing and agreed-upon procedures or compliance engagement shall be included in each of [Provider's] Annual Reports to OIG.

3. *Disclosure of Overpayments and Material Deficiencies.* If, as a result of these engagements, [Provider] or the Independent Review Organization identifies any billing, coding or other policies, procedures and/or practices that result in an overpayment, [Provider] shall notify the payor (e.g., Medicare fiscal intermediary or carrier) within 30 days of discovering the deficiency or overpayment and take remedial steps within 60 days of discovery (or such additional time as may be agreed to by the payor) to correct the problem, including preventing the deficiency from recurring. The notice to the payor shall include:
 - a. a statement that the refund is being made pursuant to this CIA;
 - b. a description of the complete circumstances surrounding the overpayment;
 - c. the methodology by which the overpayment was determined;
 - d. the amount of the overpayment;
 - e. any claim-specific information used to determine the overpayment (e.g., beneficiary health insurance number, claim number, service date, and payment date);
 - f. the cost reporting period; and
 - g. the provider identification number under which the repayment is being made.

If [Provider] determines an overpayment represents a material deficiency, contemporaneous with [Provider's] notification to the payor as provided above, [Provider] shall also notify OIG of:

- a. a complete description of the material deficiency;
- b. amount of overpayment due to the material deficiency;
- c. [Provider's] action(s) to correct and prevent such material deficiency from recurring;
- d. the payor's name, address, and contact person where the overpayment was sent;
- e. the date of the check and identification number (or electronic transaction number) on which the overpayment was repaid.

For purposes of this CIA, an "overpayment" shall mean the amount of money the provider has received in excess of the amount due and payable under the Federal health care programs' statutes, regulations or program directives, including carrier and intermediary instructions.

For purposes of this CIA, a "material deficiency" shall mean anything that involves: (i) a substantial overpayment or improper payment relating to the Medicare and/or Medicaid programs; (ii) conduct or policies that clearly violate the Medicare and/or Medicaid statute, regulations or directives issued by HCFA and/or its agents; or (iii) serious quality of care implications for federal health care beneficiaries or recipients. A material deficiency may be the result of an isolated event or a series of occurrences.

4. *Verification/Validation.* In the event that the OIG determines that it is necessary to conduct an independent review to determine whether or the extent to which [Provider] is complying with its obligations under this CIA, [Provider] agrees to pay for the

reasonable cost of any such review or engagement by the OIG or any of its designated agents.

E. Confidential Disclosure Program

Within ninety (90) days after the effective date of this CIA, [Provider] shall establish a Confidential Disclosure Program, which must include measures (e.g., a toll-free compliance telephone line) to enable employees, contractors, agents or other individuals to disclose, to the Compliance Officer or some other person who is not in the reporting individual's chain of command, any identified issues or questions associated with [Provider's] policies, practices or procedures with respect to the Federal health care program, believed by the individual to be inappropriate. [Provider] shall publicize the existence of the hotline (e.g., e-mail to employees or post hotline number in prominent common areas).

The Confidential Disclosure Program shall emphasize a non-retribution, non-retaliation policy, and shall include a reporting mechanism for anonymous, confidential communication. Upon receipt of a complaint, the Compliance Officer (or designee) shall gather the information in such a way as to elicit all relevant information from the individual reporting the alleged misconduct. The Compliance Officer (or designee) shall make a preliminary good faith inquiry into the allegations set forth in every disclosure to ensure that he or she has obtained all of the information necessary to determine whether a further review should be conducted. For any disclosure that is sufficiently specific so that it reasonably: (1) permits a determination of the appropriateness of the alleged improper practice, and (2) provides an opportunity for taking corrective action, [Provider] shall conduct an internal review of the allegations set forth in such a disclosure and ensure that proper follow-up is conducted.

The Compliance Officer shall maintain a confidential disclosure log, which shall include a record and summary of each allegation received, the status of the respective investigations, and any corrective action taken in response to the investigation.

F. Ineligible Persons

[Provider] shall not hire or engage as contractors any "Ineligible Person." For purposes of this CIA, an "Ineligible Person" shall be any individual or entity who: (i) is currently excluded, suspended, debarred or otherwise ineligible to participate in the Federal health care programs; or (ii) has been convicted of a criminal offense related to the provision of health care items or services and has not been reinstated in the Federal health care programs after a period of exclusion, suspension, debarment, or ineligibility.

Within ninety (90) days of the effective date of this CIA, [Provider] will review its list of current employees and contractors against the General Services Administration's List of Parties Excluded from Federal Programs (available through the Internet at www.arinet.gov/epl) and the HHS/OIG Cumulative Sanction Report (available through the Internet at www.dhhs.gov/progorg/oig) to ensure that it is not currently employing or contracting with any Ineligible Person. Thereafter, [Provider] will review the list once semi-annually to ensure that no current employees or contractors are or have become Ineligible Persons.

To prevent hiring or contracting with any Ineligible Person, [Provider] shall screen all prospective employees and prospective contractors prior to engaging their services by (i) requiring applicants to disclose whether they are Ineligible Persons, and (ii) reviewing the General Services Administration's List of Parties Excluded from Federal Programs (available through the Internet at www.arinet.gov/epl) and the HHS/OIG Cumulative Sanction Report (available through the Internet at www.dhhs.gov/progorg/oig).

If [Provider] has notice that an employee or agent is charged with a criminal offense related to any Federal health care program, or is suspended or proposed

for exclusion during his or her employment or contract with [Provider], within 10 days of receiving such notice [Provider] will remove such employee from responsibility for, or involvement with, [Provider's] business operations related to the Federal health care programs until the resolution of such criminal action, suspension, or proposed exclusion. If [Provider] has notice that an employee or agent has become an Ineligible Person, [Provider] will remove such person from responsibility for, or involvement with, [Provider's] business operations related to the Federal health care programs and shall remove such person from any position for which the person's salary or the items or services rendered, ordered, or prescribed by the person are paid in whole or in part, directly or indirectly, by Federal health care programs or otherwise with Federal funds at least until such time as the person is reinstated into participation in the Federal health care programs.

G. Notification of Proceedings

Within thirty (30) days of discovery, [Provider] shall notify OIG, in writing, of any ongoing investigation or legal proceeding conducted or brought by a governmental entity or its agents involving an allegation that [Provider] has committed a crime or has engaged in fraudulent activities or any other knowing misconduct. This notification shall include a description of the allegation, the identity of the investigating or prosecuting agency, and the status of such investigation or legal proceeding. [Provider] shall also provide written notice to OIG within thirty (30) days of the resolution of the matter, and shall provide OIG with a description of the findings and/or results of the proceedings, if any.

H. Reporting

1. *Credible evidence of misconduct.* If [Provider] discovers credible evidence of misconduct from any source and, after reasonable inquiry, has reason to believe that the misconduct may violate criminal, civil, or administrative law concerning [Provider's] practices relating to the Federal health care programs, then [Provider] shall promptly report the probable violation of law to OIG. Defendants shall make this disclosure as soon as practicable, but, not later than thirty (30) days after becoming aware of the existence of the probable violation. The [Provider's] report to OIG shall include:
 - a. the findings concerning the probable violation, including the nature and extent of the probable violation;
 - b. [Provider's] actions to correct such probable violation; and
 - c. any further steps it plans to take to address such probable violation and prevent it from recurring.

To the extent the misconduct involves an overpayment, the report shall include the information listed in section III.D.3 regarding material deficiencies.

2. *Inappropriate Billing.* If [Provider] discovers inappropriate or incorrect billing through means other than the Independent Review Organization's engagement, the provider shall follow procedures in section III.D.3 regarding overpayments and material deficiencies.

IV. New Locations

In the event that [Provider] purchases or establishes new business units after the effective date of this CIA, [Provider] shall notify OIG of this fact within thirty (30) days of the date of purchase or establishment. This notification shall include the location of the new operation(s), phone number, fax number, Federal health care program provider number(s) (if any), and the corresponding

payor(s) (contractor specific) that has issued each provider number. All employees at such locations shall be subject to the requirements in this CIA that apply to new employees (e.g., completing certifications and undergoing training).

V. Implementation and Annual Reports

A. Implementation Report

Within one hundred and twenty (120) days after the effective date of this CIA, [Provider] shall submit a written report to OIG summarizing the status of its implementation of the requirements of this CIA. This Implementation Report shall include:

1. the name, address, phone number and position description of the Compliance Officer required by section III.A;
2. the names and positions of the members of the Compliance Committee required by section III.A;
3. a copy of [Provider's] Code of Conduct required by section III.B.1;
4. the summary of the Policies and Procedures required by section III.B.2;
5. a description of the training programs required by section III.C including a description of the targeted audiences and a schedule of when the training sessions were held;
6. a certification by the Compliance Officer that:
 - a. the Policies and Procedures required by section III.B have been developed, are being implemented, and have been distributed to all pertinent employees;
 - b. all employees have completed the Code of Conduct certification required by section III.B.1; and
 - c. all employees have completed the training and executed the certification required by section III.C;
7. a description of the confidential disclosure program required by section III.E;
8. the identity of the Independent Review Organization(s) and the proposed start and completion date of the first audit; and
9. a summary of personnel actions taken pursuant to section III.F.

B. Annual Reports

[Provider] shall submit to OIG an Annual Report with respect to the status and findings of [Provider's] compliance activities. The Annual Reports shall include:

1. any change in the identity or position description of the Compliance Officer and/or members of the Compliance Committee described in section III.A;
2. a certification by the Compliance Officer that:
 - a. all employees have completed the annual Code of Conduct certification required by section III.B.1; and
 - b. all employees have completed the training and executed the certification required by section III.C;

3. notification of any changes or amendments to the Policies and Procedures required by section III.B and the reasons for such changes (e.g., change in contractor policy);
4. a complete copy of the report prepared pursuant to the Independent Review Organization's billing and compliance engagement, including a copy of the methodology used;
5. [Provider's] response/corrective action plan to any issues raised by the Independent Review Organization;
6. a summary of material deficiencies reported throughout the course of the previous twelve (12) months pursuant to III.D.3 and III.H;
7. a report of the aggregate overpayments that have been returned to the Federal health care programs that were discovered as a direct or indirect result of implementing this CIA. Overpayment amounts should be broken down into the following categories: Medicare, Medicaid (report each applicable state separately) and other Federal health care programs;
8. a copy of the confidential disclosure log required by section III.E;
9. a description of any personnel action (other than hiring) taken by [Provider] as a result of the obligations in section III.F;
10. a summary describing any ongoing investigation or legal proceeding conducted or brought by a government entity involving an allegation that [Provider] has committed a crime or has engaged in fraudulent activities, which have been reported pursuant to section III.G. The statement shall include a description of the allegation, the identity of the investigating or prosecuting agency, and the status of such investigation, legal proceeding or requests for information;
11. a corrective action plan to address the probable violations of law identified in section III.H; and
12. a listing of all of the [Provider's] locations (including locations and mailing addresses), the corresponding name under which each location is doing business, the corresponding phone numbers and fax numbers, each location's Federal health care program provider identification number(s) and the payor (specific contractor) that issued each provider identification number.

The first Annual Report shall be received by the OIG no later than one year and thirty (30) days after the effective date of this CIA. Subsequent Annual Reports shall be submitted no later than the anniversary date of the due date of the first Annual Report.

C. Certifications

The Implementation Report and Annual Reports shall include a certification by the Compliance Officer under penalty of perjury, that: (1) [Provider] is in compliance with all of the requirements of this CIA, to the best of his or her knowledge; and (2) the Compliance Officer has reviewed the Report and has made reasonable inquiry regarding its content and believes that, upon such inquiry, the information is accurate and truthful.

VI. Notifications and Submission of Reports

Unless otherwise stated in writing subsequent to the effective date of this CIA, all notifications and reports required under this CIA shall be submitted to the entities listed below:

OIG:

Civil Recoveries Branch — Compliance Unit
Office of Counsel to the Inspector General
Office of Inspector General
U.S. Department of Health and Human Services
Cohen Building, Room 5527
330 Independence Avenue, SW
Washington, DC 20201
Phone 202-619-2078; Fax 202-205-0604

[*Provider*]:

[*Address and Telephone number of Provider's Compliance Contact*]

VII. OIG Inspection, Audit and Review Rights

In addition to any other rights OIG may have by statute, regulation, or contract, OIG or its duly authorized representative(s), may examine [*Provider's*] books, records, and other documents and supporting materials for the purpose of verifying and evaluating: (a) [*Provider's*] compliance with the terms of this CIA; and (b) [*Provider's*] compliance with the requirements of the Federal health care programs in which it participates. The documentation described above shall be made available by [*Provider*] to OIG or its duly authorized representative(s) at all reasonable times for inspection, audit or reproduction. Furthermore, for purposes of this provision, OIG or its duly authorized representative(s) may interview any of [*Provider's*] employees who consent to be interviewed at the employee's place of business during normal business hours or at such other place and time as may be mutually agreed upon between the employee and OIG. [*Provider*] agrees to assist OIG in contacting and arranging interviews with such employees upon OIG's request. [*Provider's*] employees may elect to be interviewed with or without a representative of [*Provider*] present.

VIII. Document and Record Retention

[*Provider*] shall maintain for inspection all documents and records relating to reimbursement from the Federal health care programs or to compliance with this CIA one year longer than the term of this CIA (or longer if otherwise required by law).

IX. Disclosures

Subject to HHS's Freedom of Information Act ("FOIA") procedures, set forth in 45 C.F.R. Part 5, the OIG shall make a reasonable effort to notify [*Provider*] prior to any release by OIG of information submitted by [*Provider*] pursuant to its obligations under this CIA and identified upon submission by [*Provider*] as trade secrets, commercial or financial information and privileged and confidential under the FOIA rules. [*Provider*] shall refrain from identifying any information as trade secrets, commercial or financial information and privileged and confidential that does not meet the criteria for exemption from disclosure under FOIA.

X. Breach and Default Provisions

[*Provider*] is expected to fully and timely comply with all of the obligations herein throughout the term of this CIA or other time frames herein agreed to.

A. Stipulated Penalties for Failure to Comply with Certain Obligations

As a contractual remedy, [Provider] and OIG hereby agree that failure to comply with certain obligations set forth in this CIA may lead to the imposition of the following monetary penalties (hereinafter referred to as "Stipulated Penalties") in accordance with the following provisions.

1. A Stipulated Penalty of \$2,500 (which shall begin to accrue on the day after the date the obligation became due) for each day, beginning 120 days after the effective date of this CIA and concluding at the end of the term of this CIA, [Provider] fails to have in place any of the following:
 - a. a Compliance Officer;
 - b. a Compliance Committee;
 - c. a written Code of Conduct;
 - d. written Policies and Procedures;
 - e. a training program; and
 - f. a Confidential Disclosure Program;
2. A Stipulated Penalty of \$2,500 (which shall begin to accrue on the day after the date the obligation became due) for each day [Provider] fails to meet any of the deadlines to submit the Implementation Report or the Annual Reports to the OIG.
3. A Stipulated Penalty of \$2,000 (which shall begin to accrue on the date the failure to comply began) for each day [Provider]:
 - a. hires or contracts with an Ineligible Person after that person has been listed by a federal agency as excluded, debarred, suspended or otherwise ineligible for participation in the Medicare, Medicaid or any other Federal health care program (as defined in 42 U.S.C. 1320a7b(f)). This Stipulated Penalty shall not be demanded for any time period if [Provider] can demonstrate that it did not discover the person's exclusion or other ineligibility after making a reasonable inquiry (as described in section III.F) as to the status of the person;
 - b. employs or contracts with an Ineligible Person and that person: (i) has responsibility for, or involvement with, [Provider's] business operations related to the Federal health care programs or (ii) is in a position for which the person's salary or the items or services rendered, ordered, or prescribed by the person are paid in whole or in part, directly or indirectly, by the Federal health care programs or otherwise with Federal funds (this Stipulated Penalty shall not be demanded for any time period during which [Provider] can demonstrate that it did not discover the person's exclusion or other ineligibility after making a reasonable inquiry (as described in III.F) as to the status of the person);
 - c. employs or contracts with a person who: (i) has been charged with a criminal offense related to

any Federal health care program, or (ii) is suspended or proposed for exclusion, and that person has responsibility for, or involvement with, [Provider's] business operations related to the Federal health care programs (this Stipulated Penalty shall not be demanded for any time period before 10 days after [Provider] received notice of the relevant matter or after the resolution of the matter).

4. A Stipulated Penalty of \$1,500 (which shall begin to accrue on the date the [Provider] fails to grant access) for each day [Provider] fails to grant access to the information or documentation as required in section V of this CIA.
5. A Stipulated Penalty of \$1,000 (which shall begin to accrue ten (10) days after the date that OIG provides notice to [Provider] of the failure to comply) for each day [Provider] fails to comply fully and adequately with any obligation of this CIA. In its notice to [Provider], the OIG shall state the specific grounds for its determination that the [Provider] has failed to comply fully and adequately with the CIA obligation(s) at issue.

B. Payment of Stipulated Penalties

1. *Demand Letter.* Upon a finding that [Provider] has failed to comply with any of the obligations described in section X.A and determining that Stipulated Penalties are appropriate, OIG shall notify [Provider] by personal service or certified mail of (a) [Provider's] failure to comply; and (b) the OIG's exercise of its contractual right to demand payment of the Stipulated Penalties (this notification is hereinafter referred to as the "Demand Letter").

Within fifteen (15) days of the date of the Demand Letter, [Provider] shall either (a) cure the breach to the OIG's satisfaction and pay the applicable stipulated penalties, or (b) request a hearing before an HHS administrative law judge ("ALJ") to dispute the OIG's determination of noncompliance, pursuant to the agreed-upon provisions set forth below in section X.D. In the event [Provider] elects to request an ALJ hearing, the Stipulated Penalties shall continue to accrue until [Provider] cures, to the OIG's satisfaction, the alleged breach in dispute. Failure to respond to the Demand Letter in one of these two manners within the allowed time period shall be considered a material breach of this CIA and shall be grounds for exclusion under section X.C.

2. *Timely Written Requests for Extensions.* [Provider] may submit a timely written request for an extension of time to perform any act or file any notification or report required by this CIA. Notwithstanding any other provision in this section, if OIG grants the timely written request with respect to an act, notification, or report, Stipulated Penalties for failure to perform the act or file the notification or report shall not begin to accrue until one day after [Provider] fails to meet the revised deadline as agreed to by the OIG-approved extension. Notwithstanding any other provision in this section, if OIG denies such a timely written request, Stipulated Penalties for failure to perform the act or file the notification or report shall not begin to accrue until two (2) business days after

[*Provider*] receives OIG's written denial of such request. A "timely written request" is defined as a request in writing received by OIG at least five (5) business days prior to the date by which any act is due to be performed or any notification or report is due to be filed.

3. *Form of Payment.* Payment of the Stipulated Penalties shall be made by certified or cashier's check, payable to "Secretary of the Department of Health and Human Services," and submitted to OIG at the address set forth in section VI.
4. *Independence from Material Breach Determination.* Except as otherwise noted, these provisions for payment of Stipulated Penalties shall not affect or otherwise set a standard for the OIG's determination that [*Provider*] has materially breached this CIA, which decision shall be made at the OIG's discretion and governed by the provisions in section X.C, below.

C. Exclusion for Material Breach of this CIA

1. *Notice of Material Breach and Intent to Exclude.* The parties agree that a material breach of this CIA by [*Provider*] constitutes an independent basis for [*Provider's*] exclusion from participation in the Federal health care programs (as defined in 42 U.S.C. 1320a7b(f)). Upon a determination by OIG that [*Provider*] has materially breached this CIA and that exclusion should be imposed, the OIG shall notify [*Provider*] by certified mail of (a) [*Provider's*] material breach; and (b) OIG's intent to exercise its contractual right to impose exclusion (this notification is hereinafter referred to as the "Notice of Material Breach and Intent to Exclude").
2. *Opportunity to Cure.* [*Provider*] shall have thirty-five (35) days from the date of the Notice of Material Breach and Intent to Exclude Letter to demonstrate to the OIG's satisfaction that:
 - a. [*Provider*] is in *full* compliance with this CIA;
 - b. the alleged material breach has been cured; or
 - c. the alleged material breach cannot be cured within the 35-day period, but that: (i) [*Provider*] has begun to take action to cure the material breach, (ii) [*Provider*] is pursuing such action with due diligence, and (iii) [*Provider*] has provided to OIG a reasonable timetable for curing the material breach.
3. *Exclusion Letter.* If at the conclusion of the thirty-five (35) day period, [*Provider*] fails to satisfy the requirements of section X.C.2, OIG may exclude [*Provider*] from participation in the Federal health care programs. OIG will notify [*Provider*] in writing of its determination to exclude [*Provider*] (this letter shall be referred to hereinafter as the "Exclusion Letter"). Subject to the Dispute Resolution provisions in section X.D, below, the exclusion shall go into effect thirty (30) days after the date of the Exclusion Letter. The exclusion shall have national effect and will also apply to all other federal procurement and non-procurement programs. If [*Provider*] is excluded under the provisions of this CIA, [*Provider*] may seek reinstatement pursuant to the provisions at 42 C.F.R. §§ 1001.3001–.3004.

4. *Material Breach.* A material breach of this CIA means:
 - a. a failure by [Provider] to report a material deficiency, take corrective action and pay the appropriate refunds, as provided in section III.D;
 - b. repeated or flagrant violations of the obligations under this CIA, including, but not limited to, the obligations addressed in section X.A of this CIA;
 - c. a failure to respond to a Demand Letter concerning the payment of Stipulated Penalties in accordance with section X.B above; or
 - d. a failure to retain and use an Independent Review Organization for review purposes in accordance with section III.D.

D. Dispute Resolution

1. *Review Rights.* Upon the OIG's delivery to [Provider] of its Demand Letter or of its Exclusion Letter, and as an agreed-upon contractual remedy for the resolution of disputes arising under the obligation of this CIA, [Provider] shall be afforded certain review rights comparable to the ones that are provided in 42 U.S.C. §§ 1320a7(f) and 42 C.F.R. § 1005 as if they applied to the Stipulated Penalties or exclusion sought pursuant to this CIA. Specifically, the OIG's determination to demand payment of Stipulated Penalties or to seek exclusion shall be subject to review by an ALJ and, in the event of an appeal, the Departmental Appeals Board ("DAB"), in a manner consistent with the provisions in 42 C.F.R. §§ 1005.2–.21. Notwithstanding the language in 42 C.F.R. § 1005.2(c), the request for a hearing involving stipulated penalties shall be made within fifteen (15) days of the date of the Demand Letter and the request for a hearing involving exclusion shall be made within thirty (30) days of the date of the Exclusion Letter.
2. *Stipulated Penalties Review.* Notwithstanding any provision of Title 42 of the United States Code or Chapter 42 of the Code of Federal Regulations, the only issues in a proceeding for stipulated penalties under this CIA shall be (a) whether [Provider] was in full and timely compliance with the obligations of this CIA for which the OIG demands payment; and (b) the period of noncompliance. [Provider] shall have the burden of proving its full and timely compliance and the steps taken to cure the noncompliance, if any. If the ALJ finds for the OIG with regard to a finding of a breach of this CIA and orders [Provider] to pay Stipulated Penalties, such Stipulated Penalties shall become due and payable twenty (20) days after the ALJ issues such a decision notwithstanding that [Provider] may request review of the ALJ decision by the DAB.
3. *Exclusion Review.* Notwithstanding any provision of Title 42 of the United States Code or Chapter 42 of the Code of Federal Regulations, the only issues in a proceeding for exclusion based on a material breach of this CIA shall be (a) whether [Provider] was in material breach of this CIA; (b) whether such breach was continuing on the date of the Exclusion Letter; and (c) the alleged material breach cannot be cured within the 35-day period, but

that (i) [Provider] has begun to take action to cure the material breach, (ii) [Provider] is pursuing such action with due diligence, and (iii) [Provider] has provided to OIG a reasonable timetable for curing the material breach.

For purposes of the exclusion herein, exclusion shall take effect only after an ALJ decision that is favorable to the OIG. [Provider's] election of its contractual right to appeal to the DAB shall not abrogate the OIG's authority to exclude [Provider] upon the issuance of the ALJ's decision. If the ALJ sustains the determination of the OIG and determines that exclusion is authorized, such exclusion shall take effect twenty (20) days after the ALJ issues such a decision, notwithstanding that [Provider] may request review of the ALJ decision by the DAB.

4. *Finality of Decision.* The review by an ALJ or DAB provided for above shall not be considered to be an appeal right arising under any statutes or regulations. Consequently, the parties to this CIA agree that the DAB's decision (or the ALJ's decision if not appealed) shall be considered final for all purposes under this CIA and [Provider] agrees to waive any right it may have to appeal the decision administratively, judicially or otherwise seek review by any court or other adjudicative forum.

XI. Effective and Binding Agreement

Consistent with the provisions in the Settlement Agreement pursuant to which this CIA is entered, and into which this CIA is incorporated, [Provider] and OIG agree as follows:

- a. This CIA shall be binding on the successors, assigns and transferees of [Provider];
- b. This CIA shall become final and binding on the date the final signature is obtained on the CIA;
- c. Any modifications to this CIA shall be made with the prior written consent of the parties to this CIA; and
- d. The undersigned [Provider] signatories represent and warrant that they are authorized to execute this CIA. The undersigned OIG signatory represents that he is signing this CIA in his official capacity and that he is authorized to execute this CIA.

On Behalf of [Provider]

 Date

 Date

 Date

[Please identify all signatories]

**ON BEHALF OF THE OFFICE OF INSPECTOR GENERAL OF THE
DEPARTMENT OF HEALTH AND HUMAN SERVICES**

 Lewis Morris

 [Date]

**Assistant Inspector General for Legal Affairs
Office of Inspector General
U.S. Department of Health and Human Services**

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

[.34]

Appendix B — Sample Statement of Management's Assertions

[Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix C — Sample Engagement Letter

The following is a sample engagement letter that may be used for this kind of engagement.

[CPA Firm Letterhead]

[Client's Name and Address]

To the appropriate representative of the Company:

You have requested that we perform an agreed-upon procedures in connection with management's compliance with the terms of the Corporate Integrity Agreement (CIA) with the Office of Inspector General (OIG) of the U.S. Department of Health and Human Services (HHS) dated *[date of CIA]* for the period ending *[date]*. We are pleased to confirm our acceptance and understanding of this engagement by means of this letter.

Nature of the Engagement

The intended purpose of the engagement is to assist management and the OIG in evaluating the Company's compliance with the requirements specified in the CIA. We expect to issue an agreed-upon procedures report that will be restricted to the use of the Compliance Committee and management of the Company and the OIG. The engagement is performed pursuant to the terms specified in the CIA.

Our Responsibilities

We will perform those procedures enumerated in the attachment to this letter. Our responsibility is to carry out these procedures and report our findings in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA) and to comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence and due care.

We are not engaged to and will not perform an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on the Company's compliance with the CIA. Accordingly, we will not express such an opinion or conclusion. We have no responsibility to determine the differences between the procedures to be performed and the procedures that we would have determined to be necessary had we been engaged to perform an examination or review engagement. Accordingly, if we perform additional procedures, other matters may come to our attention that we would report to you.¹

¹ The independent accountant may wish to include an understanding with the engaging party about any limitation or other arrangements regarding liability of the practitioner or the engaging party in the engagement letter. For example, the following might be included in the letter:

Our maximum liability relating to services rendered under this letter (regardless of form of action, whether in contract, negligence or otherwise) shall be limited to the charges paid to us for the portion of the services or work products giving rise to liability. We will not be liable for consequential or punitive damages (including lost profits or savings) even if aware of their possible existence.

You will indemnify us against any damage or expense that may result from any third-party claim relating to our services or any use by you of any work product, and you will reimburse us for all expenses (including counsel fees) as incurred by us in connection with any such claim, except to the extent such claim (i) is finally determined to have resulted from our gross negligence or willful misconduct or (ii) is covered by any of the preceding indemnities.

[Footnote revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Your Responsibilities

The engagement to be performed is conducted on the basis that you agree and acknowledge that the procedures enumerated in this letter are appropriate for the purpose of assisting management and the OIG in evaluating the Company's compliance with the requirements specified in the CIA.

Management is responsible for the Company's compliance with all applicable laws, regulations, and contracts and agreements, including the CIA. Management also is responsible for the design, implementation, and monitoring of the policies and procedures upon which compliance is based.

You agree to provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the agreed-upon procedures engagement.

Our Report

We will issue a written report upon completion of the engagement. Our report will be in procedures and findings format and will be addressed to management of the Company.

Other Relevant Information

Working papers that are prepared in connection with this engagement are the property of the independent accountant. The working papers are prepared for the purpose of providing the principal support for the independent accountant's report.

If we are not able to complete all of the specified procedures, we will so advise you. At that time, we will discuss with you the form of communication, if any, that you desire for our findings. We will ask you to confirm your request in writing at that time. If you request that we delay issuance of our report until corrective action is taken that will result in compliance with all aspects of the CIA, we will do so only at your written request. Our working papers will be retained in accordance with our firm's working paper retention policy.

The distribution of the independent accountant's report will be restricted to the governing board and management of the Company and the OIG.

Our fees will be billed as work progresses and are based on the amount of time required at various levels of responsibility plus actual out-of-pocket expenses. Invoices are payable upon presentation. We will notify you immediately of any circumstances we encounter that could significantly affect our initial estimate of total fees.

We agree that to the extent required by law, we will allow the Comptroller General of the United States, HHS, and their duly authorized representatives to have access to this engagement letter and our documents and records to the extent necessary to verify the nature and amount of costs of the services provided to the Company, until the expiration of four years after we have concluded providing services to the Company that are performed pursuant to this Engagement Letter. In the event the Comptroller General, HHS, or their duly authorized representatives request such records, we agree to notify the Company of such request as soon as practicable.

In the event we are requested or authorized by the Company or are required by government regulation, subpoena, or other legal process to produce our documents or our personnel as witnesses with respect to our engagements for the Company, the Company will, so long as we are not a party to the proceeding in which the information is sought, reimburse us for our professional time and expenses, as well as the fees and expenses of our counsel, incurred in responding to such requests.

If this letter correctly expresses your understanding of this engagement, please sign the enclosed copy where indicated and return it to us. We appreciate the opportunity to serve you.

Sincerely, _____

[Partner's Signature]

[Firm Name or Firm Representative]

Accepted and agreed to: _____

[Client Representative's Signature]

[Title] _____

[Date] _____

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix D — Sample Procedures

Procedure

Findings

Governance

1. We read the Company's corporate minutes and organization chart and ascertained that, within [number] days of the date of the Corporate Integrity Agreement (CIA), the Company —
 - a. Established a Compliance Committee, which is to meet meets at least monthly and requires a quorum to meet.
 - b. Appointed to its Compliance Committee members who include, at a minimum, those individuals specified in the CIA.
 - c. Delegated to the Compliance Committee the authority to implement and monitor the CIA, as evidenced by the organization chart or the Compliance Committee's charter.
 - d. Appointed a compliance officer who reports directly to the individual specified in the CIA.
2. We interviewed the compliance officer and were informed that, in his or her opinion, the Compliance Officer —
 - a. Has sufficient staff and resources to carry out his or her responsibilities.
 - b. Actively participates in compliance training.
 - c. Has the authority to conduct full and complete internal investigations without restriction.
 - d. Periodically revises the compliance program to meet changing circumstances and risks.
3. We read the OIG notification letter as specified in the CIA and noted that the appropriate official signed the letter, that it was addressed to the OIG, that it covered items (a) through (d) in Step 1, and that it was dated within [number of] days of the execution of the CIA.

Billing Practices, Policies, and Procedures

The practitioner might be engaged to provide consulting services in connection with the evaluation of the company's billing practices, policies, and procedures. If so, generally no agreed-upon procedures would be performed relating to this area. Alternatively, if the procedures relating to the Company's billing practices, policies, and procedures are performed by others such as the Company's internal audit staff, the practitioner performs Steps 4 through 9.

4. We read the compliance work plan and noted the following:
 - a. The work plan's stated objectives include the determination that billings are accurate and complete, for services rendered that have been deemed by medical specialists as being necessary, and are submitted in accordance with federal program guidelines.
 - b. The work plan sampling methodology sets confidence levels consistent with those defined in the CIA.
 - c. The work plan identifies risk areas, as defined in the CIA (if applicable), and specifies testing procedures by risk area.
 - d. The work plan specifies that samples are taken in risk areas (if applicable) identified by the CIA.
 - e. The work plan includes testing procedures, which the practitioner should modify as required by the CIA, for the following risks areas (if applicable) identified in the CIA:

Procedure	Findings

- (1) Clinical documentation, as follows:
- (i) No documentation of service

(ii) Insufficient documentation of service

(iii) Improper diagnosis or treatment plan giving rise to the provision of a medically unnecessary service or treatment

(iv) Service or treatment does not conform medically with the documented diagnosis or treatment plan

(v) Services incorrectly coded
- (2) Billing and coding, as follows:
- (i) Noncovered or unallowable service

(ii) Duplicate payment

(iii) DRG window error

(iv) Unbundling

(v) Utilization

(vi) Medicare credit balances

[*Note to Practitioner:* Modify the preceding list as required by the CIA.]

5. We selected [*quantity*] probe samples performed by the independent review organization for the following risk areas [*list risk areas tested*]. For the probe samples selected, we noted that the —
- a. Sample patient billing files were randomly selected.

b. Sample size reflected confidence levels specified in the CIA.

c. Sample plan describes how missing items (if any) would be treated.

d. Patient billing files tested were pulled per the listing of random numbers and all patient billing files were accounted for in the working papers.

e. Work plans for the specific sample described the risk areas (if applicable) being tested and the testing approach/procedures.

f. Working papers noted the completion of each work plan step.

g. Working papers contained a summary of findings for the sample.
6. We reperformed the work plan steps [*list of specific steps performed*] for the sample patient billing files. The reperformance of work plan steps related to the medical review of the sample patient billing files was performed by the following individuals [*note the professional qualifications of individuals without listing names*]. Any exceptions between our findings and the Company's are summarized in the Attachment to this report.
7. We read the summary findings of all internal compliance reviews that the Company's Internal Audit department indicated it had performed for the Company and noted that all material billing deficiencies [*specify material threshold as defined by the Company*] noted therein were discussed in written communications addressed to the appropriate payor (for example, Medicare Part B carrier) and were dated within 60 days from the time the deficiency occurred.¹
8. We inquired of [*individual*] as to whether the Company took remedial steps within [*number of*] days (or such additional time as agreed to by the payor) to correct all material billing deficiencies noted in Step 7. We were informed that such remedial steps had been taken.

¹ The CIA provides its own legal definition of a "material deficiency." Determination of whether a billing or other act meets this definition is normally beyond the auditor's professional competence and may have to await final determination by a court of law. Accordingly, to avoid confusion, a working definition different from that provided in the CIA (e.g., a specified dollar threshold) may be necessary.

Procedure**Findings**

9. By reading applicable correspondence, we noted that any material billing deficiencies noted in Step 7 were communicated to the OIG, including specific findings relative to the deficiency, the Company's actions taken to correct the deficiency, and any further steps the Company plans to take to prevent any similar deficiencies from recurring.

Corporate Integrity Policy

10. We read the Company's Corporate Integrity Policy and noted the following.

- a. The policy was developed and implemented within [number of] days of execution of the CIA.
- b. The policy addressed the Company's commitment to preparation and submission of accurate billings consistent with the standards set forth in federal health care program statutes, regulations, procedures, and guidelines or as otherwise communicated by HCFA, its agents, or any other agency engaged in the administration of the applicable federal health care program.
- c. The policy addressed the specific issues that gave rise to the settlement, as well as other risk areas identified by the OIG in published Fraud Alerts issued through [agency].
- d. Correspondence addressed to the OIG covered the development and implementation of the policy.
- e. Documentation indicating that the policy was distributed to all employees, physicians, and independent contractors involved in submitting or preparing requests for reimbursement.
- f. The prominent display of a copy of the policy on the Company's premises.

11. We selected a sample of ten employees (involved in submitting and preparing requests for reimbursement) and examined written confirmation in the employee's personnel file indicating receipt of a copy of the Corporate Integrity Policy.

Information and Education Program

12. We read the Company's Information and Education Program and noted the following.

- a. The Information and Education Program agenda was dated within [number of] days of execution of the CIA.
- b. Correspondence covering the development and implementation of the Information and Education Program was addressed to the OIG.
- c. The Information and Education Program requires that each officer, employee, agent, and contractor charged with administering federal health care programs (including, but not limited to billers, coders, nurses, physicians, medical records, hospital administration and other individuals directly involved in billing federal health care programs) receive at least [number of] hours of training.

13. We selected a sample of ten employees involved in billing, coding and/or charge capture and examined sign-in logs of the training classes and noted that each had signed indicating that they had received at least [number of] hours of training as specified in the Information and Education Program. We also reviewed tests and surveys completed by each of the ten trained employees noting evidence that they were completed.

14. We inquired as to the training of individuals not present during the regularly scheduled training programs and were informed that each such individual is trained either individually or in a separate make-up session. We inquired as to the names of individuals not initially present and selected one such individual and examined that individual's post-training test and survey for completion.

Procedure

15. We read the course agenda and noted that the training provided to employees involved in billing, coding, and/or charge capture consisted of instructions on submitting accurate bills, the personal obligations of each individual to ensure billings are accurate, the nature of company-imposed disciplinary actions on individuals who violate company policies and/or laws and regulations applicable to federal health care program rules, legal sanctions against the company for submission of false or fraudulent information, and how to report potential abuses or fraud. We also noted that the training material addressed the following issues which gave rise to the settlement [*practitioner list*].
16. We inquired of the Corporate Compliance Officer as to the qualifications and experience of the trainers and were informed that, in the Corporate Compliance Officer's opinion, they were consistent with the topics presented.
17. We noted that the Company's draft Annual Report to the OIG dated [date] addresses certification of training.

Confidential Disclosure Program

18. We read documentation of the Company's Confidential Disclosure Program and noted that it —
 - a. Includes the printed effective date that was within [number of] days of execution of the CIA.
 - b. Consists of a confidential disclosure program enabling any employee to disclose any practices or billing procedures relating to federal health care programs.
 - c. Provides a toll-free telephone line maintained by the Company, which Company representatives have indicated is maintained twenty-four hours a day, seven days a week, for the purpose of making any disclosures regarding compliance with the Company's Compliance Program, the obligations in the CIA, and Company's overall compliance with federal and state standards.
 - d. Includes policies requiring the review of any disclosures to permit a determination of the appropriateness of the billing practice alleged to be involved and any corrective action to be taken to ensure that proper follow-up is conducted.
19. We made five test calls to the toll free telephone line (hotline) and noted the following.
 - a. Each call was captured in the hotline logs and reported with all other incoming calls.
 - b. Anonymity is not discouraged.
20. We noted that the Company included in its draft Annual Report addressed to OIG dated [date] a detailed summary of the communications (including the number of disclosures by employees and the dates of such disclosures) concerning billing practices reported as, and found to be, inappropriate under the Confidential Disclosure Program, and the results of any internal review and the follow-up on such disclosures.
21. We observed the display of the Company's Confidential Disclosure Program, including notice of the availability of its hotline, on the Company's premises.

Excluded Individuals or Entities

22. We read the Company's written policy relating to dealing with excluded or convicted persons or entities and noted that the policy —
 - a. Prohibits the hiring of or contracting with an individual or entity that is listed by a federal agency as convicted of abuse or excluded, suspended, or otherwise ineligible for participation in federal health care programs.
 - b. Includes a process to make an inquiry into the status of any potential employee or independent contractor.
 - c. Provides for a semi-annual review of the status of all existing employees and contractors to verify whether any individual had been suspended or excluded or charged with a criminal offense relating to the provision of federal health care services.

Findings

Procedure**Findings**

23. We selected a sample of ten employees hired over the course of the test period as defined in the CIA and examined support in the employee's personnel file documenting inquiries made into the status of the employee, including documentation of comparison to the *[source specified in the CIA]*.
24. We performed the following procedures related to the Company's semi-annual review of employee status.
- Read documentation of the semi-annual review as evidence that a review was performed.
 - Selected and reviewed the lesser of ten or all exceptions and determined that such employees were removed from responsibility for or involvement with Provider business operations related to the Federal health care programs.
 - Examined a notification letter addressed to the OIG and dated within 30 days of the employee's removal from employment.
 - Inquired of *[officer]* as to whether he or she was aware of any individuals employed in contravention of the prohibitions in the CIA. If so, we further noted that *[indicate specific procedures]* to confirm that such situation was cured within 30 days by *[indicate how situation was cured]*.

Annual Report

25. We read the Company's draft Annual Report dated *[date]* and determined that it included the following items, to be modified as appropriate, by the practitioner:
- Compliance Program Charter and organization chart
 - Amendments to policies
 - Detailed descriptions of reviews and audits
 - Summary of hotline communications
 - Summary of annual review of employees
 - Cross-referencing to items noted in the CIA

Record Retention

26. We read the Company's record retention policy and noted that it was consistent with the requirements as outlined in the CIA.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix E — Sample Report

Independent Accountant's Report

To [Sample Health Care Provider] and Office of Inspector General of the U.S. Department of Health and Human Services

We have performed the procedures enumerated in Attachment B to Sample Health Care Provider's (Company) compliance with the Corporate Integrity Agreement (CIA) with the Office of Inspector General (OIG) dated [date of CIA] for the [period] ending [date], which is included as Attachment A to this report. Management of the Company is responsible for the Company's compliance with the CIA.

Management of the Company has agreed to and acknowledged that the procedures performed are appropriate to assist management and the OIG in evaluating the entity's compliance with the requirements specified in the CIA. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures performed and the findings are included in the attached.

We were engaged by management of the Company to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not perform an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on the Company's compliance with the CIA. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of the Compliance Committee and management of the Company and the OIG, and is not intended to be, and should not be used by anyone other than the specified parties.

[Additional paragraphs may be added to describe other matters.]

[Include as Attachments the CIA and the summary that enumerates procedures and findings.]

[Practitioner's signature]

[City and state where the practitioner's report is issued]

[Date of practitioner's report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Auditing Standards Board 1998

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AUD Section 25

Statement of Position 01-3 Performing Agreed-Upon Procedures Engagements That Address Internal Control Over Derivative Transactions as Required by the New York State Insurance Law

June 15, 2001

NOTE

This AICPA Statement of Position (SOP) has been developed by the AICPA Reporting on Internal Control Over Derivative Transactions at Insurance Entities Task Force of the AICPA Auditing Standards Board (ASB) to provide guidance regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to agreed-upon procedures engagements performed to comply with the requirements of Section 1410 (b)(5) of the New York State Insurance Law, as amended (the law), which addresses the assessment of internal control over derivative transactions as defined in Section 1401(a) of the law, and Section 178.5 of Regulation No. 163.

An attestation SOP is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive publications are relevant to the proper application of the attestation standards in specific circumstances.

Introduction and Background

.01 In 1999 and 2000, the New York State Insurance Department (the department) issued regulations to implement the New York Derivative Law (the law) which amends Article 14 of the State of New York Insurance Law, effective July 1, 1999. The law establishes certain requirements for domestic life insurers, domestic property and casualty insurers, domestic reciprocal insurers, domestic mortgage guaranty insurers, domestic cooperative property and

casualty insurance corporations, and domestic financial guaranty insurers. Foreign insurers engaging in derivative transactions and derivative instruments are subject to and required to comply with all of the provisions of the law. However, a foreign insurer may enter into other derivative transactions provided the insurer meets certain conditions of its domestic state law. In this document, an insurer covered by the law is referred to as an *insurance company*.

.02 The requirements of the law include the following:

- Approval by the board of directors, or a similar body, of derivative transactions
- Submission of a derivative use plan (the DUP) to the Department
- Assessment by an independent certified public accountant (CPA) of the insurance company's internal control over derivative transactions

.03 In addition to the law, the Department also established Regulation No. 163, "Derivative Transactions" (11 NYCRR 178) (the Regulation), which provides guidance in implementing the law. Section 178.5 of Regulation No. 163 states the following.

As set forth in section 1410 (b)(5) of the Insurance Law, an insurer engaging in derivative transactions shall be required to include, as part of the evaluation of accounting procedures and internal controls required to be filed pursuant to section 307 of the Insurance Law, a statement describing the assessment by the independent certified public accountant of the internal controls relative to derivative transactions. The purpose of this part of the evaluation is to assess the adequacy of the internal controls relative to the derivative transactions being conducted by the insurer. Such an assessment shall be made whether or not the derivative transactions are material in relation to the insurer's financial statements. The independent certified public accountant shall issue a report regarding internal controls relative to derivative transactions, whether or not deficiencies in internal controls would lead to a "reportable condition," as that term is used in auditing standards adhered to by certified public accountants. An assessment in the form of an "agreed upon procedures engagement" or an "attestation engagement," as those terms are used in auditing standards adhered to by certified public accountants, may be used to meet this requirement. If an "agreed upon procedures engagement" is performed, the procedures used shall be those that management and the independent certified public accountant determine are appropriate to meet the purpose of the assessment as set forth above.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.[04–05] [Paragraphs deleted, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.06 An agreed-upon procedures engagement or an examination engagement may be used to satisfy the requirements of the law. However, this Statement of Position (SOP) only describes an agreed-upon procedures engagement. It does not address an examination-level attestation engagement. For guidance on performing an examination level attestation engagement, see AT-C section 205, *Examination Engagements*. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Applicability

.07 This SOP was developed to provide practitioners with guidance on performing agreed-upon procedures engagements that address an insurance company's internal control over derivative transactions to meet the requirements of the law. The engagement described in this SOP is designed only to satisfy the requirements of the law. The procedures, as set forth in this SOP, are not necessarily appropriate for use in any other engagement. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.08 Although the Department has indicated that an agreed-upon procedures engagement pursuant to this SOP can be used to satisfy the requirements for an assessment of internal control over derivative transactions, the Department has not agreed to the sufficiency or appropriateness of the procedures included in this SOP for their purposes.

The Law

Definition of a Derivative

.09 Article 14 of the law defines a derivative instrument as including caps, collars, floors, forwards, futures, options, swaps, swaptions, and warrants.

.10 The following definitions are included in the law and are applicable when performing the agreed-upon procedures engagement described in this SOP.

Cap — An agreement obligating the seller to make payments to the buyer with each payment based on the amount by which a reference price or level or the performance or value of one or more underlying interests exceeds a predetermined number, sometimes called the strike rate or strike price.

Collar — An agreement to receive payments as the buyer of an option, cap, or floor and to make payments as the seller of a different option, cap, or floor.

Floor — An agreement obligating the seller to make payments to the buyer in which each payment is based on the amount by which a predetermined number, sometimes called the floor rate or price, exceeds a reference price, level, performance, or value of one or more underlying interests.

Forward — An agreement (other than a future) to make or take delivery in the future of one or more underlying interests, or effect a cash settlement, based on the actual or expected price, level, performance, or value of such underlying interests, but shall not mean or include spot transactions effected within customary settlement periods, when-issued purchases, or other similar cash market transactions.

Future — An agreement traded on a futures exchange, to make or take delivery of, or effect a cash settlement based on the actual or expected price, level, performance, or value of one or more underlying interests.

Option — An agreement giving the buyer the right to buy or receive (a *calloption*), sell or deliver (a *putoption*), enter into, extend or terminate, or effect a cash settlement based on the actual or expected price, spread, level, performance, or value of one or more underlying interests.

Swap — An agreement to exchange or to net payments at one or more times based on the actual or expected price, yield, level, performance, or value of one or more underlying interests.

Swaption — An option to purchase or sell a swap at a given price and time or at a series of prices and times. A swaption does not mean a swap with an embedded option.

Warrant — An instrument that gives the holder the right to purchase or sell the underlying interest at a given price and time or at a series of prices and times outlined in the warrant agreement.

.11 Article 14 of the law permits an insurance company to enter into *replication transactions* provided that certain conditions set forth in the law are met. A replication transaction is defined in the law as follows.

A derivative transaction or combination of derivative transactions effected either separately or in conjunction with cash market investments included in the insurer's investment portfolio in order to replicate the investment characteristic of another authorized transaction, investment or instrument and/or operate as a substitute for cash market transactions. A derivative transaction entered into by the insurer as a hedging transaction or income generation transaction authorized pursuant to this section [of the law] shall not be considered a replication transaction.

Derivative Use Plan

.12 An insurance company entering into derivative transactions must file a DUP with the Department. The DUP generally should include the following items:¹

- A certified copy of the authorization by the insurer's board of directors, or other similar body, to file the DUP, which should include authorization of derivative transactions and an assurance that individuals responsible for derivative transactions, processes, and controls have the necessary experience and knowledge
- A section on management oversight standards including a discussion of the following:
 - Limits on identified risks
 - Controls over the nature and amount of identified risks
 - Processes for identifying such risks
 - Processes for documenting, monitoring, and reporting risk exposure
 - Internal audit and review processes that ensure integrity of the overall risk management process
 - Quarterly reporting to the board of directors
 - The establishment of risk tolerance levels
 - Management's measurement and monitoring against those levels

¹ Reference should be made to the law and the Regulation for specific details and exact requirements.

- A section on internal control and reporting including a discussion of the following:
 - The existence of controls over the valuation and effectiveness of derivative instruments
 - Credit risk management
 - The adequacy of professional personnel
 - Technical expertise and systems
 - Management reporting
 - The review and legal enforceability of derivative contracts between parties
- A section on documentation and reporting requirements which shall for each derivative transaction document the following:
 - The purpose of the transaction
 - The assets or liabilities to which the transaction relates
 - The specific derivative instrument used
 - For over-the-counter (OTC) transactions, the name of the counterparty and counterparty exposure amount
 - For exchange traded transactions, the name of the exchange and the name of the firm handling the trade
- Written guidelines to be followed in engaging in derivative transactions. The guidelines should include or address the following:
 - The type, maturity, and diversification of derivative instruments
 - The limitation on counterparty exposures, including limitations based on credit ratings
 - The limitations on the use of derivatives
 - Asset and liability management practices with respect to derivative transactions
 - The liquidity needs and the insurance company's capital and surplus as it relates to the DUP
 - The policy objectives of management specific enough to outline permissible derivative strategies
 - The relationship of the strategies to the insurer's operations
 - How the strategies relate to the insurer's risk
 - A requirement that management establish and execute management oversight standards as required by the law
 - A requirement that management establish and execute internal control and reporting standards as required by the law
 - A requirement that management establish and execute documentation and reporting standards as required by the law
- Guidelines for the insurer's determination of acceptable levels of basis risk, credit risk, foreign currency risk, interest rate risk, market risk, operational risk, and option risk

- A requirement that the board of directors and senior management comply with risk oversight functions and adhere to laws, rules, regulations, prescribed practices, or ethical standards

Related Professional Standards

AT-C Section 215, *Agreed-Upon Procedures Engagements*

.13 Agreed-upon procedures engagements performed to meet the requirements of the law are to be performed in accordance with AT-C section 215, *Agreed-Upon Procedures Engagements*. As described in paragraph .02 of AT-C section 215, an agreed-upon procedures engagement is an attestation engagement in which a practitioner performs specific procedures on subject matter and reports the findings without providing an opinion or conclusion. Not all of the provisions of AT-C section 215 are discussed herein. Rather, this SOP includes guidance to assist practitioners in the application of selected aspects of AT-C section 215. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.14] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.15 As previously stated, Regulation No. 163 states that an agreed-upon procedures engagement may be used to meet the requirement for an independent CPA's assessment of internal control over derivative transactions. When performing an agreed-upon procedures engagement under this SOP, practitioners should not eliminate any of the procedures presented in appendix B, "Agreed-Upon Procedures for Testing Internal Control Over Derivative Transactions" (paragraph .42), of this SOP or reduce the extent of the tests. The Department or the insurance company may request that additional procedures be performed and the practitioner may agree to perform such procedures. In those circumstances, it would be expected that the additional procedures would be performed in the context of a separate agreed-upon procedures engagement.

[.16] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

AU-C Section 501, *Audit Evidence — Specific Considerations for Selected Items*

.17 AU-C section 501, *Audit Evidence — Specific Considerations for Selected Items*, addresses specific considerations by the auditor in obtaining sufficient appropriate audit evidence, in accordance with AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, AU-C section 500, *Audit Evidence*, and other relevant AU-C sections in AICPA *Professional Standards*, regarding the valuation of investments in securities and derivative instruments. A practitioner performing the agreed-upon procedures engagement described in this SOP may find it helpful to consider the guidance in paragraphs .01–.10 of AU-C section 501 and the related Audit Guide *Special Considerations in Auditing Financial Instruments*. Paragraph .32 of AT-C section 105 and paragraphs .19–.20 of AT-C section 215 are applicable when a practitioner uses the work of an external specialist. Paragraph .10 of AT-C section 105 defines the term *practitioner's specialist* as an individual or organization possessing expertise in a field other than accounting or attestation whose work in that field is used by the

practitioner to assist the practitioner in obtaining evidence for the service being provided. A practitioner's specialist may be either a practitioner's internal specialist (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm) or a practitioner's external specialist. *Partner* and *firm* refer to their governmental equivalents when relevant. A specialist in securities and derivative instruments may be helpful to a practitioner performing the agreed-upon procedures described in this SOP. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.18 The procedures in this SOP are not designed to meet the requirements of generally accepted auditing standards for an audit of the financial statements of an entity that engages in derivative transactions. In addition, performing the audit procedures described in AU-C section 501 would not meet the requirements of this SOP. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.19 In an audit of financial statements, the auditor may determine that he or she will not perform procedures related to derivative transactions because they are not material to the financial statements. There is no requirement to perform the procedures described in this SOP when performing an audit of financial statements. In contrast, the law requires that an assessment of internal control be performed whether or not the derivative transactions are material to the insurer's financial statements. Accordingly, a decision not to perform procedures related to derivative transactions in an audit of financial statements, because of immateriality, would not alleviate the requirement to perform the agreed-upon procedures engagement described herein.

Procedures to Be Performed

.20 The agreed-upon procedures to be performed are directed toward tests of controls over derivative transactions that occurred during the period covered by the practitioner's report. Any projection of the practitioner's findings to the future is subject to the risk that because of change, the controls may no longer be in existence, suitably designed, or operating effectively. Also, the potential effectiveness of controls over derivative transactions is subject to inherent limitations and, accordingly, errors or fraud may occur and not be detected.

.21 The procedures to be performed in the agreed-upon procedures engagement described in this SOP are presented in appendix B (paragraph .42). The procedures have been designed so that the findings resulting from the application of the procedures can be recorded in a tabular format. The three options available to the practitioner for expressing the findings for each procedure are *No Exception*, *Exception*, or *N/A* (not applicable). If a procedure is not applicable to a particular insurance company, the procedure should be marked *N/A* rather than deleted from the report. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.22 Section 1 of appendix B (paragraph .42) of this SOP is applicable to all insurance companies that enter into derivative transactions. Therefore, the procedures in section 1 are to be performed in all engagements performed in accordance with this SOP. Sections 2–10 of appendix B (paragraph .42) of this SOP each address a specific type of derivative. The procedures in those sections are to be performed only if the insurance company entered into derivative transactions of the type covered by the section. Sections that address types of

derivatives not used by the insurance company should not be attached to the agreed-upon procedures report.

.23 If any portion of a procedure results in an exception, the findings for that entire procedure should be recorded as an exception and described in the section "Description of Exceptions If Any," at the end of each section. The practitioner should provide a brief factual explanation for each exception avoiding vague or ambiguous language and described at a level of specificity sufficient for a user to understand the nature, timing, and extent of the procedures and findings resulting in the exception. If management informs the practitioner that the condition giving rise to the exception was corrected by the date of the practitioner's report, the practitioner's explanation of the exception may include that information; for example, "Management has advised us that the condition resulting in the exception was corrected on Month X, 20XX. We have performed no procedures with respect to management's assertion." [Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.24 A practitioner may perform significant portions of the agreed-upon procedures engagement before the end of the period covered by the report. If, during that time, the practitioner identifies conditions that result in an exception in one or more agreed-upon procedures, he or she should report the exception in the findings section of the agreed-upon procedures report, even if management corrects the condition prior to the end of the period.

.25 The law requires the insurance company to provide the Department with a statement describing the independent CPA's assessment of the insurance company's internal control over derivative transactions. It also requires the insurance company to include a description of any remedial actions taken or proposed to be taken to correct any deficiencies identified by the independent CPA.

.26 Paragraph .40 of AT-C section 215 states the following.

Although the practitioner need not perform procedures beyond the procedures agreed to and acknowledged by the engaging party to be appropriate for the intended purpose of the engagement, if in connection with the application of the procedures, and through the completion of the engagement, matters come to the practitioner's attention by other means that significantly contradict the subject matter referred to in the practitioner's report, the practitioner should discuss the matter with the engaging party and take appropriate action, including determining whether the practitioner's report should be revised to disclose the matter.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.27 The phrase "through the completion of the engagement" in paragraph .40 of AT-C section 215 indicates that this requirement would apply to conditions or events occurring subsequent to the period covered by the practitioner's report but prior to the date of the practitioner's report. This would include matters that would have resulted in the reporting of an exception by the practitioner if that matter existed during the period covered by the report. For example, if during the course of applying agreed-upon procedures regarding an entity's internal control, the practitioner becomes aware of a material weakness in internal control over derivative transactions by means other than performance of the agreed-upon procedures, the practitioner would be required to determine whether the matter would be included in the practitioner's report. [Revised, April 2017, to reflect conforming changes necessary due to the

issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Agreeing on the Terms of the Engagement

.28 In accordance with paragraph .14 of AT-C section 215, the practitioner should agree upon the terms of the engagement with the engaging party. It is in the interests of both the engaging party and the practitioner to document the agreed-upon terms of the engagement before commencement of the engagement to help avoid misunderstandings. For the purposes of this SOP, the responsible party is management of the insurance company. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. To meet the requirements in paragraph .14 of AT-C section 215, the agreed-upon terms of the engagement should include the following:

- A statement that the intended purpose of the engagement is to meet the requirements of Section 1410(b)(5) of the law, which addresses the assessment of internal control over derivative transaction
- A statement that management is responsible for maintaining effective internal control over derivative transactions.
- A statement identifying the procedures to be performed as those set forth in this SOP and that the engaging party agrees to and acknowledges that the procedures to be performed are appropriate for the intended purpose of the engagement
- The responsibilities of the practitioner
- A statement indicating that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA)
- A statement that the engaging party agrees to provide, at the conclusion of the engagement, a representation letter
- Reference to the expected form and content of the practitioner's agreed-upon procedures report, including any use restrictions, if applicable
- Disclaimers to be included in the practitioner's report, if applicable
- A statement describing assistance to be provided to the practitioner, if applicable
- A statement describing any arrangements to involve a practitioner's external specialist
- Specified thresholds for reporting exceptions, if applicable

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.29 The following are other matters that are relevant to the engagement described in this SOP that may be included in the engagement letter or other written agreement:

- A statement describing the responsible party's² responsibility to comply with the law and the responsible party's responsibility for the design and operation of effective internal control over derivative transactions
- A statement describing the responsible party's responsibility for providing accurate and complete information to the practitioner
- A statement indicating that the practitioner has no responsibility for the completeness or accuracy of the information provided to the practitioner
- The circumstances under which the practitioner may decline to issue a report.

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

[.30] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Requesting Written Representations

[.31] [Paragraph renumbered and deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.32 In accordance with paragraph .27 of AT-C section 215, the practitioner should request from management written representations in the form of a letter addressed to the practitioner. The representations should include the following:

- a. A statement that management of the insurance company is responsible for maintaining effective internal control over derivative transactions.
- b. If applicable, a statement that the engaging party has obtained from all necessary parties agreement to the procedures and acknowledgment that the procedures are appropriate for their purposes.
- c. A statement that it has provided the practitioner with all relevant information and access, as applicable, as agreed upon in the terms of the engagement.
- d. A statement that all known matters contradicting the subject matter and any communication from regulatory agencies or others affecting the subject matter have been disclosed to the practitioner, including communications received between the end of the period addressed by the subject matter and the date of the practitioner's report.
- e. A statement that it is not aware of any material misstatements in the subject matter.
- f. A statement that it has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter.

² In this Statement of Position, the responsible party is usually management of the insurance company. [Footnote added, April 2017, to reflect conforming changes due to the issuance of SSAE No. 18.]

- g.* Any additional matters that the practitioner determines are appropriate.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.33 In addition to the representations required by paragraph .27 of AT-C section 215, a practitioner may request other representations from management depending on the specific nature of the engagement. For the engagement addressed in this SOP, they generally include the following representations from management:

- A statement acknowledging responsibility for establishing and maintaining effective internal control over derivative transactions
- A statement that management is not aware of any errors or fraud that might indicate a weakness in the internal control over derivative transactions
- A statement that management has disclosed to the practitioner all significant deficiencies in the design or operation of the internal control over derivative transactions
- A statement that management has responded fully to all inquiries made by the practitioner during the engagement

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.34 When management refuses to provide one or more of the written representations requested by the practitioner, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should do the following:

- a.* Discuss the matter with management
- b.* Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general
- c.* If any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's agreed-upon procedures report

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.35 An illustrative representation letter is presented in appendix C, "Illustrative Management Representation Letter" (paragraph .43), of this SOP. For additional information regarding management's representations in an agreed-upon procedures engagement, see paragraphs .27–.30, .A35 and .A45 of AT-C section 215. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Restriction on the Performance of Procedures

.36 As previously stated, a practitioner should not agree to do either of the following.

- a. Eliminate any of the procedures presented in appendix B (paragraph .42) of this SOP, unless a section is not applicable because the insurance company did not enter into derivative transactions addressed by the section.
- b. Reduce the extent of the tests in an applicable section.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.37 When circumstances impose restrictions on the performance of the agreed-upon procedures presented in appendix B (paragraph .42) of this SOP, the practitioner should discuss with the engaging party whether those restrictions are appropriate and, if the restrictions are appropriate, describe the restrictions in the practitioner's report. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Alert That Restricts the Use of the Practitioner's Agreed-Upon Procedures Report

.38 Although the practitioner is not precluded from issuing a general-use agreed upon procedures report, because the engagement is performed to comply with the requirements of Section 1410 (b)(5) of the New York State Insurance Law, as amended and, as such, the procedures performed may not be well understood by others, the practitioner may consider it appropriate to include an alert, in a separate paragraph, that restricts the use of the report. In addition to insurance company's management and Board of Directors, the New York State Insurance Department may be named as a specified party. [Paragraph added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Dating the Report

.39 In accordance with paragraph .34*w* of AT-C section 215, the practitioner's report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that (a) the attestation documentation has been reviewed, and (b) if applicable, the written presentation of the subject matter has been prepared. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Effective Date

.40 This SOP is effective upon issuance and is applicable only to agreed-upon procedures engagements that address internal control over derivative transactions required by the law. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.41

Appendix A — Illustrative Agreed-Upon Procedures Report

The following is an illustrative agreed-upon procedures report based on the guidance in AT-C section 215, *Agreed-Upon Procedures Engagements*.

Independent Accountant's Report on Applying Agreed-Upon Procedures

To the Management of ABC Insurance Company:

We have performed the applicable procedures enumerated in the American Institute of Certified Public Accountants' Statement of Position (SOP), 01-3, *Performing Agreed-Upon Procedures Engagements That Address Internal Control Over Derivative Transactions as Required by the New York State Insurance Law*, to ABC Insurance Company's compliance with the requirements of Section 1410 (b)(5) of the New York State Insurance Law, as amended (the law), which addresses the assessment of internal control over derivative transactions as defined in Section 1401(a) of the law, and Section 178.5 of Regulation No. 163 during the year ended December 31, 20XX. Management of ABC Insurance Company is responsible for maintaining effective internal control over derivative transactions.

Management of ABC Insurance Company has agreed to and acknowledged that the procedures performed are appropriate to assist users in evaluating ABC Insurance Company's compliance with the requirements of the law. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures performed and the findings are included in the attached appendix.

We were engaged by management of ABC Insurance Company to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on the internal control over derivative transactions of ABC Insurance Company for the year ended December 31, 20XX. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of ABC Insurance Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of the New York State Insurance Department and the management and Board of Directors of ABC Insurance Company and is not intended to be and should not be used by anyone other than these specified parties.

[Additional paragraphs may be added to describe other matters.]

[Signature]

[City and state where the practitioner's report is issued]

[Date]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix B — Agreed-Upon Procedures for Testing Internal Control Over Derivative Transactions

The following table lists the types of derivative transactions permitted by the New York Derivative Law (the law). We inquired of management of the insurance company as to whether the insurance company used the type of derivative addressed by each section, and marked the column entitled "Is the Section Applicable?" either *Yes* or *No* based on management's response to the inquiry. For each type of derivative with a *Yes* response, we performed the procedures in the applicable section and attached the section to the report. For each type of derivative with a *No* response, we did not perform procedures nor did we attach the applicable section to the report. We compared the types of derivative reported by the insurance company in its "Schedule of Derivative Transactions" included in the Annual Statement with the types of derivatives listed in the following table and found that the types of derivatives included in the schedule were marked *Yes* in the table.

Paragraph .A21 of AT-C section 215, *Agreed-Upon Procedures Engagements*, states that mere reading of specified information about the subject matter does not constitute a procedure sufficient to permit a practitioner to report on the results of applying procedures. For purposes of this SOP, the action of "read" as used in the following procedures is the equivalent of "inspect" and is acceptable.

Attachments to the Report

Section of the Agreed-Upon Procedures		Is the Section Applicable?
<u>No.</u>	<u>Type of Derivative</u>	<u>Yes or No</u>
1	All Derivative Types	Yes
2	Cap Contracts	
3	Collar Contracts	
4	Floor Contracts	
5	Forward Contracts	
6	Future Contracts	
7	Option Contracts	
8	Swap Contracts	
9	Swaption Contracts	
10	Warrant Contracts	

Section 1 — All Derivative Types

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
The following procedures were performed to test controls applicable to all derivative transactions. The procedures were applied to the internal control over derivative transactions in existence during the year ended December 31, 20XX			
Documentation of Controls, Policies, and Procedures			
1. Read the insurance company's derivative use plan (DUP), amendments thereto, and its documentation of controls, policies, and procedures that describe internal control over derivative transactions and found that the DUP and the documentation of controls, policies, and procedures include a description of controls that address the following:			
a. Systems or processes for the periodic valuation of derivative transactions including mechanisms for compensating for any lack of independence in valuing derivative positions (Valuation)	_____	_____	_____
b. Systems or processes for determining whether a derivative instrument used for hedging or replication has been effective (Effectiveness)	_____	_____	_____
c. Credit risk management systems or processes for over-the-counter (OTC) derivative transactions that measure credit risk exposure using the counterparty exposure amount and policies for the establishment of collateral arrangements with counterparties (Credit Risk Management)	_____	_____	_____
d. Management assessment of the adequacy and technical expertise of personnel associated with derivative transactions and systems to implement and control investment practices involving derivatives (Professional Competence)	_____	_____	_____
e. Systems or processes for regular reports to management, segregation of duties, and internal review procedures (Reporting)	_____	_____	_____
f. Procedures for conducting initial and ongoing legal reviews of derivative transactions including assessments of contract enforceability (Legal Reviews)	_____	_____	_____
Nontransaction-Specific Procedures			
2. Read the minutes of meetings of the board of directors and found an indication that the board of directors of the insurance company approved the DUP and any amendments thereto.	_____	_____	_____
3. Inquired of management as to whether the DUP and any amendments thereto were approved by the New York State Insurance Department and was advised that the DUP and any amendments thereto were approved.	_____	_____	_____
4. Read the minutes of meetings of the board of directors and found an indication that the board of directors of the insurance company approved the commitment of financial resources determined by management to be sufficient to accomplish the objectives of the insurance company's DUP.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
<i>This procedure does not provide an assessment of or assurance about the adequacy of the resources determined by management to be sufficient to accomplish the objectives of the DUP.</i>			
<i>In performing the following procedures, the practitioner frequently will find that management has designated and will have in place limits, controls, or procedures that are more restrictive than those approved for use in the DUP</i>			
5. For the year ended December 31, 20XX, inquired of management and was advised that —			
a. There was monitoring of derivative transactions by a control staff, such as internal audit or other internal review group, that is independent of derivatives trading activities.	_____	_____	_____
b. There were procedures in place for derivative personnel to obtain, prior to exceeding limits prescribed by management, at least oral approval from members of senior management who are independent of derivatives trading activities.	_____	_____	_____
c. There were procedures in place for senior management to address excesses related to management-established limits and divergences from management-approved derivative strategies, and that such management has authority to grant exceptions to derivatives limits.	_____	_____	_____
d. There were procedures in place requiring that management be informed when limits prescribed in the DUP were exceeded and for management to approve corrective action(s) in such circumstances.	_____	_____	_____
e. There were procedures in place for the accurate transmittal of derivatives positions to the risk measurement systems when management had implemented risk management systems.	_____	_____	_____
f. There were procedures in place for the performance of appropriate reconciliations to ensure data integrity across the full range of derivatives, including any new or existing derivatives that may be monitored apart from the main processing networks.	_____	_____	_____
g. There were procedures in place for risk managers and senior management to define constraints on derivative activities to ensure compliance with the DUP and to justify excesses with respect to specified management limits.	_____	_____	_____
h. There were procedures in place for senior management, an independent group, or an individual that management designated to perform at least an annual assessment of the identified controls and financial results of the derivative activities to determine that controls were effectively implemented and that the insurance company's business objectives and strategies were achieved.	_____	_____	_____
i. There were procedures in place for a review of limits in the context of changes in strategy, risk tolerance of the insurance company, and market conditions.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
Reporting to the Board of Directors or Committee Thereof			
The law contains provisions regarding management oversight of derivative and replication transactions.			
6. Read the minutes of the board of directors meetings or committees thereof and found an indication that the board of directors or committee thereof received, at least quarterly, a report regarding derivative and replication transactions.	_____	_____	_____
7. Read one quarterly report referred to in procedure 6 and found that the report contained —			
a. A list, or appropriate summaries, of the following:			
(1) Derivative transactions during the period	_____	_____	_____
(2) Derivative transactions outstanding at the end of the period	_____	_____	_____
(3) Unrealized gains or losses on open derivative positions	_____	_____	_____
(4) Derivative transactions closed during the period	_____	_____	_____
b. A summary of the performance of the derivatives in comparison to the objective of the derivative transactions	_____	_____	_____
c. An evaluation of the risks and benefits of the derivative transactions	_____	_____	_____
d. A summary of the amount, type, and performance of replication transactions	_____	_____	_____
8. If the report referred to in the preceding procedure was received, reviewed, and approved by a committee of the board of directors, read the minutes of the board of directors meeting and found an indication that a report of such committee was reviewed at the next board of directors meeting.	_____	_____	_____
9. Read the board of directors minutes and found an indication that the board of directors received a report during the year describing the level of knowledge and experience of individuals conducting, monitoring, controlling, and auditing derivative and replication transactions.	_____	_____	_____
Derivative and Replication Limitations			
The law contains limits on hedging and replication transactions. An insurance company may enter into hedging or replication transactions if, as a result of and after giving effect to the transaction, the derivative investments and replication investments do not exceed certain specified percentages of admitted assets. The following procedures were performed using one analysis per quarter prepared by the insurance company to monitor compliance with the limitations.			

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
10. Obtained and read the insurance company's analysis used to test limitations on investments in derivatives and replication transactions and found that the amounts shown in the analysis indicated that —			
a. The aggregate statement value of options, swaptions, caps, floors, and warrants purchased was not in excess of seven and one-half percent of the insurance company's admitted assets, per the last annual statement.	_____	_____	_____
b. The aggregate statement value of options, swaptions, caps, and floors written was not in excess of three percent of admitted assets.	_____	_____	_____
c. The aggregate potential exposure of collars, swaps, forwards, and futures entered into and options, swaptions, caps, and floors written was not in excess of six and one-half percent of admitted assets.	_____	_____	_____
d. The aggregate statement value of all assets being replicated did not exceed ten percent of the insurance company's admitted assets.	_____	_____	_____
e. The extent of derivative transactions did not exceed the insurance company's internal limitations or that any excess had been specifically authorized by management.	_____	_____	_____
11. Inquired of the preparer of the analysis read in procedure 10 and was advised that the analysis excluded transactions entered into to hedge the currency risk of investments denominated in a currency other than United States dollars.	_____	_____	_____
12. Obtained and read the insurance company's analysis used to test limitations on counterparty exposure, as defined in section 178.3 (e) of the Regulation, and found that the report indicated that —			
a. The counterparty exposure under one or more derivative transactions for any single counterparty, other than a "qualified counterparty," was not in excess of one percent of the insurance company's admitted assets.	_____	_____	_____
b. The counterparty exposure under one or more derivative transactions for all counterparties, other than qualified counterparties, was not in excess of three percent of the insurance company's admitted assets.	_____	_____	_____
13. If the insurance company required collateral arrangements with the counterparties, obtained and read the insurance company's analysis used to monitor the adequacy of the collateral held in accordance with the terms of the arrangement and found that the amount of the collateral held as shown on the analysis was equal to or in excess of the amount to be held.	_____	_____	_____

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>
_____	_____
_____	_____
_____	_____

Section 2 — Cap Contracts

	Findings		
	No Exception	Exception	N/A
Procedures			
Performed the following procedures on selected cap contracts to test internal control over cap transactions. Selected five percent of each type of cap transaction (that is, purchases [premium disbursements], sales [premium receipts], and closeouts [closings and settlements of the position]), with the selections distributed throughout the year. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to enter into cap contracts.	_____	_____	_____
2. For each cap selected for testing, read management's documentation describing the intended use of the cap and performed the following procedures, as applicable.	_____	_____	_____
For caps used as a hedge —			
3. Determined that the documentation described the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the cap was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the cap as a hedge	_____	_____	_____
b. The terms of the cap, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the cap hedged	_____	_____	_____
d. Evidence that the cap continued to be an effective hedge	_____	_____	_____
e. Evidence that the cap was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures, for entering into hedge transactions; for example, the notional amount or underlying	_____	_____	_____
If the cap was an exact offset to an outstanding cap —			
5. Read documentation indicating that the cap offset an outstanding cap previously purchased or sold by the insurance company and that the cap was an exact offset of the market risk of the cap being offset.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
For caps used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the cap was expected to be effective in replicating the investment characteristics of the replicated investment	_____	_____	_____
d. The approach for assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the cap, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected caps including those that are a part of a replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof, who had the authority to authorize cap transactions. Compared the name of the individual who authorized the cap transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount or strike price exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the cap transaction with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____
11. Determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____

(continued)

<i>Procedures</i>	<i>Findings</i>		
	<i>No Exception</i>	<i>Exception</i>	<i>N/A</i>
12. Obtained a list of individuals authorized by the board of directors or a committee thereof to trade cap contracts. Compared the name of the individual who executed the purchase, sale, or closeout of the cap with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve payments relating to caps. Compared the name of the individual who approved any payment relating to the cap with the names on the list and found the name of the individual on the list.	_____	_____	_____
14. Compared the name of the individual who approved any payment relating to the cap with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the cap with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the purchase, sale, or closeout of the cap and found that the purchase, sale, or closeout was confirmed by the counterparty.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade caps and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the cap contract, as stated on the deal ticket and confirmation, with the terms of the cap contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period (for example, monthly or quarterly), indicating that the insurance company determined that its accounting records for caps tested in procedure 18, agreed with or reconciled to the related control account; for example, the subsidiary ledger to the general ledger.	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the cap agreement. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
21. Compared the terms of the cap agreement recorded in the insurance company's accounting records with the terms shown in the executed copy of the cap agreement and found them to be in agreement.	_____	_____	_____
22. Obtained documentation for one reporting period (for example, monthly or quarterly), indicating that the insurance company physically inventoried the cap agreements.	_____	_____	_____
23. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody or access to the cap agreement with the names of individuals authorized to execute purchases, sales, or closeouts of cap contracts and found that the name of the individual was not on the list.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
24. Compared information regarding the cap, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
25. If the cap should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the cap, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
26. Read accounting documentation indicating that the insurance company monitored periodic cash settlements related to the cap tested, meaning, the insurance company had controls in place to determine that periodic cash settlements, if any, were received.	_____	_____	_____
Effectiveness of Caps Used As Hedges and in Replication Transactions			
27. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the cap as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
28. If the cap was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
29. Read documentation indicating that the legal department reviewed the cap agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
30. Read documentation indicating that the legal department updated its assessment of agreement enforceability at least annually.	_____	_____	_____
Valuation			
31. Obtained the insurance company's policies and procedures for valuing caps and found that the insurance company determined the fair value of the cap in accordance with the policy described in the insurance company's procedures for the valuation of caps.	_____	_____	_____
32. Read documentation supporting the fair value of the cap and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized person.	_____	_____	_____

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>

Section 3 — Collar Contracts

	Findings		
	No Exception	Exception	N/A
Procedures			
Performed the following procedures on selected collar contracts to test internal control over collar transactions. Selected five percent of each type of collar transaction (that is, executions [entering into a collar transaction in which the net position at inception may result in either no cash outlay, cash received, or cash disbursed] and closeouts [closings and settlements of the position]), with the selections distributed throughout the year. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to enter into collar contracts.	_____	_____	_____
2. For each collar selected for testing, read management's documentation describing the intended use of the collar and performed the following procedures, as applicable.	_____	_____	_____
For collars used as a hedge —			
3. Determined that the documentation described the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the collar was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the collar as a hedge	_____	_____	_____
b. The terms of the collar, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the collar hedged	_____	_____	_____
d. Evidence that the collar continued to be an effective hedge	_____	_____	_____
e. Evidence that the contract was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures, for entering into hedge transactions; for example, the notional amount or underlying	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
If the collar was an exact offset of an outstanding collar —			
5. Read documentation indicating that the collar offset an outstanding collar previously purchased or sold by the insurance company and that the collar was an exact offset of the market risk of the collar being offset.	_____	_____	_____
For collars used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the collar was expected to be effective in replicating the investment characteristics of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the collar, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected collars including those that are a part of a replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof, who had the authority to authorize collar transactions. Compared the name of the individual who authorized the collar transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount or strike price exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the collar transaction with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
11. Determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____
12. Obtained a list of individuals authorized by the board of directors or a committee thereof to trade collar contracts. Compared the name of the individual who executed the execution or closeout of the collar contract with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve payments relating to collars. Compared the name of the individual who approved any payment relating to the collar with the names on the list and found the name of the individual on the list.	_____	_____	_____
14. Compared the name of the individual who approved any payment relating to the collar with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the collar with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the execution or closeout of the collar and found that the execution or closeout was confirmed by the counterparty.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade collars and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the collar contract, as stated on the deal ticket and confirmation, with the terms of the collar contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period (for example, monthly or quarterly) indicating that the insurance company determined that its accounting records for collars, tested in procedure 18, agreed with or reconciled to the related control account; for example, the subsidiary ledger to the general ledger.	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the collar agreement. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
21. Compared the terms of the collar agreement recorded in the insurance company's accounting records with the terms shown in the executed copy of the collar agreement and found them to be in agreement.	_____	_____	_____
22. Obtained documentation for one reporting period (for example, monthly or quarterly), indicating that the insurance company physically inventoried the collar agreement.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
23. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody or access to the collar contracts with the names of individuals authorized to enter into trades, executions, or closeouts of collar contracts and found that the name of the individual was not on the list.	_____	_____	_____
24. Compared information regarding the collar, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
25. If the collar should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the collar, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
26. Read accounting documentation indicating that the insurance company monitored periodic cash settlements related to the collar tested, meaning, the insurance company had controls in place to determine that periodic cash settlements, if any, were received.	_____	_____	_____
Effectiveness of Collars Used As Hedges and in Replication Transactions			
27. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the collar as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
28. If the collar was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
29. Read documentation indicating that the legal department reviewed the collar agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
30. Read documentation indicating that the legal department updated its assessment of agreement enforceability at least annually.	_____	_____	_____
Valuation			
31. Obtained the insurance company's policies and procedures for valuing collars and found that the insurance company determined the fair value of the collar in accordance with the policy described in the insurance company's procedures for the valuation of collars.	_____	_____	_____
32. Read documentation supporting the fair value of the collar and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.	_____	_____	_____

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>
_____	_____
_____	_____
_____	_____

Section 4 — Floor Contracts

	Findings		
	No Exception	Exception	N/A
Procedures			
Performed the following procedures on selected floor contracts to test internal control over floor transactions. Selected five percent of each type of floor transaction (that is, purchases [premium disbursements], sales [premium receipts], and closeouts [closings and settlements of the position]), with the selections distributed throughout the year. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to enter into floor contracts.	_____	_____	_____
2. For each floor selected for testing, read management's documentation describing the intended use of the floor and performed the following procedures, as applicable.	_____	_____	_____
For floors used as a hedge —			
3. Determined that the documentation described the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the floor was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the floor as a hedge	_____	_____	_____
b. The terms of the floor, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the floor hedged	_____	_____	_____
d. Evidence that the floor continued to be an effective hedge	_____	_____	_____
e. Evidence that the floor was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures for entering into hedge transactions; for example, the notional amount or underlying	_____	_____	_____
If the floor was an exact offset of an outstanding floor —			
5. Read documentation indicating that the floor offset an outstanding floor previously purchased or sold by the insurance company and that the floor was an exact offset of the market risk of the floor being offset.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
For floors used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the floor was expected to be effective in replicating the investment characteristics of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the floor, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected floors including those that are a part of a replication transaction —			
8. Obtained a list of individuals approved by the board of directors or a committee thereof who had the authority to authorize floor transactions. Compared the name of the individual who authorized the floor transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount or strike price exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the floor transaction with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____
11. Determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____

(continued)

<i>Procedures</i>	<i>Findings</i>		
	<i>No Exception</i>	<i>Exception</i>	<i>N/A</i>
12. Obtained a list of individuals authorized by the board of directors or a committee thereof to trade floor contracts. Compared the name of the individual who executed the purchase, sale, or closeout of the floor with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve payments relating to floors. Compared the name of the individual who approved any payment relating to the floor with the names on the list and found the name of the individual on the list.	_____	_____	_____
14. Compared the name of the individual who approved any payment relating to the floor with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the floor with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the purchase, sale, or closeout of the floor and found that the purchase, sale, or closeout was confirmed by the counterparty.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade floors and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the floor contract, as stated on the deal ticket and confirmation, with the terms of the floor contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period (for example, monthly or quarterly), that the insurance company determined that its accounting records for floors, tested in procedure 18, agreed with or reconciled to the related control account; for example, the subsidiary ledger to the general ledger.	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the floor agreement. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
21. Compared the terms of the floor agreement recorded in the insurance company's accounting records with the terms shown in the executed copy of the floor agreement and found them to be in agreement.	_____	_____	_____
22. Obtained documentation for one reporting period (for example, monthly or quarterly), indicating that the insurance company physically inventoried the floor agreements.	_____	_____	_____
23. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody or access to the floor agreement with the names of individuals authorized to execute purchases, sales, or closeouts of floor contracts and found that the name was not on the list.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
24. Compared information regarding the floor, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
25. If the floor should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the floor, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
26. Read accounting documentation indicating that the insurance company monitored periodic cash settlements related to the floor tested, meaning, the insurance company had controls in place to determine that periodic cash settlements, if any, were received.	_____	_____	_____
Effectiveness of Floors Used As Hedges and in Replication Transactions			
27. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the floor as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
28. If the floor was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
29. Read documentation indicating that the legal department reviewed the floor agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
30. Read documentation indicating that the legal department updated its assessment of agreement enforceability at least annually.	_____	_____	_____
Valuation			
31. Obtained the insurance company's policies and procedures for valuing floors and found that the insurance company determined the fair value of the floor in accordance with the policy described in the insurance company's procedures for the valuation of floors.	_____	_____	_____
32. Read documentation supporting the fair value of the floor and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.	_____	_____	_____
Description of Exceptions if Any			
<u>Procedure Number</u>	<u>Description of Exception</u>		
_____	_____		
_____	_____		
_____	_____		
_____	_____		

Section 5 — Forward Contracts

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
Performed the following procedures on selected forward contracts to test internal control over forward transactions. Selected five percent of each type of forward transaction, with the selections distributed throughout the year. These are, (1) forward contracts entered into to make delivery, (2) forward contracts entered into to take delivery, (3) forward contracts settled by making delivery, (4) forward contracts settled by taking delivery, (5) forward contracts settled by cash. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all of the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to enter into forward contracts.	_____	_____	_____
2. For each forward selected for testing, read management's documentation describing the intended use of the forward and performed the following procedures, as applicable.	_____	_____	_____
For forward contracts used as a hedge —			
3. Determined that the documentation describes the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the forward was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the forward as a hedge	_____	_____	_____
b. The terms of the forward, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the forward hedged	_____	_____	_____
d. The specific forward contract used in the hedge	_____	_____	_____
e. Evidence that the forward continued to be an effective hedge	_____	_____	_____
f. Evidence that the forward was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures, for entering into hedge transactions; for example, the notional amount or underlying	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
If the forward was an exact offset of an outstanding forward —			
5. Read documentation indicating that the forward offset an outstanding forward previously purchased or sold by the insurance company and that the forward was an exact offset of the market risk of the forward being offset.	_____	_____	_____
For forwards used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the forward was expected to be effective in replicating the investment characteristic of the replicated investment	_____	_____	_____
d. The approach for assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the forward contract, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected forwards, including those that are a part of the replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof who had the authority to authorize forward transactions. Compared the name of the individual who authorized the forward transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the forward transaction with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
11. Determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____
12. Obtained a list of individuals authorized by the board of directors or committee thereof to trade forward contracts. Compared the name of the individual who executed the purchase or sale of the forward with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve settlements or payments related to forward contracts. For the purchase and any transaction subsequent to purchase, compared the name of the individual who approved any payment or settlement of funds in connection with the forward contract with the names on the list and found the name of the individual on the list.	_____	_____	_____
14. Compared the name of the individual who approved any settlement or payment relating to the forward with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the forward with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the purchase or sale of the forward contract and found that the purchase or sale was confirmed by the counterparty.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade forwards and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the forward contract, as stated on the deal ticket and confirmation, with the terms of the forward contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period, (for example, monthly or quarterly), that the insurance company determined that its accounting records for forwards, tested in procedure 18, agreed with or reconciled to the related control account, (for example, the subsidiary ledger to the general ledger).	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the forward contract. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
21. For one reporting period, (for example, monthly or quarterly), obtained the insurance company's documentation of the existence of the forward contract and found that the insurance company either (a) obtained a statement from the custodian confirming the existence of the forward contract, (b) physically inventoried the forward contract, or (c) obtained a statement from the counterparty acknowledging the existence of the forward contract.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
22. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody or access to the forward with the names of individuals authorized to execute purchases and sales of forwards and found that the name was not on the list.	_____	_____	_____
23. Compared information regarding the forward, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
24. If the forward should have been included in the monitoring analysis s>separately tested in step 10 within section 1, "All Derivative Types," compared information regarding the forward, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
Effectiveness of Forward Contracts Used As Hedges and in Replication Transactions			
25. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the forward as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
26. If the forward was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
27. Read documentation indicating that the legal department reviewed the forward contract to assess contract compliance with the DUP and enforceability.	_____	_____	_____
28. Read documentation indicating that the legal department updated its assessment of contract enforceability at least annually.	_____	_____	_____
Valuation			
29. Obtained the insurance company's policies and procedures for valuing forwards and found that the insurance company determined the fair value of the forward in accordance with the policy described in the insurance company's procedures for valuation of forwards.	_____	_____	_____
30. Read documentation supporting the fair value of the forward contract and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.	_____	_____	_____

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>
_____	_____
_____	_____
_____	_____
_____	_____

Section 6 — Futures Contracts

	Findings		
	No Exception	Exception	N/A
Procedures			
Performed the following procedures on selected futures contracts to test internal control over futures transactions. Selected five percent of each type of futures transaction, with the selections distributed throughout the year. These are purchases, sales, and cash settlements (closeouts of a position). If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all of the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to trade futures.	_____	_____	_____
2. For each futures transaction selected for testing, read management's documentation describing the intended use of the futures and performed the following procedures, as applicable.	_____	_____	_____
For futures used as a hedge —			
3. Determined that the documentation describes the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the futures position was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the futures as a hedge	_____	_____	_____
b. The terms of the futures transaction and the name of the exchange and firm(s) handling the trade	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the futures transaction hedged	_____	_____	_____
d. Evidence that the futures contract continued to be an effective hedge	_____	_____	_____
e. Evidence that the futures position was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures for futures transactions; for example, the notional amount or underlying	_____	_____	_____
For futures transactions that were an exact offset of an outstanding futures transaction —			
5. Read documentation indicating that the futures transaction offset an outstanding futures position previously purchased or sold by the insurer and that the futures transaction was an exact offset of the market risk of the futures position being offset.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
For futures used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the futures position was expected to be effective in replicating the investment characteristics of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the futures transaction and the name of the exchange and the firm(s) handling the trade	_____	_____	_____
c. The specific futures contract used in the replication	_____	_____	_____
For all selected futures including those that are a part of the replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof, who had the authority to authorize futures trades. Compared the name of the individual who authorized the futures transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of individuals authorized by the board of directors or committee thereof to trade futures contracts. Compared the name of the individual who executed the purchase or sale of the futures contract with the names on the list and found the name of the individual on the list.	_____	_____	_____
11. Obtained a list of individuals authorized to approve settlements or disbursements related to futures transactions. For purchases and transactions subsequent to purchase or sale of the futures contract, compared the name of the individual who approved any settlement of funds relating to the futures with the names on the list and found the name of the individual on the list.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
12. Compared the name of the individual who approved any payment relating to the futures with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
13. Compared the name of the individual who received cash or other consideration in connection with the futures with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
14. Obtained the deal ticket and confirmation for the purchase, expiration, or sale of the futures contracts and found that the purchase, sale, or expiration of the futures contract was confirmed by the deal ticket and confirmation.	_____	_____	_____
15. Compared the terms of the futures transaction, as stated on the deal ticket and confirmation, with the terms of the transaction recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
16. Obtained documentation for one reporting period, (for example, monthly or quarterly), that the insurance company determined that its accounting records for futures, tested in procedure 15, agreed with or reconciled to the related control account, (for example, the subsidiary ledger to the general ledger).	_____	_____	_____
17. For one reporting period, (for example, monthly or quarterly), obtained the insurance company's documentation of the existence of the futures contracts and found that the insurance company obtained statements from the futures counterparty(ies) or broker(s) confirming the futures transactions and positions.	_____	_____	_____
18. Compared information regarding the futures contract, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
19. If the futures position should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the futures contract, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
Effectiveness of Futures Used As Hedges and in Replication Transactions			
20. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the futures position as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
21. If the futures position was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the company policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No</u> <u>Exception</u>	<u>Exception</u>	<u>N/A</u>
Valuation			
22. Obtained the insurance company's policies and procedures for valuing positions and found that the insurance company determined the valuation of the futures contract in accordance with the policy described in the insurance company's procedures for valuation of futures.	_____	_____	_____
23. Read documentation supporting the market price of the futures contract and found that the market price was obtained from an independent source.	_____	_____	_____

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>
_____	_____
_____	_____
_____	_____

Section 7 — Option Contracts

<u>Procedures</u>	<u>Findings</u>		
	<u>No</u>		
	<u>Exception</u>	<u>Exception</u>	<u>N/A</u>
Performed the following procedures on selected option contracts to test internal control over option transactions. Selected five percent of each type of option transaction (that is, purchases, sales, expirations, and exercises), with the selections distributed throughout the year. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all of the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to trade or enter into option contracts.	_____	_____	_____
2. For each option selected for testing, read management's documentation describing the intended use of the option and performed the following procedures, as applicable.	_____	_____	_____
For options used as a hedge —			
3. Determined that the documentation described the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the option was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the option as a hedge	_____	_____	_____
b. For over-the-counter (OTC) options, the terms of the option, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. For exchange-traded options, the term of the option, the name of the exchange, and the name of the firm(s) handling the trade	_____	_____	_____
d. The assets or liabilities (or portion thereof) that the option hedged	_____	_____	_____
e. For OTC and exchange-traded options, the specific option used in the hedge	_____	_____	_____
f. Evidence that the option continued to be an effective hedge	_____	_____	_____
g. Evidence that the option was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures, for entering into hedge transactions; for example, the notional amount, or underlying	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
If the option transaction was (a) for income generation and was for the sale of a call option on securities or (b) an exact offset to an outstanding option —			
5. Read the documentation supporting the transaction which indicated that the insurance company was holding or could immediately acquire through the exercise of options, warrants, or conversion rights already owned, the underlying securities during the entire period the option was outstanding.	_____	_____	_____
6. Read documentation indicating that the option offset an outstanding option previously purchased or sold by the insurance company and that the option was an exact offset to the market risk of the option being offset.	_____	_____	_____
For options used in a replication transaction —			
7. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the option was expected to be effective in replicating the investment characteristics of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
8. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The specific option used in the replication	_____	_____	_____
c. For OTC options, the terms of the option, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
d. For exchange-traded options, the name of the exchange and the firm(s) handling the trade	_____	_____	_____
For all selected options, including those that are a part of a replication transaction —			
9. Obtained a list of individuals, approved by the board of directors or a committee thereof, who had the authority to authorize option transactions. Compared the name of the individual who authorized the option transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
10. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
11. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the option transaction with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____
12. For OTC options, determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 11.	_____	_____	_____
13. Obtained a list of individuals authorized by the board of directors or committee thereof to trade option contracts. Compared the name of the individual who executed the purchase, sale, or exercise of the option with the names on the list and found the name of the individual on the list.	_____	_____	_____
14. Obtained a list of individuals authorized to approve payments relating to options contracts. Compared the name of the individual who approved any payment relating to the option with the names on the list and found the name of the individual on the list.	_____	_____	_____
15. Compared the name of the individual who approved any payment relating to the option with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
16. Compared the name of the individual who received cash or other consideration in connection with the option with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
17. Obtained the deal ticket and confirmation for the purchase, sale, or exercise of the option and found that the purchase, sale, or exercise of the option was confirmed by the counterparty or firm handling the transaction.	_____	_____	_____
18. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade options and found that the name was not on the list.	_____	_____	_____
19. Compared the terms of the option contract, as stated on the deal ticket and confirmation, with the terms of the option contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
20. Obtained documentation for one reporting period, (for example, monthly or quarterly), indicating that the insurance company determined whether its accounting records for options, tested in procedure 19, agreed with or reconciled to the related control account, (for example, the subsidiary ledger to the general ledger).	_____	_____	_____

<i>Procedures</i>	<i>Findings</i>		
	<i>No Exception</i>	<i>Exception</i>	<i>N/A</i>
21. Obtained the accounting record documenting modifications, if any, to the option transaction. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
22. Obtained documentation for one reporting period, (for example, monthly or quarterly), indicating that the insurance company obtained a statement from the counterparty confirming the existence of the option position.	_____	_____	_____
23. Using the list of authorized traders obtained in procedure 13, compared the name of the individual who had custody of or access to the option documentation with the names of individuals authorized to purchase, sell, or exercise the option and found that the name was not on the list.	_____	_____	_____
24. Compared information regarding the option, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
25. If the option should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the option, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
Effectiveness of Options Used As Hedges and in Replication Transactions			
26. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the option as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
27. If the option was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
28. Read documentation indicating that the legal department reviewed the option agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
29. Read documentation indicating that the legal department updated its assessment of legal enforceability of the OTC option agreement at least annually.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No</u> <u>Exception</u>	<u>Exception</u>	<u>N/A</u>
Valuation			
30. Obtained the insurance company's policies and procedures for valuing options and found that the insurance company determined the fair value of OTC options and the market price of exchange-traded options, in accordance with the policy described in the insurance company's procedures for the valuation of options.	_____	_____	_____
31. Read documentation supporting the fair value for OTC options and the market price of exchange-traded options and found that the fair value or market value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.	_____	_____	_____

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>
_____	_____
_____	_____
_____	_____

Section 8 — Swap Contracts

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
Performed the following procedures on selected swap contracts to test internal control over swap transactions. Selected five percent of each type of swap transaction (that is, executions [purchases] and closeouts [sales]), with the selections distributed throughout the year. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in fewer than four items, selected four or fewer items that represented all the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to enter into swap agreements.	_____	_____	_____
2. For each swap agreement selected for testing, read management's documentation describing the intended use of the swap agreement and performed the following procedures, as applicable.	_____	_____	_____
For swaps used as a hedge —			
3. Determined that the documentation describes the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the swap was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the swap as a hedge	_____	_____	_____
b. The terms of the swap, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the swap hedged	_____	_____	_____
d. Evidence that the swap continued to be an effective hedge	_____	_____	_____
e. Evidence that the swap was consistent with the insurance company's parameters, as specified in the DUP or applicable policies and procedures, for entering into swap agreements; for example, the notional amount or underlying	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
For swaps that were an exact offset of an outstanding swap —			
5. Read documentation that indicated that the swap offset a swap previously purchased or sold, and that the swap was an exact offset to the market risk of the swap being offset.	_____	_____	_____
For swaps used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the swap was expected to be effective in replicating the investment characteristic of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the swap, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected swaps including those that are a part of a replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof who had the authority to authorize swap transactions. Compared the name of the individual who authorized the swap transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transactions tested; for example, a transaction in which the notional amount exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the swap agreement with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
11. Determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____
12. Obtained a list of individuals authorized by the board of directors or committee thereof to trade swap contracts. Compared the name of the individual who executed the swap with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve settlements or disbursements related to swaps. For purchases and any interim settlements or closeouts of the swap subsequent to purchase, compared the name of the individual who approved any settlement of funds relating to the swap with the names on the list and found the name of the individual on the list.	_____	_____	_____
14. Compared the name of the individual who approved any payment relating to the swap with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the swap with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the purchase, execution, or closeout of the swap and found that the purchase, execution, or closeout of the swap was confirmed by the counterparty.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade swaps and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the swap contract, as stated on the deal ticket and confirmation, with the terms of the swap contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period (for example, monthly, or quarterly), that the insurance company determined whether its accounting records for swaps, tested in procedure 18, agreed with or reconciled to the related control account, (for example, the subsidiary ledger to the general ledger).	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the swap agreement. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
21. Compared the terms of the swap agreement recorded in the insurance company's accounting records with the terms shown in the executed copy of the swap agreement and found them to be in agreement.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
22. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody or access to the swap agreement with the names of individuals authorized to execute swap agreements and found that the name was not on the list.	_____	_____	_____
23. Compared information regarding the swap, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
24. If the swap should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the swap, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
25. Read accounting documentation indicating that the insurance company monitored periodic cash settlements related to swap transactions, meaning, the insurance company had controls in place to determine that periodic cash settlements, if any, were received.	_____	_____	_____
Effectiveness of Swaps Used As Hedges and in Replication Transactions			
26. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the swap as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
27. If the swap was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
28. Read documentation indicating that the legal department reviewed the swap agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
29. Read documentation indicating that the legal department updated its assessment of the enforceability of the swap agreement at least annually.	_____	_____	_____
Valuation			
30. Obtained the insurance company's policies and procedures for valuing swaps and found that the insurance company determined the fair value of the swap in accordance with the policy described in the insurance company's procedures for valuation of swaps.	_____	_____	_____
31. Read documentation supporting the fair value of the swap and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.	_____	_____	_____
Description of Exceptions if Any			
<u>Procedure Number</u>	<u>Description of Exception</u>		
_____	_____		
_____	_____		
_____	_____		
_____	_____		

Section 9 — Swapion Contracts

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
Performed the following procedures on selected swapion contracts to test internal control over swapion transactions. Selected five percent of each type of swapion transaction with the selections distributed throughout the year. These are executions (purchases) and closeouts (sales). If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to buy or sell swapions.	_____	_____	_____
2. For each swapion contract selected for testing, read management's documentation describing the intended use of the swapion and performed the following procedures, as applicable.	_____	_____	_____
For swapions used as a hedge —			
3. Determined that the documentation describes the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the swapion was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the swapion as a hedge	_____	_____	_____
b. The terms of the swapion, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
c. The assets or liabilities (or portion thereof) that the swapion hedged	_____	_____	_____
d. Evidence that the swapion continued to be an effective hedge	_____	_____	_____
e. Evidence that the swapion was consistent with the insurance company's parameters, as specified in the DUP or applicable policies and procedures, for entering into swapion agreements; for example, the notional amount or underlying	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
For swaptions that were an exact offset of an outstanding swaption —			
5. Read documentation indicating that the swaption offset an outstanding swaption and that the swaption was an exact offset of the market risk of the swaption being offset.	_____	_____	_____
For swaptions used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the swaption was expected to be effective in replicating the investment characteristic of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The terms of the swaption, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected swaptions including those that are a part of a replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof, who had the authority to authorize swaptions. Compared the name of the individual who authorized the swaption transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transactions tested; for example, a transaction in which the notional amount exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support and found evidence of approval of the transaction tested.	_____	_____	_____
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the swaption transaction with names on the list and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
11. Determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____
12. Obtained a list of individuals authorized by the board of directors or committee thereof to trade swaption contracts. Compared the name of the individual who executed the swaption with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve settlements or disbursements related to swaption agreements. Compared the name of the individual who approved settlements and disbursements relating to the swaption with the names on the list and found the name on the list.	_____	_____	_____
14. Compared the name of the individual who approved any payment relating to the swaption with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the swaption with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the purchase, sale, modification, or closeout of the swaption and found that the purchase, sale, modification, or closeout was confirmed by the counterparty.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade swaptions and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the swaption contract, as stated on the deal ticket and confirmation, with the terms of the swaption contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period (for example, monthly or quarterly), that the insurance company determined whether its accounting records for swaptions, tested in procedure 18, agreed with or reconciled to the related control account, (for example, the subsidiary ledger to the general ledger).	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the swaption agreement. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____
21. Compared the terms of the swaption agreement recorded in the insurance company's accounting records with the terms shown in the executed copy of the swaption agreement and found them to be in agreement.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
22. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody or access to the swaption agreement with the names of individuals authorized to execute swaption agreements and found that the name was not on the list.	_____	_____	_____
23. Compared information regarding the swaption, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
24. If the swaption should have been included in the monitoring analysis separately tested in procedure 10 within section 1, "All Derivative Types," compared information regarding the swaption, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
Effectiveness of Swaptions Used As Hedges and in Replication Transactions			
25. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the swaption as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
26. If the swaption was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
27. Read documentation indicating that the legal department reviewed the swaption agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
28. Read documentation indicating that the legal department updated its assessment of the enforceability of the swaption agreement at least annually.	_____	_____	_____
Valuation			
29. Obtained the insurance company's policies and procedures for valuing swaptions and found that the insurance company determined the fair value of the swaption in accordance with the policy described in the insurance company's procedures for valuation of swaptions.	_____	_____	_____
30. Read documentation supporting the fair value of the swaption and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.	_____	_____	_____
Description of Exceptions if Any			
<u>Procedure Number</u>	<u>Description of Exception</u>		
_____	_____		
_____	_____		
_____	_____		
_____	_____		

Section 10 — Warrant Contracts

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
Performed the following procedures on selected warrant contracts to test internal control over warrant transactions. Selected five percent of each type of warrant transaction (that is, purchases, sales, expirations, and exercises), with the selections distributed throughout the year. If five percent of a given type of transaction exceeded 40, the number of items selected for that type of transaction was limited to 40. If five percent of a type of transaction resulted in less than four items, selected four or fewer items that represented all of the transactions of that type.			
Reporting			
1. Read the insurance company's derivative use plan (DUP) and any amendments thereto and found that the DUP permits the insurance company to trade or enter into warrant contracts.	_____	_____	_____
2. For each warrant selected for testing, read management's documentation describing the intended use of the warrant and performed the following procedures, as applicable.	_____	_____	_____
For warrants used as a hedge —			
3. Determined that the documentation described the following:			
a. The risk hedged	_____	_____	_____
b. How the hedge was consistent with the overall risk management strategy	_____	_____	_____
c. How the warrant was expected to be effective in offsetting the exposure	_____	_____	_____
d. The approach in assessing the effectiveness of the hedge	_____	_____	_____
4. Determined that the following items were documented:			
a. The purpose(s) of the warrant as a hedge	_____	_____	_____
b. For exchange-traded warrants, the term of the warrant, the name of the exchange, and the name of the firm(s) handling the trade	_____	_____	_____
c. For over-the-counter (OTC) warrants, the terms of the warrant, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
d. The assets or liabilities (or portion thereof) that the warrant hedged	_____	_____	_____
e. Evidence that the warrant continued to be an effective hedge	_____	_____	_____
f. Evidence that the warrant was consistent with the insurance company's parameters, as specified in the DUP or applicable company policies and procedures for entering into hedge transactions; for example, the notional amount or underlying	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
If the warrant transaction was an exact offset of an outstanding warrant —			
5. Read documentation indicating that the warrant transaction offset an outstanding warrant previously purchased or sold by the insurance company and that the warrant was an exact offset of the market risk of the warrant being offset	_____	_____	_____
For warrants used in a replication transaction —			
6. Determined that the documentation described the following:			
a. The investment type and characteristics replicated	_____	_____	_____
b. How the replication was consistent with the overall management investment strategy	_____	_____	_____
c. How the warrant was expected to be effective in replicating the investment characteristics of the replicated investment	_____	_____	_____
d. The approach in assessing the effectiveness of the replication transaction	_____	_____	_____
7. Determined that the following items were documented:			
a. The instruments used in the replication and the investment type and characteristics replicated	_____	_____	_____
b. The specific warrant used in the replication	_____	_____	_____
c. For exchange-traded warrants, the name of the exchange and the firm(s) handling the trade	_____	_____	_____
d. For OTC warrants, the terms of the warrant, the name of the counterparty, and the counterparty exposure amount	_____	_____	_____
For all selected warrants including those that are part of a replication transaction —			
8. Obtained a list of individuals, approved by the board of directors or a committee thereof who had the authority to authorize warrant transactions. Compared the name of the individual who authorized the warrant transaction with the names on the list and found the name of the individual on the list.	_____	_____	_____
9. Based on the details of the transaction identified in procedure 2 and company policy, compared the terms of the transaction with the insurance company's policy regarding the requirement for the board of directors or a committee thereof to authorize the specific transaction tested; for example, a transaction in which the notional amount exceeded a limit requiring additional approval. If the board of directors or a committee thereof was required to approve the transaction, read minutes of the board of directors or a committee thereof or other appropriate support, and found evidence of approval of the transaction tested.	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
10. Obtained a list of <i>qualified</i> and <i>nonqualified</i> counterparties, approved by the board of directors or a committee thereof. Compared the name of the counterparty involved in the warrant transaction with names on the list, and found the name of the counterparty on the respective qualified or nonqualified list.	_____	_____	_____
11. For OTC warrants, determined that the counterparty was listed as qualified or nonqualified in the analysis used for monitoring the insurance company's limitations on counterparty exposure, consistent with the classification in the listing obtained in procedure 10.	_____	_____	_____
12. Obtained a list of individuals authorized by the board of directors or committee thereof to trade warrant contracts. Compared the name of the individual who executed the purchase, sale, or exercise of the warrant with the names on the list and found the name of the individual on the list.	_____	_____	_____
13. Obtained a list of individuals authorized to approve payments related to warrant contracts. Compared the name of the individual who approved any payment relating to the warrant with the names on the list, and found the name of the individual on the list.	_____	_____	_____
14. Compared the name of the individual who approved any payment relating to the warrant with the name of the individual who approved entering into the contract and found that the names were different.	_____	_____	_____
15. Compared the name of the individual who received cash or other consideration in connection with the warrant with the name of the individual who entered into the contract and found that the names of the individuals were different.	_____	_____	_____
16. Obtained the deal ticket and confirmation for the purchase, sale, or exercise of an exchange-traded warrant and found that the purchase, sale, or exercise was confirmed by the firm handling the transaction.	_____	_____	_____
17. Compared the name of the individual who received the deal ticket and confirmation with the names on a list of individuals authorized to trade warrants and found that the name was not on the list.	_____	_____	_____
18. Compared the terms of the warrant contract, as stated on the deal ticket and confirmation, with the terms of the warrant contract recorded in the insurance company's accounting records and found them to be in agreement.	_____	_____	_____
19. Obtained documentation for one reporting period, (for example, monthly or quarterly), that the insurance company determined whether its accounting records for warrants, tested in procedure 18, agreed with or reconciled to the related control account, (for example, the subsidiary ledger to the general ledger).	_____	_____	_____
20. Obtained the accounting record documenting modifications, if any, to the warrant transaction. Compared the name of the individual who approved the modification with a list of individuals authorized to approve modifications and found the name of the individual who approved the modification on the list.	_____	_____	_____

(continued)

<u>Procedures</u>	<u>Findings</u>		
	<u>No Exception</u>	<u>Exception</u>	<u>N/A</u>
21. For one reporting period, (for example, monthly or quarterly), obtained the insurance company's documentation of the existence of the warrant contract and found that the insurance company either (a) obtained statements from the custodian confirming the existence of the warrant contracts or (b) physically inventoried the warrant contracts.	_____	_____	_____
22. Using the list of authorized traders obtained in procedure 12, compared the name of the individual who had custody of or access to the warrant contracts with the names of individuals authorized to execute purchases, sales, or exercises of warrants and found that the name was not on the list.	_____	_____	_____
23. Compared information regarding the warrant, such as type of derivative, notional amount, and fair value, with the comparable information included in the report to the board of directors or appropriate committee thereof and found them to be in agreement.	_____	_____	_____
24. If the warrant position should have been included in the monitoring analysis separately tested in procedure 10 of section 1, "All Derivative Types," compared information regarding the warrant, such as type of derivative, notional amount, and fair value, with the comparable information in the monitoring analysis and found them to be in agreement.	_____	_____	_____
Effectiveness of Warrants Used As Hedges and in Replication Transactions			
25. Read the insurance company's documentation of effectiveness and found that the insurance company evaluated the effectiveness of the warrant as a hedge or replication in accordance with the policies regarding effectiveness.	_____	_____	_____
26. If the warrant was no longer effective as a hedge or replication, compared the action taken by the insurance company with the action required by the accounting policies and procedures and found that the action taken was consistent with the accounting policy.	_____	_____	_____
Legal Review			
27. Read documentation indicating that the legal department reviewed a nonexchange traded warrant agreement to assess contract compliance with the DUP and enforceability.	_____	_____	_____
28. Read documentation indicating that the legal department updated its assessment of enforceability of the nonexchange traded warrant agreement at least annually.	_____	_____	_____
Valuation			
29. Obtained the insurance company's policies and procedures for valuing warrants and found that the insurance company determined the fair value of the warrant in accordance with the policy described in the insurance company's procedures for the valuation of warrants	_____	_____	_____

<u>Procedures</u>	<u>Findings</u>		
	<u>No</u>		
	<u>Exception</u>	<u>Exception</u>	<u>N/A</u>
30. Read documentation supporting the fair value of warrants and found that the fair value was either (a) obtained from an independent source, (b) checked against an independent source, or (c) calculated internally by an authorized individual.			

Description of Exceptions if Any

<u>Procedure Number</u>	<u>Description of Exception</u>

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix C — Illustrative Management Representation Letter

[Responsible Party's Letterhead]

[Date]

[CPA Firm's Name and Address]

In connection with your engagement to apply the agreed-upon procedures enumerated in the American Institute of Certified Public Accountants' Statement of Position 01-03, *Performing Agreed-Upon Procedures Engagements that Address Internal Control Over Derivative Transactions as Required by the New York State Insurance Law*, which were agreed to and acknowledged by management of ABC Insurance Company to meet the intended purpose of compliance with the requirements of Section 1410 (b)(5) of the New York State Insurance Law, as amended (the law), which addresses the assessment of internal control over derivative transactions as defined in Section 1401 (a) of the law and Section 178.5 of Regulation No. 163 during the year ended December 31, 20XX.

We confirm that, to the best of our knowledge and belief, as of [date of the practitioner's agreed-upon procedures report]:

1. ABC Insurance Company complied with the requirements of Section 1410 (b)(5) of the New York State Insurance Law, as amended (the law), during the year ended December 31, 20XX.
2. All known matters contradicting the Company's compliance with the requirements of the law or our assertion about the Company's compliance with the law and any communication from regulatory agencies or others affecting the Company's compliance with the requirements of the law or our assertion about the Company's compliance with the requirements of the law have been disclosed to you, including communications received between the end of the period addressed in our written assertion and the date of your report.
3. We are responsible for the Company's compliance with the law.
4. We have provided you with all relevant information and access to all records relevant to the Company's internal control over derivative transactions and the agreed-upon procedures.
5. We have disclosed to you all known significant deficiencies and material weaknesses in the design or operation of the Company's internal control over derivative transactions that would adversely affect the Company's ability to function in accordance with the Company's DUP and any communication from regulatory agencies or others affecting the design or operation of the Company's internal control over derivative transactions, including communications received between the December 31, 20XX and the date of your agreed-upon procedures report.
6. During the year ended December 31, 20XX, the internal control over derivative transactions was functioning in accordance with the policies and procedures set forth in the Company's derivative use plan (DUP) and related accounting policies and procedures.
7. There have been no errors or fraud that would indicate a weakness in the internal control over derivative transactions.

8. We are responsible for, establishing and maintaining effective internal control over derivative transactions in accordance with the law.
9. We have responded fully to all inquiries made to us by you during the engagement.

To the best of our knowledge and belief, no events have occurred subsequent to *[the date as of which the procedures were applied]* that would require adjustment to or modification of the findings of the agreed-upon procedures.

[Signature]

[Title]

[Signature]

[Title]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Reporting on Controls Over Derivative Transactions at Insurance Entities Task Force

ALBERT J. REZNICEK, *Chair*
EDWARD F. BADER
DARRYL BRILEY
BEN B. KORBLY
EDWARD J. METZGER

DAVID A. NACHMAN
PAULA C. PANIK
ROBERT M. SOLITRO
MARY TODD STOCKER
DEBORAH H. WHITMORE

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AICPA Staff

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Technical Manager
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AUD Section 30***Statement of Position 02-1 Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code*****May 23, 2002****NOTE**

This AICPA Statement of Position (SOP) has been developed by the AICPA New Jersey Annual Claims Prompt Payment Reports Task Force of the AICPA Auditing Standards Board (ASB) to provide guidance regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to agreed-upon procedures engagements performed to comply with the requirements of New Jersey Administrative Code, Title 11, Chapter 22, Subchapter 1 (NJAC 11:22-1 or the Code), which establishes Department of Banking and Insurance (department) standards for the payment of claims relating to health benefits plans and dental plans and contains requirements for carriers to file certain reports with the department relating to the timeliness of claims payments and the reasons for denial and late payment of claims in a format prescribed by the department. The department has approved the use of the agreed-upon procedures outlined in this SOP to comply with the reporting requirements of the Code.

This SOP is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive publications are relevant to the proper application of the attestation standards in specific circumstances.

Introduction and Background

.01 New Jersey Administrative Code, Title 11, Chapter 22, Subchapter 1 (NJAC 11:22-1 or the Code), establishes Department of Banking and Insurance (department) standards for the payment of claims relating to health benefits plans and dental plans and contains requirements for carriers to file certain reports with the department relating to the timeliness of claims payments and the reasons for denial and late payment of claims in a format prescribed by the department.

.02 NJAC 11:22-1 applies to any insurance company, health service corporation, medical service corporation, hospital service corporation, health maintenance organization, dental service corporation, and dental plan organization that issues health benefits plans or dental plans in the state of New Jersey and to any agent, employee, or other representative of such entity that processes claims for such entity.

.03 Among other things, the Code requires carriers to report:

- Quarterly to the department on the timeliness of claims payments in the format set forth in Appendix A (claims payment exhibit report) of NJAC 11:22-1, and
- Quarterly and annually on late payments of claims and the reasons for any denials (claims prompt payment report) in the format set forth in Appendix B of NJAC 11:22-1.

.04 Furthermore, the Code requires that the annual claims prompt payment report, which is due to be filed with the department on or before March 31, pursuant to NJAC 11:22-1.9(a), be accompanied by the report of a private auditing firm, which may be a Certified Public Accountant (CPA) or a firm of CPAs. However, for calendar year 2001, the report of the private auditing firm may be filed with the department on or before July 1, 2002. The department has specified, in Bulletin No. 02-07, that the work shall be conducted, and the report shall be prepared, in accordance with agreed-upon procedures acceptable to the department.

Applicability

.05 This Statement of Position (SOP) was developed to provide practitioners with guidance on performing agreed-upon procedures engagements that address annual claims prompt payment reports as required by the New Jersey Administrative Code. The engagement described in this SOP is designed only to satisfy the requirements of the Code. The procedures, as set forth in this SOP, are not necessarily appropriate for use in any other engagement. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

The Code

Definitions

.06 The following definitions are reprinted from the Code and are applicable when performing the agreed-upon procedures engagement described in this SOP.

Agent — Any entity, including a subsidiary of a carrier, or an organized delivery system as defined by N.J.S.A. 17:48H-1, with which a carrier has contracted to perform claims processing or claims payment services.

Carrier — An insurance company, health service corporation, hospital service corporation, medical service corporation or health maintenance organization authorized to issue health benefits plans in this State and a dental service corporation or dental plan organization authorized to issue dental plans in this State.

Claim — A request by a covered person, a participating health care provider, or a nonparticipating health care provider who has received an assignment of benefits from the covered person, for payment relating to health care services or supplies or dental services or supplies covered under a health benefits plan or dental plan issued by a carrier.

Clean claim —

1. The claim is for a service or supply covered by the health benefits plan or dental plan;
2. The claim is submitted with all the information requested by the carrier on the claim form or in other instructions distributed to the provider or covered person;
3. The person to whom the service or supply was provided was covered by the carrier's health benefits or dental plan on the date of service;
4. The carrier does not reasonably believe that the claim has been submitted fraudulently; and
5. The claim does not require special treatment. For the purposes of this subchapter, special treatment means that unusual claim processing is required to determine whether a service or supply is covered, such as claims involving experimental treatments or newly approved medications. The circumstances requiring special treatment should be documented in the claim file.

Covered person — A person on whose behalf a carrier offering the plan is obligated to pay benefits or provide services pursuant to the health benefits or dental plan.

Covered service or supply — A service or supply provided to a covered person under a health benefits or dental plan for which the carrier is obligated to pay benefits or provides services or supplies.

Dental plan — A benefits plan which pays dental expense benefits or provides dental services and supplies and is delivered or issued for delivery in this State by or through any carrier in this State.

Department — The Department of Banking and Insurance.

Health benefits plan — A benefits plan that pays hospital and medical expense benefits or provides hospital and medical services, and is delivered or issued for delivery in this State by or through a carrier. Health benefits plan includes, but is not limited to, Medicare supplement coverage and risk contracts to the extent not otherwise prohibited by Federal law. For the purposes of this chapter, health benefits plan shall not include the following plans, policies or contracts: accident only, credit, disability, long-term care, CHAMPUS supplement coverage, coverage arising out of a workers' compensation or similar law, automobile medical payment insurance, personal injury protection insurance issued pursuant to P.L. 1972, c.70 (N.J.S.A. 39:6A-1 et seq.) or hospital confinement indemnity coverage.

Health care provider or provider — An individual or entity which, acting within the scope of its license or certification, provides a covered

service or supply as defined by the health benefits or dental plan. Health care provider includes, but is not limited to, a physician, dentist and other health care professional licensed pursuant to Title 45 of the Revised Statutes and a hospital and other health care facilities licensed pursuant to Title 26 of the Revised Statutes.

Reporting Requirements

.07 The Code requires a carrier and its agent to remit payment of clean claims pursuant to specified time frames. The Code further requires that if a carrier or its agent denies or disputes a claim, in full or in part, the carrier or its agent must, within a specified time frame, notify both the covered person when he or she will have increased responsibility for payment, and the provider, of the basis for its decision to deny or dispute the claim.

.08 The Code requires a carrier to report to the department quarterly on the timeliness of claims payments in the format prescribed in NJAC 11:22-1, Appendix A, "New Jersey Claims Payment Exhibit." This quarterly report is not required to be subjected to an agreed-upon procedures engagement, nor is an annual claims payment exhibit report required to be filed with the department.

.09 The Code also requires a carrier to report to the department on a quarterly and annual basis on the late payment of claims and the reasons for denial of claims in the format prescribed in NJAC 11:22-1, Appendix B, "Quarterly (Annual) Claims Prompt Payment Report." The Code requires that the annual claims prompt payment report be accompanied by a report of a private auditing firm, which may be a CPA or a firm of CPAs.

.10 The department has indicated, in Bulletin No. 02-07, that an agreed-upon procedures engagement pursuant to this SOP may be used to satisfy the requirement that an annual claims prompt payment report be accompanied by the report of a private auditing firm. Furthermore, in Bulletin No. 02-12, issued in May 2002, the department has indicated that it agrees to the sufficiency of the procedures included in this SOP for its purposes.

Related Professional Standards

AT-C Section 215, *Agreed-Upon Procedures Engagements*

.11 Agreed-upon procedures engagements performed to meet the requirements of the Code are to be performed in accordance with AT-C section 215, *Agreed-Upon Procedures Engagements*. As described in paragraph .02 of AT-C section 215, an agreed-upon procedures engagement is an attestation engagement in which a practitioner performs specific procedures on subject matter and reports the findings without providing an opinion or conclusion. Not all of the provisions of AT-C section 215 are discussed herein. Rather, this SOP includes guidance to assist practitioners in the application of selected aspects of AT-C section 215. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.12] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.13 As previously stated, Bulletin No. 02-07 from the department states that an agreed-upon procedures engagement may be used to meet the requirement for an independent private auditing firm to report on the annual claims

prompt payment reports as required by the New Jersey Administrative Code. Furthermore, the department has approved the use of the agreed-upon procedures outlined in this SOP to comply with the reporting requirements of the Code. Accordingly, practitioners should not eliminate any of the procedures presented in appendix B (paragraph .31), "Agreed-Upon Procedures That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code," of this SOP or reduce the extent of the tests. The department or the carrier may request that additional procedures be performed and the practitioner may agree to perform such procedures. In those circumstances, it would be expected that the additional procedures would be performed in the context of a separate agreed-upon procedures engagement.

Procedures to Be Performed

.14 The agreed-upon procedures to be performed are applied to the carrier's annual claims prompt payment report, which reports on the late payment of claims and reasons for denial of claims in the format prescribed in NJAC 11:22-1, Appendix B.

.15 The procedures to be performed in the agreed-upon procedures engagement described in this SOP are presented in appendix B (paragraph .31) of this SOP. The procedures have been designed so that the findings resulting from the application of the procedures can be recorded in a tabular format. The three options available to the practitioner for expressing the findings for each procedure are *No Exception*, *Exception*, or *N/A* (not applicable). If a procedure is not applicable to a particular carrier, the procedure should be marked N/A rather than deleted from the report. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.16 If any portion of a procedure results in an exception, the findings for that entire procedure should be recorded as an exception and described in the section "Description of Exceptions If Any." The practitioner should provide a brief factual explanation for each exception that will enable the user of the practitioner's agreed-upon procedures report to understand the nature of the findings resulting in the exception. If management informs the practitioner that the condition giving rise to the exception was corrected by the date of the practitioner's report, the practitioner's explanation of the exception may include that information; for example, "Management has advised us that the condition resulting in the exception was corrected on Month X, 20XX. We have performed no procedures with respect to management's assertion." [Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.17 A practitioner may perform significant portions of the agreed-upon procedures engagement before the end of the period covered by the report. If, during that time, the practitioner identifies conditions that result in an exception in one or more agreed-upon procedures, he or she should report the exception in the findings section of the agreed-upon procedures report, even if management corrects the condition prior to the end of the period.

[.18] [Paragraph deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.19 Paragraph .40 of AT-C section 215 indicates that a practitioner need not perform procedures agreed to and acknowledged by the carrier to be appropriate for the intended purpose of the engagement. However, if in connection with the application, and through the completion of the agreed-upon procedures engagement, matters related to the information in the carrier's annual claims prompt payment report come to the practitioner's attention by other

means that significantly contradict, such information the practitioner should include such information in the practitioner's report. The phrase, "through the completion of the agreed-upon procedures engagement" indicates that this requirement would apply to conditions or events occurring prior to the date of the practitioner's report. This would include matters that would have resulted in the reporting of an exception by the practitioner if that matter existed during the period covered by the report. However, the practitioner has no responsibility to perform any procedure to detect such conditions or events. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Agreeing on the Terms of the Engagement

.20 In accordance with paragraph .14 of AT-C section 215, the practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. In accordance with paragraph .15 of AT-C section 215, the agreed-upon terms of the engagement should include the following:

- A statement confirming that an agreed-upon procedures engagement is to be performed to meet the requirements of NJAC 11:22-1, which addresses compliance with the requirements of New Jersey Administrative Code, Title 11, Chapter 22, Subchapter 1 (NJAC 11:22-1).
- A statement identifying the engaging party and the department as the intended users of the agreed-upon procedures report. The department has indicated that it agrees to the sufficiency of the procedures.
- Whether the practitioner's agreed-upon procedures report is expected to be restricted to the use of specified parties.
- A statement that management is responsible for maintaining effective internal control over derivative transactions.
- A statement identifying the procedures to be performed as those set forth in SOP 02-1, *Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code*
- A statement that the engaging party agrees to and acknowledges that the procedures in the SOP are appropriate for the intended purpose of the engagement and referring to Bulletin No. 02-12, which acknowledges the department's responsibility for the sufficiency of the procedures in SOP 02-1.
- A statement indicating that the practitioner is responsible for performing the agreed-upon procedures and providing the engaging party with a report in accordance with the attestation standards.
- A statement indicating that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA).
- A statement acknowledging that the practitioner makes no representation regarding the sufficiency of the procedures in SOP 02-1 either for the purpose for which the report has been requested or for any other purpose.

- A statement indicating that the practitioner was not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the carrier's compliance with the requirements of NJAC 11:22-1, the practitioner will not express such an opinion or conclusion, and if the practitioner performed additional procedures, other matters might come to the practitioner's attention that would be reported to the engaging party.
- A statement that the engaging party agrees to provide, at the conclusion of the engagement, a representation letter.
- Reference to the expected form and content of the practitioner's agreed-upon procedures report, including any use restrictions, if applicable.
- Disclaimers expected to be included in the practitioner's report, if applicable.
- Assistance to be provided to the practitioner, if applicable.
- Involvement of a practitioner's external specialist, if applicable.
- Specified thresholds for reporting exceptions, if applicable.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.21 The following are other matters that may be included in the agreed-upon terms of the engagement:

- A statement indicating that the practitioner has no responsibility for the completeness or accuracy of the information provided to the practitioner
- A statement describing the engaging party's responsibility to comply with the requirements of NJAC 11:22-1 and the engaging party's responsibility for the information in the carrier's annual claims prompt payment report
- A statement describing the engaging party's responsibility for providing accurate and complete information to the practitioner
- The circumstances under which the practitioner may decline to issue a report

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Written Representations

[.22] [Paragraph renumbered and deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.23 In accordance with paragraph .27 of AT-C section 215, the practitioner should request from the engaging party¹ written representations in the form of a letter addressed to the practitioner. The representations should

- a. include a statement that the responsible party is responsible for the subject matter.

¹ In this Statement of Position, the engaging party and the responsible party are the same and such party is usually management of the carrier. [Footnote added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

- b. if applicable, include a statement that the engaging party has obtained from all necessary parties agreement to the procedures and acknowledgment that the procedures performed are appropriate for their purposes.
- c. include a statement that the engaging party has provided the practitioner with all relevant information and access, as applicable, as agreed upon in the terms of the engagement.
- d. state that all known matters contradicting the subject matter and any communication from regulatory agencies or others affecting the subject matter or assertion have been disclosed to the practitioner, including communications received between the end of the period addressed by the subject matter and the date of the practitioner's report.
- e. state that the engaging party is not aware of any material misstatements in the subject matter.
- f. state that the engaging party has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter.
- g. include any additional representations that the practitioner agrees are appropriate.

The letter generally is signed by the appropriate members of management including the highest-ranking officer responsible for the carrier's compliance with the requirements of NJAC 11:22-1. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.24 In addition to the representations required by paragraph .27 of AT-C section 215, a practitioner may request other representations from management depending on the specific nature of the engagement. For the engagement addressed in this SOP, they ordinarily include the following representations from management:

- A statement that there have been no errors or fraud that might indicate that the carrier is not in compliance with the requirements of NJAC 11:22-1
- A statement that management has responded fully to all inquiries made by the practitioner during the engagement

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.25 If management does not provide one or more of the written representations requested by the practitioner, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should

- a. discuss the matter with the engaging or responsible party, as appropriate;²

² See footnote 1. [Footnote added, June 2020.]

- b. reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general; and
- c. if any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's agreed-upon procedures report.

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.26 An illustrative representation letter is presented in appendix C (paragraph .32), "Illustrative Management Representation Letter," of this SOP. For additional information regarding management's written representations in an agreed-upon procedures engagement, see paragraphs .27–.30, .A35, and .A43–.A45 of AT-C section 215. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Restriction on the Performance of Procedures

.27 As previously stated, a practitioner should not agree to eliminate any of the procedures presented in appendix B (paragraph .31) of this SOP. When circumstances impose restrictions on the performance of the agreed-upon procedures, the practitioner should discuss with the engaging party whether those restrictions are appropriate and, if the restrictions are appropriate, describe the restrictions in the practitioner's report. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Dating the Report

.28 The practitioner's report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that

- i. the attestation documentation has been reviewed, and
- ii. if applicable, the written presentation of the subject matter has been prepared.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Effective Date

.29 This SOP is effective upon issuance and is applicable only to agreed-upon procedures engagements that report on annual claims prompt payment reports as required by the NJAC. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix A — Illustrative Agreed-Upon Procedures Report

The following is an illustrative agreed-upon procedures report based on the requirements and guidance in AT-C section 215, *Agreed-Upon Procedures Engagements*.

Independent Accountant's Report on Applying Agreed-Upon Procedures

To the Management of ABC Carrier:

We have performed the applicable procedures enumerated in the American Institute of Certified Public Accountants' Statement of Position (SOP) 02-1, *Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code*, to ABC Carrier's compliance with the reporting requirements of New Jersey Administrative Code, Title 11, Chapter 22, Subchapter 1 (NJAC 11:22-1.9) for Appendix B 20XX Annual Report (Exhibit I) for the year ended December 31, 20XX. Management of ABC Carrier is responsible for compliance with the requirements of NJAC 11:22-1.

Management of ABC Carrier has agreed to and acknowledged that the procedures performed are appropriate to assist users in evaluating ABC Carrier's compliance with the reporting requirements of NJAC 11:22-1 for the year ended December 31, 20XX. This report may not be suitable for any other purpose. The procedures may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures performed and the findings are included in the attached Appendix.

We were engaged by ABC Carrier to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on ABC Carrier's compliance with the requirements of NJAC 11:22-1 for the year ended December 31, 20XX. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of ABC Carrier and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of the management of ABC Carrier and the State of New Jersey Department of Banking and Insurance, and is not intended to be and should not be used by anyone other than these specified parties.

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix B — Agreed-Upon Procedures That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code

<i>Procedures</i>	<i>Findings</i>		
	<i>No Exception</i>	<i>Exception</i>	<i>N/A</i>
The following procedures were applied to the ABC Carrier's 20XX Appendix B annual claims prompt payment report. We obtained supporting documentation used by management to prepare the Annual New Jersey Prompt Payment Report, and for each of the five categories (physician, dental, other health care professional, hospital, or other health care facilities), where applicable, compared the number of claims and the amount of claims for each quarter and the annual period from the supporting documentation used by management to prepare the Annual New Jersey Prompt Payment Report to the following columns of the report: • Total claims • Denied ineligible • Denied document • Denied coding/enrollment • Denied for amount • Time limit special • Time limit other • Denied referred fraud • Interest paid • Interest amount paid • Total paid We selected 10 percent of the claims from ABC Carrier's supporting documentation used by management to prepare the Annual New Jersey Prompt Payment Report, with the selections distributed throughout the year. If 10 percent of the claims exceeded 50, then the number of items selected was limited to 50. If 10 percent of the claims resulted in less than 10 claims, then the number of items selected was 10, and for each item selected we: 1. Compared the following information to ABC Carrier's claim payment system: • Paid amount • Claim finalization or payment date • Claim received date • Denial code			

<i>Procedures</i>	<i>Findings</i>		
	<i>No Exception</i>	<i>Exception</i>	<i>N/A</i>
- Claim category (physician, dental, other health care professional, hospital, or other health care facilities) 2. Compared the following information to the original claim information submissions: - Date received - Amount billed - Category (physician, dental, other health care professional, hospital, or other health care facilities) 3. Noted whether, per ABC Carrier's member records, original claim information submission, or both, the claim related to a policy issued in the state of New Jersey 4. If a selected claim was denied, compared denial reason indicated in ABC Carrier's claims system records to supporting documentation used by management to prepare the Annual New Jersey Prompt Payment Report 5. If a selected claim is a "clean claim," as defined in NJAC 11:22-1.2, and as determined by ABC Carrier, recalculated the amount of interest paid on the selected claim in accordance with the requirements of NJAC 11:22-1.5 We selected 10 claims from ABC Carrier's primary claims system, with the selections distributed throughout the year, and for each item selected, traced the selected claims covered under New Jersey contracts to the supporting documentation used by management to prepare the Annual New Jersey Prompt Payment Report. We proved the arithmetic accuracy of ABC Carrier's 20XX Appendix B annual claims prompt payment report. Description of Exceptions if Any			

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix C — Illustrative Management Representation Letter

[ABC Carrier's Letterhead]

[Date]

[CPA Firm's Name and Address]

In connection with your engagement to apply the agreed-upon procedures enumerated in the American Institute of Certified Public Accountants' Statement of Position (SOP) 02-1, *Performing Agreed-Upon Procedures Engagements That Address Annual Claims Prompt Payment Reports as Required by the New Jersey Administrative Code*, which addresses compliance with the requirements of New Jersey Administrative Code, Title 11, Chapter 22, Subchapter 1 (NJAC 11:22-1.9), for Appendix B 20XX Annual Report (Exhibit I) for the period from January 1, 20XX through December 31, 20XX, we confirm, to the best of our knowledge and belief, the following representations made to you during your engagement:

1. We are responsible for ABC Carrier's compliance with the requirements of NJAC 11:22-1, for the information in ABC Carrier's annual claims prompt payment report, for the year ended December 31, 20XX.
2. We have provided you with all relevant information and access to all records relevant to ABC Carrier's compliance with the requirements of NJAC 11:22-1 and ABC Carrier's annual claims prompt payment reports, as agreed-upon in the terms of the engagement.
3. All known matters contradicting ABC Carrier's compliance with the requirements of NJAC 11:22-1 and any communication from regulatory agencies or others affecting ABC Carrier's compliance with the requirements of NJAC 11:22-1, ABC Carrier's annual claims prompt payment reports, have been disclosed to you, including communications received between December 31, 20XX and the date of your report.
4. We are not aware of any material misstatements with respect to ABC Carrier's compliance with the requirements of NJAC 11:22-1.
5. We have disclosed to you all known events subsequent to December 31, 20XX that would have a material effect on ABC Carrier's compliance with the requirements of NJAC 11:22-1.
6. We have disclosed to you *[matters as the practitioner deems appropriate, for example,*
 - *any communications from regulatory agencies relating to the carrier's annual claims prompt payment report.*
 - *all known matters contradicting the information in the carrier's annual claims prompt payment report.]*
7. During the year ended December 31, 20XX, there have been no errors or fraud that would indicate that ABC Carrier is not in compliance with the requirements of NJAC 11:22-1.

8. We have responded fully to all inquiries made to us by you during the engagement.

[Signature]

[Title]

[Signature]

[Title]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

New Jersey Annual Claims

Prompt Payment Reports Task Force

JEFF MUZIO, *Chair*
CRAIG C. ANDERSON
JOHN D. HARRIS
JOHN LANGIONE

NANCY LOFREDO
KIM RAIMONDI
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The AICPA is grateful to Jean Connolly, James S. Gerson, and Kim Kushmerick, for their technical assistance with this document.

AUD Section 35***Statement of Position 04-1 Auditing the Statement of Social Insurance***

November 22, 2004

NOTICE TO READERS

This AICPA Statement of Position (SOP) is currently undergoing significant revision by a task force of the Auditing Standards Board to

- reflect the provisions of Statement of Federal Financial Accounting Standards (SFFAS) 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*, which requires that a financial projection be presented as required supplemental information in the consolidated financial report of the U.S. Government for years 2010, 2011, and 2012, after which time the financial projection becomes a basic financial statement;
- reflect the requirements and guidance in AT section 301, *Financial Forecasts and Projections*; and
- expand the scope of the SOP to include the projection required by SFFAS 36 and perhaps other long-term projections.

As part of this revision, the task force is also reflecting the conforming changes necessary due to the issuance of Statement on Auditing Standards Nos. 122-126. The revisions to this SOP will be reflected in a subsequent update of AICPA *Technical Practice Aids*.

NOTE

This AICPA Statement of Position (SOP) has been developed by the AICPA Social Insurance Task Force to provide guidance regarding the audits of statements of social insurance prepared in accordance with the standards of the Federal Accounting Standards Advisory Board (FASAB). Audits of federal government agencies are also governed by *Government Auditing Standards* (the Yellow Book) and applicable Office of Management and Budget (OMB) guidance.

This SOP is recognized as an interpretive publication as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. Interpretive publications are recommendations on the

(continued)

application of generally accepted auditing standards (GAAS) in specific circumstances, including engagements for entities in specialized industries.

An interpretive publication is issued under the authority of the AICPA Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with GAAS. The members of the ASB have found this SOP to be consistent with existing GAAS.

Although interpretive publications are not auditing standards, AU-C section 200 requires the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

Introduction

.01 The Federal Accounting Standards Advisory Board (FASAB) establishes accounting standards for reporting information about the following social insurance programs:

- a. Old-Age Survivors and Disability Insurance (OASDI or Social Security)
- b. Medicare ([Hospital Insurance [HI] and Medicare Supplementary Medical Insurance [SMI])
- c. Railroad Retirement benefits
- d. Black Lung benefits
- e. Unemployment Insurance

.02 FASAB standards require the financial statements of the federal agencies responsible for the Social Security, Medicare, Railroad Retirement, and Black Lung programs and the financial statements of the federal government-wide entity to present a statement of social insurance as a basic financial statement. FASAB standards require these agencies and the government-wide entity to report:

- a. The estimated present value of the income to be received from or on behalf of the following groups during a projection¹ period sufficient to illustrate the long-term sustainability of the social insurance programs:
 - (1) Current participants who have not yet attained retirement age
 - (2) Current participants who have attained retirement age

¹ The AICPA Guide *Prospective Financial Information* (guide) defines the term *projection* and differentiates it from the term *forecast*. In this Statement of Position (SOP), the term *projection* is used in its generic sense, as it is used in standards issued by the Financial Accounting Standards Advisory Board (FASAB) and the federal agencies that administer social insurance programs. The use of the term *projection* in this SOP is not intended to suggest that information presented in the statement of social insurance is a projection as defined in the guide or that the provisions of the guide would apply to the audit of the statement of social insurance.

- (3) Individuals expected to become participants
- b. The estimated present value of the benefit payments to be made during that same period to or on behalf of the groups listed in item *a*
- c. The estimated net present value of the cash flows during the projection period (the income described in item *a* over the expenditures described in item *b*, or the expenditures described in item *b* over the income described in item *a*)
- d. In notes to the statement of social insurance:
 - (1) The accumulated excess of all past cash receipts, including interest on investments, over all past cash disbursements within the social insurance program represented by the fund balance at the valuation date
 - (2) An explanation of how the net present value referred to in item *c* is calculated for the closed group² (Paragraph 27(3)(i) of Statement of Federal Financial Accounting Standards [SFFAS] No. 17, *Accounting for Social Insurance*, identifies the information to be included in this explanation.)
 - (3) Comparative financial information for items *a*, *b*, *c*, and *d*(1) for the current year and for each of the four preceding years
 - (4) The significant assumptions used in preparing the estimates

.03 The income, expenditures, and net present value of cash flows recognized in the statement of social insurance differ from traditional concepts of income and expenditures for retirement and health benefit programs. Financial reporting for social insurance programs includes estimates of income and expenditures not only for current program participants but also for individuals expected to become participants in social insurance programs in the future. In paragraphs 26–28 of the basis for conclusions section of SFFAS No. 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, FASAB acknowledges this difference and explains why the recognition of such amounts is essential to the fair presentation of federal financial statements:

26. The Board believes that the SOSI [statement of social insurance] should be treated as a basic financial statement because it is essential to fair presentation and is important to achieve the objectives of federal financial reporting. The related stewardship objectives include helping users to assess the impact on the country of the Government's activities, determine whether the Government's financial position improved or deteriorated over the period, and predict whether future budgetary resources will likely be sufficient to sustain public services and meet obligations as they come due. In that regard, the multi-trillion dollar obligations associated with Social Insurance over the next 75 years could significantly exceed the largest liabilities currently recognized in the U.S. Government Balance Sheet.

27. The Board acknowledges that there is great uncertainty inherent in long term projections, but believes that if the uncertainty is suitably disclosed—as is required by SFFAS 17—it need not preclude designating the information as

² The *closed group* is defined as those persons who, as of a valuation date, are participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.

a basic financial statement, essential for fair presentation in conformity with GAAP...

28. Even within the context of historical financial reporting, the Board notes that accrual-basis "historical" financial statements include many measurements that involve assumptions about the future. The distinction between reporting on the financial effects of events that have occurred and the effects of future events depends, obviously, upon the definition of the event. The information required by SFFAS 17 reports on the financial effects of existing law and demographic conditions and assumptions, just as the pension obligation at a point in time is based on existing conditions. In that sense, Social Insurance information can be viewed as reflecting events that have occurred and, therefore, as "historical."

Applicability

.04 This Statement of Position (SOP) provides guidance to auditors in auditing the statement of social insurance for the following social insurance programs:

- a. Old-Age Survivors and Disability Insurance (OASDI or Social Security)
- b. Medicare (Hospital Insurance [HI] and Medicare Supplementary Medical Insurance [SMI])
- c. Railroad Retirement benefits
- d. Black Lung benefits

As permitted by AU section 543, *Part of Audit Performed by Other Independent Auditors*, a principal auditor may fulfill the requirements of this SOP by using work that other independent auditors have performed in conformity with the provisions of this SOP. For example, for the OASDI program, the auditor of the federal government-wide financial statements may use the work and report of the auditor of the Social Security Administration's statement of social insurance.

Management's Responsibilities

.05 The agency's management (management) is responsible for preparing the statement of social insurance and the estimates underlying it in conformity with generally accepted accounting principles. In doing so, management must determine its best estimate³ of the economic and demographic conditions that will exist in the future. Because estimates in the statement of social insurance are based on subjective as well as objective factors, management must use judgment to estimate amounts included in the statement of social insurance. Management's judgment ordinarily is based on its knowledge and experience about past and current events and its assumptions about conditions it expects to exist. Management is responsible for the accuracy and completeness of the statement of social insurance.

³ Paragraph 25 of FASAB Statement of Federal Financial Accounting Standards (SFFAS) No. 17, *Accounting for Social Insurance*, states, in part, "The projections and estimates used should be based on the entity's best estimates of demographic and economic assumptions, taking each factor individually and incorporating future changes mandated by current law." Certain agencies prepare social insurance information using assumptions prepared by a board of trustees. Auditors should consider such assumptions to represent the agency's "best estimates" if the trustees have characterized them as such, and agency management has determined them to be reasonable. With respect to these assumptions, the auditor should perform audit procedures that are consistent with the guidance in paragraphs .09–.35 of this SOP.

Preparing Social Insurance Estimates

.06 Management is responsible for preparing the estimates underlying the statement of social insurance. That process ordinarily consists of:

- a. Identifying the relevant factors that may affect the estimates
- b. Developing assumptions that represent management's best estimate of circumstances and events with respect to the relevant factors
- c. Accumulating relevant, sufficient, and reliable data on which to base the estimates
- d. Determining the estimated amounts based on assumptions and other relevant factors
- e. Determining that the estimates are presented in conformity with generally accepted accounting principles and that disclosure is adequate

Conceptual Model

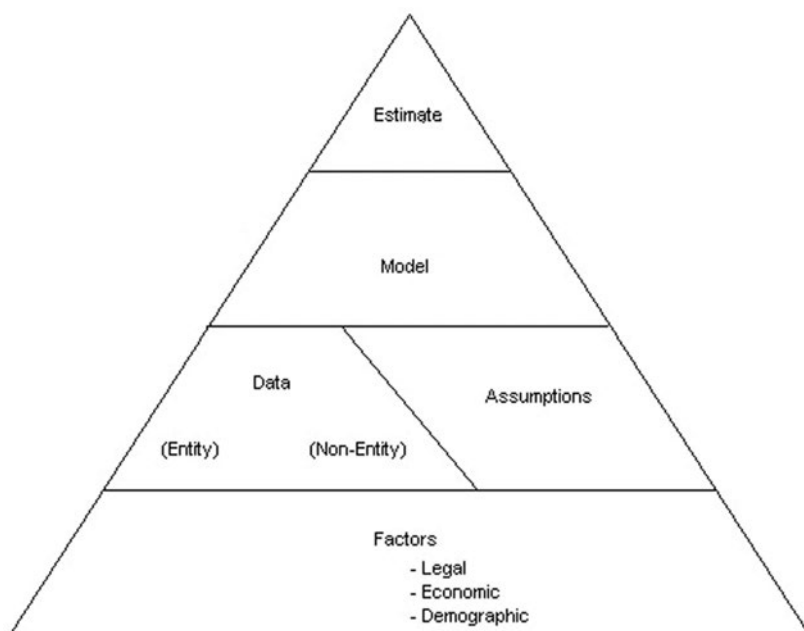


Figure 1: Elements of the Process of Developing Social Insurance Estimates

.07 Figure 1, "Elements of the Process of Developing Social Insurance Estimates," is a conceptual model depicting the elements of the process that results in the statement of social insurance. It is not intended to depict the⁴ actual

⁴ Office of Management and Budget (OMB) Circular No. A-123, *Management Accountability and Control*, section II, "Establishing Management Controls," states, in part, "...documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

process used by an organization to develop the statement of social insurance. With the assistance of internal and external specialists, management considers, identifies, and documents factors, assumptions, and data that serve as input to a model for developing estimates. The factors, data, assumptions, and models used to develop the statement of social insurance are closely interrelated and may not be separable. Following are definitions of the terms used in figure 1:

- a. *Factors.* The elements or variables that affect income or expenditures for a program and for which data must be gathered and assumptions must be generated, for example, legal, economic, and demographic factors. An example of a factor is the number of individuals reaching age 65 in a specific year.
- b. *Assumptions.* Expectations about what will happen in the future. An example of an assumption is that there will be a 1 percent increase in the number of women working outside the home in each of the next five years. An assumption is expressed as a value or direction assigned to a factor.
- c. *Data.* Organized factual information used for analysis or to make decisions. An example is census data and classifications of that data, such as the population classified by sex or age. Data may be developed within the entity that prepares the statement of social insurance or it may come from sources outside the entity.
- d. *Models.* Methods or formulas for mathematically expressing how the assumptions and data relate to each other. For example, a model might indicate that a 1 percent decline in the birth rate in a given year will result in a 0.2 percent decrease in social insurance income and benefit payments 10 years later. A model is a set of coded instructions, rules, or procedures used to perform a desired sequence of events or to obtain a result. Typically, models are developed by using various computer applications.
- e. *Estimates.* The amounts or valuations that result after processing the factors, data, and assumptions in a model. These estimates will be used in preparing the statement of social insurance.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Designing and Implementing Internal Control Related to Estimates

.08 Controls that are designed and implemented in a manner consistent with Standards for Internal Control in the Federal Government issued by the Government Accountability Office help ensure the accuracy and completeness of the statement of social insurance. An entity's internal control may reduce the likelihood of material misstatements of financial statement assertions involving estimates. Among the aspects of internal control that are relevant to the process of developing estimates are the following:

- a. Management communication of the need for proper estimates
- b. Accumulation of relevant, sufficient, and reliable data on which to base accounting estimates
- c. Preparation of the estimates by qualified personnel
- d. Adequate review and approval of the estimates by appropriate levels of authority, for example:
 - (1) Review of the sources of the relevant factors

- (2) Review of the process used to develop assumptions
 - (3) Review of the reasonableness of the assumptions and resulting estimates
 - (4) Consideration of the need to use the work of specialists
 - (5) Consideration of changes in previously established methods for developing estimates
- e. Comparison of prior estimates with actual subsequent results to assess the reliability of the process and models used to develop the estimates
 - f. Appropriate general and application controls related to computer-based models used in the calculation of estimates included in the statement of social insurance

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

The Auditor's Responsibility

.09 Paragraph .10 of AU section 342, *Auditing Accounting Estimates*, states that the auditor should obtain an understanding of how management developed the estimate. Based on that understanding, the auditor should use one or a combination of the following approaches to evaluate the reasonableness of an estimate:

- a. Review and test the process used by management to develop the estimate.
- b. Develop an independent expectation of the estimate to corroborate the reasonableness of management's estimate.
- c. Review subsequent events or transactions occurring prior to the date of the auditor's report.

In auditing the statement of social insurance, if controls over the estimation process are effective, the most practicable and efficient approach may be to review and test the process used by management. However, if the auditor finds that controls over the estimation process are ineffective, the auditor should consider whether it is practicable to:

- Develop an independent expectation of the estimate, or portions of the estimate, to corroborate management's estimate
- or
- Obtain sufficient appropriate audit evidence from outside the audited agency's process that would support the assertions in the statement of social insurance.

If it is not practicable to mitigate the effects of the ineffective controls through substantive procedures such as these, the auditor's report on the statement of social insurance should be modified. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.10 The auditor's objective when auditing the statement of social insurance is to obtain sufficient appropriate audit evidence to provide reasonable assurance that:

- a. The estimates presented in the statement of social insurance are reasonable in the circumstances.

- b. The statement of social insurance is presented fairly, in all material respects, in conformity with generally accepted accounting principles, including adequate disclosure.

Paragraphs .11–.43 of this SOP describe how the auditor achieves this objective. As discussed in footnote 9 of paragraph .19, if the auditor does not possess the level of competence in actuarial science to qualify as an actuary, it is necessary for the auditor to obtain the services of an independent actuary⁵ to assist the auditor in planning and performing auditing procedures. Generally, the auditor will need the assistance of an independent actuary in performing various procedures during all phases of the audit and related to all elements of the estimates. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining an Understanding of the Entity and Its Environment, Including Its Internal Control

.11 AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. [Paragraph added, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.12 The procedures the auditor performs to obtain the required understanding are known as *risk assessment procedures*. In an audit of the statement of social insurance, the auditor's risk assessment procedures should include

- a. obtaining knowledge about the agency and its environment including the following matters:
 - (1) The agency's program and its operations including relevant laws and regulations governing the program that have a direct and material effect on the statement of social insurance (paragraphs .13–.14)
 - (2) The agency's process for developing, evaluating, and incorporating estimates in the statement of social insurance (paragraph .15)
 - (3) The work performed by the agency's actuary (paragraphs .16–.20)
 - (4) The work performed and findings reported by any external review groups that have been commissioned by the agency,

⁵ The actuary can either be under contract with the audit firm or employed by the audit firm. In either case, the actuary performing services for the audit firm would need to meet the independence standards of generally accepted governmental auditing standards (GAGAS), which are applicable to audits of statements of social insurance. For example, for actuaries under contract with the audit firm, the auditor should determine whether the actuary's firm is independent of the agency being audited and then assess the actuary's ability to impartially perform the work and report results. In conducting this assessment, the auditor should provide the actuary with the GAGAS independence requirements and obtain representations from the actuary regarding his or her independence from the audited entity. For actuaries employed by the audit firm, the independence requirements are the same as those for auditors. Paragraphs 3.06–.18 of chapter 3, "General Standards," *Government Auditing Standards: 2003 Revision* (GAO-03-673G) describe applicable independence requirements.

an appropriate advisory board, or the trustees⁶ (paragraph .21).

- b. considering materiality (paragraphs .22–.23).
- c. obtaining an understanding of the agency's internal control as it relates to the preparation of the statement of social insurance (paragraphs .24–.27).
- d. assessing the risk of material misstatement of the financial statements (paragraphs .28–.29).⁷
- e. performing further audit procedures (paragraphs .30–.35).

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining Knowledge About the Agency's Program and Its Operations

.13 Relevant knowledge about the program and its operations includes the following:

- a. The nature of the program's activities
- b. The source of its funding
- c. Who the beneficiaries are

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.14 An important aspect of the program and its operations are the laws and regulations governing the program that may have a direct and material effect on amounts reported as social insurance income and expenditures. To obtain the laws and regulations governing the operation of the social insurance program, the auditor may request them from agency management. Through inquiry of management, the auditor may obtain information about

- a. the laws and regulations that significantly affect the determination of amounts included in the statement of social insurance and
- b. how management has given effect to changes in laws and to new regulations published in final form in determining future social insurance income and expenditures.

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining Knowledge About the Agency's Process for Developing, Evaluating, and Incorporating Estimates in the Statement of Social Insurance

.15 The auditor should obtain knowledge about the agency's process for developing, evaluating, and incorporating estimates in the statement of social

⁶ Certain social insurance programs are overseen by a board of trustees. For example, the Social Security Act establishes a board of trustees to oversee the financial operations of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The board is composed of six members, four of whom serve automatically by virtue of their positions in the federal government: the Secretary of the Treasury (the managing trustee), the Secretary of Labor, the Secretary of Health and Human Services, and the Commissioner of Social Security. The other two members are appointed by the President and confirmed by the Senate to serve as public representatives.

⁷ The auditor generally would conclude that inherent risk is high for assertions about estimates in the statement of social insurance because of the complexity of such estimates and the need for significant judgment in preparing them. Other factors that may affect inherent risk in auditing the statement of social insurance include the political climate surrounding social insurance programs, budget limitations, and economic conditions.

insurance. Procedures the auditor may perform to obtain that knowledge include the following:

- a. Making inquiries of management; individuals responsible for initiating, processing, or recording estimates; and internal and external specialists with expertise in relevant subject matter, such as actuarial science, economics, and law.
- b. Reading entity or nonentity documents and records used to prepare the statement of social insurance, as well as the agency's documentation of the process for preparing the statement of social insurance.
- c. Observing entity activities and operations used to prepare the statement of social insurance, such as transferring data from a tabulation report to a computerized application.

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining Knowledge About the Work Performed by the Agency's Actuary

.16 Information presented in the statement of social insurance ordinarily is determined on the basis of an actuarial valuation of the program performed or reviewed by the agency's actuary, using data received from sources inside and outside the agency, and actuarial techniques. Paragraph .12 of AU section 336, *Using the Work of a Specialist*, states the following:

The auditor should (a) obtain an understanding of the methods and assumptions used by the specialist, (b) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (c) evaluate whether the specialist's findings support the related assertions in the financial statements.

[Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.17 The auditor's qualifications do not encompass actuarial science or the complexities of probability and longevity associated with social insurance income and expenditures. The auditor may have a general awareness and understanding of actuarial concepts and practices; however, he or she does not purport to act in the capacity of an actuary. The auditor, therefore, should follow the guidance in AU section 336 to obtain assurance regarding the work of an actuary on such matters as program income and benefit payments. [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.18 An audit of the statement of social insurance requires cooperation and coordination between the auditor and the actuary. The auditor uses the work of the actuary as an audit procedure to obtain sufficient appropriate audit evidence; the auditor does not merely rely on the report of an actuary. Although the appropriateness and reasonableness of the methods and assumptions used, as well as their application, are within the expertise of the actuary, the auditor does not divide responsibility with the actuary for his or her opinion on the financial statements taken as a whole. Thus, the auditor should satisfy himself or herself as to the professional qualifications and reputation of the actuary as well as the actuary's objectivity, and should obtain an understanding of the actuary's methods and assumptions, test data provided to the actuary, and consider whether the actuary's findings support the related representations in the financial statements. [Paragraph renumbered and revised, June 2009, to

reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.19 If the actuary who has prepared or reviewed the actuarial valuation of the social insurance program was engaged by the agency administering that program, it is necessary for the auditor to obtain the services of an independent actuary⁸ to assist the auditor in performing auditing procedures that assess the agency actuary's methods, assumptions, and estimates, and aid the auditor in determining whether the agency actuary's findings are not unreasonable in the circumstances.⁹ *Government Auditing Standards*, which are applicable to audits of statements of social insurance, provide independence requirements and examples of personal, external, and organizational impairments to independence. [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.20 The auditor should document (a) the specific audit procedures that were performed with the assistance of an independent actuary, and the related findings and conclusions, (b) the relationship between the procedures performed with the assistance of an independent actuary and the auditor's assessments of audit risk and materiality, and (c) all other significant matters related to the objectives and scope of the independent actuary's work, including any limitations on the independent actuary's procedures. [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining Knowledge About the Work Performed by External Review Groups

.21 In some cases, the agency responsible for the preparation of the statement of social insurance or the program's trustees may commission the services of an external review group comprising technical experts in relevant fields to review the factors, assumptions, data, estimates, and models used to prepare the statement of social insurance. In many instances, individuals assigned to perform these reviews are recognized authorities in their respective fields of study. Because of the nature of these external review groups and the qualifications of the individuals typically assigned to them, information about the work performed by the external review group, how its findings are communicated to the agency, and how the agency has responded to these findings are relevant to an audit of the statement of social insurance.¹⁰ See paragraph A-18c of the appendix of this SOP, entitled "Illustrative Controls and Audit Procedures," for examples of inquiries the auditor may make of management to obtain knowledge about the work performed by external review groups. [Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

⁸ See footnote 5.

⁹ Although paragraph .11 of AU section 336, *Using the Work of a Specialist*, does not preclude the auditor from using the work of a specialist who is related to the client, because of the significance of the estimates of income and expenditures to the statement of social insurance, and the complexity and subjectivity involved in developing such estimates, auditing estimates in the statement of social insurance requires the use of an outside actuary, that is, an actuary who is not employed or managed by the agency. If the auditor has the requisite knowledge and experience in actuarial science, the auditor may serve as the actuary. If the auditor does not possess the level of competence in actuarial science to qualify as an actuary, the auditor should use the work of an independent outside actuary.

¹⁰ Although reviews by external review groups may not be conducted annually, in auditing the statement of social insurance the auditor should obtain and review the most recent report of such external review groups.

Considering Materiality

.22 The auditor's determination of materiality is a matter of professional judgment and is influenced by the auditor's perception of the needs of users of financial statements. Materiality judgments are made in light of surrounding circumstances and necessarily involve both quantitative and qualitative considerations. Auditors should design audit procedures to obtain reasonable assurance of detecting misstatements that, either individually or when aggregated with other misstatements, could be material to the financial statements taken as a whole. Auditors should exercise due professional care when setting the materiality base, carefully assessing the information gained from risk assessment procedures and the needs of users of the financial statements. [Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.23 For certain federal agencies, amounts reported in the statement of social insurance may vary significantly from the amounts reported in the other basic financial statements, or may differ significantly on a qualitative basis. In such cases, it may not be appropriate to establish a single materiality threshold for the entire set of financial statements. Instead, the auditor should consider using a separate materiality level when planning and performing the audit of the statement of social insurance and related disclosures. [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining an Understanding of the Agency's Internal Control

.24 AU section 314 defines internal control as a process—effected by those charged with governance, an entity's board of directors, management, and other personnel—designed to provide reasonable assurance regarding the achievement of the entity's objectives with regard to (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. [Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.25 In auditing the statement of social insurance, the auditor should obtain a sufficient understanding of the agency's internal control by performing risk assessment procedures to evaluate the design of the agency's controls relevant to an audit of the statement of social insurance and to determine whether those controls have been implemented. The auditor should use this knowledge to

- a. identify types of potential misstatements.
- b. consider factors that affect the risks of material misstatement.
- c. design tests of controls, when applicable, and substantive procedures.

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

[.26] [Paragraph renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.27 Internal control consists of the following five interrelated components:

- a. *Control* environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.

- b. Entity's *risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- c. *Information and communication systems* support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- d. *Control activities* are the policies and procedures that help ensure that management directives are carried out.
- e. *Monitoring* is a process that assesses the quality of internal control performance over time.

Ordinarily, controls that are relevant to an audit pertain to the entity's objective of preparing financial statements that are fairly presented in conformity with generally accepted accounting principles. [Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Assessing the Risks of Material Misstatement

.28 Using the information gained from the auditor's risk assessment procedures, the auditor should identify and assess the risks of material misstatement for assertions in the statement of social insurance. [Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.29 The risk of material misstatement of estimates ordinarily varies with the complexity and subjectivity of the process, the availability and reliability of the relevant data, the number and significance of assumptions that are made, and the degree of uncertainty associated with the assumptions. [Paragraph added, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Performing Further Audit Procedures

.30 The auditor should design further audit procedures, including tests of the operating effectiveness of controls, where relevant or necessary, and substantive procedures, whose nature, timing, and extent are responsive to the assessed risks of material misstatement at both the financial statement and the relevant assertion level. [Paragraph added, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

[.31] [Paragraph renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.32 AU section 318, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, states that the auditor should perform tests of controls when the auditor's risk assessment includes an expectation of the operating effectiveness of controls or when substantive procedures alone do not provide sufficient appropriate audit evidence at the relevant assertion level. However, when auditing the statement of social insurance, the complexity and subjectivity of the estimates, the volume of data involved, and the importance of controls ordinarily would make performing only substantive tests an ineffective strategy.¹¹ [Paragraph renumbered and

¹¹ OMB Bulletin No. 01-02 states that "For those internal controls that have been properly designed and placed in operation, the auditor shall perform sufficient tests to support a low assessed level of control risk."

revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

[.33] [Paragraph renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

[.34] [Paragraph renumbered and deleted, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.35 As indicated in paragraph .09 of this SOP, in evaluating the reasonableness of the estimates in the statement of social insurance, the auditor primarily reviews and tests the process used by management. The appendix of this SOP contains examples of

- a. procedures the auditor performs to obtain knowledge about the agency's process for developing, evaluating, and incorporating estimates in the statement of social insurance.
- b. controls that are relevant to an agency's preparation of the statement of social insurance. (The auditor should obtain an understanding of the design of such controls and determine whether they have been placed in operation.)
- c. procedures the auditor performs to test controls, assess control risk, and test assertions in the statement of social insurance.

[Paragraph added, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Testing the Work of the Agency's Actuary

.36 When auditing estimates and considering the related factors, assumptions, data, and models, the auditor should obtain the services of an actuary in accordance with AU section 336.¹² [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.37 With respect to the actuarial present value of amounts reported in the statement of social insurance, the auditor, in following the guidance in AU section 336, should

- a. read the agency actuary's actuarial report.
- b. evaluate the professional qualifications, competence, and objectivity of the agency's actuary. Examples of factors that should be considered are the actuary's membership in a recognized professional organization and the opinion of other actuaries, whom the auditor knows to be qualified, regarding the actuary's professional qualifications.
- c. obtain an understanding of the actuary's objectives, scope of work, methods, and assumptions, and their consistency of application. The Actuarial Standards Board establishes Actuarial Standards of Practice (ASOPs) that identify what the actuary should consider, document, and disclose when performing an actuarial assignment. The auditor may consult the ASOPs in obtaining an understanding of the methods and assumptions used in the valuation of the social insurance program.¹³ Management, not the actuary, is responsible for the assumptions made and methods used.

¹² See footnote 9.

¹³ Relevant standards include Actuarial Standards of Practice No. 21, *The Actuary's Responsibility to the Auditor*, No. 23, *Data Quality*, and No. 32, *Social Insurance*.

- d. test the reliability and completeness of the data provided by the agency and used by the actuary in the actuarial valuation. (See paragraphs A-11–A-14 in the appendix to this SOP.) For example, laws or regulations governing program operations can affect the determination of the data or methods to be used in the actuarial calculations. In testing the reliability and completeness of the data, the auditor may inquire as to whether the actuarial valuation considers all pertinent provisions of laws and regulations governing program operations, including any changes in laws or regulations affecting the actuarial calculations since the date of the latest statement of social insurance. In the event that data provided to the actuary are significantly incomplete, the auditor may inquire of the actuary about the treatment of the incomplete data and determine whether the method used by the actuary to give effect to the missing data in his or her valuation is reasonable in the circumstances.
- e. assess the nature and significance of any reservations concerning assumptions or data that the actuary has stated in his or her report.

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Testing the Fund Balance

.38 Paragraph 27(3)(h) of SFFAS No. 17 requires the agency to report "the accumulated excess of all past cash receipts, including interest on investments, over all past cash disbursements within the social insurance program represented by the fund balance at the valuation date." As noted in paragraph 26 of SFFAS No. 17, the valuation date for the statement of social insurance may differ from the valuation date for the other financial statements. Accordingly, the auditor should conduct appropriate testing of the accumulated cash receipts over the accumulated cash disbursements, as of the social insurance valuation date. The nature and extent of testing is a matter of professional judgment. Examples of procedures the auditor may perform are confirmation testing or roll-forward testing. [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Obtaining Management's Representations

.39 AU section 333, *Management Representations*, requires the auditor to obtain a representation letter from management confirming representations given to the auditor during the engagement, for example, a representation regarding the completeness of the information provided to the auditor. In an audit of the statement of social insurance, the representation letter should include, as applicable, the following representations:

- a. The actuarial assumptions and methods used to measure amounts in the statement of social insurance for financial accounting and disclosure purposes represent management's best estimates regarding future events based on demographic and economic assumptions, and future changes mandated by law.
- b. There were no material omissions from the data provided to the agency's actuary for the purpose of determining the actuarial present value of the estimated future income to be received, and estimated future expenditures to be paid during a projection period sufficient to illustrate the long-term sustainability of the

[*name of the social insurance program*] as of [*dates of statements of social insurance presented*].

- c. Management is responsible for the assumptions and methods used in the preparation of the statement of social insurance. Management of the agency agrees with the actuarial methods and assumptions used by the agency's actuary and has no knowledge or belief that would make such methods or assumptions inappropriate in the circumstances. Management did not give any instructions, nor cause any instructions to be given to the agency's actuary with respect to values or amounts derived, and is not aware of any matters that have affected the objectivity of the agency's actuary. Management believes that the actuarial assumptions and methods used to measure amounts in the statement of social insurance for financial accounting purposes are appropriate in the circumstances.
- d. The statement of social insurance covers a projection period sufficient to illustrate long-term sustainability of the social insurance program.
- e. Management has provided the auditor with all the reports developed by external review groups appointed by the agency or the program's trustees related to estimates in the statement of social insurance.
- f. The following matters relating to the statement of social insurance have been disclosed properly in the notes to the financial statements:
 - (1) The accumulated excess of all past cash receipts, including interest on investments, over all past cash disbursements within the social insurance program represented by the fund balance at the valuation date
 - (2) An explanation of how the net present value is calculated for the closed group¹⁴ (Paragraph 27(3)(i) of SFFAS No. 17 identifies the information to be included in this explanation.)
 - (3) Comparative financial information for the items in paragraphs .02a, .02b, .02c, and .02d(1) of this SOP, for the current year and for each of the four preceding years
 - (4) Significant assumptions used in preparing the estimates
- g. There have been no changes in [*or, Changes in the following have been properly recorded or disclosed in the financial statements*]:
 - (1) The actuarial methods or assumptions used to calculate amounts recorded or disclosed in the financial statements between the valuation dates (that is, January 1, 20X8, and January 1, 20X7) or changes in the method of collecting data.
 - (2) The actuarial methods or assumptions used to calculate amounts recorded or disclosed in the financial statements between the valuation date and the financial reporting date (that is, January 1, 20X8, and September 30, 20X8) or changes in the method of collecting data.

¹⁴ The *closed group* is defined as those persons who, as of a valuation date, are participants in a social insurance program as beneficiaries, covered workers, or payers of earmarked taxes or premiums.

- h. There have been no changes in [or, Changes in the following have been properly recorded or disclosed in the financial statements]:
 - (1) Laws and regulations affecting social insurance program income and benefits between the valuation dates (January 1, 20X8, and January 1, 20X7).
 - (2) Laws and regulations affecting social insurance program income and benefits between the valuation date and the financial reporting date (that is, January 1, 20X8, and September 30, 20X8).
- i. Accounting estimates applicable to the financial information of the agency included in the statement of social insurance are based on management's best estimate, after considering past and current events and assumptions about future events.

[Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Reporting

.40 Because FASAB has defined the statement of social insurance as a basic financial statement, the auditor should report on it as a part of his or her report on the other basic financial statements. In addition to following the requirements of AU section 508, *Reports on Audited Financial Statements*, the auditor's report on a federal agency's financial statements that present a statement of social insurance should include the following elements:

- a. An opinion as to whether the statement of social insurance presents fairly, in all material respects, the financial condition¹⁵ of the agency's social insurance program(s) as of the valuation date in conformity with generally accepted accounting principles.
- b. An explanatory paragraph following the opinion paragraph, describing that (i) the statement of social insurance presents the actuarial present value of the agency's estimated future income to be received from or on behalf of the participants and estimated future expenditures to be paid to or on behalf of participants during a projection period sufficient to illustrate long-term sustainability of the social insurance program; (ii) in preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the

¹⁵ In Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, the FASAB articulates a concept of *financial condition*, as distinct from *financial position*. Financial condition is broader and more forward-looking than financial position. Presenting information on financial condition is consistent with FASAB's financial reporting objective of stewardship. In illustrating how the stewardship objective aligns with the needs of users of federal financial statements, FASAB observes that,

All users need information on earmarked revenues recorded in trust funds. They want to know, for example, whether the Social Security Trust funds are likely, in the foreseeable future, to need infusions of new taxes to pay benefits. Citizens need to know the implications of investing trust fund revenues in government securities.

In reporting the actuarial present value of the estimated future income to be received, estimated future expenditures to be paid, and excess of income over expenditures during a projection period sufficient to illustrate the long-term sustainability of an agency's social insurance programs, and in disclosing in the notes to the financial statements comparative financial information for the five most recent years, the statement of social insurance presents the financial condition of the programs. Thus, in reporting on the statement of social insurance, the auditor refers to the financial condition of the agency's social insurance programs.

assertions in the statement; and (iii) because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.

- c. Reference to any standards or regulations in addition to generally accepted auditing standards, such as *Government Auditing Standards*, that apply to audits of federal financial statements and any additional elements of the auditor's report that those standards or regulations require.

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.41 The following is an illustrative auditor's report for a statement of social insurance.

Independent Auditor's Report¹⁶

We have audited the accompanying consolidated balance sheets of XYZ Social Insurance Agency, as of September 30, 20X8 and 20X7, the related consolidated statements of net cost, of changes in net position and of financing; the combined statements of budgetary resources for the years then ended; and statements of social insurance as of January 1, 20X8, 20X7, 20X6, 20X5, and 20X4.¹⁷ These financial statements are the responsibility of XYZ Social Insurance Agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of XYZ Social Insurance Agency as of September 30, 20X8 and 20X7; its net cost of operations; changes in net position, budgetary resources, and financing for the year then ended; and the financial condition of its social insurance programs as of January 1, 20X8, 20X7, 20X6, 20X5, and 20X4, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note X to the financial statements, the statements of social insurance present the actuarial present value of the Agency's estimated future

¹⁶ Paragraphs .65–.74 of AU section 508, *Reports on Audited Financial Statements*, provide guidance on reporting on comparative financial statements, including guidance on reporting when there has been a change in auditors.

¹⁷ The auditor's report on the statement of social insurance covers a period of five years (see paragraph 27(3)(j) of SFFAS No. 17); whereas, the auditor's report on the other financial statements covers a period of two years. In the first year's audit of the statement of social insurance, the auditor would only express an opinion on one year; in year two, the auditor would express an opinion on two years, and so on, until all five years were covered.

income to be received from or on behalf of the participants and estimated future expenditures to be paid to or on behalf of participants during a projection period sufficient to illustrate long-term sustainability of the social insurance program. In preparing the statements of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statements. However, because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis (MD&A) and the Required Supplementary Information (RSI) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A and RSI in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the MD&A and RSI because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with *Government Auditing Standards*, we have also issued a report dated [report date] on our consideration of the agency's internal control and a report dated [report date] on its compliance with laws and regulations. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

[Signature]

[Date]

[Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120.]

.42 The statement of social insurance does not articulate with the other basic financial statements. For that reason, the portion of the auditor's report that addresses the statement of social insurance ordinarily will not affect the auditor's report on the balance sheet or the statements of net costs, changes in net position, financing, or budgetary resources. The following illustrates a report in which the auditor disclaims an opinion on the statement of social insurance but expresses an unqualified opinion on the other financial statements.

Independent Auditor's Report

We have audited the accompanying consolidated balance sheets of XYZ Social Insurance Agency, as of September 30, 20X8 and 20X7, the related consolidated statements of net cost, of changes in net position and of financing, and the combined statements of budgetary resources for the years then ended, and we were engaged to audit the statements of social insurance as of January 1, 20X8, 20X7, 20X6, 20X5, and 20X4. These financial statements are the responsibility of XYZ Social Insurance Agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as explained in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

[Insert paragraph describing limitation on scope of the audits of the statements of social insurance.]

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the statements of social insurance as of January 1, 20X8, 20X7, 20X6, 20X5, and 20X4.

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of XYZ Social Insurance Agency as of September 30, 20X8 and 20X7, its net cost of operations, changes in net position, budgetary resources, and financing for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[Omit explanatory paragraph required by paragraph .40(b) of this SOP.]

[Modify the paragraph reporting on Management's Discussion and Analysis and Required Supplementary Information for the effects of the scope limitations regarding the statement of social insurance on that information, considering the guidance in AU section 550, Other Information in Documents Containing Audited Financial Statements, AU section 551, Supplementary Information in Relation to the Financial Statements as a Whole, and AU section 552, Reporting on Condensed Financial Statements and Selected Financial Data.]

[Reference to reports on internal control and compliance with laws and regulations in accordance with the Government Auditing Standards is the same as in the illustration in paragraph .41 of this SOP.]

[Signature]

[Date]

[Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120.]

.43 If the agency that operates a social insurance program issues financial statements that purport to present financial position, net cost of operations, changes in net position, budgetary resources, and financing for the years then ended, but omits the related statements of social insurance, the auditor ordinarily will conclude that the omission requires qualification of the auditor's opinion in the following manner.

Independent Auditor's Report

We have audited the accompanying consolidated balance sheets of XYZ Social Insurance Agency, as of September 30, 20X8 and 20X7, the related consolidated statements of net cost, of changes in net position and of financing, and the

combined statements of budgetary resources for the years then ended. These financial statements are the responsibility of XYZ Social Insurance Agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

[Same second paragraph as the standard report]

The agency declined to present statements of social insurance as of January 1, 20X8, 20X7, 20X6, 20X5, and 20X4. Presentation of such statements describing the financial condition of its social insurance programs is required by accounting principles generally accepted in the United States of America.

In our opinion, except that the omission of the statements of social insurance results in an incomplete presentation as explained in the preceding paragraph, the financial statements referred to previously present fairly, in all material respects, the financial position of XYZ Social Insurance Agency as of September 30, 20X8 and 20X7; its net cost of operations; and changes in net position, budgetary resources, and financing for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[Omit explanatory paragraph required by paragraph .40(b) of this SOP.]

[Modify, in accordance with the guidance in paragraph .09 of AU section 558, Required Supplementary Information, the paragraph regarding Management's Discussion and Analysis and the Required Supplementary Information (RSI) for the omission of the RSI.]

[Reference to reports on internal control and compliance with laws and regulations in accordance with Government Auditing Standards is the same as in the illustration in paragraph .41 of this SOP.]

[Signature]

[Date]

[Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120.]

Effective Date and Transition

.44 This SOP is effective for audits of statements of social insurance for periods beginning after September 30, 2005. SFFAS No. 17 (subparagraph 27(3)(a-h)) requires disclosure of the information for the current year and for each of the four preceding years. Comparative information in the statement of social insurance that has not been audited should be marked as unaudited. Earlier implementation of the provisions of this SOP is permitted. [Paragraph renumbered, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Appendix—Illustrative Controls and Audit Procedures

A-1. This appendix contains examples of:

- a. Procedures the auditor performs to obtain knowledge about the agency's process for developing, evaluating, and incorporating estimates in the statement of social insurance
- b. Controls that are relevant to the agency's preparation of the statement of social insurance (The auditor should obtain an understanding of the design of such controls and determine whether they have been implemented.)
- c. Procedures the auditor performs to tests controls and assertions in the statement of social insurance

A-2. The appendix is divided into the following five sections:

- a. Factors (paragraphs A-3–A-5)
- b. Assumptions (paragraphs A-6–A-10)
- c. Data (paragraphs A-11–A-14)
- d. Models (paragraphs A-15–A-17)
- e. Estimates (paragraphs A-18–A-20)

Each of these sections includes examples of the items described in paragraph A-1. The procedures and controls included in this appendix are illustrative and do not represent a complete list of procedures and controls.

Factors

A-3. In evaluating the reasonableness of an accounting estimate, the auditor ordinarily concentrates on key factors that are significant to the estimate, sensitive to variation, deviations from historical patterns, and subjective and susceptible to misstatement and bias. The following are examples of procedures the auditor performs to obtain knowledge about how the agency generates, evaluates, selects, and reviews factors to be included in estimates in the statement of social insurance:

- a. Identifying the individuals involved in generating, evaluating, selecting, and reviewing factors to be included in estimates in the statement of social insurance
- b. Determining how factors affecting social insurance estimates are generated, evaluated, selected, and reviewed, and how that process is documented¹
- c. Reading documentation of the process for generating, evaluating, selecting, and reviewing estimates to be included in the statement of social insurance

¹ Office of Management and Budget (OMB) Circular No. A-123, *Management and Accountability Control*, and No. A-127, *Financial Management Systems*, outline documentation requirements for manual and automated financial related transactions and systems.

- A-4.** The auditor should obtain a sufficient understanding of the entity's internal control by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented. The following are examples of controls related to factors:
- a.* Management's process for monitoring the environment to determine the effect that change in the environment (for example, legal, political, health, immigration) might have on the factors considered
 - b.* Procedures to prevent or detect and correct the inadvertent omission of factors that should be considered in developing the estimate (an example of such a control would be comparing factors considered and selected in the current period with those of prior periods)
 - c.* Hiring procedures to ensure that individuals responsible for generating, evaluating, selecting, and reviewing factors have the appropriate education and experience
- A-5.** The following are examples of procedures the auditor performs to test controls and financial statement assertions related to factors:
- a.* Reviewing documentation of the factors considered in developing the estimate
 - b.* Evaluating whether the factors that have been considered are relevant and sufficient for the purpose of preparing the statement of social insurance
 - c.* Considering whether there are additional key factors that management has not addressed

Assumptions

- A-6.** In evaluating the reasonableness of an accounting estimate, the auditor ordinarily concentrates on assumptions that are significant to the accounting estimate, sensitive to variation, deviations from historical patterns, and subjective and susceptible to misstatement and bias.
- A-7.** The following are examples of matters the auditor inquires about in discussions with management and other knowledgeable personnel to determine how the agency generates, evaluates, selects, and reviews assumptions to be included in estimates in the statement of social insurance:
- a.* The source of the assumptions for significant estimates²

² For some agencies, the assumptions are established by an external board of trustees and provided to the agency. For example, for the Social Security program, the Social Security Act establishes a board of trustees to oversee the financial operations of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund. The board is composed of six members, four of whom serve automatically by virtue of their positions in the federal government. They are the Secretary of the Treasury (the managing trustee), the Secretary of Labor, the Secretary of Health and Human Services, and the Commissioner of Social Security. The other two members are appointed by the President and confirmed by the Senate to serve as public representatives. In such circumstances, the auditor's procedures generally would focus on testing the work performed by the agency's actuary in reviewing the assumptions developed by the board of trustees. The agency's actuary reports on whether (a) the techniques and methodology used to evaluate the financial and actuarial status of the program is based upon sound principles of actuarial practice and are generally accepted within the actuarial profession; and (b) the assumptions used and the resulting actuarial estimates are, individually and in the aggregate, reasonable for the purpose of evaluating the financial and actuarial status of the trust funds, taking into consideration the past experience and future expectations for the population, the economy, and the program.

- b.* How the assumptions underlying the estimates are documented
- c.* The process for determining the best estimate (for example, intermediate) assumptions (possible outcomes)
- d.* How management considers and determines the effect that variation in the underlying assumptions will have on the estimates

A-8. The following are examples of controls related to assumptions:

- a.* The agency's documentation of the process used to generate, evaluate, select, and review assumptions
- b.* How management monitors the environment for possible changes that might affect the assumptions used to develop estimates, for example, the need to consider alternative assumptions
- c.* Comparing assumptions made in the current period with those of prior periods and reconciling differences
- d.* Hiring procedures to ensure that personnel have the appropriate education and experience to meet job description requirements

A-9. The following are examples of procedures the auditor performs to test controls and financial statement assertions related to assumptions:

- a.* Identifying the assumptions used and evaluating the reasonableness of those assumptions
- b.* Determining whether data and other related information support the assumptions
- c.* Evaluating whether interrelated assumptions are consistent with each other
- d.* Comparing assumptions made by the entity to the range of assumptions made by entities in other industries, for example, insurance companies, financial institutions, or other government agencies, and evaluating the implications of significant differences
- e.* Considering whether there are alternative assumptions about the factors
- f.* Evaluating whether the assumptions selected are consistent with supporting data, relevant historical data, and industry data
- g.* Reviewing available documentation of the assumptions used in developing the estimates
- h.* Evaluating whether facts and informed judgment about past and future events or circumstances support the underlying assumptions
- i.* Evaluating whether any of the significant assumptions are so subjective that no reasonably objective basis could exist to support the use of the assumption
- j.* Inquiring of program managers regarding the reasonableness of assumptions that are related to the manager's realm of responsibility

- k.* Evaluating whether the assumptions appear to be complete, that is, whether assumptions have been developed for each key factor
 - l.* Considering whether the assumptions appear to be relatively objective, that is, are not unduly optimistic or pessimistic
 - m.* Evaluating whether the assumptions are consistent with the laws and regulations governing the program
 - n.* Evaluating whether the assumptions, individually and in the aggregate, make sense in the context of the statement of social insurance taken as a whole
 - o.* Evaluating whether significant assumptions are appropriately disclosed in the statement of social insurance
- A-10.** Assumptions that have no material effect on the statement of social insurance may not have to be individually evaluated; however, the aggregate effect of individually insignificant assumptions should be considered in making an overall evaluation of whether the assumptions underlying the reported amounts are reasonable.

Data

- A-11.** The following are examples of matters the auditor inquires about in discussions with management and other knowledgeable personnel, and reads about in agency documentation to determine how the agency generates, evaluates, selects, and reviews data to be included in estimates in the statement of social insurance:
- a.* The source of the data for significant estimates and whether the data are developed internally or by outside parties
 - b.* How data are collected, maintained, processed, and updated
 - c.* How the data underlying the estimates are documented
- A-12.** The following are examples of controls related to data:
- a.* Controls over the accuracy and completeness of internally prepared data, for example, review of the data for reasonableness and consistency with other data, and general and application controls over the data such as edit checks and batch totals
 - b.* Controls that prevent or detect and correct errors in the collection, maintenance, processing, and updating of the data, for example, manual controls to ensure that data are accurately entered and uploaded to a computerized system
 - c.* Controls over the reliability of external sources of data, for example, confirming and verifying data by tracing and agreeing it to census information in reports prepared by the United States Census Bureau
 - d.* Procedures to identify and document authorized users of the system and to restrict access to the system, for example, the use of unique user passwords and periodic changes to those passwords

- e.* Preparation and review of a risk assessment on a regular basis or when a significant change occurs in either the internal or external physical environment
- f.* Preventive maintenance agreements or procedures for key system hardware components
- g.* On a regular basis, backing up software and data that are stored offsite
- h.* Restricting access to utility programs that can read, add, change, or delete data or programs to authorized individuals
- i.* Establishing procedures to ensure that original source documents are retained or are reproducible by the agency for an adequate amount of time to facilitate the retrieval or reconstruction of data

A-13. The following are examples of procedures the auditor performs to test controls and financial statement assertions related to data:

- a.* Evaluating whether the data used to develop the estimates are relevant, reliable, and sufficient for the purpose
- b.* Identifying the source of the data, that is, whether the data were developed by the agency or by an outside entity
- c.* Reviewing documentation of the data used to develop estimates
- d.* Determining whether data used to develop estimates are consistent with supporting data, historical data, and other related information. An example would be determining whether a positive or negative correlation exists between sets of data if such a correlation would be expected to exist
- e.* Evaluating the accuracy and completeness of internally prepared data
- f.* Tracing and agreeing internally prepared data to system output reports generated by the agency

A-14. In determining the extent of the procedures to be performed on data obtained from an external source, a factor to consider is whether the data are widely disseminated and used, or whether the data were developed for limited use. An example of data that are widely disseminated and used is a report prepared by the U.S. Census Bureau. For such data, the auditor may trace and agree the information to reports prepared by the U.S. Census Bureau. If management has made adjustments to data obtained from a widely disseminated and used external source, the auditor should evaluate:

- a.* Management's reason for adjusting the data
- b.* The accuracy and completeness of the adjustments to the externally obtained data
- c.* Management's documentation supporting the adjustment

For data meant for limited use, all other factors being equal, the auditor should confirm or otherwise verify data obtained from other federal agencies and other external sources that were used in the actuarial valuation. If management has made adjustments to data developed for limited use, the auditor should evaluate:

- a.* Management's reason for adjusting the data

- b.* The accuracy and completeness of the adjustments to the externally obtained data
- c.* Management's documentation supporting the adjustment

Models

A-15. The following are examples of procedures the auditor performs to obtain knowledge about how the agency generates, evaluates, selects, and reviews models used to develop estimates included in the statement of social insurance:

- a.* Inquiring of management and other knowledgeable personnel about how they design or select the model used for the development of estimates and how they document that model
- b.* Inquiring of management and other knowledgeable personnel about how they determine the effect that variations in the underlying assumptions have on the estimates

A-16. The following are examples of controls related to models:

- a.* General and application controls related to the model, such as controls over input to the model and processing of that input
- b.* Controls that prevent or detect and correct errors in the development and processing of the model
- c.* Controls that prevent or detect and correct unauthorized access or changes to the model, for example, an access control table that is a component of the system and prohibits unauthorized users from accessing and changing the model. An example of a detective control is an audit log that tracks any changes made to the model
- d.* Controls designed to ensure that the information contained in the statement of social insurance and related disclosures conforms to generally accepted accounting principles
- e.* Designating responsibility for significant information resources within the agency (for example, data and programs) and establishing and maintaining security over such resources
- f.* Comparing existing system security features to documented system security requirements
- g.* Assigning responsibility to individuals in a manner that ensures that no single individual has the authority to read, add, change, or delete information without an independent review of that activity
- h.* Subjecting hardware and software acquisitions and implementations to extensive testing prior to acceptance in production

A-17. The following are examples of procedures the auditor performs to test controls and financial statement assertions related to models:

- a.* Reviewing documentation that describes the instructions, rules, or procedures used in the model to calculate estimates
- b.* Reperforming calculations used in the model to translate the assumptions, data, and factors into the estimate

- c. Reviewing management's documentation of its sensitivity analysis and considering whether the results are consistent with the auditor's expectations
- d. If available, comparing the results of the model with the results of models used by other organizations for reasonableness

Estimates

A-18. The following are examples of matters the auditor inquires about in discussions with management and other knowledgeable personnel to determine how the agency generates, evaluates, selects, and reviews estimates to be included in the statement of social insurance:

- a. How management obtains the expertise to develop and evaluate estimates in the statement of social insurance, including hiring procedures, professional development activities, and procedures for engaging outside specialists
- b. Who has final authority for reviewing and approving estimates
- c. The work performed by external review groups, their findings, and how those findings are used by the agency, for example:
 - (1) The scope and timing of the work performed by external review groups
 - (2) The composition of external review groups and the qualifications of the members
 - (3) Whether the external review groups are independent of the agency
 - (4) Whether the external review groups issued formal reports including findings or recommendations

A-19. The following are examples of controls related to estimates:

- a. Procedures related to the review and implementation of recommendations developed by external review groups
- b. General and application controls related to estimates, such as evidence of supervisory and management review of estimates and supporting documentation
- c. Controls intended to ensure that the information contained in the statement of social insurance and related notes conforms to Federal Accounting Standards Advisory Board (FASAB) guidance
- d. Controls related to the supervision of individuals who develop estimates, and the review of those estimates and supporting documentation
- e. Controls to regularly verify that personnel developing estimates are qualified to perform those tasks based on their education, training, and experience, as required

A-20. The following are examples of procedures the auditor performs to test controls and financial statement assertions related to estimates:

- a. Developing a trend analysis in which one period is compared to the next period

- b. Determining whether the information in the statement of social insurance, including related disclosure, is supported by sufficient, competent evidential matter
- c. Comparing the estimated future expenditures predicted by the actuarial model to actual expenditures for the previous fiscal year
- d. Evaluating the reasonableness of the time period covered by the statement of social insurance. FASAB standards require that the statement of social insurance cover a projection period sufficient to illustrate long-term sustainability of the social insurance program

[Paragraph renumbered and revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

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AUD Section 40***Statement of Position 07-2 Attestation Engagements That Address Specified Compliance Control Objectives and Related Controls at Entities That Provide Services to Investment Companies, Investment Advisers, or Other Service Providers*****October 15, 2007****NOTE**

This AICPA Statement of Position (SOP) has been developed by the AICPA Chief Compliance Officers Task Force of the AICPA Auditing Standards Board (ASB) to provide guidance regarding the application of Statements on Standards for Attestation Engagements (SSAEs) primarily to examination engagements in which a practitioner reports on the suitability of the design and operating effectiveness of a service provider's controls in achieving specified compliance control objectives. Examples of the service providers addressed by this SOP are investment advisers, custodians, transfer agents, administrators, and principal underwriters that provide services to investment companies (including business development companies), investment advisers, or other service providers (user organizations). A practitioner's report on the suitability of the design and operating effectiveness of a service provider's controls in achieving specified compliance control objectives is used primarily by user organizations because aspects of a user organization's compliance or internal control over compliance with laws, regulations, and rules may be affected by or include controls at service providers.

An attestation SOP is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive publications are relevant to the proper application of the attestation standards in specific circumstances.

Introduction and Background

.01 In December 2003, the Securities and Exchange Commission (SEC) adopted Rule 38a-1 under the Investment Company Act of 1940 and Rule 206(4)-7 under the Investment Advisers Act of 1940. The rules were adopted to protect investors by ensuring that (a) each investment company registered with the SEC under the Investment Company Act of 1940, and each business development company¹ (collectively, funds) has an internal program to enhance compliance with federal securities laws² and (b) each investment adviser registered with the SEC has an internal program to enhance compliance with the Investment Advisers Act of 1940, including SEC rules issued thereunder.

.02 Many operations of funds and, in some instances, operations of investment advisers are carried out by entities that provide services to the funds or investment advisers. In this Statement of Position (SOP), such entities are termed *service providers*. Service providers have their own compliance policies and procedures that may affect or be part of a fund's or investment adviser's compliance or internal control over compliance with federal securities laws, individual statutes or provisions thereof, or corresponding SEC rules (*federal securities laws or elements thereof*).³ Rule 38a-1 requires each fund to adopt and implement written policies and procedures reasonably designed to prevent violation of federal securities laws by the fund or any of the following service providers named in the rule: investment advisers, principal underwriters, administrators, and transfer agents. Accordingly, a fund's compliance policies and procedures provide for oversight of the compliance procedures performed by the named service providers. Further, Rule 206(4)-7 requires an investment adviser to adopt and implement written policies and procedures reasonably designed to prevent violation by the investment adviser and its supervised persons of the Investment Advisers Act of 1940 and SEC rules issued thereunder. In this SOP, the term *service providers* refers to the service providers named in Rule 38a-1 as well as other service providers, such as custodians. The term *user organization* generally refers to a fund or investment adviser that uses the services of a service provider. In some instances, a single entity may be a service provider *and* a user organization. For example, Administrator A, in its capacity as a service provider to a fund, may be responsible for monitoring whether the fund's registration statement filed with the SEC complies with SEC disclosure requirements, but may subcontract that function to Administrator B that specializes in that area. In this situation, Administrator A is also a user organization because it uses the services of Administrator B. In this SOP, Administrator B is referred to as a *subservice provider*. In applying the guidance in this SOP, a subservice provider is considered a service provider.

.03 Among other provisions, the rules mentioned in paragraph .01 require funds and investment advisers to

¹ A business development company is a closed-end investment company that, among other requirements, has elected to be subject to the provisions of certain sections of the Investment Company Act of 1940.

² Rule 38a-1 defines *federal securities laws* to include the Securities Act of 1933, the Securities Exchange Act of 1934, the Sarbanes-Oxley Act of 2002, the Investment Company Act of 1940, the Investment Advisers Act of 1940, Title V of the Gramm-Leach-Bliley Act, any rules adopted by the Securities and Exchange Commission (SEC) under any of these statutes, the Bank Secrecy Act as it applies to funds, and any rules adopted thereunder by the SEC or the Department of the Treasury.

³ In this Statement of Position (SOP), *federal securities laws or elements thereof* is defined as federal securities laws (see footnote 2), individual statutes or provisions thereof, or corresponding SEC rules.

- adopt and implement written policies and procedures⁴ reasonably designed to prevent violation of, in the case of funds, federal securities laws and, in the case of investment advisers, the Investment Advisers Act of 1940, including SEC rules issued thereunder.
- review those policies and procedures at least annually for their adequacy and the effectiveness of their implementation.⁵
- designate a chief compliance officer (CCO) to be responsible for administering the policies and procedures (for funds, the CCO must report directly to the fund's board of directors).

.04 SEC Release Nos. IC-26299 and IA-2204 adopting the rules note that it may be impractical for a fund or its CCO to directly review all of its named service providers' policies and procedures, particularly if one or more of the service providers are not affiliated with the fund. In these circumstances, the SEC considers the fund to have satisfied the requirements of Rule 38a-1 if the fund's board of directors, in evaluating whether to approve the service provider's compliance program, uses a "third-party report" on the service provider's policies and procedures.⁶ In the United States fund industry, in connection with the audit of a fund's financial statements, a number of service providers are accustomed to engaging an independent auditor to report on the suitability of the design and operating effectiveness of controls at the service provider that may be relevant to the fund's internal control over financial reporting. These engagements are performed under AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*, and reports issued thereunder are used by the funds' independent auditor when auditing the fund's financial statements. Similarly, since the adoption of the rules in December 2003, service providers have received requests from funds and investment advisers for information and assurance regarding the suitability of the design and operating effectiveness of the service provider's controls in achieving compliance control objectives. Also, in some circumstances, subservice providers (service providers that provide services to other service providers, for example, a service organization that reports fund share balances and transactions of retirement plan participants, in aggregate, to a fund's transfer agent and maintains records thereof) have received similar requests from service providers. Such information assists funds and investment advisers in fulfilling their responsibilities to perform an annual review of specified compliance activities and assists service providers and subservice providers in their consideration of their own controls. [Revised, August

⁴ Rule 38a-1 and Rule 206(4)-7 use the term *policies and procedures* to refer to the principles and activities an entity adopts and implements to prevent violation of federal securities laws or elements thereof. In this SOP, the term *controls* is used to refer to the policies and procedures an entity adopts and implements to achieve specified compliance control objectives.

⁵ The annual review requirement is imposed upon the fund or investment adviser. Specifically, the rules do not require the fund or adviser to engage an independent accountant to attest to management's annual review or to perform a separate evaluation of any aspect of the fund's or investment adviser's compliance policies and procedures. Further, the rules do not require that the annual review employ a specific framework or methodology for evaluating the effectiveness of a fund's or investment adviser's compliance policies and procedures. Lastly, there is no requirement that annual or other compliance reports prepared by chief compliance officers of funds or investment advisers be filed with the SEC; however, the SEC may request such reports in connection with their inspection and examination programs of funds and investment advisers or in other circumstances.

⁶ The SEC release states that the third party report must describe the service provider's compliance program as it relates to the types of services provided to the fund, discuss the types of compliance risks material to the fund, and assess the adequacy of the service provider's compliance controls. Information produced as a result of an engagement covered by this SOP may be used by the fund, in part, to meet these provisions. The report must be provided to the fund no less frequently than annually.

2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.05 Specific information about the rules is provided in "Compliance Programs of Investment Companies and Investment Advisers," which can be accessed at the United States SEC website at www.sec.gov/rules/final/ia-2204.htm. The following is a table that briefly summarizes significant provisions of the rules. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

SEC Rule and (Section Number)	Rule 38a-1 (§17 CFR 270.38a-1)	Rule 206(4)-7 (§17 CFR 275.206(4)-7) and Amendments to Rule 204-2 (§17 CFR 275.204-2)
Applicable entity	Investment companies and business development companies (funds) must:	Investment advisers must:
Nature of the policies and procedures to be adopted and implemented	Adopt and implement written policies and procedures reasonably designed to prevent violation of federal securities laws by the fund, including policies and procedures that provide for oversight of compliance by each investment adviser, principal underwriter, administrator, and transfer agent (named service providers) of the fund.	Adopt and implement written policies and procedures reasonably designed to prevent violation, by the investment adviser and persons supervised by the investment adviser, of the Investment Advisers Act of 1940 and the SEC rules issued thereunder.
Board approval of policies and procedures	Obtain approval by the fund's board of directors of the fund's policies and procedures and those of each of the named service providers.	
Annual review of policies and procedures	Review, no less frequently than annually, (1) the adequacy of the policies and procedures of the fund and each of the named service providers and (2) the effectiveness of their implementation.	Review, no less frequently than annually, (1) the adequacy of the policies and procedures established pursuant to the rule and (2) the effectiveness of their implementation.

SEC Rule and (Section Number)	Rule 38a-1 (§17 CFR 270.38a-1)	Rule 206(4)-7 (§17 CFR 275.206(4)-7) and Amendments to Rule 204-2 (§17 CFR 275.204-2)
Applicable entity	Investment companies and business development companies (funds) must:	Investment advisers must:
Individual responsible for administering policies and procedures	Designate an individual to be the fund's chief compliance officer (CCO), responsible for administering the policies and procedures adopted under paragraph(a)(1) of the rule. The designation and compensation of the CCO must be approved by the fund's board of directors, and the CCO may be removed only by action and approval of the fund's board of directors.	Designate an individual (who is a supervised person) to be the adviser's CCO, responsible for administering the policies and procedures that are adopted under paragraph(a) of the rule.
Report to the board of directors	The CCO must provide a written report to the fund's board of directors, no less frequently than annually, that addresses at a minimum: • The operation of the fund's policies and procedures and those of each of the named service providers, any material changes made to those policies and procedures since the last report, and any material changes to the policies and procedures recommended as a result of the annual review.	

(continued)

SEC Rule and (Section Number)	Rule 38a-1 (§17 CFR 270.38a-1)	Rule 206(4)-7 (§17 CFR 275.206(4)-7) and Amendments to Rule 204-2 (§17 CFR 275.204-2)
Applicable entity	Investment companies and business development companies (funds) must:	Investment advisers must:
	Each <i>material compliance matter</i>⁷ that occurred since the date of the last report. After the initial report, subsequent CCO reports are expected to cover the period since the date of the last report.	

Objective of the Examination Engagement

.06 Because federal securities laws encompass a significantly comprehensive set of obligations and responsibilities, the compliance control objectives presented by management of the service provider ordinarily would not include all conceivable compliance control objectives related to federal securities laws or elements thereof. Also, although Rule 38a-1 requires a fund's CCO to include in the fund's annual compliance report information concerning any material compliance matter(s) that occurred during the relevant period, the objective of the examination engagement described in paragraphs .01–.35 of this SOP is not to identify and report any material compliance matter(s) that may have existed at the service provider during the period covered by the practitioner's report. Rather, the objective of the examination engagement described in paragraphs .01–.35 of this SOP is for the practitioner to report on the suitability of the design (at the end of a specified period) and the operating effectiveness (during the specified period) of the service provider's controls in achieving the compliance control objectives specified by management of the service provider. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.07 AT-C section 205, *Examination Engagements*, allows a practitioner to report on either management's assertion or on the subject matter to which it

⁷ SEC Rule 38a-1 defines a *material compliance matter* as any compliance matter about which the fund's board of directors would reasonably need to know to oversee fund compliance and that involves, without limitation, (a) a violation of federal securities laws (as defined in Rule 38a-1) by the fund, its investment adviser, principal underwriter, administrator, or transfer agent (or officers, directors, employees, or agents thereof); (b) a violation of the policies and procedures of the fund, its investment adviser, principal underwriter, administrator, or transfer agent; or (c) a weakness in the design or implementation of the policies and procedures of the fund, its investment adviser, principal underwriter, administrator, or transfer agent.

relates.⁸ Paragraph .62 of AT-C section 205 indicates that when the practitioner reports on an assertion, the assertion should either be (a) bound with or accompany the practitioner's report or (b) clearly stated in the practitioner's report. In view of the intended use of the information produced in connection with examination engagements covered by this SOP, practitioners are strongly encouraged to report on management's assertion rather than on the subject matter to ensure that management's assertion will be available to users of the report. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Subject Matter of the Examination Engagement

.08 The examination engagement described in paragraphs .01–.35 of this SOP should be performed in accordance with AT-C section 205 of the attestation standards. The attestation standards enable a practitioner to design an engagement and report on subject matter (or an assertion thereon) other than financial statements. The subject matter of the engagement described in paragraphs .01–.35 of this SOP is the suitability of the design and operating effectiveness of a service provider's controls directed at achieving specified compliance control objectives. Use of the practitioner's examination report is restricted to the CCOs, management, boards of directors, and independent auditors of the service provider and of the entities that use the services of the service provider because these users would be expected to have the requisite knowledge and familiarity with the service provider's organization to understand the context of the examination report. [Revised, June 2009, to reflect conforming changes due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Management's Responsibilities

.09 In an examination engagement in which the practitioner reports on the suitability of the design and operating effectiveness of controls to achieve specified compliance control objectives, management of the service provider is responsible for

- a. specifying compliance control objectives and related controls that are relevant to the services provided to user organizations and their internal control over compliance with federal securities laws or elements thereof.
- b. preparing and providing the practitioner with a written description of the specified compliance control objectives and related controls referred to in paragraph .09a (see appendix A-4 [paragraph .43] of this SOP, "Illustrative Service Provider's Description of Specified Compliance Control Objectives and Related Controls"). If applicable, the written description should include the applicable information described in paragraphs .16–.17 of this SOP concerning compliance control objectives and related controls of sub-service providers.

⁸ Paragraph .79 of AT-C section 205, *Examination Engagements*, states that if the practitioner has concluded that conditions exist that individually or in combination, result in one or more material misstatements (or deviations) based on the criteria, the practitioner should modify the opinion and express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement. [Footnote revised, April 2017, to reflect changes necessary due to the issuance of SSAE No. 18.]

- c. preparing and providing the practitioner with a written assertion regarding the suitability of the design and operating effectiveness of the controls in achieving the specified compliance control objectives⁹ (see appendix A-3 [paragraph .42] of this SOP for an illustrative management assertion). The criteria management use in evaluating the suitability of the design and operating effectiveness of the controls included in management's description and in making its assertion are the specified compliance control objectives.
- d. identifying and presenting a list of user control considerations if the application of controls by user organizations is necessary to achieve the specified compliance control objectives. In certain circumstances, a service provided by a service provider may be designed with the assumption that certain controls will be implemented by user organizations. For example, the service may be designed with the assumption that user organizations will have controls in place for authorizing transactions before they are sent to the service provider for processing. If such user controls are required to achieve the stated compliance control objectives, the service provider should describe them either in its written description or in a separate list accompanying the description.
- e. preparing and providing the practitioner with a representation letter that should include the items listed in paragraph .26a–i of this SOP.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Criteria

.10 Paragraph .25 of AT-C section 105, *Concepts Common to All Attestation Engagements*, includes as one of the preconditions for an attestation engagement that "The criteria to be applied in the preparation and evaluation of the subject matter are suitable and will be available to the intended users." AT-C section 105 states that suitable criteria exhibit all of the following attributes: relevance, objectivity, measurability, and completeness. In the examination engagement covered by this SOP, the criteria to be used to evaluate the suitability of the design and operating effectiveness of the controls are the specified compliance control objectives. Practitioners should not perform an engagement covered by this SOP if the criteria are not measurable; that is, so subjective or vague that reasonably consistent measurements, qualitative or quantitative, of the subject matter cannot ordinarily be obtained (paragraph .A42 of AT-C section 105). For example, the following compliance control objective ordinarily would be too subjective for evaluation:

Advertising and sales literature is frequently and properly reviewed.

The following revision of this control objective improves its objectivity and measurability:

At the end of each quarter, advertising and sales literature is reviewed by the service provider's compliance officer for conformity with the service provider's written policies.

⁹ Paragraph .10 of AT-C section 205 states that a practitioner should obtain a written assertion about the measurement or evaluation of the subject matter against the criteria. [Footnote revised, April 2017, to reflect changes necessary due to the issuance of SSAE No. 18.]

Furthermore, although this SOP does not require all service providers to present identical compliance control objectives for similar business activities or services (for example, transfer agency and fund administration) included in the scope of the attestation engagement, compliance control objectives or elements thereof that pertain to those business activities or services and are relevant to user organizations should not be omitted if management of the service provider or the practitioner becomes aware of deficiencies in the suitability of the design or operating effectiveness of controls that would prevent the achievement of such objectives. See also related guidance in paragraphs .12*b* and .21–.22 of this SOP. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Reference to Laws, Regulations, and Rules

.11 The written description of specified compliance control objectives and related controls prepared by management of the service provider should not include general or broad references¹⁰ to federal securities laws or elements thereof that might imply that the specified compliance control objectives completely address or directly correspond to such laws or elements thereof. Such references may mislead user organizations and others because most laws, regulations, and rules contain numerous and detailed provisions, all of which may not be addressed by the compliance control objectives and related controls. Management of the service provider may, however, include a citation from such federal securities laws or elements thereof within the specified compliance control objective, in the written description, if the citation is sufficiently specific. An example is a citation containing the specific section or subsection of the law, regulation, or rule corresponding to the specified compliance control objective as in "For money market mutual funds, investments are monitored on a weekly basis for compliance with the portfolio maturity and quality provisions of SEC Rule 2a-7c.2 and 2a-7c.3, respectively."

Practitioner's Responsibilities

.12 For the practitioner to express an opinion on the suitability of the design¹¹ and operating effectiveness of a service provider's controls in achieving specified compliance control objectives, the practitioner should

- a.* obtain an understanding of the nature of the services provided by the service provider to user organizations and determine whether the specified compliance control objectives included in management's description are relevant to the services provided. Methods for obtaining an understanding of the services provided include
 - reading representative contracts between the service provider and user organizations, marketing or other material provided to user organizations, reports developed by internal auditors, and correspondence to and from regulatory authorities; and

¹⁰ For example, the written description should not include a table that aligns the specified compliance control objectives with generally or broadly described federal securities laws or elements thereof. Such a presentation could cause readers to incorrectly conclude that the specified control objectives address all provisions of the federal securities laws or elements thereof referenced in the table.

¹¹ A control is suitably designed if individually, or in combination with other controls, it is likely to prevent or detect errors that could result in the nonachievement of specified compliance control objectives when the described controls are complied with satisfactorily.

- making inquiries of management and other service provider personnel.
- b. obtain a written description prepared by management of the service provider of the specified compliance control objectives and related controls that are relevant to the services provided to user organizations and their internal control over compliance with federal securities laws or elements thereof (see appendix A-4 [paragraph .43] of this SOP, "Illustrative Service Provider's Description of Specified Compliance Control Objectives and Related Controls"). If the practitioner concludes that the description is materially misstated or misleading in the circumstances, the practitioner should inform the service provider's management and request that the description be amended. If management refuses to amend the description in a manner that addresses the practitioner's concerns, the practitioner should consider withdrawing from the engagement.
- c. consider the linkage between the controls and the specified compliance control objectives and the ability of the controls to prevent or detect errors related to the specified compliance control objectives.
- d. obtain sufficient appropriate evidence regarding the suitability of the design and operating effectiveness of the controls in achieving the specified compliance control objectives. Procedures to obtain evidence regarding the suitability of the design and implementation of relevant controls may include inquiry of appropriate service provider personnel, observation of the application of specific controls, inspection of documents and reports, and tracing transactions relevant to the subject matter of the engagement through the service provider's applicable information and communication systems. Inquiry alone is not sufficient to evaluate the design of a control relevant to an examination engagement and to determine whether it has been implemented. In testing the operating effectiveness of controls, the practitioner should obtain evidence about how the controls were applied at relevant times during the period under examination, the consistency with which they were applied, and by whom or what means they were applied. Tests of the operating effectiveness of controls ordinarily include the same types of procedures used to evaluate the design and implementation of controls, and may also include reperformance of the application of the control by the practitioner. Because inquiry alone is not sufficient, the practitioner should use a combination of procedures to obtain sufficient appropriate evidence regarding the operating effectiveness of controls.
- e. obtain a written assertion prepared by management of the service provider regarding the suitability of the design and operating effectiveness of the service provider's controls in achieving the specified compliance control objectives (see appendix A-3 [paragraph .42] of this SOP for an illustrative management assertion). As noted in paragraph .07 of this SOP, to ensure that management's assertion will be available to users of the report, practitioners are strongly encouraged to report on management's written assertion rather than on the subject matter, except when a deficiency or deficiencies in controls exist that, individually or in combination,

result in the nonachievement of one or more specified compliance control objectives.

- f. obtain a representation letter from management that includes the items in paragraph .26a–i of this SOP.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.13 Ordinarily, for the examination engagement described in this SOP, the relevant aspects of a service provider's internal control over compliance pertaining to its control environment, risk assessment, and monitoring would not be presented in the form of compliance control objectives; however, management of the service provider is not precluded from doing so. The practitioner should perform tests of the relevant aspects of the service provider's control environment, risk assessment, and monitoring that relate to the services provided and should assess their effectiveness in establishing, enhancing, or mitigating the effectiveness of specific controls. If there are weaknesses in relevant aspects of the control environment, risk assessment, and monitoring the practitioner should consider an appropriate response. For example, modifying the practitioner's procedures to obtain more persuasive evidence about the operating effectiveness of the controls and whether the specified compliance control objectives have been achieved. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Matters Addressed by the Compliance Control Objectives

.14 As noted in paragraph .06, because federal securities laws encompass a significantly comprehensive set of obligations and responsibilities, management's description ordinarily would not include all conceivable compliance control objectives related to federal securities laws or elements thereof.

.15 Unless the compliance control objectives have been designated by an outside party, such as a regulatory authority or a user group, management of the service provider is responsible for specifying the compliance control objectives and related controls that are the subject of the engagement. In establishing the compliance control objectives and related controls, management of the service provider should consider

- a. the nature of the services provided to user organizations.
- b. the service provider's contractual obligations to user organizations.
- c. the information and assurance needs of user organizations, including the relevancy of the compliance control objectives and related controls to the services provided to user organizations and their internal control over compliance with federal securities laws or elements thereof.¹²

Further, when circumstances permit, discussions between management of the service provider and user organizations are advisable in determining the compliance control objectives intended to address the needs of user organizations.

¹² See SEC Release Nos. IC-26299 and IA-2204 adopting Rules 38a-1 and 206(4)-7, respectively (Section II.A., *Adoption and Implementation of Policies and Procedures*).

.16 Service providers may have contractual or other arrangements with one or more subservice providers or other parties that perform administrative, computer operations, transaction processing, recordkeeping, or other activities on their behalf. In these circumstances, management of the service provider determines whether the subservice provider's relevant control objectives and related controls are to be included or excluded from its written description of specified compliance control objectives and related controls. Although the inclusive method provides more information to user organizations, it may not be appropriate or feasible in many or all instances. In determining which approach to use, management of the service provider should consider (a) the nature and extent of information about the subservice provider from which user organizations would derive benefit, (b) the degree of responsibility management would assume by including information about the subservice organization in its description and accompanying written assertion, and (c) the practical difficulties entailed in implementing the inclusive method. Whether the subservice provider's relevant control objectives and related controls are included or excluded from the written description, the description should include a brief statement of the functions and nature of the services performed by the subservice provider. Ordinarily, disclosure of the identity of the subservice provider is not required. If, however, management of the service provider determines that the identity of the subservice provider would be relevant to user organizations, the name of the subservice provider may be included in the written description provided that there are no prohibitions against doing so, by contract or otherwise, and any necessary approvals have been obtained by the service provider. Also, when included, the written description should clearly differentiate between controls of the service provider and controls of the subservice provider.

.17 If the subservice provider's relevant compliance control objectives and related controls are excluded, management of the service provider should state in the written description that the subservice provider's compliance control objectives and related controls are omitted from the description and, unless achievement of the compliance control objectives depends on controls at the subservice provider, that the compliance control objectives included in the written description include only those objectives that the service provider's controls are intended to achieve. Reporting guidance for situations in which the service provider excludes the subservice provider's compliance control objectives and related controls from the service provider's written description is presented in paragraph .33 of this SOP.

.18 As noted in paragraph .13, ordinarily in the examination engagement described in this SOP, the relevant aspects of a service provider's internal control pertaining to its control environment, risk assessment, and monitoring would not be presented in the form of compliance control objectives; however, management of the service provider is not precluded from presenting those aspects in the form of compliance control objectives.

Evaluating Deficiencies in Controls

.19 Criteria are defined in AT-C section 105 as the benchmarks used to measure or evaluate the subject matter. In this SOP, the criteria used by the practitioner to evaluate the suitability of the design and operating effectiveness of the controls included in management's description are the specified compliance control objectives. The practitioner should evaluate the results of the procedures the practitioner performed to obtain sufficient appropriate evidence about the suitability of the design and operating effectiveness of the controls and determine the significance of any identified deficiencies in controls, individually and in combination, to the achievement of the specified compliance

control objectives. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if it operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.20 The following are examples of factors that are relevant in evaluating the significance of identified deficiencies in controls:

- The existence of other effective controls that have been tested and evaluated and limit the severity of the deficiency
- The significance of the control(s) to achieving the compliance control objective
- The existence of multiple deficiencies in controls that, in combination, may be significant to the achievement of a compliance control objective, even if the deficiencies are individually insignificant to the achievement of the compliance control objective

The practitioner may conclude that the specified compliance control objective has been achieved even if a deficiency or deficiencies in controls have been identified. However, if, after performing the practitioner's procedures, the practitioner concludes that the specified compliance control objective was not achieved, the practitioner should modify the practitioner's report. See paragraph .31 of this SOP for related reporting guidance. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

User Organizations Affected by a Service Provider's Noncompliance With Federal Securities Laws or Elements Thereof

.21 In the course of performing procedures at a service provider, a practitioner may become aware of a matter or matters constituting noncompliance with federal securities laws or elements thereof (including material compliance matters) that occurred during the period covered by the practitioner's report and relate to business activities or services included in the scope of the attestation engagement. Unless the instance(s) of noncompliance are clearly inconsequential, the practitioner should obtain an understanding of

- the nature of the noncompliance matter(s),
- the cause(s) of such,
- the period during which the noncompliance matter(s) existed or occurred, and
- the nature of any remediation activities taken to subsequently achieve compliance or the status of any remediation activities the service provider plans to take to achieve compliance.

.22 Further, the practitioner should determine whether information about the noncompliance matter(s) has been communicated to affected user organizations. If management of the service provider has not communicated this information and is unwilling to do so, and the practitioner believes the nature of the noncompliance matter(s) could be significant to user organizations, the

practitioner should inform management and those charged with governance of the service provider of the circumstances. If management and those charged with governance of the service provider do not respond in an appropriate manner, the practitioner should consider withdrawing from the engagement. The practitioner generally is not required to confirm with the user organizations that the service provider has communicated such information. If the user organizations have been notified in writing, the practitioner may request a copy from the service provider of the written communication. In all cases, judgment should be used by the practitioner in considering the effect, if any, of all information obtained about the noncompliance matter(s) on (a) the written assertion provided by management of the service provider regarding the suitability of the design and operating effectiveness of controls in achieving the specified compliance control objectives; and (b) the practitioner's procedures and report. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Management Assertion

.23 An assertion is defined in AT-C section 105 as any declaration or set of declarations about whether the subject matter is in accordance with (or based on) the criteria. For the examination engagement described in this SOP, the practitioner should obtain a written assertion from management of the service provider regarding the suitability of the design and operating effectiveness of the service provider's controls in achieving the specified compliance control objectives. Appendix A-3 (paragraph .42) of this SOP contains an illustrative management assertion. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.24 Management's assertion regarding the suitability of the design and operating effectiveness of the controls should specify the "as of" date and period covered by management's assertion. The determination of an appropriate period is at the discretion of management; however, to be useful to user organizations, the assertion and related practitioner's report ordinarily covers a minimum reporting period of six months. The following are examples of factors that are relevant in establishing the reporting period:

- The anticipated needs of users of the report
- The degree and frequency of changes in the service provider's controls related to the specified compliance control objectives
- The period needed to provide sufficient and appropriate evidence regarding the operating effectiveness of the controls

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Written Representations

[.25] [Paragraph deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.26 The practitioner should request from the responsible party¹³ written representations in the form of a letter addressed to the practitioner. In accordance with paragraph .50 of AT-C section 205, the representations should

¹³ In this SOP, the responsible party is usually management of the service provider. [Footnote added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

- a. include the responsible party's assertion about the subject matter based on the criteria.
- b. state that all relevant matters are reflected in the measurement or evaluation of the subject matter or assertion.
- c. state that management has disclosed to the practitioner all known matters contradicting the assertion and any communication from regulatory agencies or others related to the service provider's compliance, or internal control over compliance, with federal securities laws or elements thereof during the period covered by the practitioner's report (or assertion about these matters) that may affect one or more user organizations, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report.
- d. acknowledge responsibility for
 - i. the subject matter of the examination engagement and its written assertion about the subject matter; namely, the suitability of the design and operating effectiveness of the controls in achieving the specified compliance control objectives.
 - ii. selecting the criteria used and determining the appropriateness of such criteria for its purposes, including selecting and presenting compliance control objectives that are relevant to the services provided to user organizations and their internal control over compliance with federal securities laws or elements thereof (practitioners may wish to include in the representation letter the definition of the term federal securities laws or elements thereof found in footnotes 2 and 3 of this SOP).
 - iii. its description of specified compliance control objectives and related controls.
 - iv. establishing and maintaining compliance and effective internal control over compliance with federal securities laws or elements thereof as they relate to the scope of the examination engagement, including establishing and maintaining controls that are suitably designed and operating effectively to achieve the specified compliance control objectives.
- e. state that any known events subsequent to the period of the subject matter being reported on that would have a material effect on the subject matter or assertion have been disclosed to the practitioner.
- f. state that management has provided the practitioner with all relevant information and access.
- g. if applicable, state that management believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the subject matter.
- h. if applicable, state that significant assumptions used in making any material estimates are reasonable
- i. state that management has disclosed to the practitioner
 - i. all deficiencies in internal control relevant to the engagement of which the responsible party is aware in the design or operation of the service provider's internal control

- over compliance with federal securities laws or elements thereof, related to the scope of the attestation engagement, that existed during the period covered by the practitioner's report, including those for which management believes the cost of corrective action may exceed the benefits.
- ii. its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter.
- j. address other matters as the practitioner deems appropriate, such as statements that
- i. management has disclosed to the practitioner any significant changes in the service provider's controls related to the scope of the attestation engagement made since the service provider's last examination.
 - ii. management has disclosed to the practitioner any instances of which it is aware of the service provider's noncompliance with federal securities laws or elements thereof, related to the scope of the attestation engagement, that existed during the period covered by the practitioner's report and that may affect one or more user organizations.
 - iii. management has disclosed to the practitioner all instances of which it is aware when the service provider's controls have not operated with sufficient effectiveness during the period covered by the practitioner's report to achieve the specified compliance control objectives.
 - iv. management has responded fully to all inquiries made by the practitioner during the engagement.

[Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Engaging Party Is the Responsible Party

.27 When the engaging party is the responsible party and one or more of the requested written representations is not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, paragraph .55 of AT-C section 205 states that the practitioner should

- a. discuss the matter with the appropriate party;
- b. reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general; and
- c. if any of the matters are not resolved to the practitioner's satisfaction, take appropriate action.

Paragraph .A64 of AT-C section 205 states that in the situation discussed in paragraph .55 of AT-C section 205, the refusal to furnish such evidence in the form of written representations constitutes a limitation on the scope of an examination sufficient to preclude an unmodified opinion and may be sufficient to cause the practitioner to withdraw from the engagement. [Revised, June 2009, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Engaging Party Is Not the Responsible Party

.28 When the engaging party is not management, and management refuses to provide the representations in paragraph .50 of AT-C section 205 in writing, paragraph .51 of AT-C section 205 states that the practitioner should make inquiries of management about, and seek oral responses to, the matters in paragraph .50. If the practitioner receives satisfactory oral responses to the practitioner's inquiries sufficient to enable the practitioner to conclude that the practitioner has sufficient appropriate evidence to form an opinion about the subject matter, the practitioner's report should contain a separate paragraph that restricts the use of the report to the engaging party. If one or more of the requested representations are provided neither in writing nor orally from management, a scope limitation exists, and the practitioner should determine the effect on the report or the practitioner should withdraw from the engagement. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.29 Paragraph .52 of AT-C section 205 indicates that when the engaging party is not management, the practitioner should request the written representations in paragraph .52 of AT-C section 205 from the engaging party in the form of a letter addressed to the practitioner. The representations requested from the engaging party are in addition to the representations requested from management. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Reporting

.30 Appendix A-1 (paragraph .40) of this SOP contains an illustrative practitioner's examination report on an assertion by management of a service provider regarding specified compliance control objectives and related controls. The illustrative report includes the required elements of a practitioner's unmodified report listed in paragraphs .63–.64 of AT-C section 205. The exhibit, "Illustrative Practitioner's Examination Reports," of AT-C section 205 presents additional illustrative examination reports. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.31 Paragraph .19 of this SOP notes that criteria are the standards or benchmarks against which a practitioner evaluates the subject matter, and in this SOP, the criteria for evaluating the suitability of the design and operating effectiveness of the controls are the specified compliance control objectives. If, after performing the procedures described in paragraphs .12–.13 and .19–.22 of this SOP, the practitioner concludes that the controls were not suitably designed or operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives were achieved, the practitioner should modify the practitioner's report and include a separate paragraph that provides a description of the matter(s) giving rise to the modification. The matter or matters pertaining to the suitability of the design or operating effectiveness of controls and giving rise to a qualified or adverse opinion in a report on the examination engagement described in this SOP should be referred to as a deficiency or deficiencies. Further, paragraph .79 of AT-C section 205 states, in part, that "...if the practitioner has concluded that conditions exist that, individually or in combination, result in one or more material misstatements based on the criteria, the practitioner should modify the opinion and express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement." Appendix B (paragraph .44) of this SOP contains an illustrative practitioner's examination report

containing a qualified opinion on a service provider's controls in achieving the specified compliance control objectives. In that illustrative report, the practitioner reports on the subject matter rather than on the assertion. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.32 Paragraph .68 of AT-C section 205 states that the practitioner should modify the opinion when either of the following circumstances exist and, in the practitioner's professional judgment, the effect of the matter is or may be material:

- a. The practitioner is unable to obtain sufficient appropriate evidence to conclude that the subject matter is in accordance with (or based on) the criteria, in all material respects.
- b. The practitioner concludes, based on evidence obtained, that the subject matter is not in accordance with (or based on) the criteria, in all material respects.

Paragraphs .69–.84 and .A103–.A113 of AT-C section 205 further address this topic. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.33 If a subservice provider's compliance control objectives and related controls are excluded from the service provider's written description of specified compliance control objectives and related controls (see paragraph .17 of this SOP), the scope paragraph of the practitioner's report should be modified to

- refer to the disclosure in the written description regarding the service provider's use of a subservice provider and the functions and nature of the services performed by the subservice provider.
- state that the subservice provider's compliance control objectives and related controls are omitted from the written description and that the practitioner's examination did not extend to controls of the subservice provider.

Appendix A-2 (paragraph .41) of this SOP contains an illustrative practitioner's examination report on a service provider's specified compliance control objectives and related controls when the service provider uses a subservice provider and the subservice provider's control objectives and related controls are excluded from the description. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.34 As noted in paragraph .17, situations may arise in which the service provider specifies compliance control objectives whose achievement depends on controls at a subservice provider. In those circumstances, if the service provider has excluded the subservice provider's controls from the written description, the practitioner should modify the scope and opinion paragraphs of the practitioner's report to include the phrase "and subservice providers applied the controls contemplated in the design of the service provider's controls." [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.35 A practitioner may perform significant portions of the engagement before the end of the period covered by the report. If during that time the practitioner identifies compliance control objectives that have not been achieved, the practitioner should include a description of the condition in the practitioner's report, even if management corrects the condition prior to the end of the period. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Agreed-Upon Procedures

.36 A practitioner may also perform agreed-upon procedures related to compliance control objectives and related controls. Such engagements are performed in accordance with AT-C section 215, *Agreed-Upon Procedures Engagements*. In these engagements, the practitioner performs specific procedures on subject matter and reports the findings without providing an opinion or conclusion. Because they best understand their own needs, the engaging party is required to agree to the procedures and acknowledge that the procedures performed are appropriate for the intended purpose of the engagement prior to issuance of the practitioner's agreed-upon procedures report. In an agreed-upon procedures engagement, the practitioner does not perform an examination or review engagement on the subject matter and does not provide an opinion or conclusion about the subject matter. The practitioner's report on agreed-upon procedures is in the form of procedures and findings. An illustrative agreed-upon procedures report is presented in appendix E (paragraph .47) of this SOP. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18; Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.37 In accordance with paragraph .14 of AT-C section 215, a practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. Paragraph .15 of AT-C section 215 further address agreeing on the terms of an agreed-upon procedures engagement. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18; Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.38] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Effective Date

.39 This SOP is effective upon issuance. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix A-1 — Illustrative Practitioner's Examination Report on a Service Provider's Assertion Regarding Specified Compliance Control Objectives and Related Controls

Note: The compliance control objectives and related controls referenced in the following illustrative practitioner's report are examples only and should not be viewed as representative of or a complete description of the compliance control objectives or related controls a service provider might be expected to (1) establish and implement to meet any contractual responsibilities to funds or any other clients, (2) monitor for investment compliance, or (3) include in its description of specified compliance control objectives and related controls in an examination engagement covered by this Statement of Position (SOP). Additionally, there may be other areas of responsibility (beyond investment compliance) that a service provider might assume on behalf of funds or any other clients that might result in the inclusion and presentation of different or additional compliance control objectives and related controls for engagements covered by this SOP.

Report of Independent Accountants

To the Management of XYZ Service Provider:

[Introductory paragraph]

We have examined the assertion made by the management of XYZ Service Provider pertaining to controls over investment compliance that XYZ Service Provider performs for user organizations. Management's assertion is included in the accompanying document titled, "Management's Assertion Regarding XYZ Service Provider's Specified Compliance Control Objectives and Related Controls" and states that:

- The controls described in the accompanying document titled, "XYZ Service Provider's Description of Specified Compliance Control Objectives and Related Controls" (management's description), were suitably designed as of December 31, 20X1 to provide reasonable assurance that the compliance control objectives established by management and described therein would be achieved, if those controls were complied with satisfactorily *[and user organizations applied the controls contemplated in the design of XYZ Service Provider's controls]*;¹ and
- The controls described in management's description were operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives described therein were achieved during the period from January 1, 20X1 to December 31, 20X1.

Management of XYZ Service Provider is responsible for its assertion. Our responsibility is to express an opinion on management's assertion based on our examination.

[Scope paragraph]

¹ Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve specified control objectives. Otherwise omit this reference.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects. An examination involves performing procedures to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We were not engaged to perform and did not perform an examination of XYZ Service Provider's or user organizations' compliance or internal control over compliance with Federal Securities Laws, as that term is defined by Securities and Exchange Commission (SEC) Rule 38a-1 under the Investment Company Act of 1940 ("Federal Securities Laws"). We also were not engaged to perform and did not perform an examination of XYZ Service Provider's compliance with its contractual obligations to its clients during the period from January 1, 20X1 to December 31, 20X1.

Our examination was limited to examining, for the purposes described above, management's assertion about the specified compliance control objectives and related controls included in management's description and did not consider any other compliance control objectives or controls that may be relevant to XYZ Service Provider's or user organizations' compliance or internal control over compliance with Federal Securities Laws. Further, the relative effectiveness and significance of specific controls at XYZ Service Provider, and their effect on user organizations' compliance or internal control over compliance with Federal Securities Laws are dependent on their interaction with the controls and other factors present at individual user organizations. We have performed no procedures to evaluate the effectiveness of such controls or such other factors at individual user organizations.

The compliance control objectives and related controls set forth in management's description have been provided to enable user organizations, when performing their annual compliance reviews as required by SEC Rule 38a-1 under the Investment Company Act of 1940, to consider such information along with information about their own compliance or internal control over compliance with Federal Securities Laws, and any other relevant information.

[Inherent limitations paragraph]

Management's description is as of December 31, 20X1. Any projection of such information to the future is subject to the risk that, because of change, the description may no longer portray the system or controls in existence. The potential effectiveness of controls in achieving the specified compliance control objectives established by XYZ Service Provider is subject to inherent limitations and, accordingly, lack of compliance with controls and instances of errors or fraud may occur and not be detected. Furthermore, the projection of any evaluations, based on our findings, to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with such controls may deteriorate, or changes made to the system or controls, or the failure to make needed changes to the system or controls, may alter the validity of such evaluations.

[Opinion paragraph]

In our opinion, management's assertion that

- the controls described in the accompanying document titled, "XYZ Service Provider's Description of Specified Compliance Control

Objectives and Related Controls" (management's description), were suitably designed as of December 31, 20X1 to provide reasonable assurance that the compliance control objectives established by management and described therein would be achieved, if those controls were complied with satisfactorily [*and user organizations applied the controls contemplated in the design of XYZ Service Provider's controls*];² and

- the controls described in management's description were operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives described therein were achieved during the period from January 1, 20X1 to December 31, 20X1

is fairly stated, in all material respects.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

² Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve specified control objectives. Otherwise omit this reference.

Appendix A-2 — Illustrative Practitioner's Examination Report on a Service Provider's Assertion Regarding Specified Compliance Control Objectives and Related Controls When the Service Provider Uses a Subservice Provider and the Subservice Provider's Control Objectives and Related Controls are Excluded From the Description and the Scope of the Practitioner's Engagement

Note: The compliance control objectives and related controls referenced in the following illustrative practitioner's report are examples only and should not be viewed as representative of or a complete description of the compliance control objectives or related controls a service provider might be expected to (1) establish and implement to meet any contractual responsibilities to funds or any other clients (2) monitor for investment compliance, or (3) include in its description of specified compliance control objectives and related controls in an examination engagement covered by this Statement of Position (SOP). Additionally, there may be other areas of responsibility (beyond investment compliance) that a service provider might assume on behalf of funds or any other clients that might result in the inclusion and presentation of different or additional compliance control objectives and related controls for engagements covered by this SOP.

Report of Independent Accountants

To the Management of XYZ Service Provider:

[Introductory paragraph]

We have examined the assertion made by the management of XYZ Service Provider pertaining to controls over investment compliance that XYZ Service Provider performs for user organizations. Management's assertion is included in the accompanying document titled, "Management's Assertion Regarding XYZ Service Provider's Specified Compliance Control Objectives and Related Controls" and states that:

- The controls described in the accompanying document, "XYZ Service Provider's Description of Specified Compliance Control Objectives and Related Controls" (management's description), were suitably designed as of December 31, 20X1 to provide reasonable assurance that the compliance control objectives established by management and described therein would be achieved, if those controls were complied with satisfactorily *[and user organizations applied the controls contemplated in the design of XYZ Service Provider's controls]*.¹
- The controls described in management's description were operating with sufficient effectiveness to provide reasonable assurance

¹ Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve the specified control objectives. Otherwise omit this reference. Also, if the application of controls by the subservice provider is necessary to achieve the specified compliance control objectives, and the subservice provider's controls are excluded from the description, the practitioner's report should be modified to include the phrase, "and the subservice provider applied the controls contemplated in the design of XYZ Service Provider's controls."

that the specified compliance control objectives described therein were achieved during the period from January 1, 20X1 to December 31, 20X1.

As stated in management's description, XYZ Service Provider uses a computer processing service provider for all of its computerized application processing. Management's description includes only those compliance control objectives and related controls of XYZ Service Provider, and does not include compliance control objectives and related controls of the computer processing service provider. Our examination did not extend to controls of the computer processing service provider.

Management of XYZ Service Provider is responsible for its assertion. Our responsibility is to express an opinion on management's assertion based on our examination.

[Scope paragraph]

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether management's assertion is fairly stated, in all material respects. An examination involves performing procedure to obtain evidence about management's assertion. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of management's assertion, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We were not engaged to perform and did not perform an examination of XYZ Service Provider's or user organizations' compliance or internal control over compliance with Federal Securities Laws, as that term is defined by Securities and Exchange Commission (SEC) Rule 38a-1 under the Investment Company Act of 1940 ("Federal Securities Laws"). We also were not engaged to perform and did not perform an examination of XYZ Service Provider's compliance with its contractual obligations to its clients during the period from January 1, 20X1 to December 31, 20X1.

Our examination was limited to examining, for the purposes described above, management's assertion about the specified compliance control objectives and related controls included in management's description and did not consider any other compliance control objectives or controls that may be relevant to XYZ Service Provider's or user organizations' compliance or internal control over compliance with Federal Securities Laws. Further, the relative effectiveness and significance of specific controls at XYZ Service Provider, and their effect on user organizations' compliance or internal control over compliance with Federal Securities Laws are dependent on their interaction with the controls and other factors present at individual user organizations and at subservice providers. We have performed no procedures to evaluate the effectiveness of such controls or such other factors at individual user organizations or at subservice providers.

The compliance control objectives and related controls set forth in management's description have been provided to enable user organizations, when performing their annual compliance reviews as required by SEC Rule 38a-1 under the Investment Company Act of 1940, to consider such information along with information about their own compliance or internal control over compliance with Federal Securities Laws, and any other relevant information.

[Inherent limitations paragraph]

Management's description is as of December 31, 20X1. Any projection of such information to the future is subject to the risk that, because of change, the

description may no longer portray the system or controls in existence. The potential effectiveness of controls in achieving the specified compliance control objectives established by XYZ Service Provider is subject to inherent limitations and, accordingly, lack of compliance with controls and instances of errors or fraud may occur and not be detected. Furthermore, the projection of any evaluations, based on our findings, to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with such controls may deteriorate, or changes made to the system or controls, or the failure to make needed changes to the system or controls, may alter the validity of such evaluations.

[Opinion paragraph]

In our opinion, management's assertion that:

- the controls described in the accompanying document, "XYZ Service Provider's Description of Specified Compliance Control Objectives and Related Controls" (management's description), were suitably designed as of December 31, 20X1 to provide reasonable assurance that the compliance control objectives established by management and described therein would be achieved, if those controls were complied with satisfactorily *[and user organizations applied the controls contemplated in the design of XYZ Service Provider's controls]*.²
- the controls described in management's description were operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives described therein were achieved during the period from January 1, 20X1 to December 31, 20X1

is fairly stated, in all material respects.

[Restricted use paragraph]

This report is intended solely for the information and use of chief compliance officers, management, boards of directors, and the independent auditors of XYZ Service Provider and of the entities that use the services of XYZ Service Provider, and is not intended to be and should not be used by anyone other than these specified parties.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

² Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve the specified control objectives. Otherwise omit this reference. Also, if the application of controls by the subservice provider is necessary to achieve the specified compliance control objectives, and the subservice provider's controls are excluded from the description, the practitioner's report should be modified to include the phrase, "and the subservice provider applied the controls contemplated in the design of XYZ Service Provider's controls."

Appendix A-3 — Illustrative Management Assertion Regarding a Service Provider’s Specified Compliance Control Objectives and Related Controls

Management's Assertion Regarding XYZ Service Provider's Specified Compliance Control Objectives and Related Controls

XYZ Service Provider provides certain investment compliance services to funds (user organizations). XYZ Service Provider's description of specified compliance control objectives and related controls is presented in the accompanying document, "XYZ Service Provider's Description of Specified Compliance Control Objectives and Related Controls" (management's description). We, as members of management of XYZ Service Provider, are responsible for the description as well as for the suitability of the design and operating effectiveness of those controls.

Management's description is provided to enable user organizations, when performing their annual compliance review as required by Securities and Exchange Commission (SEC) Rule 38a-1 under the Investment Company Act of 1940, to consider such information, along with information about their own compliance and internal control over compliance with Federal Securities Laws, as that term is defined in Rule 38a-1, and any other relevant information. We have evaluated the suitability of the design and operating effectiveness of these controls in achieving the compliance control objectives included in management's description during the period from January 1, 20X1 through December 31, 20X1. The criteria against which the controls were evaluated are the specified compliance control objectives included in management's description. Based on our evaluation, we assert that:

- The controls included in management's description were suitably designed as of December 31, 20X1 to provide reasonable assurance that the compliance control objectives described therein would be achieved, if those controls were complied with satisfactorily *[and user organizations applied the controls contemplated in the design of XYZ Service Provider's controls]*.¹
- The controls set forth in management's description were operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives, included in management's description, were achieved during the period from January 1, 20X1 to December 31, 20X1.

By: _____
[Signature, name, and title of appropriate official]

By: _____
[Signature, name, and title of appropriate official]

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

¹ Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve the specified control objectives. Otherwise omit the reference. Also, if the application of controls by a subservice provider is necessary to achieve the specified compliance control objectives, and the subservice provider's controls are excluded from the description, the practitioner's report should be modified to include the phrase, "and the subservice provider applied the controls contemplated in the design of XYZ Service Provider's controls."

Appendix A-4 — Illustrative Service Provider's Description of Specified Compliance Control Objectives and Related Controls

XYZ Service Provider's Description of Specified Compliance Control Objectives and Related Controls

Note: The following is an illustration of a description of investment compliance control objectives and related controls for an investment adviser (XYZ Service Provider) performing investment compliance-related services for funds.¹ This illustration is presented solely to provide an example of control objectives and related controls pertaining to investment-compliance related services and should not be viewed as representative of or a complete set of compliance control objectives or related controls that a service provider might be expected to (1) perform in these circumstances or similar circumstances, (2) establish and implement to meet any contractual responsibilities to funds or any other clients, or (3) include in its written description of specified compliance control objectives and related controls in an examination engagement covered by this Statement of Position (SOP). Additionally, there may be other areas of responsibility (beyond investment compliance) that a service provider might assume on behalf of funds or any other clients that might result in the inclusion and presentation of different or additional compliance control objectives and related controls for engagements covered by this SOP.

Monitoring Compliance with Fund Investment Guidelines and Restrictions

[XYZ Service Provider uses a computer processing service provider for all of its computerized application processing.² The accompanying description includes only those compliance control objectives and related controls of XYZ Service Provider, and does not include compliance control objectives and related controls of the computer processing service provider.]

Control Objective 1: Controls provide reasonable assurance that securities trades for the fund and the fund's securities holdings comply with investment guidelines and restrictions included in the fund's investment advisory agreement, prospectus, and statement of additional information.

Controls:

1. Before any securities trading commences for a fund (a) XYZ Service Provider's trading desk representative enters information (coding) in the fund's securities trading order entry and compliance (STOEC) module to reflect all investment guidelines and restrictions included in the documents identified in Control Objective 1, and (b) a supervisor in XYZ Service Provider's fund services department compares, for completeness and accuracy, the

¹ In this illustration, the investment adviser performs investment compliance-related services in addition to investment advisory services for funds. In other situations, investment compliance-related services may be performed, in whole or in part, by one or more other service providers or subservice providers.

² If the service provider uses a subservice provider, management's description should include a brief statement of the functions and nature of the services performed by the subservice provider. In addition, the description should indicate whether the subservice provider's compliance control objectives and related controls are included in or excluded from the description. See paragraphs .16–.17 of the Statement of Position for additional information about the information to be included in this disclosure.

information (coding) entered in the fund's STOEC module to the corresponding information included in the source documents referred to in Control Objective 1. Any discrepancies that appear to be the result of data entry errors (for example, entering the number 50% when the prospectus states 5%) are corrected upon identification by XYZ Service Provider. Any other discrepancies related to differences in interpretation or uncertainty about the meaning of information in the source documents, are communicated to the fund's treasurer or chief compliance officer for research, clarification, and resolution. Any subsequent changes to the original information (coding) entered by XYZ Service Provider must be approved by the fund's treasurer or chief compliance officer.

2. On a daily basis, a report of all deletions, modifications, and additions made to investment guidelines and restrictions in the fund's STOEC module is reviewed by a supervisor in XYZ Service Provider's fund services department. The supervisor compares each change made to a written authorization to effect the change submitted by the fund's treasurer or chief compliance officer.
3. Annually, a supervisor in XYZ Service Provider's fund services department compares, for completeness and accuracy, the current information (coding) in each fund's STOEC module to the corresponding source documents referred to in the Control Objective.
4. For all securities trades for which the functionality of a fund's STOEC module identifies an apparent or possible noncompliant securities trade order, the order is 'pending' until the fund's treasurer or chief compliance officer reviews the circumstances of the requested trade and determines whether it is permissible. If permissible, the 'pending' trade is released for processing upon written approval by either the fund's treasurer or chief compliance officer. If not permissible, the trade is cancelled. On the basis prescribed in the fund's compliance policies and procedures (daily, weekly, monthly, or quarterly), members of the compliance staff of XYZ Service Provider review reports generated by the STOEC module to ascertain that no violations of the fund's investment guidelines and restrictions have occurred. Any violations are researched, and XYZ Service Provider's compliance staff ascertains that corrective actions were approved by the fund's treasurer or chief compliance officer, and effected.

Control Objective 2: Controls provide reasonable assurance that the dollar-weighted average portfolio maturities (WAPM) of money market funds do not exceed 90 days, as required by Securities and Exchange Commission (SEC) Rule 2a-7.

Controls:

1. For each new security purchased, a trade department analyst at XYZ Service Provider compares the terms entered in the trade system to the corresponding information in the documentation of the security purchase, including the date used for the WAPM calculation (for example, interest-rate reset date or maturity date).
2. On a quarterly basis, XYZ Service Provider's compliance staff verifies that the computation logic in its securities accounting system

(SAS), which affects the calculation of the funds' WAPM, is consistent with applicable provisions of SEC Rule 2a-7 and regulatory guidance issued.

3. On a daily basis, using reports and information produced by the SAS, XYZ Service Provider's compliance staff determines whether any of the funds' WAPM exceeds 75 days. If so, the compliance staff alerts the portfolio manager so that this information can be taken into account by the portfolio manager when making prospective investment management decisions for the fund. If a fund's WAPM exceeds 80 days, the compliance staff also alerts the fund's treasurer.
4. On a daily basis, using reports and information produced by the SAS, XYZ Service Provider's compliance staff identifies changes of 3 days or more in any fund's WAPM from the fund's prior day WAPM, and researches the fund's investing activities sufficiently to identify the reason for the change and whether there is a reasonable basis for the change. The results of the research are documented and provided to a compliance department manager for his or her written review and approval.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix B — Illustrative Practitioner's Examination Report Containing a Qualified Opinion on the Suitability of the Design and Operating Effectiveness of a Service Provider's Controls in Achieving Specified Compliance Control Objectives

Paragraph .79 of AT-C section 205 states, "If the practitioner has concluded that conditions exist that, individually or in combination, result in one or more material misstatements, based on the criteria, the practitioner should modify the opinion and express a qualified or adverse opinion directly on the subject matter, not on the assertion, even when the assertion acknowledges the misstatement." The following illustrative practitioner's report relates to an examination engagement in which the practitioner identified a control deficiency in the operating effectiveness of the service provider's controls; accordingly, the practitioner reports on the subject matter, rather than on the assertion. Also, in a separate paragraph, the practitioner describes the matters giving rise to the modification. In this engagement, the practitioner has concluded that the deficiency in controls is not sufficiently pervasive to warrant an adverse opinion.

Report of Independent Accountants

To the Management of ABC Service Provider:

[Introductory paragraph]

We have examined whether the controls described in the accompanying document, "ABC Service Provider's Description of Specified Compliance Control Objectives and Related Controls" (management's description), were:

- suitably designed, as of December 31, 20X1, to provide reasonable assurance that the specified compliance control objectives established by management of ABC Service Provider and described therein would be achieved, if those controls were complied with satisfactorily; *[and user organizations applied the controls contemplated in the design of ABC Service Provider's controls];*¹ and
- operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives described therein were achieved during the period from January 1, 20X1 to December 31, 20X1. (Collectively referred to as the subject matter and criteria.)

Management of ABC Service Provider is responsible for the suitability of the design and operating effectiveness of these controls in achieving the specified compliance control objectives. Our responsibility is to express an opinion whether the subject matter is in accordance with the criteria, based on our examination.

[Scope paragraph]

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those

¹ Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve the specified control objectives. Otherwise omit this reference.

standards require that we plan and perform the examination to obtain reasonable assurance about whether the subject matter is in accordance with the criteria, in all material respects. An examination involves performing procedures to obtain evidence about the subject matter. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the subject matter, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

We were not engaged to perform and did not perform an examination of ABC Service Provider's or user organizations' compliance or internal control over compliance with Federal Securities Laws, as that term is defined by Securities and Exchange Commission (SEC) Rule 38a-1, under the Investment Company Act of 1940 ("Federal Securities Laws"). We also were not engaged to perform and did not perform an examination of ABC Service Provider's compliance with its contractual obligations to its clients during the period from January 1, 20X1 to December 31, 20X1.

Our examination was limited to examining, for the purposes described above, the suitability of the design and operating effectiveness of the controls in achieving the specified compliance control objectives included in management's description and did not consider any other compliance control objectives or controls that may be relevant to ABC Service Provider's or user organizations' compliance or internal control over compliance with Federal Securities Laws. Further, the relative effectiveness and significance of specific controls at ABC Service Provider, and their effect on user organizations' compliance or internal control over compliance with Federal Securities Laws are dependent on their interaction with the controls and other factors present at individual user organizations. We have performed no procedures to evaluate the effectiveness of such controls or such other factors at individual user organizations.

The compliance control objectives and related controls set forth in management's description have been provided to enable user organizations, when performing their annual compliance reviews as required by SEC Rule 38a-1 under the Investment Company Act of 1940, to consider such information along with information about their own compliance or internal control over compliance with Federal Securities Laws, and any other relevant information.

[Inherent limitations paragraph]

Management's description is as of December 31, 20X1. Any projection of such information to the future is subject to the risk that, because of change, the description may no longer portray the system or controls in existence. The potential effectiveness of controls in achieving the specified compliance control objectives established by ABC Service Provider is subject to inherent limitations and, accordingly, lack of compliance with controls and instances of errors or fraud may occur and not be detected. Furthermore, the projection of any evaluations, based on our findings, to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with such controls may deteriorate, or changes made to the system or controls, or the failure to make needed changes to the system or controls, may alter the validity of such evaluations.

[Explanatory paragraph]

Management of ABC Service Provider has included in its description a control requiring that the manager of the advertising and sales department review and approve performance data used in ABC Service Provider's advertising and sales literature prior to its release to the public. Our tests of operating effectiveness noted that the manager of the advertising and sales department did

not review and approve the aforementioned performance data prior to its release to the public. The manager's failure to perform this control is a deficiency in the operating effectiveness of the service provider's controls that resulted in the nonachievement of the compliance control objective included in management's description: "Performance data used in advertising and sales literature are accurate and approved before release to the public."

[Opinion paragraph]

In our opinion, in all material respects, ABC Service Provider's controls were suitably designed at December 31, 20X1 to provide reasonable assurance that the specified compliance control objectives as described in management's description, would be achieved, if those controls were complied with satisfactorily *[and user organizations applied the controls contemplated in the design of ABC Service Provider's controls]*.² Also, in our opinion, except for the deficiency described in the preceding paragraph, ABC Service Provider's controls were operating with sufficient effectiveness to provide reasonable assurance that the specified compliance control objectives were achieved during the period from January 1, 20X1 through December 31, 20X1, in all material respects.³

[Restricted use paragraph]

This report is intended solely for the information and use of chief compliance officers, management, boards of directors, and the independent auditors of ABC Service Provider and of the entities that use the services of ABC Service Provider, and is not intended to be and should not be used by anyone other than these specified parties.

[Practitioner's signature]

[Practitioner's city and state]

[Date of practitioner's report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

² Refer to user controls only in situations in which the application of controls by the user organizations is necessary to achieve the specified control objectives. Otherwise omit this reference.

³ In instances in which a control is not suitably designed, the phrase "except for the deficiency described in the preceding paragraph" would be inserted in the first sentence of the opinion paragraph, which relates to the suitability of the design of controls.

Appendix C — Additional Illustrative Compliance Control Objectives

Note: The following are additional illustrative compliance control objectives pertaining to various services service providers might provide. These illustrative compliance control objectives are only examples and should not be viewed as representative of or a complete set or description of compliance control objectives that a service provider might be expected to (1) establish and implement to meet any contractual responsibilities to funds or any other clients, (2) monitor for achievement, or (3) include in its description of specified compliance control objectives and related controls in an attestation engagement covered by this Statement of Position (SOP). Additionally, there may be other areas of responsibility (beyond those listed below) that a service provider might assume on behalf of funds or any other clients that might result in the inclusion and presentation of different or additional compliance control objectives and related controls for engagements covered by this SOP.

Fund Advertising and Sales Literature

Controls provide reasonable assurance that:

1. Advertising and sales literature is reviewed for compliance with the service provider's established policies and is timely submitted to the National Association of Securities Dealers (NASD) for approval
2. Comments from the NASD on advertising and sales literature are reviewed and timely reflected in advertising and sales literature as required
3. Performance data used in advertising and sales literature are accurate and approved before release
4. Expiring advertisement and sales literature is identified and updated or disposed of before the expiration date
5. Regulatory changes are monitored and reflected in current and future advertising and sales literature

Valuation of Client Assets or Investments

Controls provide reasonable assurance that:

1. Securities price information is received from authorized sources in accordance with client instructions and is entered completely and accurately into the portfolio accounting system
2. Foreign exchange rates are received from authorized sources in accordance with client instructions and are entered completely and accurately into the portfolio accounting system
3. Securities that do not have readily determinable market values (for example, those valued at fair value in good faith), including international equity securities whose values are determined by adjusting the closing price on the foreign securities exchange, are valued according to consistently applied policies and procedures established by the service provider's client
4. For registered money-market-fund securities valued at amortized cost, valuation is monitored for compliance with the "mark-to-market" provision of Securities and Exchange Commission (SEC)

Rule 2a-7 and deviations in excess of established thresholds are reported in accordance with client instructions

Privacy

Controls provide reasonable assurance that:

1. The use of and access to nonpublic client information is restricted to authorized personnel
2. Customers of the fund are provided with a notice of privacy policies at the time they become a customer and in the event of a change to the privacy policy
3. Access to and use of material nonpublic information is restricted to authorized personnel
4. At least annually, employees are provided with written policies related to material nonpublic information and instruction about those policies
5. Customer information is disclosed only to authorized third parties

Transfer Agency

Controls provide reasonable assurance that:

1. As required by policies and procedures, the identity of any person seeking to open an account with the fund is verified by examining specified documents and other information and maintaining records of the information used to verify the person's identity
2. Cash equivalents under \$10,000 are monitored and tracked for a rolling 12-month period; Internal Revenue Service (IRS) Form 8300 is filed, and the shareholder is notified as required by the IRS
3. Certificate redemption requests are processed in a timely manner and archived in a secure manner for subsequent inquiry
4. Missing, lost, stolen, or counterfeit certificate notifications are processed in a timely manner, and Form X-17F-1A is filed with the Securities Information Center within the required number of business days
5. Transfer agent employees are fingerprinted and the related records are maintained for the required time period
6. Shareholder financial-related transactions are priced using the appropriate net asset value per share
7. Dividends are processed completely and accurately; dividend distributions are reconciled between the fund's general ledger and the shareholder accounting system; and any exceptions are researched and resolved by the next reporting period
8. Signature guarantees pertaining to shareholder transactions are reviewed upon presentment; rejected signature guarantees are communicated to the compliance department for tracking

Investment Compliance

Controls provide reasonable assurance that on a weekly basis:

1. Securities holdings are monitored for compliance with prospectus guidelines
2. Securities holdings are monitored to ensure that the portfolio meets a 15 percent liquidity standard

3. Securities of money market funds are monitored for compliance with the portfolio maturity and credit quality provisions of SEC Rules 2a-7c.2 and 2a-7c.3, respectively

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix D — Matters Identified in Securities and Exchange Commission Release Nos. IC-26299 and IA-2204 Adopting Rules 38a-1 and 206(4)-7 Pertaining to Compliance Policies and Procedures of Funds and Investment Advisers

As described in paragraph .15 of this Statement of Position (SOP), when management of the service provider establishes the compliance control objectives and related controls that are the subject of the engagement, it should consider, among other things, the compliance matters identified in Securities and Exchange Commission (SEC) Release Nos. IC-26299 and IA-2204 adopting Rule 38a-1 under the Investment Company Act of 1940 and Rule 206(4)-7 under the Investment Advisers Act of 1940, respectively. The SEC Release indicates that the SEC expects the policies and procedures of funds and their advisers to, at a minimum, address the following specified areas if those areas are relevant to the services the entity provides:

- Portfolio management processes, including allocation of investment opportunities among clients, and consistency of portfolios with clients' investment objectives, disclosures by the adviser, and applicable regulatory restrictions
- Trading practices, including procedures by which the adviser satisfies its best execution obligation, uses client brokerage to obtain research and other services (soft dollar arrangements), and allocates aggregated trades among clients
- Proprietary trading of the adviser and personal trading activities of supervised persons
- Accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements
- Safeguarding of client assets from conversion or inappropriate use by advisory personnel
- Accurate creation of required records and their maintenance in a manner that secures them from unauthorized alteration or use and protects them from untimely destruction
- Marketing advisory services, including the use of solicitors
- Processes to value client holdings and assess fees based on those valuations
- Safeguards for the privacy protection of client records and information
- Business continuity plans

Additional matters that the SEC expects funds (or their service providers) to address are listed in paragraph .02. This SOP does not require that a service provider's compliance control objectives address all of the relevant areas identified in the SEC Release; however, the areas listed in this paragraph and in paragraph .02 comprise matters that, if relevant in the circumstances, should be considered by management of the service provider in determining

compliance control objectives to be included in the scope of the attestation engagement.

The following is a summary of the additional areas, identified in the SEC Release, for which a fund or its service providers would be expected to have policies and procedures.

Pricing of portfolio securities and fund shares. The Investment Company Act of 1940 requires funds to sell and redeem their shares at prices based on their current net asset value, to pay redemption proceeds promptly, and, when market quotations are readily available, to calculate net asset values using the market value of the portfolio securities. If a market quotation is not readily available, the fund should use the fair value of the security, as determined in good faith by the fund's board. Further, Rule 38a-1 requires funds to adopt policies and procedures requiring the fund to monitor for circumstances that may necessitate the use of fair value prices, establish criteria for determining when market quotations are no longer reliable for a particular portfolio security, provide a methodology or methodologies by which the fund determines the current fair value of the portfolio security, and regularly review the appropriateness and accuracy of the method used in valuing securities and make any necessary adjustments.

Processing of fund shares. Pursuant to SEC rules, an investor submitting a purchase order or redemption request must receive the price next calculated after receipt of the purchase order or redemption request. A fund must have procedures in place that segregate investor orders received before the fund prices its shares (which will receive that day's price) from those that were received after the fund prices its shares (which will receive the following day's price). Rule 38a-1 requires funds to approve and periodically review the policies and procedures of transfer agents. Funds should also take affirmative steps to protect themselves and their shareholders against late trading by obtaining assurances that those policies and procedures are effectively administered.

Identification of affiliated persons. To prevent self-dealing and overreaching by persons in a position to take advantage of the fund, the Investment Company Act of 1940 prohibits funds from entering into certain transactions with affiliated persons. Funds should have policies and procedures in place to identify these persons and to prevent unlawful transactions with them.

Protection of nonpublic information. The federal securities laws prohibit insider trading, and section 204A of the Investment Advisers Act of 1940 requires investment advisers (including advisers to funds) to establish, maintain, and enforce policies and procedures designed to prevent the adviser or any of its associated persons from misusing material, nonpublic information. Fund advisers should incorporate their section 204A policies into the policies required by Rule 38a-1. A fund's compliance policies and procedures should also address other potential misuses of nonpublic information, including the disclosure to third parties of material information about the fund's portfolio, its trading strategies or pending transactions, and the purchase or sale of fund shares by advisory personnel based on material, nonpublic information about the fund's portfolio.

Compliance with fund governance requirements. Fund boards are responsible for, among other things, approving the fund's advisory contracts, underwriting agreements, and distribution plans. The Investment Company Act of 1940 requires that fund boards be elected by fund shareholders and that a certain percentage of the board be "independent directors." To rely on many of the SEC's exemptive rules, independent directors must constitute a majority of the board, must be selected and nominated by other independent directors, and, if they hire legal counsel, must hire independent legal counsel. A fund's policies and procedures should be designed to guard against, among other things, an improperly constituted board, the failure of the board to properly consider matters

entrusted to it, and the failure of the board to request and consider information required by the Investment Company Act of 1940 from the fund adviser and other service providers.

Market timing. Under Rule 38a-1, a fund must have procedures reasonably designed to ensure compliance with its disclosed policies regarding market timing. Market timing is the excessive short-term trading of mutual fund shares that may be harmful to the fund. These procedures should provide for monitoring of shareholder trades or flows of money in and out of the funds in order to detect market timing activity, and for consistent enforcement of the fund's policies regarding market timing. If the fund permits any waivers of those policies, the procedures should be reasonably designed to prevent waivers that would harm the fund or its shareholders or subordinate the interests of the fund or its shareholders to those of the adviser or any other affiliated person or associated person of the adviser. Fund boards are strongly urged by the SEC to require fund advisers, or other persons authorized to waive market timing policies, to report to the board at least quarterly all waivers granted so that the board can determine whether the waivers were proper. Many funds' prospectuses already disclose market timing policies, and failure to adhere to those disclosed policies violates the antifraud provisions of the federal securities laws. Moreover, a fund adviser who waives or disregards those policies for the benefit of itself or a third party has breached its fiduciary responsibilities to the fund.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix E — Illustrative Practitioner's Agreed-Upon Procedures Report

The following is an illustrative agreed-upon procedures report for procedures performed at a service provider.

Independent Accountant's Report on Applying Agreed-Upon Procedures

To the Management of XYZ Service Provider:

We have performed the procedures enumerated in Attachment X which address XYZ Service Provider's internal control over compliance during the year ended December 31, 20X1. Management of XYZ Service Provider is responsible for maintaining effective internal control over compliance with federal securities laws, regulations, and related SEC rules.

XYZ Service Provider's management has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of assisting users in determining whether the entity maintained effective internal control over compliance with federal securities laws, regulations, and related SEC rules. This report may not be suitable for any other purpose. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

The procedures performed and the findings are included in Attachment X.

We were engaged by XYZ Service Provider's management to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on internal control over compliance by XYZ Service Provider for the year ended December 31, 20X1. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

We are required to be independent of XYZ Service Provider and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our agreed-upon procedures engagement.

[Additional paragraphs may be added to describe other matters.]

This report is intended solely for the information and use of XYZ Service Provider and is not intended to be and should not be used by anyone other than this specified party.^[1]

[Signature of the practitioner's firm]

[City and state where practitioner's report is issued]

[Date of the practitioner's report]

^[1] [Footnote deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18; Paragraph revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Chief Compliance Officers Task Force

BRIAN GALLAGHER, *Chair*

JOSEPH GRAINGER

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BRENT D. OSWALD

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The AICPA is grateful to Stephen Callahan, Matthew Epp, Michael P. Fay, Kevin W. O'Connell, and Mark Twerdok for their technical assistance with this document.

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Statement of Position 12-1 — Reporting Pursuant to the 2010 Edition of the Global Investment Performance Standards

October 2012

NOTE

This Statement of Position (SOP) has been developed by the AICPA's Investment Performance Standards Task Force to provide guidance regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to engagements to report pursuant to Global Investment Performance Standards.

This SOP is an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attest Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the AICPA Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive publications are relevant to the proper application of the attestation standards in specific circumstances. If a practitioner does not apply the attestation guidance included in this SOP, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by this SOP.

Introduction and Background

.01 To promote fair representation, full disclosure, and greater comparability of investment performance, the CFA Institute developed the Global Investment Performance Standards (GIPS® standards).¹ Although compliance with the GIPS standards is voluntary, an investment management firm's claim of compliance with the GIPS standards gives current and potential clients more confidence in the integrity of the performance presentations and the general practices of a compliant firm.

¹ For information on the appropriate use of the Global Investment Performance Standards registered trademark, see the CFA Institute website at www.cfainstitute.org.

.02 All references to the GIPS standards in this Statement of Position (SOP) refer to the 2010 edition of the GIPS standards. The GIPS standards specify that they include any updates, guidance statements, interpretations, questions and answers, and clarifications published by the CFA Institute and the GIPS Executive Committee, all of which are available at www.gipsstandards.org, as well as in the *GIPS Handbook*.

.03 The GIPS standards recommend that investment management firms obtain independent third-party verification. *Verification* is a process in which an independent third party, referred to as a verifier, assesses whether (a) the firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis, and (b) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification is intended to provide a firm and its existing and prospective clients with greater confidence in the firm's claim of compliance with the GIPS standards. Verification does not provide absolute assurance that a firm is in compliance with the GIPS standards.

.04 In addition to verification, a firm may choose to have a verifier perform a specifically focused performance examination of any of the firm's composites and their associated compliant presentations. A *compliant presentation* is defined as a presentation for a composite that contains all the information required by the GIPS standards and that may also include additional or supplemental information. The GIPS standards permit a report on the performance examination of a composite and its associated compliant presentation to be issued only if a verification report has also been issued.

.05 A verifier may or may not be a CPA. A CPA in public practice hired to perform a verification or performance examination is referred to in this SOP as a practitioner. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Scope

.06 This SOP provides guidance to practitioners for engagements to examine and report on aspects of a firm's claim of compliance with the GIPS standards (a verification). It also provides guidance on engagements to examine and report on any of the firm's composites and their associated compliant presentations (a performance examination). Practitioners are required to perform such engagements pursuant to AT-C section 205, *Examination Engagements*. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.07 Although a verification consists of examining aspects of a firm's compliance with the GIPS standards and the design of certain policies and procedures, a verification is not a compliance attestation engagement, as governed by AT-C section 315, *Compliance Attestation*, or an internal controls attestation engagement as governed by AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.08 This SOP supersedes SOP 06-1, *Reporting Pursuant to the Global Investment Performance Standards*. This SOP also supersedes paragraphs 11.37.42 of chapter 11, "Independent Auditor's Reports and Client Representations," of the AICPA Audit and Accounting Guide *Investment Companies* (as of May 1, 2012).

Overview of the GIPS Standards

Compliance With the GIPS Standards

.09 The GIPS standards establish both requirements and recommendations for firms to follow when calculating and presenting investment performance. Adherence to the recommendations of the GIPS standards is encouraged. The GIPS standards use the term *must* to indicate requirements and the term *should* to indicate recommendations. The attestation standards established by the AICPA use the terms *must*, *is required*, or *should* to indicate requirements and *may* to indicate recommendations. To avoid confusion, this SOP uses the terms *is required* or *must* to indicate requirements of AT-C sections 105 and 205 and of the GIPS standards. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.10 The GIPS standards require an entity to define itself as a firm. For a firm to claim compliance with the GIPS standards, the firm must meet all the requirements of the GIPS standards on a firmwide basis. Firms are prohibited from claiming compliance "except for ..." or making any other statements that may indicate partial compliance with the GIPS standards.

.11 The GIPS standards provide *suitable criteria*, as defined in AT-C section 105, for verifications and performance examinations. The criteria are available to *users* as they are posted to www.gipsstandards.org. The GIPS standards require verifiers to use the criteria set forth therein. Consequently, practitioners who perform a verification or performance examination pursuant to the GIPS standards are required to understand the GIPS standards, including interpretative guidance. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.12 Practitioners are required to be independent of the firm, in accordance with the AICPA Code of Professional Conduct and the *GIPS Guidance Statement on Verifier Independence*.

Verification

.13 A verification tests whether the

- a. firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis.
- b. firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards.

The GIPS standards specify procedures that practitioners are required to perform for a verification, as well as recommendations and guidance (see chapter IV of the GIPS standards, the *GIPS Guidance Statement on Verification*, and the *GIPS Guidance Statement on Verifier Independence*).

.14 According to the GIPS standards, when a firm has obtained a verification report, the firm may state that it is verified. This statement may or may not be accompanied by a presentation of performance history for a specific composite. A verification, however, does not imply that the verifiers have examined the accuracy of the performance results of any specific composite presentation that may accompany the verification report (see paragraph .43).

Performance Examination

.15 In addition to a verification, a firm may choose to have a verifier conduct a performance examination. The GIPS standards specify procedures that

practitioners are required to perform for a performance examination and also include recommendations and guidance (see the *GIPS Guidance Statement on Performance Examinations*). A verification is required to be performed prior to, or concurrent with, any performance examination. A firm is not permitted to state that a particular composite and its associated compliant presentation have been independently examined with respect to the GIPS standards unless the firm has also obtained a firmwide verification report covering the periods of the performance examination. Firms cannot state that a particular composite and its associated compliant presentation have been GIPS verified or make any claim to that effect.

Verification and Performance Examination Engagements

Engagement Objectives

.16 Practitioners are required to conduct verifications and performance examinations in accordance with attestation standards established by the AICPA. In addition, the GIPS standards specify that these engagements must be conducted in accordance with the procedures required in the GIPS standards. This SOP is not intended to provide all the required and recommended procedures set forth in the GIPS standards or all the applicable attestation standards established by the AICPA.

.17 For a verification, the practitioner's objective is to express an opinion on whether, in all material respects, the

- a. firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis.
- b. firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards.

.18 For a performance examination of a specific composite, the practitioner's objective is to express an opinion on whether, in all material respects, the firm has

- a. constructed the composite and calculated the composite performance in compliance with the GIPS standards.
- b. prepared and presented the composite presentation in compliance with the GIPS standards.

A firm that has met the requirements of the GIPS standards with regard to a specific composite presentation is considered to have prepared and presented that composite presentation in compliance with the GIPS standards.

Requesting a Written Assertion

.19 Paragraph .10 of AT-C section 205 requires the practitioner to request from the responsible party a written assertion about the measurement or evaluation of the subject matter against the criteria. When the engaging party is the responsible party and refuses to provide a written assertion, paragraph .82 of AT-C section 205 requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable law or regulation. When the engaging party is not the responsible party, and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement. In that case, paragraph .84 of AT-C section 205 requires the practitioner to disclose that refusal in the practitioner's report and restrict the

use of the report to the engaging party. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Planning the Engagement

.20 Paragraph .11 of AT-C section 205 requires the practitioner to establish an overall strategy that sets the scope, timing, and direction of the engagement and guides the development of the engagement plan. To develop such a strategy, practitioners need to have sufficient knowledge to enable them to adequately understand the events, transactions, and practices that, in their judgment, have a significant effect on the subject matter or assertion. Such knowledge includes a sufficient understanding of the investment management industry and the GIPS standards, AICPA interpretive guidance, and applicable laws and regulations regarding the calculation and presentation of investment performance. The GIPS standards also address qualifications for verifiers. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Agreeing on the Terms of the Engagement

.21 The practitioner is required to agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement is required to be specified in sufficient detail in an engagement letter or other suitable form of written agreement and is required to include the following:

- a. The objective and scope of the engagement
- b. The responsibilities of the practitioner
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different
- e. A statement about the inherent limitations of an examination
- f. Identification of the criteria for the measurement, evaluation, or disclosure of the subject matter
- g. An acknowledgement that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.22 See appendix A, "Example Engagement Letter—Verification and Performance Examination," of this SOP for an example engagement letter. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.23 The terms of the engagement may include a statement that if the engaging party intends to use the practitioner's report(s) or refer to the practitioner in connection with any sales or advertising literature, the engaging party will provide a draft of such literature to the practitioner for the practitioner's review and comment prior to issuance. See appendix A of this SOP for an example of an engagement letter. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Obtaining Sufficient Appropriate Evidence

.24 [Paragraph renumbered and deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.25 [Paragraph renumbered and deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.26 To obtain reasonable assurance, the practitioner is required to obtain sufficient appropriate evidence to reduce attestation risk² to an acceptably low level and thereby enable the practitioner to draw reasonable conclusions on which to base the practitioner's opinion. Paragraphs .A49.A52 of AT-C section 205 discuss the attributes of sufficient appropriate evidence. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.27 As noted previously, the GIPS standards specify procedures that practitioners are required to perform for a verification and performance examination of one or more specific composites and their associated compliant presentations, as well as recommendations and guidance (see chapter IV of the GIPS standards, the *GIPS Guidance Statement on Verification*, the *GIPS Guidance Statement on Performance Examinations*, and the *GIPS Guidance Statement on Verifier Independence*). A practitioner may perform other procedures in addition to those specified in the GIPS standards. Regardless of the scope of the engagement, the practitioner is required to obtain sufficient evidence to provide a reasonable basis for the opinion expressed in the report. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.28 The GIPS standards permit the use of a sampling methodology when performing verification or performance examination procedures. The practitioner may find it helpful to consider the guidance in the AICPA Audit Guide *Audit Sampling* when performing procedures that involve the use of sampling. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.29 The GIPS standards specify that a verifier must understand the firm's policies and procedures for establishing and maintaining compliance with all the applicable requirements and adopted recommendations of the GIPS standards, evaluate whether all applicable policies are properly included and adequately documented, and then test the firm's compliance with the established policies and procedures. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.30 When a performance examination of one or more composites and their associated presentations is conducted subsequent to, not concurrent with, a verification, the practitioner is required to update the practitioner's understanding of the firm's policies and procedures and inquire about any other changes that may affect the planning and conduct of the performance examination. In addition, the practitioner is required to follow the preperformance examination procedures required by the GIPS standards. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.31 The GIPS standards require that firms initially claiming compliance with the GIPS standards report, at a minimum, 5 years of investment performance for each composite presented (or performance since inception of the

² See paragraph .10 of AT-C section 105, *Concepts Common to All Attestation Engagements*, for the definition of *attestation risk*. [Footnote added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

composite or firm if the period since inception is less than 5 years). After the initial presentation of GIPS-compliant performance, the firm must add an additional year of performance until the firm presents a 10-year GIPS-compliant performance record. Thereafter, at a minimum, a 10-year GIPS-compliant performance record must be presented. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.32 The initial minimum period for which verifications can be performed is one year of the firm's presented performance or from firm inception date to period-end if less than one year. Subsequent verifications may cover any additional time periods, with annual updates being common and quarterly updates also performed. After the initial verification or performance examination is complete, it is industry practice to append subsequent verification or performance examination periods to the initial period. For example, if an initial performance examination was completed on a firm from January 1, 2006, to December 31, 2010, the following year's performance examination period would cover from January 1, 2006, to December 31, 2011. Documentation for each annual engagement is required to indicate the procedures performed supporting the consideration of prior period opinions. Such procedures may include inquiries and evaluation of the implication of the findings of current year's procedures for prior periods. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.33 During a verification or performance examination, the practitioner is required to consider information about subsequent events and subsequently discovered facts that come to his or her attention. Such subsequent events and subsequently discovered facts include circumstances and events that affect prior period-compliant presentations. Errors in prior period-compliant presentations would be assessed in accordance with the firm's error correction policies. If a correction is required by the firm's error correction policy, and the firm does not correct the error, the practitioner is required to consider the implications for the performance examination and, if applicable, the related verification. If the firm corrects, or has corrected, a prior period-compliant presentation, the practitioner would perform appropriate testing of material revisions to previously reported information, including disclosures, regarding the changes and would consider the implications on the practitioner's ability to issue his or her report (see paragraph .38). [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Representation Letter

.34 Paragraph .50 of AT-C section 205 requires the practitioner to request from the responsible party³ written representations in the form of a letter addressed to the practitioner. The representations should

- a. include the responsible party's assertion about the subject matter based on the criteria.
- b. state that all relevant matters are reflected in the measurement or evaluation of the subject matter or assertion.
- c. state that all known matters contradicting the subject matter or assertion and any communication from regulatory agencies or

³ In this Statement of Position, the responsible party is usually management of the service provider. [Footnote added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

others affecting the subject matter or assertion have been disclosed to the practitioner, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report.

- d. acknowledge responsibility for
 - i. the subject matter and the assertion;
 - ii. selecting the criteria, when applicable; and
 - iii. determining that such criteria are appropriate for the responsible party's purposes.
- e. state that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter or assertion have been disclosed to the practitioner.
- f. state that it has provided the practitioner with all relevant information and access.
- g. if applicable, state that the responsible party believes the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the subject matter.
- h. if applicable, state that significant assumptions used in making any material estimates are reasonable.
- i. state that the responsible party has disclosed to the practitioner
 - i. all deficiencies in internal control relevant to the engagement of which the responsible party is aware;
 - ii. its knowledge of any actual, suspected, or alleged fraud or noncompliance with laws or regulations affecting the subject matter; and
 - iii. other matters as the practitioner deems appropriate.

As noted in paragraph .34, the GIPS standards include a listing of required representations, as well as a listing of other representations that are typically included, for both verifications and performance examinations. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.35 The GIPS standards also specify that the verifier must obtain a representation letter from the firm before issuing an opinion on a verification or performance examination. The representations for a verification and performance examination(s) can be included in one letter. Appropriate parties to sign the representation letter are responsible persons with an appropriate level of authority (for example, chief executive officer, chief financial officer, chief compliance officer, or chief investment officer). [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.36 The GIPS standards include a listing of required representations, as well as a listing of other representations that are typically included, for both verifications and performance examinations. The GIPS standards require that the representation letter include, among other representations, confirmation that policies and procedures used in establishing and maintaining compliance with the GIPS standards are as described in the firm's policies and procedures documents and have been consistently applied throughout the period(s). The representation letter must also include confirmation that the firm complies with the GIPS standards for the period(s) and any other relevant representations made to the practitioner during the engagement. Because the practitioner is concerned with events occurring up to the date of the practitioner's report, the written representations are dated as of the date of the practitioner's report.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.37 Appendix B, "Example Representation Letter," of this SOP contains an example representation letter that includes required and recommended management representations. Management's refusal to furnish all appropriate written representations constitutes noncompliance with the GIPS standards that would preclude the practitioner from rendering an opinion (see paragraph .38). [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Reporting

.38 The GIPS standards do not permit the issuance of a report with a qualified or an adverse opinion or a disclaimer of opinion for either a verification or performance examination. After conducting the procedures for a verification or performance examination, the practitioner may conclude that

- a. the records of the firm cannot support a verification or performance examination, or
- b. the firm is not in compliance with the GIPS standards, including situations in which the composite presentation does not comply with the GIPS standards.

In such situations, the GIPS standards specify that the practitioner must issue a statement to the firm clarifying why it was not possible to issue a verification or performance examination report. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.39 When a performance examination report cannot be issued, the GIPS standards require the practitioner and firm to consider the impact of the practitioner's inability to provide the performance examination report on the investment management firm's claim of compliance with the GIPS standards. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.40 AT-C section 105 permits the practitioner to report either on the assertion or directly on the subject matter to which the assertion relates. According to AT-C section 205, if the practitioner is reporting on management's assertion, the assertion should be bound with or accompany the practitioner's report, or the assertion should be clearly stated in the report. The illustrative reports in appendix C, "Illustrative Attest Report: Verification (Reporting Directly on the Subject Matter)," and appendix D, "Illustrative Attest Reports: Verification and Performance Examination (Reporting Directly on the Subject Matter)," of this SOP present examples of reporting directly on the subject matter because that is industry practice. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.41 Paragraph .63 of AT-C section 205 requires, in part, that the practitioner's report include (a) an identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates, and (b) a description of the nature of an examination engagement. Accordingly, for engagements covered by this SOP, the practitioner is required to clearly indicate in the report whether a verification, performance examination, or both have been performed. The GIPS standards also require that the report state the period(s) covered. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.42 Appendix C of this SOP presents an illustrative report for a verification. Appendix D of this SOP presents illustrative reports for a verification and performance examination. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.43 The GIPS standards require that the verification report include a statement indicating that verification does not ensure the accuracy of any specific composite presentation (see the verification report in appendix C of this SOP). This disclaimer of opinion is an acknowledgement of the fact that the practitioner cannot control whether the verification report may accompany a composite presentation distributed by the firm, even though no performance examination was conducted. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.44 The GIPS standards specify that the compliant presentation for the specified composite(s) that is (are) the subject of a performance examination report must be included in, or attached to, the performance examination report. The practitioner may request that the firm's composite presentation for an examined composite disclose that publically available benchmark returns have not been examined by the practitioner to avoid the implication that the practitioner is providing assurance on the development of the benchmark. The practitioner also should add a paragraph to a performance examination report disclaiming an opinion on composite presentations included or attached for any periods that were not examined by the practitioner or stating that the report does not relate to any composite presentations other than those identified in the report. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.45 When a firm has changed verifiers, and prior periods presented were subject to verification or performance examination by another verifier, the firm may request that the practitioner refer to all verified or examined periods in the practitioner's report. A practitioner may decide to refer to the report(s) of a predecessor verifier. The successor practitioner would consider the appropriateness of referring to reports on verifications or performance examinations conducted by other verifiers in the specific circumstances. If the successor practitioner decides to refer to the report(s) of the predecessor verifier, the report would be modified appropriately. Appendix E, "Illustrative Attest Report: Successor Practitioner Report—Verification and Performance Examination," of this SOP contains an example of a successor practitioner's report referring to the predecessor verifier's performance examination report. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Other Information

.46 If prior to or after the release of the practitioner's performance examination report on a composite compliant presentation or presentations, the practitioner is willing to permit the inclusion of the practitioner's performance examination report in a document containing the composite compliant presentation or presentations and other information, the practitioner should read the other information to identify material inconsistencies, if any, with the composite compliant presentation or presentations, management's assertion, or with the report. If upon reading the other information, in the practitioner's professional judgment

- a. a material inconsistency between that other information and the composite compliant presentation or presentations, management's assertion, or the report exists, or

- b. a material misstatement of fact exists in the other information, the composite compliant presentation or presentations, management's assertion, or the report,

the practitioner should discuss the matter with the firm and take further action as appropriate. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

.47 Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example, the following:

- Requesting the firm to consult with a qualified third party, such as the firm's legal counsel
- Obtaining legal advice about the consequences of different courses of action
- If required or permissible, communicating with third parties (for example, a regulator)
- Describing the material inconsistency in the practitioner's report
- Withdrawing from the engagement

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Effective Date

.48 This SOP is effective upon issuance. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix A—Example Engagement Letter—Verification and Performance Examination

The following is an illustration of an example engagement letter that may be used for this kind of engagement.

[Practitioner Letterhead]

[Client's Name and Address]

Dear _____:

This will confirm our understanding of the arrangements for our examination of whether (1) Investment Firm (the Firm) has complied with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0; this is referred to as a verification under the GIPS standards. [When also conducting a performance examination, add: We have also been engaged to conduct an examination (referred to as a performance examination under the GIPS standards) of [specify composites] and their associated compliant presentations for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards.]

Our examination will be conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants and criteria set forth in the GIPS standards. Our responsibility is to express an opinion on the items described above (the subject matter) based on our examination.

Our examination will involve performing procedures to obtain evidence about the subject matter. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the subject matter, whether due to fraud or error.

The Firm's management is responsible for

- selecting the GIPS standards as the criteria against which we will evaluate its compliance and for determining that the GIPS standards are appropriate criteria for its purposes.
- compliance with all applicable laws, regulations, contracts, and agreements, including the GIPS standards.
- the design, implementation, and monitoring of the policies and procedures upon which compliance is based.
- making available to us all records and related information relevant to your examination.
- providing a signed representation letter at the completion of our examination.¹

¹ The independent practitioner may wish to include in the engagement letter an understanding with the Firm about any limitation or other arrangements regarding liability of the practitioner or Firm.

- providing a written assertion about whether
 - the Firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0
 - the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0
 - the Firm has constructed the XYZ Composite and calculated the XYZ Composite performance for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards; and
 - the Firm has prepared and presented the [refer to accompanying composite compliant presentation] of the Firm's XYZ Composite for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards.

If conditions not now anticipated preclude us from performing our examination procedures and issuing a report, as contemplated by the preceding paragraph, we will advise you promptly and take such action as we deem appropriate.

Working papers that are prepared in connection with this engagement are our property. The working papers are prepared for the purpose of providing principal support for our report(s).

As you are aware, there are inherent limitations in the examination process, including, for example, selective testing and the possibility that collusion or forgery may preclude the detection of material errors, fraud, and illegal acts.

Our fees will be billed as work progresses and are based on the amount of time required at various levels of responsibility plus actual out-of-pocket expenses. Invoices are payable upon presentation. We will notify you immediately of any circumstances we encounter that could significantly affect our initial estimate of total fees. The quoted fees assume that you will provide an accumulation of data for the period to be tested and that the records provided to us are clear, concise, and accurate.

In the event we are requested or authorized by management or required by government regulation, subpoena, or other legal process to produce our documents or personnel as witnesses with respect to our engagement, the Firm will reimburse us for our professional time and expenses, as well as any fees and expenses of our counsel, incurred in responding to such requests.

If the Firm intends to use our report in whole or part or refer to [*name of practitioner*] in connection with any sales or advertising literature, a draft of such literature will be provided to us for review and comment prior to issuance.

Either party may terminate this agreement at will.

If these arrangements are acceptable, please sign one copy of this letter and return it to us. We appreciate the opportunity to serve you.

Very truly yours,

[*Name of Practitioner*]

Accepted and agreed to:

[Client Representative's Signature]

[Title]

[Date]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix B—Example Representation Letter

The following illustrative representation letter includes the representations required by paragraph .50 of AT-C section 205, Examination Engagements, additional representations required by the Global Investment Performance Standards (GIPS® standards), and optional representations ordinarily included in representation letters for the engagement described in this SOP.

[Date]

[Name of Practitioner]

We are providing this letter in connection with your examination of whether (1) Investment Firm (the Firm) has complied with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0. *[When also conducting a performance examination, add: (3) constructed the [specify composite(s)] and calculated the [specify composite(s)] performance for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards; and (4) prepared and presented the compliant presentation(s) for [specify composite(s)] for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards.]*

We confirm, to the best of our knowledge and belief, the following representations made to you during your examination(s):

1. We are responsible for (a) compliance with all the composite construction requirements of the GIPS standards on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and (b) the design of the Firm's policies and procedures to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0. We further confirm that we are responsible for the selection of the GIPS standards as the criteria against which you are evaluating our compliance and for determining that the GIPS standards are appropriate criteria for our purposes.
2. We assert to you that (a) we have complied with all the composite construction requirements of the GIPS standards on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0; (b) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0; and (c) the Firm's policies and procedures are as described in the firm's GIPS policies and procedures documents and have been consistently applied for the periods from January 1, 20X1, to December 31, 20Y0.
3. We assert that we are in compliance with the GIPS standards on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and we have disclosed all known matters contradicting the assertion and any communications from the CFA Institute or regulatory agencies concerning (a) noncompliance with the GIPS standards or our assertion with regard thereto or (b) noncompliance with any other criteria relevant to investment performance, including communications received from January 1, 20Y1 through the date of this letter.

4. We have *[no knowledge of]* *[disclosed to you all information that we are aware of regarding]* (a) actual, suspected or alleged fraud or noncompliance with laws and regulations involving management or employees who have significant roles in the Firm's policies and procedures relating to compliance with the GIPS standards or (b) actual, suspected or alleged fraud or noncompliance with laws and regulations involving others that could have a material effect on the Firm's compliance with the GIPS standards.
5. We have provided you with all relevant information and access.
6. There are no violations or possible violations of laws or regulations, including the Investment Advisers Act of 1940 *(if applicable)*, whose effects should be considered for disclosure in your report or in the composite compliant presentations.
7. We acknowledge responsibility for maintaining sufficient books and records, as required by the GIPS standards and/or applicable regulatory requirements, and we have maintained such records to comply with those requirements.
8. We have disclosed to you any known events that occurred subsequent to the period being reported on and through the date of this letter that would have a material effect on the outcome of the examination.
9. We have disclosed to you all deficiencies in internal control over the Firm's compliance with the GIPS standards of which we are aware.

When also conducting a performance examination, add:

10. We assert that we have constructed *[specify composite(s)]* and calculated the composite performance for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards; and that *[refer to accompanying composite compliant presentation(s)]* of *[specify composite(s)]* for the periods from January 1, 20X1, to December 31, 20Y0, is prepared and presented in compliance with the GIPS standards.

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix C—Illustrative Attest Report: Verification (Reporting Directly on the Subject Matter)

Independent Accountant's Verification Report

Investment Firm
10 Main Street
Anytown, USA

We have examined Investment Firm's (the Firm's) (1) compliance with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0. The Firm's management is responsible for compliance with the GIPS standards and the design of its policies and procedures used to calculate and present performance in compliance with the GIPS standards. Our responsibility is to express an opinion on the Firm's (1) compliance with the composite construction requirements of the GIPS standards and (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards, based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether (1) the Firm complied, in all material respects, with the composite construction requirements of the GIPS standards, and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards, in all material respects. An examination involves performing procedures to obtain evidence about (1) the Firm's compliance with the GIPS standards and (2) the design of its policies and procedures used to calculate and present performance in compliance with the GIPS standards. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks (1) of material noncompliance with the specified requirements, and (2) that the design of the policies and procedures is not suitable for calculating and presenting performance in compliance with the GIPS standards, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Our examination does not provide a legal determination on the Firm's compliance with the specified requirements.

In our opinion, in all material respects

- the Firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0; and
- the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0.

We have not been engaged to examine and did not examine any presentations of the Firm's composites for any period, including any presentations that may

accompany this report, and accordingly, we express no opinion on any such performance.

[Practitioner's Signature]

[Practitioner's City and State]

[Date of Practitioner's Report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix D—Illustrative Attest Reports: Verification and Performance Examination (Reporting Directly on the Subject Matter)

Example 1—Verification and Performance Examination Report Independent Accountant's Verification and Performance Examination Report

Investment Firm
10 Main Street
Anytown, USA

We have examined Investment Firm's (the Firm's) (1) compliance with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0. We have also examined the accompanying [*refer to accompanying composite compliant presentation*] of the Firm's XYZ Composite for the periods from January 1, 20X1, to December 31, 20Y0. The Firm's management is responsible for compliance with the GIPS standards, the design of its policies and procedures used to calculate and present performance in compliance with the GIPS standards, and the [*refer to accompanying composite compliant presentation*]. Our responsibility is to express an opinion on the Firm's (1) compliance with the composite construction requirements of the GIPS standards, (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards, and (3) [*refer to accompanying composite compliant presentation*], based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether (1) the Firm complied, in all material respects, with the composite construction requirements of the GIPS standards, (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards, in all material respects, and (3) the accompanying [*refer to accompanying composite performance presentation*] of the Firm's [XYZ Composite] for the periods from January 1, 20X1 to December 31, 20Y0 is in compliance with the GIPS standards, in all material respects. An examination involves performing procedures to obtain evidence about (1) the Firm's compliance with the composite construction requirements of the GIPS standards, (2) the design of its policies and procedures used to calculate and present performance in compliance with the GIPS standards, and (3) the accompanying [*refer to accompanying composite compliant presentation*]; and performing the procedures for a verification and a performance examination required by the GIPS standards. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks (1) of material noncompliance with the composite construction requirements of the GIPS standards, (2) that the design of the policies and procedures is not suitable for calculating and presenting performance in compliance with the GIPS standards, and (3) of material misstatement of the accompanying [*refer to accompanying composite compliant presentation*], whether due to fraud

or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Our examination does not provide a legal determination on the Firm's compliance with the specified requirements.

In our opinion, in all material respects,

- the Firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0; and
- the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0.

Also, in our opinion, in all material respects, the Firm has

- constructed the XYZ Composite and calculated the XYZ Composite performance for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards; and
- prepared and presented the *[refer to accompanying composite compliant presentation]* of the Firm's XYZ Composite for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards.

This report does not contain an opinion on accuracy of any composite presentation of the Firm other than the *[refer to accompanying composite compliant presentation]* of the Firm's XYZ Composite for the periods from January 1, 20X1, to December 31, 20Y0.

[Practitioner's Signature]
[Practitioner's City and State]
[Date of Practitioner's Report]

Example 1A—Illustrative GIPS-Compliant Presentation for
Report Example 1

Investment Firm
XYZ Composite
January 1, 20X1, to December 31, 20Y0

Year	Composite Gross Return (%)	Composite Net Return (%)	Custom Benchmark Return (%)	Composite 3-Yr St Dev (%)	Benchmark 3-Yr St Dev (%)	Number of Portfolios	Internal Dispersion (%)	Composite Assets (\$ M)	Firm Assets (\$ M)
20X1	−10.5	−11.4	−11.8			31	4.5	165	236
20X2	16.3	15.1	13.2			34	2.0	235	346
20X3	7.5	6.4	8.9			38	5.7	344	529
20X4	1.8	0.8	0.3			45	2.8	445	695
20X5	11.2	10.1	12.2			48	3.1	520	839
20X6	6.1	5.0	7.1			49	2.8	505	1,014
20X7	−21.3	−22.1	−24.9			44	2.9	475	964
20X8	16.5	15.3	14.7			47	3.1	493	983
20X9	10.6	9.5	13.0			51	3.5	549	1,114
20Y0	2.7	1.7	0.4	7.1	7.4	54	2.5	575	1,236

Investment Firm (the Firm) claims compliance with the Global Investment Performance Standards (GIPS® standards) and has prepared and presented this report in compliance with the GIPS standards. The Firm has been independently verified for the periods from January 1, 20X1, to December 31, 20Y0. The verification report is available upon request. Verification assesses whether

(1) the Firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis, and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Notes:

1. The Firm is a balanced portfolio investment manager that invests solely in U.S. securities. The Firm is defined as an independent investment management firm that is not affiliated with any parent organization. Firm policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.
2. The composite includes all institutional balanced portfolios that invest in large-cap U.S. equities and investment-grade bonds with the goal of providing long-term capital growth and steady income from a well-diversified strategy. Although the strategy allows for equity exposure ranging between 50 percent and 70 percent, the typical allocation is between 55 percent and 65 percent. The account minimum for the composite is \$5 million.
3. The custom benchmark is 60 percent YYY U.S. Equity Index and 40 percent ZZZ U.S. Aggregate Bond Index. The benchmark is rebalanced monthly.
4. Valuations are computed and performance reported in U.S. dollars.
5. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Composite and benchmark returns are presented net of nonreclaimable withholding taxes. Net-of-fees returns are calculated by deducting the highest fee of 0.083 percent from the monthly gross composite return. The management fee schedule is as follows: 1 percent on the first \$25 million and 0.60 percent thereafter.
6. This composite was created in February 20X1. A complete list of composite descriptions is available upon request.
7. Internal dispersion is calculated using the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year.
8. The 3-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. The standard deviation is not presented for 20X1 to 20X9 because monthly composite and benchmark returns were not available and is not required for periods prior to 20Y0.

Example 2—Performance Examination Report With a Reference to a Separate Verification Report

Independent Accountant's Performance Examination Report

Investment Firm
10 Main Street
Anytown, USA

We have examined the accompanying¹ [*refer to accompanying composite compliant presentations*] of Investment Firm's (the Firm's) ABC and XYZ

¹ See example 1A for an illustrative composite-compliant presentation that would accompany the report.

Composites for the periods from January 1, 20X1, to December 31, 20Y0. The Firm's management is responsible for these compliant presentations. Our responsibility is to express an opinion on the *[refer to accompanying composite compliant presentations]* based on our examination.

We previously conducted an examination (also referred to as a verification) of the Firm's (1) compliance with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firmwide basis for the periods from January 1, 20X1, to December 31, 20Y0, and (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards as of December 31, 20Y0; our report dated August 7, 20Y1, with respect thereto is attached.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the *[refer to accompanying composite compliant presentations]* is in accordance with the GIPS standards, in all material respects. An examination involves performing procedures to obtain evidence about the *[refer to accompanying composite compliant presentations]*. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the *[refer to accompanying composite compliant presentations]* whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, in all material respects, the Firm has

- constructed the Firm's ABC and XYZ Composites and calculated the composite performance for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards; and
- prepared and presented the *[refer to accompanying composite compliant presentations]* of the Firm's ABC and XYZ Composites for the periods from January 1, 20X1, to December 31, 20Y0, in compliance with the GIPS standards.

This report does not attest to the accuracy of any composite presentation of the Firm other than the Firm's ABC and XYZ Composites.

[Practitioner's Signature]

[Practitioner's City and State]

[Date of Practitioner's Report]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Appendix E—Illustrative Attest Report: Successor Practitioner Report—Verification and Performance Examination

Reporting Directly on the Subject Matter (Verification and Performance Examination Report) in Successor Practitioner's Report When the Predecessor Verifier's Report Is Not Presented

Independent Accountant's Verification and Performance Examination Report

Investment Firm
10 Main Street
Anytown, USA

We have examined Investment Firm's (the Firm's) compliance with the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firmwide basis for the period from January 1, 2011, to December 31, 2011, and (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards as of December 31, 2011. We have also examined the accompanying [*refer to accompanying composite compliant presentation*] of the Firm's XYZ Composite for the period from January 1, 2011, to December 31, 2011. The Firm's management is responsible for compliance with the GIPS standards, the design of its policies and procedures used to calculate and present performance in compliance with the GIPS standards, and the [*refer to accompanying composite compliant presentation*]. Our responsibility is to express an opinion on the Firm's (1) compliance with the specified requirements, (2) design of policies and procedures used to calculate and present performance in compliance with the GIPS standards, and (3) [*refer to accompanying composite compliant presentation*] based on our examination. [*Refer to accompanying composite compliant presentation*] of the Firm's XYZ Composite for the periods from January 1, 2002, to December 31, 2010, was examined by other independent verifiers, whose report is dated August 27, 2011.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether (1) the Firm complied, in all material respects, with the GIPS standards, (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards, in all material respects, and (3) the accompanying [*refer to accompanying composite performance presentation*] of the Firm's [XYZ Composite] for the periods from January 1, 2011 to December 31, 2011 is in compliance with the GIPS standards, in all material respects. An examination involves performing procedures to obtain evidence about (1) the Firm's compliance with the GIPS standards, (2) the design of its policies and procedures used to calculate and present performance in compliance with the GIPS standards, and (3) the accompanying [*refer to accompanying composite compliant presentation*]; and performing the procedures for a verification and a performance examination required by the GIPS standards. The nature, timing, and extent of the procedures selected depend on

our judgment, including an assessment of the risks of (1) material noncompliance with the GIPS standards, (2) that the design of the policies and procedures is not suitable for calculating and presenting performance in compliance with the GIPS standards, and (3) of material misstatement of the accompanying [*refer to accompanying composite compliant presentation*], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, in all material respects

- the Firm has complied with all the composite construction requirements of the GIPS standards on a firmwide basis for the period from January 1, 2011, to December 31, 2011; and
- the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 2011.

Also, in our opinion, in all material respects, the Firm has

- constructed the Firm's XYZ Composite and calculated the composite performance for the period from January 1, 2011, to December 31, 2011, in compliance with the GIPS standards; and
- prepared and presented the [*refer to accompanying composite compliant presentation*] of the Firm's XYZ Composite for the period from January 1, 2011, to December 31, 2011, in compliance with the GIPS standards.¹

We have not been engaged to examine and did not examine the Firm's XYZ Composite for any period prior to January 1, 2011, as shown in the accompanying [*refer to the accompanying composite compliant presentation*], and accordingly, we express no opinion on any such performance.

This report does not attest to the accuracy of any composite presentation of the Firm other than the Firm's XYZ Composite.

[*Practitioner's Signature*]

[*Practitioner's City and State*]

[*Date of Practitioner's Report*]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Investment Performance Standards Task Force

Todd Johnson, *Chair*
Jonathan Boersma
Kimberly S. Cash
Karen Foley
Steve Perazzoli
Kenneth Robinson
John Stomper
Dan Strasshofer
Karyn D. Vincent

¹ See example 1A in appendix D, "Illustrative Attest Reports: Verification and Performance Examination (Reporting Directly on the Subject Matter)," of this Statement of Position for an illustrative composite-compliant presentation that would accompany the report.

AICPA Staff

Charles E. Landes
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Professional Standards and Services

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Audit and Attest Standards

AUD Section 46

Statement of Position 20-1 — Reporting Pursuant to the 2020 Global Investment Performance Standards

January 2020

NOTE

This Statement of Position (SOP) is an interpretative publication, and it represents the recommendations of the AICPA's Investment Performance Standards Task Force regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to engagements to report pursuant to the Global Investment Performance Standards. The Auditing Standards Board (ASB) has found the recommendations in this SOP to be consistent with existing standards covered by the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct.

Interpretative publications are not as authoritative as a pronouncement of the ASB; however, if a practitioner does not apply the attestation guidance included in this SOP, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by this SOP.

Introduction and Background

.01 To promote fair representation, full disclosure, and greater comparability of investment performance, CFA Institute developed the Global Investment Performance Standards (GIPS').¹ Although compliance with the GIPS standards is voluntary, an investment management firm's or asset owner's claim of compliance with the GIPS standards may give current and potential clients, beneficiaries, and oversight boards more confidence in the integrity of the performance presentations and the general practices of a compliant firm or asset owner.

.02 All references to the GIPS standards in this Statement of Position (SOP) refer to the 2020 edition of the GIPS standards. As of the publication date of this SOP, there are three chapters of the 2020 edition of the GIPS standards: the GIPS Standards for Firms, the GIPS Standards for Asset Owners, and the GIPS Standards for Verifiers. The GIPS standards specify that they include any guidance statements, interpretations, and questions and answers published by CFA Institute and the GIPS standards governing bodies.

.03 The GIPS standards require an entity to define itself as a *firm* or *asset owner* and to comply with the applicable chapter of the GIPS standards.

¹ For information on the appropriate use of the Global Investment Performance Standards registered trademark, see the CFA Institute website at www.cfainstitute.org.

- The GIPS standards define a *firm* as an investment firm, subsidiary, or division held out to the public as a distinct business entity.
- The GIPS standards define an *asset owner* as an entity that manages investments, directly and/or through the use of external managers, on behalf of participants, beneficiaries, or the organization itself. Asset owners include, but are not limited to, public and private pension funds, endowments, foundations, family offices, provident funds, insurers and reinsurers, sovereign wealth funds, and fiduciaries. The GIPS Standards for Asset Owners apply to asset owners that do not compete for business by marketing investment performance to prospective clients. Firms and asset owners that compete for business by marketing investment performance to prospective clients must follow the GIPS Standards for Firms.

.04 The GIPS standards recommend that investment firms and asset owners obtain independent third-party verification. The GIPS standards define *verification* as a process in which an independent third party, referred to as a *verifier*, assesses whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been (a) designed in compliance with the GIPS standards and (b) implemented on a firm-wide basis. Verification is intended to provide a firm and its existing and prospective clients and pooled fund investors with greater confidence in the firm's claim of compliance with the GIPS standards. Verification does not provide assurance on the firm's claim of compliance with the GIPS standards in its entirety. The GIPS standards do not include verification or performance examination guidance specific to asset owners and require verifiers to interpret references to firms as also referring to asset owners. All references to firms in this SOP also refer to asset owners, unless otherwise specified.

.05 In addition to verification, a firm may choose to have a verifier perform a specifically focused performance examination of any of the firm's composites or pooled funds and their associated GIPS reports. A GIPS Composite Report is defined as a presentation for a composite that contains all the information required by the GIPS standards and may also include recommended information or supplemental information. A GIPS Pooled Fund Report is defined as a presentation for a pooled fund that contains all the information required by the GIPS standards and may also include recommended information or supplemental information. The term *GIPS reports* refers to both GIPS Composite Reports and GIPS Pooled Fund Reports and, for purposes of this SOP, also refers to GIPS Asset Owner Reports. The GIPS standards permit a report on the performance examination of a composite or a pooled fund and its associated GIPS report to be issued only if a verification report has also been issued.

.06 A verifier may or may not be a CPA. A CPA in public practice hired to perform a verification or performance examination is referred to in this SOP as a *practitioner*. Practitioners are required to perform such engagements pursuant to AT-C section 205, *Examination Engagements*. Only CPAs in public practice can issue a practitioner's report in accordance with AT-C section 205.

Scope

.07 This SOP provides guidance to practitioners for engagements to examine and report on aspects of a firm's claim of compliance with the 2020 edition of the GIPS standards (a verification). It also provides guidance on engagements

to examine and report on any of the firm's composites or pooled funds and their associated GIPS reports (a performance examination).

.08 Although a verification consists of examining aspects of a firm's compliance with the GIPS standards and the design and implementation of certain policies and procedures, CFA Institute requires a statement that verification does not provide assurance on the operating effectiveness of the firm's controls or policies and procedures for complying with the GIPS standards. Accordingly, a verification is not a compliance attestation engagement, as governed by AT-C section 315, *Compliance Attestation*, or an internal controls attestation engagement as governed by AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*.

Transition From the 2010 Reporting Guidance to 2020 Reporting Guidance

.09 Firms complying with the 2010 edition of the GIPS standards must transition to the reporting requirements of the 2020 edition of the GIPS standards when reporting performance in GIPS reports for periods ending on or after December 31, 2020. Early adoption of the 2020 edition of the GIPS standards is permitted. Practitioners conducting verification or performance examination engagements for firms complying with the 2020 edition of the GIPS standards are required by the GIPS standards to conduct the engagement in accordance with the 2020 edition of the GIPS standards. When conducting engagements for firms reporting under the 2010 edition of the GIPS standards, practitioners are required to conduct their verification and performance examination engagements in accordance with the 2010 edition of the GIPS standards and SOP 12-1, *Reporting Pursuant to the 2010 Edition of the Global Investment Performance Standards* (AUD sec. 45). Prior editions of the GIPS standards may be found online at www.gipsstandards.org or www.cfainstitute.org.

Overview of the GIPS Standards

Compliance With the GIPS Standards

.10 The GIPS standards establish both requirements and recommendations for firms to follow when calculating and presenting investment performance. Adherence to the recommendations of the GIPS standards is encouraged. The GIPS standards use the term *must* to indicate requirements and the term *should* to indicate recommendations. The attestation standards established by the AICPA use the terms *must*, *is required*, or *should* to indicate requirements and *may* to indicate recommendations. To avoid confusion, this SOP uses the terms *is required* or *must* to indicate requirements of AT-C sections 105, *Concepts Common to All Attestation Engagements*, and 205 and of the GIPS standards.

.11 For a firm to claim compliance with the GIPS standards, the firm must meet all the requirements of the GIPS standards on a firm-wide basis. Firms are prohibited from claiming compliance "except for ..." or making any other statements that may indicate partial compliance with the GIPS standards.

.12 The GIPS standards require that, when initially claiming compliance with the GIPS standards,

- firms (excluding asset owners) report, at a minimum, 5 years of investment performance for each composite or pooled fund

presented (or performance since inception of the composite or pooled fund if the period since inception is less than 5 years).

- asset owners report, at a minimum, 1 year of investment performance for each total fund or composite presented (or performance since inception of the total fund or composite if the period since inception is less than 1 year).

After the initial presentation of GIPS-compliant performance, the firm or asset owner must add an additional year of performance until a 10-year GIPS-compliant performance record is presented. Thereafter, at a minimum, a 10-year GIPS-compliant performance record must be presented.

.13 Firms are permitted to retroactively construct the initial five-year historical period (or longer) prior to the firm's initial compliance with the GIPS standards using policies and procedures implemented at the time of initial compliance. In such instances, practitioners performing verifications may opine on the implementation of policies and procedures during historical periods because verifications test that the policies and procedures were implemented "for" that period versus "during" that period.

.14 The GIPS standards provide *suitable criteria*, as defined in AT-C section 105, for verifications and performance examinations. The criteria are available to users as they are posted to www.cfainstitute.org. The GIPS standards require verifiers to use the criteria set forth therein. Consequently, practitioners who perform a verification or performance examination pursuant to the GIPS standards are required to understand the GIPS standards, including interpretative guidance.

.15 Practitioners are required to be independent of the firm, in accordance with the AICPA Code of Professional Conduct and the GIPS Standards *Guidance Statement on Verifier Independence*.

Verification

.16 A *verification* tests whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been

- a. designed in compliance with the GIPS standards, and
- b. implemented on a firm-wide basis.

The GIPS standards specify procedures that practitioners are required to perform for a verification.

.17 According to the GIPS standards, when a firm has obtained a verification report, the firm may state that it is verified. This statement may or may not be accompanied by a presentation of performance history for a specific composite. A verification, however, does not imply that the verifiers have examined the accuracy of the performance results of any specific GIPS report that may accompany the verification report (see paragraph .44).

Performance Examination

.18 In addition to a verification, a firm may choose to have a verifier conduct a performance examination. The GIPS standards specify procedures that verifiers are required to perform for a performance examination. A verification is required to be performed prior to, or concurrent with, any performance examination. A firm is not permitted to state that a particular composite or pooled fund and its associated GIPS report have been independently examined with

respect to the GIPS standards unless the firm has also obtained a firm-wide verification report covering the periods of the performance examination. Firms cannot state that a particular composite or pooled fund and its associated GIPS report have been verified or make any claim to that effect.

Verification and Performance Examination Engagements

Engagement Objectives

.19 Practitioners are required to conduct verifications and performance examinations in accordance with attestation standards established by the AICPA. In addition, the GIPS standards specify that these engagements must be conducted in accordance with required verification or performance examination procedures. This SOP is not intended to provide all the required procedures set forth in the GIPS standards or cover all the requirements in the applicable attestation standards established by the AICPA.

.20 For a verification, the practitioner's objective is to express an opinion on whether, in all material respects, the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been

- a. designed in compliance with the GIPS standards, and
- b. implemented on a firm-wide basis.

.21 For a performance examination of a specific composite, the practitioner's objective is to express an opinion on whether, in all material respects, the firm has

- a. constructed the composite and calculated the composite performance in compliance with the GIPS standards, and
- b. prepared and presented the GIPS Composite Report in compliance with the GIPS standards.

.22 For a performance examination of a specific pooled fund, the practitioner's objective is to express an opinion on whether, in all material respects, the firm has

- a. calculated the pooled fund performance in compliance with the GIPS standards, and
- b. prepared and presented the GIPS Pooled Fund Report in compliance with the GIPS standards.

.23 For a performance examination of a specific asset owner total fund or composite, the practitioner's objective is to express an opinion on whether, in all material respects, the asset owner has

- a. constructed the [*total fund or composite*] and calculated the [*total fund or composite*] performance in compliance with the GIPS standards, and
- b. prepared and presented the GIPS Asset Owner Report in compliance with the GIPS standards.

Agreeing on the Terms of the Engagement

.24 The practitioner is required by both AT-C section 205 and the GIPS standards to agree upon the terms of the engagement with the engaging party.

The agreed-upon terms of the engagement are required to be specified in sufficient detail in an engagement letter or other suitable form of written agreement that is required to include the following:

- a. The objective and scope of the engagement, including the period being verified or examined
- b. The responsibilities of the practitioner
- c. A statement that the engagement will be conducted in accordance with attestation standards established by the AICPA and criteria set forth in the GIPS standards
- d. The responsibilities of the responsible party and the responsibilities of the engaging party, if different
- e. A statement about the inherent limitations of a verification or performance examination
- f. A statement that the GIPS standards are the criteria for the engagement
- g. For a verification engagement, a statement that the verification does not provide assurance on the operating effectiveness of the firm's controls or policies and procedures for complying with the GIPS standards
- h. An acknowledgment that the engaging party agrees to provide the practitioner with a representation letter at the conclusion of the engagement

.25 The terms of the engagement may include a statement that if the engaging party intends to use the practitioner's reports or refer to the practitioner in connection with any sales or advertising literature, the engaging party will provide a draft of such literature to the practitioner for the practitioner's review and comment prior to issuance. See exhibit A, "Example Engagement Letter: Verification and Performance Examination," of this SOP for an example engagement letter.

Requesting a Written Assertion

.26 Paragraph .10 of AT-C section 205 requires the practitioner to request from the responsible party a written assertion about the measurement or evaluation of the subject matter against the criteria. When the engaging party is the responsible party and refuses to provide a written assertion, paragraph .82 of AT-C section 205 requires the practitioner to withdraw from the engagement when withdrawal is possible under applicable law or regulation. When the engaging party is not the responsible party, and the responsible party refuses to provide a written assertion, the practitioner need not withdraw from the engagement. In that case, paragraph .84 of AT-C section 205 requires the practitioner to disclose that refusal in the practitioner's report and restrict the use of the report to the engaging party.

Planning the Engagement

.27 Paragraphs .11–.13 of AT-C section 205 requires the practitioner to establish an overall strategy that sets the scope, timing, and direction of the engagement and guides the development of the engagement plan. To develop such a strategy, practitioners need to have sufficient knowledge to enable them to adequately understand the events, transactions, and practices that, in their judgment, have a significant effect on the subject matter or assertion. Such knowledge includes a sufficient understanding of the investment management

industry and the GIPS standards, AICPA interpretive guidance, and applicable laws and regulations regarding the calculation and presentation of investment performance. The GIPS standards also address qualifications for verifiers.

Obtaining Sufficient Appropriate Evidence

.28 To obtain reasonable assurance, the practitioner is required to obtain sufficient appropriate evidence to reduce attestation risk to an acceptably low level and thereby enable the practitioner to draw reasonable conclusions on which to base the practitioner's opinion. Paragraphs .A49–.A52 of AT-C section 205 discuss the attributes of sufficient appropriate evidence.

.29 As noted previously, the GIPS standards specify procedures that practitioners are required to perform for a verification and performance examination of one or more specific composites or pooled funds and their associated GIPS reports. A practitioner may perform other procedures in addition to those specified in the GIPS standards. Regardless of the scope of the engagement, the practitioner is required to obtain sufficient appropriate evidence to provide a reasonable basis for the opinion expressed in the report.

.30 The GIPS standards permit the use of a sampling methodology when performing verification or performance examination procedures. The practitioner may find it helpful to consider the guidance in AICPA Audit Guide *Audit Sampling* when performing procedures that involve the use of sampling.

.31 The GIPS standards specify that a verifier must

- understand the firm's policies and procedures for establishing and maintaining compliance with all the applicable requirements and adopted recommendations of the GIPS standards,
- evaluate whether all applicable policies are properly included and adequately documented,
- determine that the firm's policies and procedures are suitably designed to enable the firm to comply with the GIPS standards, and
- test the firm's compliance with the established policies and procedures.

.32 When a performance examination of one or more composites or pooled funds and their associated GIPS reports is conducted subsequent to, not concurrent with, a verification, the practitioner is required to update the practitioner's understanding of the firm's policies and procedures and inquire about any other changes that may affect the planning and conduct of the performance examination. In addition, the practitioner is required to follow the performance examination procedures required by the GIPS standards.

.33 The period for which a firm can claim compliance with the GIPS standards can be different from the period for which verifications or performance examinations are conducted. The initial minimum period for which a verification can be performed is one year of the firm's presented performance, or from firm inception date to period-end if less than one year. Subsequent verifications may cover any additional time periods, with annual updates being common, and quarterly updates also performed. After the initial verification or performance examination is complete, it is industry practice to append subsequent verification or performance examination periods to the initial period. For example, if an initial verification was completed on a firm from January 1, 2016 to December 31, 2020, the following year's verification period would cover from January 1, 2016 to December 31, 2021. Documentation for each annual engagement is required to indicate the procedures performed supporting the consideration of

prior-period opinions. Such procedures may include inquiries and evaluation of the implication of the findings of current year's procedures for prior periods.

.34 During a verification or performance examination, the practitioner is required to inquire whether the firm is aware of any events subsequent to the period covered by the examination engagement, and to consider information about subsequent events and subsequently discovered facts that come to his or her attention.² Such subsequent events and subsequently discovered facts include circumstances and events that affect prior-period GIPS reports. Errors in prior-period GIPS reports would be assessed in accordance with the firm's error correction policies. If correction of a GIPS report is required by the firm's error correction policy, and the firm does not correct the error, the practitioner is required to consider the implications for the verification and, if applicable, the related performance examination. If the firm corrects or has corrected a GIPS report, the practitioner would perform appropriate testing of material revisions to previously reported information, including disclosures regarding the changes, and would consider the implications on the practitioner's ability to issue his or her report (see paragraph .39).

Representation Letter

.35 The GIPS standards specify that the verifier must obtain a representation letter from the firm before issuing an opinion on a verification or performance examination. The representations for verification and performance examinations can be included in one letter.

.36 Appropriate parties to sign the representation letter are responsible persons with an appropriate level of authority (for example, CEO, CFO, CIO, chief compliance officer, or head of performance). Because the practitioner is concerned with events occurring up to the date of the practitioner's report, the written representations are dated as of the date of the practitioner's report. Management's refusal to furnish all appropriate written representations constitutes noncompliance with the GIPS standards that would preclude the practitioner from rendering an opinion (see paragraph .39).

.37 Paragraph .50 of AT-C section 205 includes a listing of required representations, as do the GIPS standards for both verifications and performance examinations. The GIPS standards require that the representation letter for a verification include, among other representations, confirmation of the firm's assertion that policies and procedures used in establishing and maintaining compliance with the GIPS standards are (a) as described in the firm's policies and procedures, (b) have been designed in compliance with the GIPS standards, and (c) have been implemented on a firm-wide basis for all periods being verified. The representation letter must also include confirmation of the firm's assertion that the firm complies with the GIPS standards for all periods being verified, and any other relevant representations made to the practitioner during the engagement.

.38 Exhibit B, "Example Representation Letter," of this SOP contains an example representation letter that includes required and recommended management representations.

Reporting

.39 The GIPS standards do not permit the issuance of a report with a qualified or an adverse opinion or a disclaimer of opinion for either a verification or

² Paragraphs .48–.49 of AT-C section 205, *Examination Engagements*.

performance examination. After conducting the procedures for a verification or performance examination, the practitioner may conclude that the firm is not in compliance with the GIPS standards, including situations in which the firm's records cannot support a verification or performance examination. In such situations, the GIPS standards specify that the practitioner must inform the firm why it was not possible to issue a verification or performance examination report.

.40 When a performance examination report cannot be issued, the GIPS standards require the practitioner and firm to consider the effect of the practitioner's inability to provide the performance examination report on the firm's claim of compliance with the GIPS standards. The practitioner's inability to provide the performance examination report may also affect the practitioner's ability to issue a verification report.

.41 AT-C section 105 permits the practitioner to report either on the assertion or directly on the subject matter to which the assertion relates. According to AT-C section 205, if the practitioner is reporting on management's assertion, the assertion should be bound with or accompany the practitioner's report, or the assertion should be clearly stated in the report. Reporting directly on the subject matter is industry practice.

.42 AT-C section 205 requires, in part, that the practitioner's report include (a) an identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates, and (b) a description of the nature of an examination engagement. Accordingly, for engagements covered by this SOP, the practitioner is required to clearly indicate in the report whether a verification, performance examination, or both, have been performed. The GIPS standards also require that the report include the periods covered by the verification or performance examination.

.43 Exhibit C, "Illustrative Attest Report: Verification (Reporting Directly on the Subject Matter)," of this SOP presents an illustrative report for a verification. Exhibit D, "Illustrative Attest Reports: Verification and Performance Examination (Reporting Directly on the Subject Matter)," of this SOP presents illustrative reports for a verification and performance examination.

.44 The GIPS standards require that the verification report include a statement indicating that the verification does not provide assurance on any specific performance report (see the verification report in exhibit C of this SOP). This disclaimer is an acknowledgment of the fact that the practitioner cannot control whether the verification report may accompany a GIPS report or other composite or pooled fund presentations distributed by the firm.

.45 The GIPS standards specify that the GIPS report for the specified composites or pooled funds that are the subject of a performance examination report must be included in or attached to the performance examination report. The practitioner may request that the firm's GIPS report for an examined composite or pooled fund disclose that publicly available benchmark returns have not been examined by the practitioner to avoid the implication that the practitioner is providing assurance on the development of the benchmark. The practitioner also should add a paragraph to a performance examination report disclaiming an opinion on GIPS reports or other composite or pooled fund presentations included or attached for any periods that were not examined by the practitioner and stating that the report does not relate to any GIPS reports or composite or pooled fund presentations other than those identified in the report.

.46 If supplemental information is included in the GIPS report for the specified composites or pooled funds that are the subject of a performance

examination report, the GIPS standards also require that the performance examination report include a statement indicating whether or not the performance examination covers the supplemental information.

.47 The GIPS standards require the inclusion of the following statement in a verification or performance examination report: "GIPS' is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein."

.48 When a firm has changed verifiers, and prior periods presented were subject to verification or performance examination by another verifier, the firm may request that the practitioner refer to all verified or examined periods in the practitioner's report. A practitioner may decide to refer to the reports of a predecessor verifier. The successor practitioner would consider the appropriateness of referring to reports on verifications or performance examinations conducted by other verifiers in the specific circumstances. If the successor practitioner decides to refer to the reports of the predecessor verifier, the report would be modified appropriately. Exhibit E, "Illustrative Attest Report: Successor Practitioner Report — Verification and Performance Examination," of this SOP contains an example of a successor practitioner's report referring to the predecessor verifier's verification and performance examination report.

Other Information

.49 If prior to or after the release of the practitioner's performance examination report the practitioner is willing to permit the inclusion of the practitioner's performance examination report in a document containing other information, the practitioner should read the other information to identify material inconsistencies, if any, with the GIPS reports. If upon reading the other information, in the practitioner's professional judgment

- a. a material inconsistency between that other information and the GIPS report exists, or
- b. a material misstatement of fact exists in the other information,

the practitioner should discuss the matter with the firm and take further action as appropriate.³

.50 Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example, the following:

- Requesting the firm to consult with a qualified third party, such as the firm's legal counsel
- Obtaining legal advice about the consequences of different courses of action
- If required or permissible, communicating with third parties (for example, a regulator)
- Withdrawing from the engagement

Effective Date

.51 This SOP is effective upon issuance for engagements reporting on a firm's compliance with the 2020 edition of the GIPS standards.

³ See paragraphs .57 and .A67–.A68 of AT-C section 205.

Appendix

The illustrative verification and performance examination reports in this appendix apply to firms claiming compliance with the 2020 edition of the GIPS standards. The reports are inclusive of a firm's prior compliance with, and prior-year verification and performance examinations performed under, previous editions of the GIPS standards.

Exhibit A — Example Engagement Letter: Verification and Performance Examination

The following is an illustration of an example engagement letter that may be used for this kind of engagement.

[*Practitioner Letterhead*]

[*Client's Name and Address*]

Dear _____:

This will confirm our understanding of the arrangements for our examination of whether the policies and procedures of the Investment Firm (the Firm) related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been (1) designed in compliance with the Global Investment Performance Standards (GIPS[®]) for the periods from January 1, 20X1 to December 31, 20Y0, and (2) implemented on a firm-wide basis for the period from January 1, 20X1 to December 31, 20Y0; this is referred to as a *verification* under the GIPS standards. [*When also conducting a performance examination, add: We have also been engaged to conduct an examination (referred to as a performance examination under the GIPS standards) of [specify composites or pooled funds] and their associated GIPS reports [if relevant, add: and the Firm's presentation of supplemental information included in the GIPS reports (Supplemental Information)] for the periods from January 1, 20X1 to December 31, 20Y0, in compliance with the GIPS standards.*]

Our examination will be conducted in accordance with the attestation standards established by the AICPA and criteria set forth in the GIPS standards. Our responsibility is to express an opinion on the items described above (the subject matter) based on our examination.

Our examination will involve performing procedures to obtain evidence about the subject matter. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks of material misstatement of the subject matter, whether due to fraud or error. A verification does not provide assurance on the operating effectiveness of the firm's controls or policies and procedures for complying with the GIPS standards.

The Firm's management is responsible for the following:

- Selecting the GIPS standards as the criteria against which we will evaluate its compliance and for determining that the GIPS standards are appropriate criteria for its purposes.
- Compliance with all applicable laws, regulations, contracts, and agreements, including the GIPS standards.
- The design, implementation, and monitoring of the policies and procedures upon which compliance is based.
- Making available to us all records and related information relevant to our examination.
- Providing a signed representation letter at the completion of our examination.
- Providing a written assertion about whether

- the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been (1) designed in compliance with the GIPS standards for the periods from January 1, 20X1 to December 31, 20Y0, and (2) implemented on a firm-wide basis for the periods from January 1, 20X1 to December 31, 20Y0;
- *[if examining a composite and its associated GIPS Composite Report]* the Firm has constructed the Example Composite and calculated the Example Composite performance and has prepared and presented the *[refer to accompanying GIPS report]* of the Firm's Example Composite, for the periods from January 1, 20X1 to December 31, 20Y0, in compliance with the GIPS standards;
- *[if examining a pooled fund and its associated GIPS Pooled Fund Report]* the Firm has calculated the Sample Fund performance and has prepared and presented the *[refer to accompanying GIPS report]* of the Firm's Sample Fund, for the periods from January 1, 20X1 to December 31, 20Y0, in compliance with the GIPS standards; and
- *[if applicable]* the Firm's presentation of Supplemental Information is fairly stated in accordance with the measurement and disclosure criteria as set forth in the GIPS reports.

If conditions not now anticipated preclude us from performing our examination procedures and issuing a report, as contemplated by the preceding paragraph, we will advise you promptly and take such action as we deem appropriate.

Working papers that are prepared in connection with this engagement are our property. The working papers are prepared for the purpose of providing principal support for our reports.

As you are aware, there are inherent limitations in the examination process, including, for example, selective testing and the possibility that collusion or forgery may preclude the detection of material errors, fraud, and illegal acts.

Our fees will be billed as work progresses and are based on the amount of time required at various levels of responsibility plus actual out-of-pocket expenses. Invoices are payable upon presentation. We will notify you immediately of any circumstances we encounter that could significantly affect our initial estimate of total fees. The quoted fees assume that you will provide an accumulation of data for the period to be tested and that the records provided to us are clear, concise, and accurate.

In the event we are requested or authorized by management or required by government regulation, subpoena, or other legal process to produce our documents or personnel as witnesses with respect to our engagement, the Firm will reimburse us for our professional time and expenses, as well as any fees and expenses of our counsel, incurred in responding to such requests.

If the Firm intends to use our report in whole or part or refer to *[name of practitioner]* in connection with any sales or advertising literature, a draft of such literature will be provided to us for review and comment prior to issuance.

Either party may terminate this agreement at will with 30 days' notice by delivery of a written termination notice.

If these arrangements are acceptable, please sign one copy of this letter and return it to us. We appreciate the opportunity to serve you.

Very truly yours,

[Name of Practitioner]

Accepted and agreed to:

[Client Representative's Signature]

[Title]

[Date]

Exhibit B — Example Representation Letter

The following illustrative representation letter includes the representations required by paragraph .50 of AT-C section 205, *Examination Engagements*, additional representations required by the Global Investment Performance Standards (GIPS'), and optional representations ordinarily included in representation letters for the engagement described in this SOP.

[Date]

[Name of Practitioner]

We are providing this letter in connection with your examination of whether, for the periods from January 1, 20X1 to December 31, 20Y0, the policies and procedures of the Investment Firm (the Firm) for complying with the GIPS standards related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been (1) designed in compliance with the GIPS standards, and (2) implemented on a firm-wide basis. [When also conducting a performance examination, add: (3) constructed the Example Composite and calculated the Example Composite and Sample Fund performance for the periods from January 1, 20X1 to December 31, 20Y0, in compliance with the GIPS standards, and (4) prepared and presented the GIPS reports for Example Composite and Sample Fund for the periods from January 1, 20X1 to December 31, 20Y0, in compliance with the GIPS standards.]

We confirm, to the best of our knowledge and belief, the following representations made to you during your examinations:

1. We are responsible for whether the policies and procedures for complying with the GIPS standards related to composite and pooled fund maintenance and the calculation and presentation of performance for the periods from January 1, 20X1 to December 31, 20Y0, and to distribution of performance beginning from [insert date], when the firm first claimed compliance with the GIPS standards, to December 31, 20Y0, have been designed in compliance with the GIPS standards and implemented on a firm-wide basis. We further confirm that we are responsible for the selection of the GIPS standards as the criteria against which you are evaluating our compliance and for determining that the GIPS standards are appropriate criteria for our purposes.
2. We assert to you that (a) the policies and procedures for complying with the GIPS standards related to composite and pooled fund maintenance and the calculation and presentation of performance for the periods from January 1, 20X1 to December 31, 20Y0, and to distribution of performance beginning from [insert date], when the firm first claimed compliance with the GIPS standards, to December 31, 20Y0, have been designed in compliance with the GIPS standards and implemented on a firm-wide basis, and (b) the Firm's policies and procedures are as described in the firm's GIPS standards policies and procedures and have been consistently applied for the periods from January 1, 20X1 to December 31, 20Y0.
3. We assert that we are in compliance with the GIPS standards on a firm-wide basis for the periods from January 1, 20X1 to December 31, 20Y0, and we have disclosed all known matters contradicting the assertion and any communications from CFA Institute or regulatory agencies concerning (a) noncompliance with the GIPS standards or our assertion with regard thereto or (b) noncompliance with any other criteria relevant to investment

performance, including communications received from January 1, 20Y1 through the date of this letter.

4. We have *[no knowledge of]* *[disclosed to you all information that we are aware of regarding]* (a) actual, suspected, or alleged fraud or noncompliance with laws and regulations involving management or employees who have significant roles in the Firm's policies and procedures relating to compliance with the GIPS standards or (b) actual, suspected, or alleged fraud or noncompliance with laws and regulations involving others that could have a material effect on the Firm's compliance with the GIPS standards.
5. We have provided you with all relevant information and access.
6. There are no violations or possible violations of laws or regulations, *[if applicable: including the Investment Advisers Act of 1940,]* whose effects should be considered for disclosure in your report or in the GIPS reports.
7. We acknowledge responsibility for maintaining sufficient books and records, as required by the GIPS standards or applicable regulatory requirements, and we have maintained such records to comply with those requirements.
8. We have disclosed to you any known events that occurred subsequent to the period being reported on and through the date of this letter that would have a material effect on the outcome of the examination.
9. We have disclosed to you all deficiencies in internal control over the Firm's compliance with the GIPS standards of which we are aware.

[When also conducting a performance examination, add:]

10. We assert that we have constructed Example Composite and calculated the Example Composite and Sample Fund performance for the periods from January 1, 20X1 to December 31, 20Y0, in compliance with the GIPS standards, and that *[refer to accompanying GIPS reports]* of Example Composite and Sample Fund for the periods from January 1, 20X1 to December 31, 20Y0, is prepared and presented in compliance with the GIPS standards.
11. *[If applicable]* We assert that the Firm's presentation of Supplemental Information is fairly stated in accordance with the measurement and disclosure criteria as set forth in the GIPS reports.

[Name of CEO and Title]

[Name of CFO and Title]

Exhibit C — Illustrative Attest Report: Verification (Reporting Directly on the Subject Matter)

Independent Accountant's Verification Report

Investment Firm
10 Main Street
Anytown, USA

We have examined whether Investment Firm (the Firm) has, for the periods from January 1, 20X1 to December 31, 20Y0, (1) designed policies and procedures for complying with the Global Investment Performance Standards (GIPS') related to composite and pooled fund maintenance and the calculation, presentation, and distribution of performance (the applicable policies and procedures) in compliance with the GIPS standards, and (2) implemented the applicable policies and procedures on a firm-wide basis.

The Firm's management is responsible for its claim of compliance with the GIPS standards and the design of its policies and procedures used for its compliance with the GIPS standards. Our responsibility is to express an opinion on the Firm's design and implementation of the applicable policies and procedures based on our examination. We are also responsible for being independent of the Firm.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, the Firm (1) designed the applicable policies and procedures in compliance with the GIPS standards, and (2) implemented the applicable policies and procedures on a firm-wide basis. An examination involves performing procedures to obtain evidence about the Firm's design and implementation of the applicable policies and procedures. Our examination was also conducted in accordance with the required verification procedures of the GIPS standards, which also include testing performed on a sample basis. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks (1) of material noncompliance with the requirements of the GIPS standards, whether due to fraud or error, and (2) that the design of the applicable policies and procedures is not suitable for compliance with the GIPS standards. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, for the periods from January 1, 20X1 to December 31, 20Y0, the Firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been, in all material respects

- designed in compliance with the GIPS standards, and
- implemented on a firm-wide basis.

We have not been engaged to examine and did not examine any performance reports of the Firm's composites or pooled funds for any period, including any performance reports that may accompany this report and, accordingly, we express no opinion on any such performance. Our examination does not provide assurance on the operating effectiveness of the Firm's controls or policies and procedures for complying with the GIPS standards. GIPS' is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this

organization, nor does it warrant the accuracy or quality of the content contained herein.

[Practitioner's Signature]

[Practitioner's City and State]

[Date of Practitioner's Report]

Exhibit D — Illustrative Attest Reports: Verification and Performance Examination (Reporting Directly on the Subject Matter)

Example 1: Verification and Performance Examination Report on a Composite¹

Independent Accountant's Verification and Performance Examination Report

Investment Firm
10 Main Street
Anytown, USA

We have examined whether Investment Firm (the Firm) has, for the periods from January 1, 20X1 to December 31, 20Y0, (1) designed policies and procedures for complying with the Global Investment Performance Standards (GIPS') related to composite and pooled fund maintenance and the calculation, presentation, and distribution of performance (the applicable policies and procedures) in compliance with the GIPS standards, and (2) implemented the applicable policies and procedures on a firm-wide basis. We have also examined the accompanying [refer to accompanying GIPS report] of the Firm's Example Composite for the periods from January 1, 20X1 to December 31, 20Y0.

The Firm's management is responsible for its claim of compliance with the GIPS standards, the design of its policies and procedures used for its compliance with the GIPS standards, and for the [refer to accompanying GIPS report]. Our responsibility is to express an opinion, based on our examination, on the Firm's design and implementation of the applicable policies and procedures; the construction² of the Example Composite; the calculation of Example Composite performance; and the preparation and presentation of the [refer to accompanying GIPS report]. We are also responsible for being independent of the Firm.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, the Firm (1) designed the applicable policies and procedures in compliance with the GIPS standards, (2) implemented those policies and procedures on a firm-wide basis, (3) constructed³ the Example Composite and calculated the Example Composite performance in compliance with the GIPS standards, and (4) prepared and presented the [refer to accompanying GIPS report] in compliance with the GIPS standards. An examination involves performing procedures to obtain evidence about the Firm's design and implementation of the applicable policies and procedures; the construction⁴ of the Example Composite and calculation of the Example Composite performance; and the preparation and presentation of the [refer to accompanying GIPS report]. Our examination was also conducted in accordance with the required verification and performance examination procedures of the GIPS standards, which also include testing performed on a sample basis. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks

¹ For a performance examination of a pooled fund, the pooled fund would be specified instead of the composite.

² For a performance examination of a pooled fund, the words "construction of the [pooled fund]" would be omitted because the practitioner does not opine on the construction of a pooled fund.

³ See footnote 2.

⁴ See footnote 2.

(1) of material noncompliance with the requirements of the GIPS standards, (2) that the design of the applicable policies and procedures is not suitable for compliance with the GIPS standards, and (3) of material misstatement of the accompanying [*refer to accompanying GIPS report*], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, for the periods from January 1, 20X1 to December 31, 20Y0, the Firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been, in all material respects

- designed in compliance with the GIPS standards, and
- implemented on a firm-wide basis.

Also, in our opinion, for the periods from January 1, 20X1 to December 31, 20Y0, the Firm has, in all material respects

- constructed⁵ the Example Composite and calculated the Example Composite's performance in compliance with the GIPS standards, and
- prepared and presented the [*refer to accompanying GIPS report*] of the Firm's Example Composite in compliance with the GIPS standards.

This report does not attest to the accuracy of any performance presentation of the Firm other than the Firm's Example Composite. Our examination does not provide assurance on the operating effectiveness of the Firm's controls or policies and procedures for complying with the GIPS standards. GIPS[®] is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

[*Practitioner's Signature*]

[*Practitioner's City and State*]

[*Date of Practitioner's Report*]

⁵ See footnote 2.

Example 1A: Illustrative GIPS Composite Report for Example 1

COMPOSITE WITH TIME-WEIGHTED RETURNS									
Spinning Top Investments Large Cap Growth Composite February 1, 2011 to December 31, 2020									
3-Year Std Deviation									
Year	Composite Gross Return TWR (%)	Composite Net Return TWR (%)	Benchmark Return (%)	Composite Gross (%)	Benchmark (%)	Number of Portfolios	Internal Dispersion (%)	Composite Assets (\$ M)	Firm Assets ^(b) (\$ M)
2011 ^(a)	2.18	1.25	1.17			31	n/a	165	n/a
2012	18.66	17.49	15.48			34	2.0	235	n/a
2013	41.16	39.80	33.36			38	5.7	344	n/a
2014	14.50	13.37	13.03	11.30	9.59	45	2.8	445	1,032
2015	6.52	5.47	5.67	12.51	10.68	48	3.1	520	1,056
2016	8.22	7.15	7.09	12.95	11.15	49	2.8	505	1,185
2017	33.78	32.48	30.18	12.29	10.53	44	2.9	475	1,269
2018	-0.84	-1.83	-0.65	13.26	11.91	47	3.1	493	1,091
2019	33.08	31.78	29.76	12.81	11.71	51	3.5	549	1,252
2020	7.51	6.44	6.30	13.74	12.37	54	2.5	575	1,414
(a) Returns are for the period February 1, 2011 to December 31, 2011. (b) Spinning Top Investments acquired the composite through an acquisition of ABC Capital in May 2014. Firm assets prior to 2014 are not presented because the composite was not part of the firm. Disclosures 1. Spinning Top Investments claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS standards. Spinning Top Investments has been independently verified for the periods January 1, 2011 to December 31, 2020. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. 2. Spinning Top Investments is an equity investment manager that invests solely in U.S.-based securities. Spinning Top Investments is defined as an independent investment management firm that is not affiliated with any parent organization. Spinning Top Investments acquired ABC Capital in May 2014. 3. The Large Cap Growth Composite includes all institutional portfolios that invest in large-cap U.S. stocks that are considered to have growth in earnings prospects that are superior to that of the average company within the Example Large Cap Growth Index. Key material risks include the risks that stock prices will decline and that the composite will underperform its benchmark. The account minimum for the composite is \$5 million. Prior to July 2016, the account minimum was \$2 million. Prior to March 2020, the name of the composite was the Growth Composite. 4. Performance prior to May 2014 occurred while the investment management team was affiliated with another firm. The investment management team has managed the composite since its inception, and the investment process has not changed. The historical performance has been linked to performance earned at Spinning Top Investments. 5. The benchmark is the Example Large Cap Growth Index, a market-capitalization-weighted equity index of all U.S. stocks with a market cap greater than \$10 billion and a growth tilt. 6. Returns presented are time-weighted returns. Valuations are computed, and performance is reported in U.S. dollars. 7. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. Composite and benchmark returns are presented gross of nonreclaimable withholding taxes. Net-of-fees returns are calculated by deducting a model management fee of 0.083%, 1/12 of the highest management fee of 1.00%, from the monthly gross composite return. The management fee schedule for separate accounts is as follows: 1.00% on the first \$25 million; 0.60% thereafter. The management fee schedule and total expense ratio for the Large Cap Collective Fund, which is included in the composite, are 0.65% on all assets and 0.93%, respectively. 8. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request. 9. A list of composite descriptions and a list of broad distribution pooled funds are available upon request. 10. The composite was created in November 2011, and the inception date is February 1, 2011. 11. As of January 1, 2014, internal dispersion is calculated using the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year. Prior to 2014, internal dispersion was calculated using asset-weighted standard deviation.									

Example 2: Performance Examination Report With a Reference to a Separate Verification Report**Independent Accountant's Performance Examination Report**

Investment Firm

10 Main Street

Anytown, USA

We have examined the accompanying⁶ [*refer to accompanying GIPS reports*] of Investment Firm's (the Firm's) Example Composite and Sample Fund for the periods from January 1, 20X1 to December 31, 20Y0. The Firm's management is responsible for its claim of compliance with the Global Investment Performance Standards (GIPS') and for the [*refer to accompanying GIPS reports*]. Our responsibility is to express an opinion, based on our examination, on the Firm's (1) construction of the Example Composite and calculation of Example Composite and Sample Fund performance, and (2) preparation and presentation of the [*refer to accompanying GIPS reports*]. We are also responsible for being independent of the Firm. We previously conducted an examination (also referred to as a *verification*) of whether, for the period from January 1, 20X1 to December 31, 20Y0, the policies and procedures of the Firm for complying with the GIPS standards related to composite and pooled fund maintenance and the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards, and implemented on a firm-wide basis; our report dated August 7, 20Y1, with respect thereto is attached.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, the Firm (1) constructed the Example Composite and calculated the performance of the Example Composite and Sample Fund in compliance with the GIPS standards, and (2) prepared and presented the [*refer to accompanying GIPS reports*] in compliance with the GIPS standards. An examination involves performing procedures to obtain evidence about (1) the Firm's construction of the Example Composite and calculation of the performance of the Example Composite and Sample Fund and (2) preparation and presentation of the [*refer to accompanying GIPS reports*]. Our examination was also conducted in accordance with the required performance examination procedures of the GIPS standards, which also include testing performed on a sample basis. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks (1) of material noncompliance with the requirements of the GIPS standards, and (2) of material misstatement of the accompanying [*refer to accompanying GIPS reports*], whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, for the periods from January 1, 20X1 to December 31, 20Y0, the Firm has, in all material respects

- constructed the Firm's Example Composite and calculated the Example Composite and Sample Fund performance in compliance with the GIPS standards, and
- prepared and presented the [*refer to accompanying GIPS reports*] in compliance with the GIPS standards.

⁶ See example 1A, "Illustrative GIPS Composite Report for Example 1" for an illustrative GIPS Composite Report that would accompany the report.

This report does not attest to the accuracy of any performance presentation of the Firm other than the Firm's Example Composite and Sample Fund. Our examination does not provide assurance on the operating effectiveness of the Firm's controls or policies and procedures for complying with the GIPS standards. GIPS⁷ is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

[Practitioner's Signature]

[Practitioner's City and State]

[Date of Practitioner's Report]

Example 3: Verification and Performance Examination Report on an Asset Owner Total Fund⁷

Independent Accountant's Verification and Performance Examination Report

Asset Owner

10 Main Street

Anytown, USA

We have examined whether Asset Owner (the Asset Owner) has, for the periods from January 1, 2011 to December 31, 2020, (1) designed policies and procedures for complying with the Global Investment Performance Standards (GIPS⁷) related to the total fund and composite maintenance and the calculation, presentation, and distribution of performance (the applicable policies and procedures) in compliance with the GIPS standards, and (2) implemented the applicable policies and procedures on an asset-owner-wide basis. We have also examined the accompanying GIPS Asset Owner Report of the Asset Owner's Total Fund (Total Fund GIPS Asset Owner Report) for the period from January 1, 2012 to December 31, 2020, including the Supplemental Information and accompanying notes from January 1, 2020 to December 31, 2020. The Asset Owner is responsible for (1) its claim of compliance with the GIPS standards, (2) the design of the applicable policies and procedures, and (3) the Total Fund GIPS Asset Owner Report. Our responsibility is to express an opinion, based on our examination, on (1) the Asset Owner's design and implementation of the applicable policies and procedures; (2) calculation of Asset Owner Total Fund performance; and (3) preparation and presentation of the Total Fund GIPS Asset Owner Report. We are also responsible for being independent of the Asset Owner.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, the Asset Owner (1) designed the applicable policies and procedures in compliance with the GIPS standards, (2) implemented the applicable policies and procedures on an asset-owner-wide basis, (3) calculated the Total Fund performance in compliance with the GIPS standards, and (4) prepared and presented the Total Fund GIPS Asset Owner Report in compliance with the GIPS standards. An examination involves performing procedures to obtain evidence about (1) the Asset Owner's design and implementation of the applicable policies and procedures for complying with the GIPS standards, (2) the calculation

⁷ For a performance examination of a composite, the composite would be specified instead of the Total Fund.

of the Total Fund performance, and (3) the preparation and presentation of the Total Fund GIPS Asset Owner Report. Our examination was also conducted in accordance with the required verification and performance examination procedures of the GIPS standards, which also include testing performed on a sample basis. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks (1) of material noncompliance with the requirements of the GIPS standards, (2) that the design of the applicable policies and procedures is not suitable for compliance with the GIPS standards, and (3) of material misstatement of the accompanying Total Fund GIPS Asset Owner Report, whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, for the periods from January 1, 2011 to December 31, 2020, the Asset Owner's policies and procedures related to total fund and composite maintenance, as well as the calculation, presentation, and distribution of performance, have been, in all material respects

- designed in compliance with the GIPS standards, and
- implemented on an asset-owner-wide basis.

Also, in our opinion, for the periods from January 1, 2012 to December 31, 2020, the Asset Owner has, in all material respects

- calculated the Total Fund's performance in compliance with the GIPS standards, and
- prepared and presented the accompanying Total Fund GIPS Asset Owner Report in compliance with the GIPS standards.

Additionally, in our opinion, the Supplemental Information for the periods from January 1, 2020 to December 31, 2020, included in the Total Fund GIPS Asset Owner Report has been calculated and presented, in all material respects, in compliance with the methods described in the Supplemental Information accompanying notes.

This report does not attest to the accuracy of any performance presentation of the Asset Owner other than the Total Fund GIPS Asset Owner Report. Our examination does not provide assurance on the operating effectiveness of the Asset Owner's controls or policies and procedures for complying with the GIPS standards. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

[Practitioner's Signature]

[Practitioner's City and State]

[Date of Practitioner's Report]

Exhibit E — Illustrative Attest Report: Successor Practitioner Report — Verification and Performance Examination

Reporting Directly on the Subject Matter (Verification and Performance Examination Report) in Successor Practitioner's Report When the Predecessor Verifier's Report Is Not Presented

Independent Accountant's Verification and Performance Examination Report

Investment Firm
10 Main Street
Anytown, USA

We have examined whether Investment Firm (the Firm) has, for the periods from January 1, 2015 to December 31, 2020, (1) designed policies and procedures for complying with the Global Investment Performance Standards (GIPS') related to composite and pooled fund maintenance and the calculation, presentation, and distribution of performance (the applicable policies and procedures) in compliance with the GIPS standards, and (2) implemented the applicable policies and procedures on a firm-wide basis. We have also examined the accompanying *[refer to accompanying GIPS report]* of the Firm's Example Composite for the periods from January 1, 2020 to December 31, 2020. The Firm's management is responsible for its claim of compliance with the GIPS standards, the design of its policies and procedures, and for the *[refer to accompanying GIPS report]*. Our responsibility is to express an opinion, based on our examination, on the Firm's design and implementation of the applicable policies and procedures, construction of the Example Composite and calculation of Example Composite performance, and preparation and presentation of the *[refer to accompanying GIPS report]*. We are also responsible for being independent of the Firm. A verification covering the periods from January 1, 1999 to December 31, 2014, and a performance examination of the Firm's *[refer to accompanying GIPS report]* for the periods from January 1, 2010 to December 31, 2014, were performed by another independent verifier, whose report, dated August 27, 2015, expressed an unqualified opinion thereon.

Our examination was conducted in accordance with attestation standards established by the AICPA. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether, in all material respects, the Firm (1) designed the applicable policies and procedures in compliance with the GIPS standards, (2) implemented the applicable policies and procedures on a firm-wide basis, (3) constructed Example Composite and calculated Example Composite performance in compliance with the GIPS standards, and (4) prepared and presented the *[refer to accompanying GIPS report]* in compliance with the GIPS standards. An examination involves performing procedures to obtain evidence about (1) the design and implementation of the applicable policies and procedures; the construction of Example Composite and calculation of Example Composite performance; and the *[refer to accompanying GIPS report]*. Our examination was also conducted in accordance with the required verification and performance examination procedures of the GIPS standards, which also include testing performed on a sample basis. The nature, timing, and extent of the procedures selected depend on our judgment, including an assessment of the risks (1) of material noncompliance with the requirements of the GIPS standards, (2) that the design of the applicable policies and procedures is not suitable for compliance with the GIPS standards, and (3) of material misstatement of the accompanying *[refer to accompanying GIPS report]*, whether

due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, for the periods from January 1, 2015 to December 31, 2020, the Firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been, in all material respects

- designed in compliance with the GIPS standards, and
- implemented on a firm-wide basis.

Also, in our opinion, for the periods from January 1, 2020 to December 31, 2020, the Firm has, in all material respects

- constructed the Firm's Example Composite and calculated the Example Composite's performance in compliance with the GIPS standards, and
- prepared and presented the [*refer to accompanying GIPS report*] of the Firm's Example Composite in compliance with the GIPS standards.

We have not been engaged to examine and did not examine the Firm's Example Composite for any periods prior to January 1, 2020, as shown in the accompanying [*refer to the accompanying GIPS report*], and accordingly, we express no opinion on any such performance.

This report does not attest to the accuracy of any performance presentation of the Firm other than the Firm's Example Composite. Our examination does not provide assurance on the operating effectiveness of the Firm's controls or policies and procedures for complying with the GIPS standards. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

[*Practitioner's Signature*]

[*Practitioner's City and State*]

[*Date of Practitioner's Report*]

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AUD Section 55***Statement of Position 13-2 — Performing Agreed-Upon Procedures Engagements That Address the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information*****September 2013****NOTE**

This AICPA Statement of Position (SOP) has been developed by the AICPA XBRL Assurance Task Force of the AICPA Assurance Services Executive Committee to provide guidance regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to engagements in which a practitioner performs and reports on agreed-upon procedures related to the completeness of the XBRL data, mapping of the source information consistency of the XBRL data with the source information or structure of the XBRL data. In this SOP, the source information consists of the financial statements (including notes) and required schedules to be formatted in XBRL. The terms *completeness*, *mapping*, *consistency*, and *structure* as used in this SOP are defined in paragraph .07 of this SOP. This SOP supersedes SOP 09-1, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data*.

This SOP is recognized as an interpretive publication as defined in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the Auditing Standards Board (ASB) after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs. The members of the ASB have found this SOP to be consistent with existing SSAEs.

Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing the attestation engagement because interpretive publications are relevant to the proper application of the attestation standards in specific circumstances.

Introduction and Background

.01 This Statement of Position (SOP) provides practitioners with guidance on performing agreed-upon procedures engagements for issuers submitting XBRL data embedded as part of the Interactive Data File within an HTML document using Inline XBRL and exhibits to the SEC containing eXtensible Business Reporting Language (XBRL) data.^{1, [2]} However, this SOP also may be considered for performing agreed-upon procedures engagements for other applications of XBRL. This SOP supersedes SOP 09-1, *Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data*. [Revised, June 2020, to reflect updates in the XBRL technology.]

SEC Rules

.02 The SEC issued a release, "Interactive Data to Improve Financial Reporting," adopting final rules (SEC rules) that require issuers to submit their financial statements and the related notes and required schedules in interactive data format using XBRL, as an exhibit to their financial statements submitted to the SEC via the Electronic Data-Gathering, Analysis, and Retrieval (EDGAR) system. The SEC issued a release, "Inline XBRL Filing of Tagged Data," adopting amendments to the SEC rules that required the use of the Inline XBRL format. These amendments require issuers to submit their financial statements and the related notes and required schedules and embed a part of the Interactive Data File within an HTML document using Inline XBRL and submit the contextual information about the XBRL tags embedded in the filing as an exhibit to their financial statements submitted to the SEC. [Revised, June 2020, to reflect revised SEC requirements.]

.03 In order for XBRL to be a useful tool for investors and other users of business information, the data contained in XBRL data needs to be accurate and reliable. Preparers of XBRL-formatted information are responsible for providing complete and accurate information in their XBRL data on which investors and other users of business information may rely. For issuers, the SEC rules emphasize the SEC's expectation that preparers of XBRL-formatted information take the initiative to develop practices to promote tagging processes that result in complete and accurate XBRL data. [Revised, June 2020, to reflect updates to XBRL technology.]

.04 The SEC rules^[3] state that, "an auditor will not be required to apply AS 2710 (*Other Information in Documents Containing Audited Financial Statements*), AS 4101 (*Responsibilities Regarding Filings Under Federal Securities Statutes*), or AS 4105 (*Reviews of Interim Financial Information*) (prior to December 31, 2016, AU Sections 550, 711, and 722, respectively) to the interactive data provided as an exhibit in a company's reports or registration statements, or to the viewable interactive data." Although the SEC rules do not require auditor involvement with the XBRL data, issuers may voluntarily obtain third-party services to assist them in assessing the quality of their XBRL data. [Revised, June 2020, to reflect revised PCAOB standards.]

¹ Information formatted in interactive data is referred to herein as "XBRL data." [Footnote revised, June 2020, to reflect updates to XBRL technology.]

^[2] [Footnote deleted, June 2020, to reflect updates to XBRL technology.]

^[3] [Footnote deleted, June 2020, to reflect updates to XBRL technology.]

XBRL Terminology

.05 In this SOP, the term *XBRL-formatted information* (commonly referred to as *tagged information*) means information that has been represented using XBRL and included in one or more electronic files. XBRL is a global standard that provides unique electronically readable codes (tags) representing each item in the financial statements or other business reports.

.06 Taxonomies are dictionaries that contain the terms used in financial statements and other business reports and their corresponding XBRL tags. Taxonomies specify the elements to be used for individual items of information, such as the element for the line item "cash and cash equivalents," and for a group of items, such as narrative disclosures. Taxonomies also identify relationships among terms, (for example, the term *cash and cash equivalents* is related to the term *current assets*). Business rules may be expressed within a taxonomy, such as "gross assets less accumulated depreciation should equal the net assets." Reporting companies may add to the dictionaries of terms, relationships, and business rules (that is, they may extend the taxonomy).

Agreed-Upon Procedures Engagements

.07 Given that management of an entity is responsible for the accuracy and reliability of the XBRL data, including identification of and compliance with the SEC's requirements, management (or other parties, such as the audit committee) may decide to engage a practitioner to provide attestation services to assist it in assessing the quality of its XBRL data, which may include assessing the completeness of the XBRL data (completeness), the mapping of the source information (mapping), the consistency of the XBRL data with the source information (consistency), or the structure of the XBRL data (structure) as defined here:

Completeness of the XBRL data. All required information is formatted at the required level of detail, as defined by the SEC's requirements. Only permitted information is included in the XBRL data.

Mapping of the source information. The elements selected are consistent with the meaning of the corresponding business reporting concepts in the source information in accordance with the SEC's requirements.

Consistency of the XBRL data with the source information. All formatted information in the XBRL data is consistent with the source information and formatted in accordance with the SEC's requirements.

Structure of the XBRL data. XBRL data are structured in accordance with the SEC's requirements.

[Revised, June 2020, to reflect updates to XBRL technology.]

.08 The engagement is performed under AT-C section 215, *Agreed-Upon Procedures Engagements*. Not all of the provisions of AT-C section 215 are discussed in this SOP. Rather, this SOP includes guidance to assist practitioners in applying certain aspects of AT-C section 215 to the subject matter of XBRL data. [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect updates to XBRL technology.]

.09 Because the engaging party (typically management of the entity) best understands its own needs, the engaging party is required to agree to the procedures and acknowledge that the procedures performed are appropriate for the intended purpose of the engagement prior to issuance of the practitioner's agreed-upon procedures report. The practitioner performs the procedures and reports his or her findings. The engaging party and intended users assess for themselves the procedures and findings reported by the practitioner and draw their own conclusions from the work performed by the practitioner. [Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.10] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.11] [Paragraph deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Preconditions for Engagement Performance

.12 A practitioner may perform an agreed-upon procedures engagement described in this SOP provided that

- a. the practitioner is independent, unless the practitioner is required by law or regulation to accept the engagement and report on the subject matter or assertion.⁴
- b. the responsible party is a party other than the practitioner and takes responsibility for the XBRL data.
- c. the engagement exhibits all of the following characteristics:
 - i. The subject matter is appropriate. (Application guidance regarding appropriate subject matter is provided in paragraphs .A36–.A41 of AT-C section 105.)
 - ii. The criteria to be applied in the preparation and evaluation of the subject matter are suitable and will be available to the intended users. (Application guidance regarding suitable and available criteria is provided in paragraphs .A42–.A52 of AT-C section 105.)
 - iii. The practitioner expects to be able to obtain the evidence related to the completeness, mapping, consistency, or structure of the XBRL data needed to arrive at the practitioner's findings, including
 - (1) access to all information of which the responsible party is aware that is relevant to the measurement, evaluation, or disclosure of the subject matter;
 - (2) access to additional information that the practitioner may request from the responsible party for the purpose of the engagement; and
 - (3) unrestricted access to persons within the appropriate party(ies) from whom the practitioner determines it necessary to obtain evidence.

⁴ In these circumstances, the practitioner's report should specifically state that the practitioner is not independent. [Footnote added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

- iv. The practitioner's findings, in the form appropriate to the engagement, is to be contained in a written practitioner's report.
- d. the practitioner determines that the procedures can be performed and reported on in accordance with AT-C section 215.
- e. the engaging party agrees, or will be able to agree, to the procedures and acknowledges that the procedures are appropriate for the intended purpose of the engagement.
- f. the procedures to be applied with respect to the completeness, mapping, consistency, or structure of the XBRL data are expected to result in reasonably consistent findings.
- g. when applicable, the practitioner agrees to apply a threshold for reporting exceptions established by the engaging party. (See the discussion in paragraph .31 of this SOP.)

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect updates to XBRL technology.]

.13 The practitioner should establish an understanding with the engaging party regarding the nature of the engagement, including the following:

- a. The intended purpose of the engagement and the intended users of the agreed-upon procedures report
- b. Whether the practitioner's agreed-upon procedures report is expected to be restricted to the use of specified parties
- c. Whether the engagement to be performed is pursuant to any law, regulation, or contract
- d. Whether parties in addition to the engaging party will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes

[Paragraph added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.14 The practitioner is precluded from accepting an agreed-upon procedures engagement if the practitioner believes the intended purpose of the engagement is not clear or the engaging party will not have a basis for agreeing and acknowledging that the procedures are appropriate for the intended purpose of the engagement. [Paragraph added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.15 There are audit committee preapproval requirements applicable to acceptance of agreed-upon procedures engagements. Such requirements have been established by the SEC, PCAOB, and other regulatory bodies. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.16] [Paragraph renumbered and deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]^[5]

[.17] [Paragraph renumbered and deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

^[5] [Footnote deleted, June 2020, to reflect conforming changes due to the issuance of SSAE No. 19.]

[.18] [Paragraph renumbered and deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Subject Matter

.19 XBRL data subject to agreed-upon procedures engagements are typically as of a specified date and for a specified period (for example, for SEC purposes the XBRL data may be for comparative financial statements in a specific Form 10-K annual report or Form 10-Q quarterly report). It is common for the agreed-upon procedures to be performed on draft, rather than final XBRL data. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect updates to XBRL technology. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.20 Management may engage a third party to assist in the preparation of the XBRL data. In such instances, management remains responsible for the XBRL data and for any representations made by such third party. For example, a service organization may make representations that the XBRL data complies with specified SEC EDGAR Filer Manual (EFM) guidelines. Management is responsible for all representations, including any that are made by third parties. [Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect updates to XBRL technology.]

.21 Criteria are the benchmarks used to measure or evaluate the subject matter. Paragraph .25b(ii) of AT-C section 105 requires that the criteria to be applied in the preparation and evaluation of the subject matter be suitable. Suitable criteria are relevant, objective, measurable, and complete. The agreed-upon procedures to be performed are dependent on the relevant criteria against which the XBRL data are to be evaluated. Examples of criteria include those in the exhibit in *Principles and Criteria for XBRL-Formatted Information*, the SEC rules, and sections of the EFM⁶ that are agreed upon by the specified parties. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect updates to XBRL technology.]

.22 Appendix D, "Illustrative Procedures and Findings," of this SOP presents certain illustrative procedures aligned with the criteria that a practitioner might perform and findings that might be reported as part of an agreed-upon procedures engagement related to the completeness, mapping, consistency, or structure of XBRL-formatted information. The principles and criteria are not designed for measuring compliance with all of the applicable SEC rules and regulations (that is, the EFM includes additional requirements that are not included in this SOP; for example, certain requirements that are checked in an automated manner and those using the SEC's EDGAR XBRL validation process are excluded as well as some SEC requirements related to structure of the XBRL data and format of the information). Therefore, the procedures herein are illustrative and do not represent a complete set of procedures that might be performed in an agreed-upon procedures engagement relating to XBRL-formatted information. [Paragraph renumbered, April 2017, to reflect conforming changes

⁶ Certain sections of the SEC's EDGAR Filer Manual (EFM) may not be objective enough to be considered suitable criteria. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect updates to XBRL technology.]

Agreeing on the Terms of the Engagement

.23 In accordance with paragraph .14 of AT-C section 215, the practitioner should agree upon the terms of the engagement with the engaging party. The agreed-upon terms of the engagement should be specified in sufficient detail in an engagement letter or other suitable form of written agreement. The agreement should include the following:

- a.* The nature of the engagement established pursuant to paragraph .13 of this SOP.
- b.* Identification of the subject matter and the responsible party.
- c.* The responsibilities of the practitioner.
- d.* A statement that the engagement will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants.
- e.* A statement that the responsible party is responsible for the subject matter.
- f.* A statement that the engaging party agrees to provide the practitioner, prior to the completion of the engagement, with a written agreement and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement.
- g.* A statement that the engaging party agrees to provide, at the conclusion of the engagement, a representation letter.
- h.* If known at the onset of the engagement, an identification of any other parties, in addition to the engaging party, that will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes. If the request is expected to be made by the engaging party, a statement that the engaging party agrees to provide, at the conclusion of the engagement, a written representation that the engaging party has obtained from all necessary other parties agreement to the procedures and acknowledgment that the procedures performed are appropriate for their purposes.
- i.* If the engaging party is not the responsible party, a statement that written representations may be requested from the responsible party.
- j.* Reference to the expected form and content of the practitioner's agreed-upon procedures report, including any use restrictions, if applicable.
- k.* Disclaimers expected to be included in the practitioner's report, if applicable.
- l.* Assistance to be provided to the practitioner, if applicable.
- m.* Involvement of a practitioner's external specialist, if applicable.
- n.* Specified thresholds for reporting exceptions, if applicable.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.24 Other matters that the practitioner may wish to include in the written terms of the engagement addressed by this SOP are statements

- identifying any timing sensitivities in the performance of the procedures or delivery of the report.
- acknowledging management's responsibility for
 - compliance with the SEC's requirements including those related to the completeness, mapping, consistency, and structure of the entity's XBRL data and its assertions thereon.
 - providing accurate and complete information to the practitioner.
- indicating that the practitioner has no responsibility for the completeness or accuracy of the information provided to the practitioner.
- the circumstances under which the practitioner may decline to issue a report.

An illustrative engagement letter is presented in appendix B, "Illustrative Engagement Letter," of this SOP.

[Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect updates to XBRL technology. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Nature, Timing, and Extent of Procedures

Responsibilities of Management

.25 Management is responsible for both the completeness and accuracy of the source information and compliance with the SEC's requirements, including those related to the completeness, mapping, consistency, and structure of its XBRL-formatted information. That responsibility encompasses

- a. identifying the applicable XBRL-formatted information filing requirements of the SEC.
- b. establishing and maintaining controls relating to the preparation and submission of the entity's XBRL-formatted information to the SEC.
- c. evaluating the completeness, mapping, consistency, and structure of the entity's XBRL-formatted information.
- d. providing XBRL-formatted information in a form and manner that satisfies the SEC's requirements.

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Responsibilities of the Practitioner

.26 In accordance with paragraph .32a of AT-C section 105, the engagement partner should be satisfied that the engagement team, and any practitioner's external specialists, collectively, have the appropriate competence, including knowledge of the subject matter, and capabilities to

- comply with professional standards and applicable legal and regulatory requirements and
- enable the issuance of a practitioner's report that is appropriate in the circumstances.

That knowledge would include an understanding of XBRL and a familiarity with the applicable XBRL taxonomies used, knowledge of the SEC rules and requirements (including permitted taxonomies, such as the permitted version of the U.S. GAAP or IFRS Taxonomies), as well as knowledge of the source information and supporting records.⁷ [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect updates to XBRL technology. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Procedures to Be Performed

.27 The practitioner should perform procedures agreed-to and acknowledged by the engaging party to meet the intended purpose of the engagement as established with the engaging party. However, mere reading about specified information about the XBRL-formatted information does not constitute a procedure sufficient to permit a practitioner to report on the results of applying agreed-upon procedures. In some circumstances the procedures evolve or are modified during the course of the engagement. Paragraph .17 of AT-C section 215 states that the practitioner should not perform procedures that are open to varying interpretations or use vague or ambiguous language. Examples of appropriate procedures are included in appendix D of this SOP. Examples of inappropriate procedures include the following:

- Merely reading a description of the services performed by a third party involved in the preparation of XBRL-formatted information (for example, by a service provider)
- Evaluating the competence or objectivity of another party involved in preparing or in providing assistance in the preparation of the XBRL-formatted information
- Obtaining an understanding about XBRL-related requirements⁸

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

⁷ Practitioners performing engagements for audit clients may have specific knowledge of the underlying source information and supporting records and may possess a level of expertise that would significantly lessen the range of judgment needed in performing procedures related to the XBRL-formatted information. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

⁸ Although the practitioner may need to obtain an understanding of XBRL-related requirements, obtaining such an understanding is not in itself an agreed-upon procedure (see paragraph .28 of this SOP). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

Involvement of a Specialist⁹

.28 Generally, the use of a specialist would not be necessary. However, if specialized matters were included in the engagement that required expertise beyond that possessed by the practitioner (such as compliance with certain highly technical aspects of the EFM), the practitioner and the engaging party should explicitly agree to the involvement of a practitioner's external specialist if assisting the practitioner in the performance of the agreed-upon procedures engagement. This agreement may be reached when agreeing upon the terms of the engagement or as part of obtaining the engaging party's agreement to the procedures and acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement. The practitioner's report should describe the nature of the assistance provided by the practitioner's external specialist. [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.29 A practitioner may apply procedures to the report or work product of a practitioner's external specialist that does not constitute assistance by the external specialist to the practitioner in an agreed-upon procedures engagement. For example, the practitioner may reference information contained in a report of a practitioner's external specialist in describing a procedure. However, it is inappropriate for the practitioner to merely read the external specialist's report solely to describe or repeat the findings or to take responsibility for all or a portion of any procedures performed by a practitioner's external specialist or the external specialist's work product. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Reporting Considerations

.30 A practitioner's report on agreed-upon procedures should be in the form of procedures and findings. The practitioner should not provide negative assurance in his or her report about the completeness, mapping, consistency, or structure of the XBRL data. For example, the practitioner should not include a statement that "nothing came to our attention that caused us to believe that the assertion is not fairly stated in accordance with the criteria." [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect updates to XBRL technology. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.31 The practitioner should report all findings from the application of the agreed-upon procedures. If the engaging party has established a threshold for reporting exceptions, the practitioner should describe such threshold in the practitioner's report. [Paragraph renumbered and revised, April 2017, to reflect

⁹ A practitioner's specialist is an individual or organization possessing expertise in a field other than accounting or attestation, whose work in that field is used by the practitioner to assist the practitioner in the performance of the agreed-upon procedures engagement. A practitioner's specialist may be either a practitioner's internal specialist (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm) who does not participate in the engagement or a practitioner's external specialist. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.32 The practitioner's report on agreed-upon procedures should include all of the following:

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant.
- b. An appropriate addressee as required by the circumstances of the engagement.
- c. Identification of the engaging party.
- d. An identification of the subject matter to which the procedures have been applied.
- e. Identification of the responsible party, including a statement that the responsible party is responsible for the subject matter. When the engaging party is not the responsible party and identification of the responsible party and its responsibility for the subject matter is based solely on representations received from the engaging party, the practitioner's agreed-upon procedures report should include a statement to that effect.
- f. A statement that the engaging party acknowledged that the procedures performed are appropriate to meet the intended purpose of the engagement.
- g. An identification of the intended purpose of the engagement in sufficient detail to enable the user to understand the nature of the work performed.
- h. A statement that the practitioner's report may not be suitable for any other purpose.
- i. A statement that the procedures performed may not address all the items of interest to a user of the report and may not meet the needs of all users of the report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.
- j. A statement that an agreed-upon procedures engagement involves the practitioner performing specific procedures that the engaging party has agreed to and acknowledged to be appropriate for the intended purpose of the engagement and reporting on findings based on the procedures performed.
- k. A description of the procedures performed detailing the nature and extent, and if applicable, the timing of each procedure.
- l. A description of the findings from each procedure performed, including sufficient details on exceptions found.
- m. If applicable, a description of any specified threshold established by the engaging party for reporting exceptions. (Refer to the discussion in paragraph .31 of this SOP.)
- n. A statement that
 - i. the agreed-upon procedures engagement was conducted in accordance with the attestation standards established by the AICPA.
 - ii. the practitioner was not engaged to and did not conduct an examination or review, the objective of which would be

- the expression of an opinion or conclusion, respectively, on the subject matter.
- iii. the practitioner does not express such an opinion or conclusion.
 - iv. had the practitioner had performed additional procedures, other matters might have come to the practitioner's attention that would have been reported.
- a. A statement that the practitioner is required to be independent of the responsible party and to meet the practitioner's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the agreed-upon procedures engagement.
 - p. If applicable, a description of the nature of the assistance provided by a practitioner's external specialist.
 - q. When applicable, reservations or restrictions concerning procedures or findings.
 - r. The manual or printed signature of the practitioner's firm.
 - s. The city and state where the practitioner's report is issued.
 - t. The date of the report.

An illustrative report is presented in appendix E, "Illustrative Agreed-Upon Procedures Report," of this SOP.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.33 The practitioner should consider whether to include an alert, in a separate paragraph, that restricts the use of the practitioner's agreed-upon procedures report, taking into account the understanding with the engaging party regarding the nature of the engagement. [Paragraph added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.34 If the practitioner determines to include an alert, in a separate paragraph, that restricts the use of the practitioner's report, such alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.35 The report should be dated no earlier than the date on which the practitioner completed the procedures and determined the findings, including that

- a. the attestation documentation has been reviewed, and
- b. if applicable, the written presentation of the subject matter has been prepared.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.36] [Paragraph renumbered and deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Explanatory Language in the Practitioner's Agreed-Upon Procedures Report

.37 The practitioner may include explanatory language in the practitioner's agreed-upon procedures report related to matters such as the following:

- Disclosure of stipulated facts, assumptions, or interpretations (including the source thereof) used in the application of agreed-upon procedures
- Description of the condition of records, controls, or data to which the procedures were applied
- Explanation that the practitioner has no responsibility to update his or her report
- Explanation that the sample may not be representative of the population
- Explanation that the procedures performed do not address all of the SEC's requirements for XBRL submissions
- Explanation that the XBRL data and source information may be updated prior to filing with the SEC. Accordingly, the findings in the report may not correspond to the final XBRL data submitted.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Revised, June 2020, to reflect updates to XBRL technology. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Adding Other Specified Parties After the Release of the Practitioner's Report

.38 When the practitioner issues a report that includes an alert restricting the use of the practitioner's report to certain specified parties, and the engaging party subsequently requests the practitioner to add an additional specified party, the practitioner should determine whether to add the additional specified party. As part of this determination, the practitioner should consider whether

- a. the additional specified party has acknowledged or will be requested to acknowledge that the procedures performed are appropriate for their purposes. If the practitioner determines that the acknowledgment is necessary, the practitioner should either obtain such acknowledgment directly from the additional specified party or obtain a representation from the engaging party that the additional specified party has agreed to the procedures and acknowledged that the procedures performed are appropriate for their purposes, and
- b. the report will be reissued to identify the additional specified party.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.39 If the practitioner provides a written acknowledgment to the engaging party and the additional party that such party has been added as a specified party, the practitioner should state in the acknowledgment that no procedures were performed subsequent to the original date of the practitioner's agreed-upon procedures report. [Paragraph added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.40] [Paragraph renumbered and deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Written Representations

.41 In accordance with paragraph .27 of AT-C section 215, the practitioner should request from the engaging party written representations in the form of a letter addressed to the practitioner. The representations should include

- a. a statement that the responsible party is responsible for the subject matter.
- b. if applicable, a statement that the engaging party has obtained from all necessary parties agreement to the procedures and acknowledgment that the procedures are appropriate for their purposes.
- c. a statement that it has provided the practitioner with all relevant information and access, as applicable, as agreed upon in the terms of the engagement.
- d. a statement that all known matters contradicting the subject matter and any communication from regulatory agencies or others affecting the subject matter have been disclosed to the practitioner, including communications received between the end of the period addressed by the subject matter and the date of the practitioner's report.
- e. a statement that it is not aware of any material misstatements in the subject matter.
- f. a statement that it has disclosed to the practitioner all known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter.
- g. any additional representations that the practitioner deems are appropriate.

An illustrative representation letter is presented in appendix C, "Illustrative Representation Letter," of this SOP.

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

.42 When the engaging party is not the responsible party, in addition to requesting representations from the engaging party, paragraph .28 of AT-C section 215 requires the practitioner to consider requesting the relevant written representations pursuant to paragraph .27 of AT-C section 215 from the responsible party in the form of a letter addressed to the practitioner. [Paragraph added, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Requested Written Representations Not Provided or Not Reliable

.43 When one or more of the written representations that the practitioner has requested pursuant to paragraphs .27–.28 of AT-C section 215 are not provided, or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner should do the following:

- a. Discuss the matter with the engaging or responsible party, as appropriate
- b. Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general
- c. If any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's agreed-upon procedures report

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Knowledge of Matters Outside Agreed-Upon Procedures

.44 Although the practitioner need not perform procedures beyond the procedures agreed to and acknowledged by the engaging party to be appropriate for the intended purpose of the engagement, if, in connection with the application of the procedures, and through the completion of the engagement, matters come to the practitioner's attention by other means that significantly contradict the subject matter referred to in the practitioner's report, the practitioner should discuss the matter with the engaging party and take appropriate action, including determining whether the practitioner's report should be revised to disclose the matter (for example, if during the course of performing agreed-upon procedures that address XBRL-formatted financial statements and the related notes and required schedules submitted in Inline XBRL format and as an exhibit to the SEC, the practitioner becomes aware by means other than performing the agreed upon procedures that a calculation linkbase has been omitted, the practitioner should discuss the matter with the engaging party and determine whether to include this matter in the practitioner's report). [Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect revised SEC requirements.]

Effective Date

.45 This SOP is effective for any XBRL agreed-upon procedures engagements accepted subsequent to the issuance of this SOP. [Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

[.46]

[Appendix A — Illustrative Management Assertions]

[Paragraph renumbered and deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Appendix B — Illustrative Engagement Letter

This appendix presents an illustrative engagement letter^[1] for the agreed-upon procedures engagement described in this SOP (engagement described in this SOP addresses the completeness, mapping, consistency, or structure of an entity's XBRL-formatted financial statements and the related notes and required schedules submitted in Inline XBRL format and as an exhibit to the SEC). It is intended to be illustrative only.

In this illustrative engagement letter, management and the audit committee of XYZ Company are the engaging and responsible party. The procedures are known at the onset of the engagement and the engaging party acknowledges that the procedures to be performed are appropriate for the intended purpose of the engagement in the engagement letter.

[CPA Firm Letterhead]

[Client's Name and Address]

To Management and the Audit Committee of XYZ Company:

This will confirm our understanding of the arrangements for our performance of certain agreed-upon procedures related to *[identify subject matter and criteria]* (for example, the completeness of the XBRL data, mapping of the source information to the XBRL data, consistency of the XBRL data) with the source information and the structure of the XBRL data related to the *[identify source information and period]* (for example, the Company's [Quarterly or Annual] Report on Form [10-K or 10-Q] for the period ended *[identify date]* to be submitted to the Securities Exchange Commission [SEC]) in accordance with the *Principles and Criteria for XBRL-Formatted Information*).

You agree to the procedures enumerated in the attachment to this letter and acknowledge that the procedures to be performed are appropriate for the intended purpose of the engagement. Our responsibility is to carry out these procedures and report our findings. We will conduct our engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants.²

Management is responsible for both the completeness and accuracy of the source information and compliance with the SEC's requirements including those related to the completeness of the XBRL data, mapping of the source information to the XBRL data, consistency of the XBRL data with the source information, structure of the XBRL data, and for the information provided to us. Management also is responsible for the design, implementation, effectiveness, and monitoring of controls over the preparation and submission of XYZ Company's XBRL data. It is understood that we make no representation regarding the completeness or accuracy of the source information provided to us during this engagement.

^[1] [Footnote renumbered and deleted, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

² Although not required, the practitioner may include a statement such as the following to clarify the practitioner's responsibility for the appropriateness of the procedures:

It is understood that we make no representation regarding the appropriateness of the procedures described in the attachment for the purpose for which this report has been requested or for any other purpose.

[Footnote added, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

You agree to provide, at the conclusion of our engagement, written confirmation concerning representations made to us in connection with the agreed-upon procedures engagement.

Our engagement to perform agreed-upon procedures is substantially less in scope than an examination or review, the objective of which is the expression of an opinion or conclusion, respectively, on management's assertion regarding the XBRL data. Accordingly, the report will not express an opinion or any other form of assurance thereon and if additional procedures were to be performed, other matters might have come to our attention.

At the completion of the agreed-upon procedures, we expect to issue a report that will state the procedures performed and the findings from those procedures. If, however, we are not able to complete all of the specified procedures, we will so advise you. Our report will include an alert that restricts its use to the audit committee and management of the Company.

[Discuss other practitioner-specific matters, such as billing arrangements.]

If this letter correctly expresses your understanding of this engagement, please sign the enclosed copy where indicated and return it to us.

Sincerely,

[Firm Name or Firm Representative's Signature]

Accepted and agreed to by XYZ Company

[Client Representative's Signature (such as Name of Chief Financial Officer)]

[Title]

[Date]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect revised SEC requirements and updates to XBRL technology.]

Appendix C — Illustrative Representation Letter

This appendix includes an illustrative representation letter for the agreed-upon procedures engagement described in this SOP (agreed-upon procedures that address the completeness, mapping, consistency, or structure of an entity's XBRL-formatted financial statements and the related notes and required schedules submitted in Inline XBRL format and as an exhibit to the SEC). This representation letter is illustrative only and is not intended to be applicable to all engagements. In addition, it may not include items that are relevant to a specific engagement.

[Date]

To [CPA Firm]:

We are providing this letter in connection with the performance of certain agreed-upon procedures related to [identify subject matter and criteria (for example, the completeness of the XBRL data, mapping of the source information to the XBRL data, consistency of the XBRL data)] with the source information and structure of the XBRL data related to the [identify source document and period (for example, the Company's [Quarterly or Annual] Report on Form [10-K or 10-Q] for the period ended [identify date] to be submitted to the Securities Exchange Commission [SEC])]. We confirm that we are responsible for the XBRL data relating to our financial statements and the related notes and required schedules^[1] and for compliance with the SEC's requirements including those related to the completeness, mapping, consistency, and structure of XYZ Company's XBRL data and its assertions thereon, and for the completeness and accuracy of information provided to you, including the source information. We also confirm that we are responsible for selecting the criteria specified in the procedures and for determining that such criteria and procedures are sufficient for our purposes.

We confirm, to the best of our knowledge and belief, as of [identify date of agreed-upon procedures report], the following representations made to you during your agreed-upon procedures engagement.

1. The XBRL data related to the [identify source information and period (for example, the Company's [Quarterly or Annual] Report) on Form [10-K or 10-Q] for the period ended [identify date] to be submitted to the Securities Exchange Commission (SEC)] (XBRL data) are in compliance with the SEC's requirements including, but not limited, to the following:
 - a. **Completeness of the XBRL data.** All required information is formatted at the required levels of detail, as defined by the SEC's requirements. Only permitted information is included in the XBRL data.
 - b. **Mapping of the source information.** The elements selected are consistent with the meaning of the corresponding business reporting concepts in the source information in accordance with the SEC's requirements.

^[1] [Footnote deleted, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

- [Name of Chief Financial Officer and Title]

² If this representation letter is obtained subsequent to the issuance of the underlying financial statements, a representation such as the following may be appropriate: "We are not aware of any communication from any regulatory agencies regarding the financial statements or previously submitted XBRL exhibits, and no material modifications exist that need to be made to the financial statements." [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect revised SEC requirements and updates to XBRL technology.]

Appendix D — Illustrative Procedures and Findings

This appendix presents a table that includes illustrative procedures that a practitioner might perform and findings that a practitioner might report as part of the agreed-upon procedures engagement described in this SOP (agreed-upon procedures that address the completeness, mapping, consistency, or structure of XBRL-formatted financial statements (including notes) and required schedules submitted in Inline XBRL format and as an exhibit to the SEC). These procedures are illustrative only and do not represent a complete set of procedures that might be performed in any specific engagement. In addition, they do not necessarily address every attribute associated with a particular management assertion.

The following items provide additional information about the procedures, the reporting of findings, and sources of information about SEC requirements regarding XBRL-formatted information.

1. Certain agreed-upon procedures may appear in the following table under one assertion, but may be relevant to more than one assertion; however, each procedure would only need to be performed once.
2. As indicated in paragraph .31 of this SOP, the practitioner should report and describe all differences, exceptions, and other findings noted during the application of the agreed-upon procedures as part of his or her findings, unless they are below any specified threshold established by the engaging party for reporting exceptions described in the practitioner's report.
3. In planning for the execution of such an agreed-upon procedures engagement, the practitioner may find it useful to perform additional activities to assist in gaining an understanding of the entity's formatting approach. Examples of such activities may include
 - inquiring of management to gain an understanding of its overall formatting and validation process,¹ including software applications or third-party providers used, and relevant experience and knowledge of those involved with the XBRL reporting process.
 - requesting management to provide a list of known differences between its XBRL data and the SEC requirements.
4. Certain of these procedures may be performed using XBRL software (for example, analysis, querying, validation).² Accordingly, as part of tailoring the procedures to a specific agreed-upon procedures engagement, management might agree to or specify the

¹ Various software applications or third party providers used may produce different reports or present information in a different manner, which may affect the timing, nature, and performance of procedures. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

² The XBRL US Center for Data Quality has developed validation rules which are aimed to help reduce common input errors by filers. These rules are incorporated into the US GAAP Taxonomy and can be run by various software applications. When the rules identify a potential error, they provide detailed information on the potential error with guidance on how to correct it. [Footnote added, June 2020, to reflect updates to XBRL technology.]

use of a particular XBRL software product and version for performing such procedures.

5. The SEC provides requirements for the proper formatting of the XBRL data and maintains electronic systems to receive, validate, and process the XBRL data. Filers are responsible for compliance with these requirements and are encouraged to make a test submission of the XBRL data prior to submission to the SEC to reduce the likelihood of the exhibit not being accepted by the SEC systems.³
6. This table provides some references to relevant guidance in the SEC's EDGAR Filer Manual (EFM) Version 53.⁴ The most current document is available on the SEC's website at <http://xbml.sec.gov> and is updated frequently.

Illustrative Procedures and Findings for an Agreed-Upon Procedures Engagement that Addresses the Completeness, Mapping, Consistency, or Structure of XBRL-Formatted Information

	Principles and Criteria ^[5]		Procedure		Finding
Completeness of the XBRL Data — All required information is formatted at the required levels of detail as defined by the SEC's requirements. Only permitted information⁶ is included in the XBRL data.					
A	All information that is required to be formatted as defined by the SEC's requirements is formatted at the appropriate levels of detail in the XBRL data	C1	Inspect the XBRL data ⁷ to ascertain whether each of the following items in the source information is included in the XBRL data and is formatted at the level of detail noted in the following list:	C1	All such items in the [identify source information] that were required to be formatted as defined by the SEC's requirements were included in the XBRL data and formatted at the level of detail indicated [except as follows: <i>list facts</i>].

(continued)

³ The SEC's validation system checks only a subset of the requirements and should not be considered a method to measure compliance with all of the requirements. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

⁴ Future updates to the EFM could result in changes to the requirements, which could affect the procedures that the client might request be performed. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

^[5] [Footnote renumbered and deleted, June 2020, to reflect updates to XBRL technology.]

⁶ In a case in which an entity elects to format permitted information in addition to the required information, preparers should consider the level of detail to format such information so that it is not misleading to the user of the XBRL files. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

⁷ Inspection of the XBRL data may take different forms (for example, different XBRL analysis software may be used to view, manipulate or export the data into various forms for analysis). Alternatively, a mapping worksheet that is prepared by the entity prior to finalizing the XBRL data for submission may be used; in this case additional procedures would be necessary to ascertain whether the selected elements in the mapping worksheet are the same as those included in the final XBRL data. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
A (1)	All information (including parenthetical information) on the face of the financial statements in the source information ⁸ is formatted in the XBRL data, including facts that represent zero or do not have amounts.		● Each amount on the face of the financial statements (including "0" and amounts represented by numbers or words and including amounts in parentheses and amounts in superscript⁹ footnotes) ● Each line item on the face of the financial statements that represents no value (for example, commitments and contingencies¹⁰ for which there is only disclosure and no value) ● Each heading in the financial statements is formatted as an abstract element		
A (2)	All required document and entity information (DEI) is formatted in the XBRL data.		● Each required document and entity information concept is formatted		

⁸ Source information for purposes of submission to the SEC is the electronic or paper-based financial statements, including the notes; required schedules under Regulation S-X; and document and entity information (DEI) (which includes document type, document period end date, registrant name, central index key (CIK), fiscal year end date, public float, fiscal year, fiscal period, filer category, and reporting status as well as an indication of whether an amendment flag exists [if so, include a description of the reason for the amendment], whether the filer is not required to file reports, and whether the filer is a well-known seasoned issuer). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

⁹ Text that is included at the bottom of the page or table that is preceded by a superscript number or symbol which represents a footnote. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

¹⁰ Business reporting concepts that have no value for all periods, such as commitments and contingencies, must have the nil attribute set to "true." [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
A (3)	Each complete note and required schedule under Regulation S-X are formatted separately using a text block element.		- Each note to the financial statements is formatted using a text block element - Each schedule required by Regulation S-X is formatted using a text block element		
A (4)	Each significant accounting policy (whether included in the accounting policies note or elsewhere within the notes to the financial statements) is formatted separately using a text block ¹¹ element.		Each significant accounting policy, identified by management (whether included in the accounting policies note or other notes to the financial statements), is formatted using a text block element		
A (5)	Each table within each note is formatted separately using a text block element.		Each table within each note is formatted using a text block element		

(continued)

¹¹ The U.S. GAAP Taxonomy has adopted a convention for distinguishing among text block elements intended for use in tagging accounting policies, tables, and disclosures. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
A (6)	Each amount ¹² disclosed in the notes and required schedules under Regulation S-X (including amounts written as words) is formatted separately.		● Each amount¹³ in the notes that is represented in numbers or words (including "0" and amounts in parentheses and amounts in superscript footnotes) ● Each amount in the schedules (including "0" and amounts in parentheses and amounts in superscript footnotes) that is represented in numbers or words ● Amounts which appear more than once and represent the same accounting concept for the same entity (dimensionality is consistent) are tagged consistent with the SEC requirements for tagging of duplicate facts.		
A (7)	Each amount included in the superscript footnotes is formatted separately.		<i>Preceding bullets address this criterion.</i>		

¹² Not all amounts are required to be formatted (for example, there is no need to format the "2" in "2 percent milk") (See SEC Compliance and Disclosure Interpretation 146.16 located on the SEC's website for additional examples). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

¹³ Optional information may be formatted to provide more context to individual amounts. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
A (8)	Text that is shown on the face of the financial statements at the bottom of the page preceded by a superscript is formatted using XBRL footnote links. ¹⁴		Text immediately following each superscript footnote number on the face of the financial statements is formatted using a footnote link		
B	The XBRL data contain only facts or presentation or calculation relationships that are included in the source information and other required or permitted information (such as DEI ¹⁵ required by the SEC) and contain only unused elements and linkbase information that are used intermittently unless otherwise prohibited. ¹⁶	C2	Compare the tagged facts in the XBRL data to the source information and identify any tagged facts that are not included in the source information other than other required (for example, DEI) or permitted information (for example, definitions for extension elements).	C2	All tagged facts that were included in the XBRL data were in the source information or otherwise permitted [except as follows: <i>describe elements and relationships</i>].
Mapping of the source information — The elements¹⁷ selected are consistent with the meaning of the corresponding business reporting concepts in the source information in accordance with the SEC's requirements.					

(continued)

¹⁴ The EFM requires this only for the face of the financial statements. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

¹⁵ DEI includes information that may be outside of the financial statements such as the number of outstanding shares of a company's stock that is in the hands of public investors, as opposed to company officers, directors, or controlling-interest investors (public float) and CIK. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

¹⁶ The entity may carry forward unused elements or presentation, definition, or calculation relationships in the taxonomy that are used intermittently in the XBRL data (for example, taxonomies may reflect elements or relationships used in XBRL data for annual financial statements [Form 10-K] but not used in the XBRL data for quarterly financial statements [Form 10-Q]). Used elements or relationships refer to those used in the XBRL data. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

¹⁷ Elements include line items and combinations of line items, domain members, and axes. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
C	Elements used in the XBRL data, considering their attributes; ¹⁸ definitions (for example, documentation labels in the label linkbase); and references are consistent with the corresponding business reporting concepts in the underlying source information.	M1	For each element used in the XBRL data, compare the following aspects of the element to the nature of the business reporting concept in the source information: ● Reference ● Period type (that is, instant, duration) ● Data type (for example, block text, monetary value, or other numeric value) ● Other attributes (that is, documentation labels and standard labels in the label linkbase, and abstract true/false)	M1	All such aspects of the elements used in the XBRL data reflect the nature of the business reporting concepts in the [identify: source information] [except for the following: list elements and describe differences].
C (1)	Headings in the source information are represented as abstract elements.		<i>Procedures C1 and M1, listed previously, address this criterion.</i>		<i>See findings under C1 and M1, listed previously.</i>

¹⁸ The "basic element attributes" include (a) abstract, (b) data type (that is, whether the content is expected to conform to a certain type of content, such as block text, a monetary value, or other numeric value), (c) period type (that is, whether it is a point in time or a period of time), and (d) balance type (that is, whether it is normally a debit or a credit). The balance attribute is currently not a primary consideration in selecting elements in the SEC program. The SEC's EFM 6.6.29 provides guidance for the order in which the attributes take precedence when selecting the most appropriate element. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered and revised, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
D	The most specific elements or dimensional combination of elements across the entire taxonomy whose attributes; definitions (for example, documentation labels in the label linkbase); and references are consistent with the corresponding business reporting concepts have been used.	M2	Search the taxonomy for any elements and any combination of elements for which element aspects (that is, references, documentation labels, and standard labels in the label linkbase) that reflect more specifically ¹⁹ the corresponding business reporting concept without violating the criteria for element selection (aspects of elements as listed previously in procedure M1).	M2	No elements from the [specify taxonomy ²⁰] for which references, definitions, and standard labels in the label linkbase may more specifically reflect the corresponding business reporting concepts in the [identify: source information] were noted. Or The following elements from the [specify taxonomy] for which definitions and standard labels in the label linkbase, and references more specifically reflect the corresponding business reporting concepts in the [identify: source information and list the elements and the business reporting concepts].

(continued)

¹⁹ This may include identifying more detailed elements. For example, in the case of a concept on the financial statements for short-term investments available for sale, the entity used the short-term investments element in the XBRL data; however, the practitioner may identify short-term investments available for sale as a more specific element. There may be some situations that require the exercise of a level of judgment that may not be appropriate for an agreed-upon procedure engagement. In such cases, the practitioner should not make the judgment but should lay out the facts. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and updates to XBRL technology.]

²⁰ This procedure may be performed against a standard taxonomy (for example, U.S. GAAP Taxonomy as documented in the EFM) or against the extension taxonomy of the XBRL data (incorporating extension elements). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered and revised, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
D (1)	Certain elements required for use by the SEC (for example, DEI elements or elements for reporting consolidating entities) have been used if applicable.	M3	From the list of required elements per the SEC's EFM (sections 6.5.20, 6.5.21, 6.6.3 through 6.6.10, and 6.5.45 for Inline XBRL filings) pertaining to ● consolidations and legal entities, ● stock classes, and ● document and entity (and cover page)-related information trace the required elements for business reporting concepts included in the source information to inclusion in the XBRL data.	M3	Required elements for business reporting concepts pertaining to consolidations and legal entities, stock classes, and document and entity-related information included in the source information were included in the XBRL data [except for the following elements: <i>list elements not included</i>].
E	Use of selected elements is permitted (for example, the selected element is not deprecated)	M4	Search the XBRL data to identify the elements ²¹ in the XBRL data that have a deprecated label in the standard taxonomy.	M4	The XBRL data do not contain any elements that have deprecated labels in the standard taxonomy [except the following elements used in the XBRL data: <i>list elements</i>].

²¹ The procedure to be performed addresses the situation of deprecated elements; however, there may be other conditions where elements are not permitted. Procedures to address other examples are not included in this SOP because they may be automatically tested with software. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
F	The same business reporting concepts appearing multiple times in the source information are formatted once using the same elements or combination of elements throughout the XBRL data, when appropriate. ²²	M5	For business reporting concepts appearing more than once in the source information (including those concepts with values reported for more than one period), search the XBRL data for use of more than one element for the same business reporting concept except when alternative line item and domain member combinations are prescribed by related guidance or if the application of guidance related to duplicates under the Inline XBRL specification specifies a particular treatment.	M5	No items were noted in which a different element was used for the same business reporting concept appearing more than once or for different periods [except as follows: <i>describe, for example, cash appearing on the balance sheet was tagged with a different element (or combination of elements) than cash appearing on the cash flow statement</i>].
G	The same elements are used consistently to report the same business reporting concepts, including for each period for which such concepts appear in the underlying source information. ²³		<i>Procedure M5, listed previously, addresses this criterion.</i>		<i>See findings in M5, listed previously.</i>

(continued)

²² Exceptions exist when business reporting concepts will be formatted using different line item and domain member combinations, or when the related guidance requires different elements to be used based on the level of granularity of the source data being formatted (for example, in situations where concepts must use both dimensional and nondimensional approaches, such as Treasury stock presented on the balance sheet without dimensions and then presented on the statement of stockholders' equity with dimensions). The appropriate use of duplicate elements should be considered, and redundantly formatted facts should be eliminated. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

²³ Although the source information may contain different values (for example, positive, negative, or zero) in one period as compared with another (for example, net income [loss]) or represent an ending balance in one period and the beginning balance in the next, the same element should be used in all periods presented. Notwithstanding, there may be certain situations in which the taxonomy may include different elements to reflect positive and negative values (for example, certain elements relating to tax assets and tax liabilities in the U.S. GAAP Taxonomy). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
H	Extension elements are created only when both of the following conditions are met: no suitable elements exist in the selected taxonomy, and extensions are permitted in accordance with the SEC's rules.		<i>Procedures M1, M2, and M3, listed previously, address this criterion.</i>		<i>See findings from M1, M2, and M3, listed previously.</i>
I	Definitions, if provided (for example, documentation labels in the label linkbase) for extension elements used in the XBRL data, are consistent with the source information.		<i>Procedure M1, listed previously, addresses this criterion.</i>		<i>See findings from M1, listed previously.</i>
Consistency of the XBRL Data With the Source Information — All formatted information²⁴ in the XBRL data is consistent with the source information and formatted in accordance with the SEC's requirements.					
J	Formatted amounts in the XBRL data reflect the entire numbers of the corresponding business reporting concepts (that is, the XBRL amounts are not scaled ²⁵).	CO1	For each amount tagged in the XBRL data, compare such information with the amount of the corresponding business reporting concept in the source information to identify any amount that does not reflect the entire number.	CO1	All amounts in the XBRL data reflect the entire number of the corresponding business reporting concept [except for the following elements: <i>list elements and describe differences</i>].

²⁴ Formatted information includes data (for example, amounts, text, dates); contextual information (for example, monetary units); and relationships (for example, presentation order and calculations). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

²⁵ Amounts in financial statements are often presented in various formats (for example, rounded to millions) and may represent a different scale. However, amounts formatted in XBRL must be entered without such presentational formatting. For example, 23.5 million would be entered as 23500000, 14.3 percent would be entered as .143. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
		CO2	For Inline XBRL data, for each date, time, ordinal number, symbol that represents a true/false value or textual number, compare the format attribute to the approved list of transformations specified by the SEC. ²⁶	CO2	No differences were noted in the transformations used in the XBRL data as compared to the standard list of format attributes specified by the SEC <i>[except for the following format attributes in the XBRL data: list elements and describe any differences]</i> .
K	Formatted amounts have the appropriate signs based on the nature of the values in the source information, balance attributes, and definitions (documentation labels in the label linkbase) of the elements.	CO3	For negative amounts in the XBRL data, that have been tagged with elements whose definitions or standard labels do not include terminology identified in the table in the SEC's Staff Observations (SEC table) ²⁷ (for example, increase/decrease, gain/loss, provided by/used in) within the definition (documentation label in the label linkbase) or standard label, compare the sign ²⁸ to the nature of the value of the corresponding business reporting concepts in the source information.	CO3	The signs for negative amounts for elements with definitions or standard labels that do not include terminology from the SEC table are consistent with the nature of the value of the corresponding business reporting concepts in the <i>[identify: source information]</i> <i>[except for the following: list elements]</i> .

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²⁶ The SEC's EFM 5.2.5.12 provides the Inline XBRL transformation registries supported by EDGAR and lists a set of format attributes with content input values that will provide the XBRL formatted amount. [Footnote added, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

²⁷ Under the heading "Negative Values" in the SEC's *Staff Observations from the Review of Interactive Data Financial Statements (from December 13, 2011)* is a table in which the SEC staff provides examples of language included in definitions or standard labels of elements that can be negative. This is not necessarily a complete list, therefore, the practitioner and preparer may agree to extend this procedure beyond the elements that have definitions or labels that contain specified language included in the table. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

²⁸ Identified negative amounts may not be an error; however, they likely require further assessment by management. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
		CO4	For elements for which the definition (documentation label in the label linkbase) or standard label includes terminology identified in the SEC table, compare the sign for each amount in the XBRL data to the nature of the value of the corresponding business reporting concept in the source information.	CO4	The signs for the formatted amounts in the XBRL data of elements for which the definitions or standard labels includes terminology in the SEC table are consistent with the nature of the value of the corresponding business reporting concepts in the <i>[identify: source information]</i> [except for the following: <i>list elements and describe differences in signs</i>].
L	All text, dates, and uniform resource identifiers in the XBRL data are consistent with the underlying source information.	CO5	For text, dates, and uniform resource identifiers (URIs) tagged in the XBRL data, compare such information with the corresponding concepts in the source information.	CO5	No differences for text, dates, and URIs in the XBRL data as compared with <i>[identify source information]</i> were noted [except for the following elements: <i>list elements and describe differences</i>].
L (1)	Nil attribute ²⁹ is used only to convey business reporting concepts reported that have no amounts associated but are not zero (for example, commitments and contingencies).	CO6	For each business reporting concept in the source information that represents no value (associated with it) inspect whether the nil attribute for the corresponding element is set to true in the XBRL data.	CO6	Nil attributes were set to true in the XBRL data for each concept in the <i>[identify source information]</i> for which no value is associated [except for the following elements: <i>list elements</i>].

²⁹ A nil attribute is used only for elements in the XBRL data and presentation to convey business reporting concepts that have no amounts, text, dates, or uniform resource identifiers in the source information. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered and revised, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
		CO7	For each element in the XBRL data for which the nil attribute is set to true, identify those elements that represent business reporting concepts other than commitments and contingencies and preferred stock. ³⁰	CO7	For none of the elements in the XBRL data other than commitments and contingencies and preferred stock was the nil attribute set to true. Or Elements in the XBRL data other than commitments and contingencies and preferred stock for which the nil attribute is set to true include <i>[list elements]</i> .
M	Extension elements included in the XBRL data for monetary amounts include debit or credit balance attributes or documentation labels with an indication of the meaning of positive or negative values, when applicable, that are consistent with the nature of the business reporting concepts in the underlying source information.	CO8	For each line item in the XBRL data that has an extension element with a monetary type and a balance (debit / credit) attribute, compare the balance attribute to the nature of the business reporting concept in the source information.	CO8	No monetary type line item extension elements were noted that contain a balance attribute (or definition, as applicable) that is inconsistent with the nature of the business reporting concepts in the <i>[identify source information]</i> [except for the following elements: <i>list elements and describe differences from the source information</i>].

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³⁰ Management may specify other appropriate concepts for which the nil attribute would be set to true and modify this procedure to include such other appropriate concepts. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
			and not a balance (debit / credit) attribute, inspect the elements for a definition (that is, documentation label) that includes an indication of the meaning of a positive or negative value (for example, "A positive adjustment value indicates a net increase in accounts receivable") and compare such definition to the nature of the business reporting concept in the source information.		
M (1)	Extension elements included in the XBRL data for monetary amounts of balance sheet or income statement concepts include balance attributes (debit or credit) that are consistent with the nature of the underlying source information.	CO9	Identify the monetary type extension elements included in the XBRL data for monetary amounts presented in the balance sheet or income statement that do not include balance attributes. <i>[Procedure CO8 (first bullet), in combination with this procedure addresses this criterion.]</i>	CO9	No such items were noted for monetary amounts presented on the balance sheet and income statement that do not include balance attributes [except the following elements: <i>list extension elements and describe differences</i>]. <i>Also see findings for CO8.</i>

	Principles and Criteria		Procedure		Finding
N	The context periods ³¹ are consistent with the source information (for example, second calendar quarter 2012 is expressed as "2012-04-01 to 2012-06-30").	CO10	For each business reporting concept that appears on the face of the financial statements or in tables in the source information, compare the reporting period (implied and explicitly stated) to the corresponding context period in the XBRL data.	CO10	No differences were noted in the XBRL data relating to context periods for concepts appearing on the face of the financial statements or in tables in the <i>[identify source information]</i> [except for the following elements: <i>list elements and describe differences</i>].
		CO11	For business reporting concepts within narrative text (for example, in the notes), compare the "as of" or period dates in the source information to the dates ³² in the context period of the corresponding elements in the XBRL data. • For amounts with a period type of instant – if a date is specified in the notes (for example, "as of" or "on"), ascertain whether the date for the context period in the XBRL data is the date specified in the source information.	CO11	No differences were noted in the XBRL data relating to context periods for business reporting concepts included with narrative text in the <i>[identify source information]</i> [except for the following context periods: <i>list elements and describe differences</i>]

(continued)

³¹ Context periods for a roll-forward format use the same "instant" context for the beginning balance as for the ending balance of the previous period. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

³² Procedures may be tailored, as appropriate, for application to periods included in the source information in addition to those listed. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
			- if the month is specified (for example, March), ascertain whether the date for the context period in the XBRL data is the last day of that month. - if the quarter is specified (for example, in the second quarter), ascertain whether the date for the context period in the XBRL data is the end date for that quarter. ● For amounts that have a period type of duration - if the month is specified (for example, March), ascertain whether the date for the context period in the XBRL data is first and last day of the month. - if the quarter is specified (for example, in the second quarter), ascertain whether the date for the context period in the XBRL data is the first and last day of the quarter.		

	Principles and Criteria		Procedure		Finding
N (1)	The required DEI elements use the Required Context. ³³	CO12	Compare the contexts used in the XBRL data for DEI to those required by the SEC's EFM (sections 6.5.20 and 6.5.21) pertaining to DEI.	CO12	The context in the XBRL data used for DEI elements agreed with the context required by sections 6.5.20 and 6.5.21 of the SEC's EFM [except the following elements for which the context did not use the Required Context: <i>list elements</i>].
O	The decimal attribute values are consistent with the degree of accuracy of the amounts as represented in source information (for example, 23.5 million is rounded to the hundred thousandths).	CO13	For each amount in the XBRL data compare the value of the decimal attribute (for example, "-6") to the corresponding degree of accuracy represented in the source information.	CO13	No differences were noted between the decimal attribute values in the XBRL data and the degree of accuracy represented in the [identify source information] [except for the following decimal attributes in the XBRL data: <i>list elements and describe differences</i>].
P	The units defined in the XBRL data are consistent with the measurements represented in the source information (for example, U.S. dollars are defined as "iso4217:USD", as properly defined in XBRL Specification 2.1).	CO14	For each amount included in the XBRL data, compare the units (including custom units) to the standard list of units specified by the SEC (for example, in the International Organization for Standardization (ISO) currency codes, or the XBRL International Unit Registry).	CO14	No differences were noted in the units used in the XBRL data as compared to the standard list of units specified by the SEC [except for the following units in the XBRL data: <i>list elements and describe any differences</i>].
		CO15	For each amount included in the XBRL data, compare the units (including custom units) to the nature of the corresponding unit in the source information.	CO15	No differences were noted in the units used in the XBRL data as compared to the source information [except for the following units in the XBRL data: <i>list elements and describe any differences</i>].

(continued)

³³ The *Required Context* is defined in the EFM as the context when the dates cover the current reporting period and no segment or scenario information (that is, dimensional information) is included. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
Q	The entity identifier in the XBRL data properly represents the reporting entity [for example, central index key (CIK)] in accordance with the SEC requirements.	CO16	Compare the identifier(s) used in the XBRL data to the registrant's unique CIK code.	CO16	The CIK code used in the XBRL data agrees with the registrant's CIK code. Or The following <i>[identify CIK code(s)]</i> were used in the XBRL data that did not agree with the registrant's CIK code.
Q (1)	Only one CIK code is used throughout the XBRL data.	CO17	Search the contexts for the use of more than one CIK code in the XBRL data.	CO17	Only one CIK code was used in the XBRL data. Or The following <i>[identify CIK codes]</i> were used in the XBRL data.
R	The format and layout of the text block information are consistent ³⁴ with the format and layout of the content in the source information.	CO18	Compare the format and layout of the text block information in the XBRL data to the form and layout in the source information (for example, content, indentations, italics, bold, color, order).	CO18	No differences were noted in the format and layout of text block information in the XBRL data as compared to the <i>[identify source information]</i> [except for the following elements: <i>list elements and describe differences</i>].
S	The order and hierarchy (that is, arrangement of appropriate abstracts and line items) reflected in the presentation linkbase are consistent ³⁵ with the SEC's requirements.	CO19	Compare the order and hierarchy of the elements in the presentation linkbase with the source information.	CO19	No differences were noted in the order and hierarchy of the elements in the presentation linkbase as compared to the <i>[identify source information]</i> [except for the following: <i>list elements and describe differences</i>].

³⁴ The EFM requires the same format and layout in text blocks as in the source information. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

³⁵ When using dimensions to format information, it may not be possible to present this information in the same order and hierarchy (for example, transposed or intermingled axes for line items and domain members may occur). [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
T	Labels ³⁶ are consistent ³⁷ with the captions or meanings in the source information, as applicable.	CO20	Compare labels for line item elements (with no dimensions) reflecting business reporting concepts on the face of the financial statements or in tables in the source information to the captions in the source information Compare labels for all other tagged facts with the corresponding business reporting concept in the source information.	CO20	No differences other than those permitted ³⁸ were noted with the label information of elements appearing in the rendering as compared to the [identify source information] [except for the following: list elements and describe differences].
		CO21	Compare standard "en-US" labels used for each extension element in the XBRL data to the labels of other elements in the XBRL data and the standard taxonomy to ascertain whether duplicate standard English labels "en-US" are used.	CO21	No duplicate standard "en-US" labels were noted [except for the following extension elements: list elements with duplicate standard en-US labels].

(continued)

³⁶ Labels in the label linkbase under the SEC rules must be the same as the captions in the source information, including parenthetical information. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

³⁷ Consistent means the same as the printed captions in the source information, when required, or within the scope of variances otherwise permitted. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

³⁸ EFM 6.11.3 requires additional information be included in the label for certain elements within a presentation group to distinguish the units in those elements where the majority of the elements within the group use a different unit. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
T (1)	The appropriate label roles (in the label linkbase) are specified in presentation groupings and are consistent with the source information, as applicable. (For example, negated labels are used to reverse the sign of numeric values for presentation purposes.)	CO22	Compare the preferred label roles in the XBRL data with the presentation of the corresponding business reporting concept in the source information and the following requirements: ● For period type of "instant": - A Period Start label role was used when concepts were presented as a beginning of a roll forward (for example, cash balances) - A Period End label role was used when concepts were presented as an ending of a roll forward (for example, cash balances) ● Total label role must be used when representing concepts presented as a summation of other line items ● Negated label roles were used when necessary to reverse the sign of the numeric value for presentation purposes to correspond to the business reporting concept as presented in the source information.	CO22	No differences were noted for the preferred label roles as compared to the presentation of the corresponding business reporting concept in the source information and the label requirements [except for the following: <i>list elements and labels and describe differences</i>].

	Principles and Criteria		Procedure		Finding
U	Calculations reflected in the source information are included in the calculation linkbase in accordance with the SEC's requirements to the extent possible within the technical limitations ³⁹ of XBRL.	CO23	For those subtotals/totals that have two or more line items in the source information with amounts in the same context and within the dates represented by the period of the Required Context ⁴⁰ (no dimensional information), compare such relationships with the corresponding calculation relationship in the XBRL data.	CO23	No differences in the calculation relationships were noted in the XBRL data as compared to the source information [except for the following business reporting concepts: <i>list business reporting concepts and describe differences</i>].
Structure of the XBRL data — XBRL data are structured⁴¹ in accordance with the following listed criteria.					
V	Taxonomies, including versions, referenced in the XBRL data are permitted by the SEC's requirements.	S1	Compare the taxonomies used in the XBRL data to the list of permitted taxonomies at www.sec.gov/info/edgar/edgartaxonomies.shtml .	S1	We noted that the taxonomy(ies) used in the XBRL data is (are) permitted according to the SEC website. Or We noted that the taxonomy(ies) used in the XBRL data is (are) not permitted according to the SEC website.
W	Presentation groupings are consistent with the titles and order of the components of the underlying source information and in accordance with the SEC's requirements.		<i>Procedures S2 and S3, listed subsequently, address this criterion</i>		<i>See findings under S2 and S3.</i>

(continued)

³⁹ Due to current limitations of XBRL, calculations cannot be performed across different contexts; accordingly, it is currently not possible to include such calculations in the XBRL data. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered and revised, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

⁴⁰ See definition of Required Context in footnote 33. Although not required, additional calculations outside of the required context are permitted. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

⁴¹ It is beyond the scope of these principles and criteria to include all applicable rules, regulations and technical requirements related to the intended purpose of the XBRL submissions. Notwithstanding, preparers are responsible for identification of and compliance with all of the SEC's requirements and a preparer may choose to request that a practitioner perform procedures with respect to such requirements. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
W (1)	Separate note presentations groupings (base sets) are created for each required level (I, II, III, and IV) and ordered in accordance with the SEC's requirements	S2	Compare the existence and order of the base sets in the presentation linkbase to the financial statement and note whether they appear in order of the source information and the ordering requirements as described in the SEC's EFM (section 6.7.12) as follows: 1. Each financial statement followed by a base set for the parentheticals within the statement [<i>in order of statements</i>] 2. Notes (text block) [<i>order of notes</i>] 3. Schedules (text block) 4. Significant accounting policies (policies) 5. Notes (tables) 6. Notes (detail) 7. Schedules (detail)	S2	The order of the presentation base sets in the presentation linkbase agreed to the [<i>identify source information</i>] and the EFM requirements [except for the following base sets: <i>list base sets and describe differences</i>].
W (2)	Titles of presentation groupings are in accordance with the SEC's formatting requirements.	S3	Compare base set titles (role type definition link) in the presentation linkbase to the SEC formatting requirements ⁴² for the following: 1. Formatting pattern: {SortCode} - {Type} - {Title} (for example: 01 - Statement - Statement of Income) 2. Titles of statements and notes in the source information	S3	No differences were noted with respect to the base set titles [except the following: <i>list base sets and describe how they did not conform to or agree with the SEC formatting requirements</i>].

⁴² This is not a complete list of all SEC formatting requirements. Refer to EFM for requirements. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
X	The entity scheme (for example, www.sec.gov/CIK) for each context throughout the XBRL data is in accordance with the SEC's requirements.	S4	For each context, compare the entity scheme to http://www.sec.gov/CIK .	S4	We noted that the entity scheme http://www.sec.gov/CIK was used in all contexts [except for the following: <i>list contexts and describe differences</i>].
Y	New table structures are only created when no suitable table structure exists in the applicable standard taxonomy's definition linkbase.	S5	Compare the table structures in the definition linkbase (that is, table, axis, domain member, line item) to the predefined table structures ⁴³ in the standard taxonomy's definition linkbase.	S5	No new table structures were created when a suitable table structure existed [except for the following: <i>list contexts and describe differences</i>]. No differences were noted in table structures as compared to the predefined table structures in the [specify taxonomies] [except for the following tables: <i>list tables and describe differences</i>].
Z	The names of extension elements contain no prohibited information.		<i>Procedure S6, in the following row, addresses this criterion.</i>		<i>See findings under S6.</i>
Z (1)	The names of extension elements (excluding domain members) do not include company- or period-specific information.	S6	Search the element name of each extension element (excluding domain members) for company or period specific information within the element name.	S6	No such elements were noted that have company or period specific information within the element name [except for the following elements: <i>list elements and describe differences</i>].

(continued)

⁴³ Dimensional structures in the definition linkbase of the standard taxonomy contain ordered combinations of tables, axes, line items, and domain members. Definition linkbases for extension taxonomies should include dimensional structures from the standard taxonomy's definition linkbase when they exist. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

	Principles and Criteria		Procedure		Finding
AA	The XBRL data include all files required by the SEC (for example, an instance, schemas and linkbases).	S7	Inspect the XBRL data to ascertain whether there is only one of each of the following files ⁴⁴ included: ● Instance document or HTML, as appropriate⁴⁵ ● Presentation linkbase ● Label linkbase ● Calculation linkbase ● Schema ● Definition linkbase	S7	Only one of each of the required files was included. Or The following files were missing: <i>[list files]</i> Or Multiple schema files were included.
BB	The language of the information in the XBRL data uses a permitted (or required) language (for example, English).		<i>Procedures S8 and S9, in the following rows, address this criterion.</i>		<i>See findings under S8 and S9.</i>
BB (1)	Elements must include fact values and labels expressed in U.S. English.	S8	For each fact in the source information in a language other than U.S. English, ascertain whether the corresponding formatted information in the XBRL data has values and labels expressed in U.S. English.	S8	No items were noted in which business reporting concepts in the source information in a language other than U.S. English were not formatted in the XBRL data with values and labels expressed in U.S. English [except for the following concepts: <i>list concepts and describe differences</i>].
		S9	Search extension elements in the XBRL data for any that do not have a standard English "en-US" label.	S9	No elements were noted in the XBRL data that did not have a standard "en-US" label [except for the following elements: <i>list elements and describe differences</i>].

[Paragraph renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect revised SEC requirements and updates to XBRL technology.]

⁴⁴ Although the EFM permits multiple linkbases and schema files, in most cases there will only be one included with the submission. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Footnote subsequently renumbered, June 2020, to reflect revised SEC requirements and updates to XBRL technology.]

⁴⁵ Filers submitting an Inline XBRL document are not required to submit a separate instance document. [Footnote added, June 2020, to reflect revised SEC requirements.]

Appendix E — Illustrative Agreed-Upon Procedures Report

The following is an illustrative practitioner's report for an agreed-upon procedures engagement described in this SOP (agreed-upon procedures that address the completeness, mapping, consistency, or structure of an entity's XBRL-formatted financial statements [and related notes] and required schedules submitted as an exhibit to the SEC). It is illustrative only and is not intended to be applicable to, or comprehensive for, all engagements. A practitioner should tailor the report to the specific facts and circumstances of each engagement.

Independent Accountant's Report on Applying Agreed-Upon Procedures

To Management and the Audit Committee of XYZ Company:

We have performed the procedures enumerated in Attachment A on XYZ Company's XBRL data related to the [identify source information and period]^[1] (for example, the Company's [Quarterly or Annual] Report on Form [10-K or 10-Q] for the period ended [identify date] to be submitted to the U.S. Securities Exchange Commission [SEC])). XYZ Company's management is responsible for its XBRL data.

XYZ Company's management has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of assisting you in evaluating the completeness of the XBRL data, mapping of the source information to the XBRL data, consistency of the XBRL data with the source information, and structure of XYZ Company's XBRL data. The procedures performed may not address all of the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

[Additional explanatory language may be added, such as the following:²

The procedures performed do not address all of the SEC's requirements for XBRL submissions.

The XBRL data and source information may be updated prior to submitting to the SEC, therefore, the findings in this report may not correspond to the final XBRL data submitted.]

The findings relating to the procedures are included in Attachment A.

We were engaged by XYZ Company's management to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review engagement, the objective of which would be the expression of an opinion or conclusion, respectively, on the XBRL data. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

^[1] [Footnote deleted, June 2020, to reflect revised SEC requirements.]

² Refer to paragraph .37 of this SOP for additional examples. [Footnote renumbered, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

We are required to be independent of XYZ Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

[Optional paragraph if the practitioner considers it necessary to restrict the use of the report:]

This report is intended solely for the information and use of the audit committee and management of XYZ Company and is not intended to be and should not be used by anyone other than these specified parties.

[Additional paragraphs may be added to describe other matters.]

[Signature]

[City and state where the practitioner's report is issued]

[Date]

[Include as an attachment an enumeration of the procedures and findings.]

[Paragraph renumbered and revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. Paragraph renumbered and revised, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19 and to reflect revised SEC requirements and updates to XBRL technology.]

Appendix F — Glossary

abstract. An attribute of an element to primarily indicate that the element is used only in a hierarchy to group related elements together or to provide headings in a rendering. An abstract element cannot be used to tag data in an instance document.

attribute. A property of an element that indicates the kind of data that can be tagged to the concept, such as its data type, period type, and whether the element is abstract.

axis (pl. axes). An instance document contains facts; an axis (and domain member) differentiates facts, and each axis represents a way the facts may be classified. For example, revenue for a period might be reported along a business unit axis, country axis, product axis, and so forth.

balance type. An attribute of a monetary item type designated as debit or credit; a designation, should be the natural or most expected balance of the element — credit or debit — and, thus, indicates how calculation relationships involving the element may be assigned a weight attribute (–1 or 1), as well as how numbers should be entered into the instance document.

calculation linkbase. A taxonomy file that defines weighted summation, aggregating relationships between numeric items expressed as parent-child hierarchies.

caption. Explanatory text provided to describe facts presented in a report.

context. Entity- and report-specific information (reporting period, segment information, and so forth) required by eXtensible Business Reporting Language (XBRL) that allows tagged data to be understood in relation to other information.

decimal. Fact attribute used to express the number of decimal places to which numbers have been rounded.

deprecated element. An element within a taxonomy that has been declared not to be used in instance documents for various reasons (for example, superseded, redundant, or incorrect).

domain. An element that represents an entire set of other elements that are used to further describe line items; the domain and its members are used to classify facts along the axis of a table. For example, "Arkansas" could be a domain member in the domain "States" and would be used to classify elements, such as revenues and assets, in Arkansas as distinct from other states. When a fact does not have any domain member specified, that means it applies to the entire domain.

domain member. An element representing one of the classifications within a domain. A domain member categorizes the information to which it is applied.

element. An XBRL component, such as a line item, domain member, and dimension (a dimension is called an axis in the U.S. GAAP Taxonomy). The representation of a business reporting concept, including line items in the face of the financial statements, important narrative disclosures, and rows and columns in tables are all examples of elements in a taxonomy. The terms *concept*, *element*, and *tag* (noun) are often used interchangeably in XBRL.

element definition. A description of a reporting concept, most commonly a documentation label in the label linkbase.

extension element. An element that is created in an extension taxonomy to define business reporting concepts that have not previously been defined in a standard taxonomy.

extension taxonomy. A taxonomy in which users can add additional entity-specific elements and indicate additional relationships to a standard taxonomy in order to define business reporting concepts or element relationships and aspects (presentation, calculation, labels, and so forth) to reflect their own unique reporting characteristics.

fact. The occurrence of an amount or other information tagged in an instance document by a taxonomy element or combination of elements.

formatted information. Information represented using XBRL and included in one or more electronic files. Commonly referred to as tagged data or structured data.

hierarchy. An organizational treelike structure to present relationships between elements (such as order and indentation of elements in linkbases).

instance or instance document. A file that contains business reporting information and represents a collection of business facts and report-specific information using elements from one or more XBRL taxonomies.

label. Name or description for an element for presentation purposes; under the SEC mandate, for example, each element has, at a minimum, a standard label in U.S. English (such as, cash and cash equivalents) and is unique across the taxonomy.

label type. A distinguishing name for each distinct label indicating the circumstances in which it should be used; each is given a separate defining role to use in different presentation situations (for example, beginning, ending, and so forth).

line item. Elements that conventionally appear on the vertical axis (rows) of a table or columnar presentation. Line items represent the primary business reporting concepts of tagged data in the instance document.

linkbase. A taxonomy file that contains additional defining information and relationships for taxonomy elements. The primary taxonomy linkbases in XBRL are calculation, definition, label, presentation, and reference.

mapping. Process of identifying the elements that correspond to lines, columns, and tables in the source information to elements in the taxonomy.

name. An attribute that uniquely identifies an element in a schema.

namespace. Every element is associated with a universal resource identifier that may identify the organization that maintains the taxonomy. In the 2012 US GAAP Financial Reporting Taxonomy, namespaces start with <http://xbrl.fasb.org/us-gaap/2012>.

negated label. A negated label is a special label type that can be referenced in the presentation linkbase. A negated label role is a convention used to indicate that the sign for a tagged amount should be reversed when presented in a rendering.

- nil.** An attribute of an element that, when marked as "true" in an instance document, reflects a concept tagged without a value.
- period type.** An attribute of an element that reflects whether it is reported as a point in time (an instant) or period of time (duration).
- presentation linkbase.** A taxonomy file that defines presentation order of elements in the taxonomy. The presentation linkbase also suggests which label type should be used at each point of presentation.
- render or rendering.** To process an instance document into a layout that facilitates readability and understanding of its contents.
- scaling.** A process that automatically adjusts numeric data to present a specific format, thus saving time of entering zeros during the entry or creation process. The XBRL specification does not support the scaling of numeric values (all values must be reported in their entirety); however, it is a feature commonly found in instance document creation software.
- segment.** Tag that allows additional information to be included in the context of an instance document; this information captures segment information, such as an entity's business units, type of debt, and type of other income.
- sign value.** Denotes whether a numeric fact in an instance has an implied positive (no sign) or a negative (–) value.
- source information.** The information (which may be in electronic format) that is to be formatted in XBRL (for example, financial statements, including the notes, and required schedules; sustainability reports; or the "Risk/Return Summary" section of the mutual fund prospectuses).
- table.** Generally, a presentation of rows and columns also known as a hypercube. In the presentation linkbase, an element that organizes a set of axes and set of line items to indicate that each fact of one of the line items could be further characterized along one or more of its axes. For example, if a line item is "Sales," and an axis is "Scenario," this means that an instance document could have facts that are either for an unspecified scenario or a specific scenario, such as "forecast."
- tag (noun).** The terms *element* and *tag* are often used interchangeably in XBRL. The tag is the structure that brings together the content being tagged with the associated element from the taxonomy and additional attributes to related contexts, units, and other information.
- tag (verb).** To apply tags to business reporting concepts.
- taxonomy(ies).** Electronic "dictionary" of elements used to report business data, their definitions, and interrelationships.
- transformation.** A format attribute used for Inline XBRL purposes that converts data from a written format to an XBRL format. If required, fact values like dates, times, ordinal and text numbers must be translated into XBRL using transformations.
- type or data type.** Attribute that defines type (for example, monetary, string, share, decimal) of data that an element represents.
- unit of measure.** The units in which numeric items have been measured, such as U.S. dollars (iso4217:USD); shares (xbrli:shares); euros (iso4217:EUR); or compound units, such as U.S. dollars per share.

validation. Process of checking that instance documents and taxonomies correctly meet the rules of the XBRL specification and certain requirements of the entity's reporting environment.

XBRL data. Data that may include embedded tags in an HTML document, instance document, taxonomy extension schema, label linkbase, calculation linkbase, presentation linkbase, and definition linkbase documents (or other linkbases)

XBRL footnote link. Additional information that is attached to an element used to tag information in superscript footnotes.

[Revised, June 2020, to reflect revised SEC requirements and updates to XBRL technology. Paragraph renumbered, June 2020, to reflect conforming changes necessary due to the issuance of SSAE No. 19.]

Assurance Services Executive Committee (ASEC)

XBRL Assurance Task Force

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<i>and Advisory Services</i>	<i>and Advisory Services</i>

AUD Section 60***Statement of Position 17-1 — Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936***

October 2017; deleted by the issuance of SOP No. 21-1, June 2021.

NOTE

In December 2019, the AICPA Auditing Standards Board issued Statement on Standards for Attestation Engagements (SSAE) No. 19, *Agreed-Upon Procedures Engagements*, which supersedes AT-C section 215 of SSAE No. 18, *Attestation Standards, Clarification and Recodification*, and amends certain provisions of AT-C section 105, *Concepts Common to All Attestation Engagements*. SSAE No. 19 is effective for agreed-upon procedures reports dated on or after July 15, 2021, with early implementation permitted. SOP 17-1 has been revised to reflect the changes to agreed-upon procedures engagements introduced by SSAE No. 19 and is now being issued as SOP 21-1, *Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936* (AUD section 65).

AUD Section 65***Statement of Position 21-1 — Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936***

June 2021

NOTE

This AICPA Statement of Position (SOP) has been developed by the Asset-Backed Securities Agreed-Upon Procedures Task Force of the AICPA Auditing Standards Board (ASB) to provide guidance to practitioners regarding the application of Statements on Standards for Attestation Engagements (SSAEs) to agreed-upon procedures (AUP) attestation engagements related to third-party due diligence services performed in connection with rated asset-backed securities (ABS) issued in accordance with the Securities Exchange Act of 1934, as amended (Exchange Act), as those services are defined in the SEC rules as amended or adopted by SEC Release No. 34-72936, *Nationally Recognized Statistical Rating Organizations*, and the accompanying text (the release).

An attestation SOP is recognized as an interpretive publication as described in AT-C section 105, *Concepts Common to All Attestation Engagements*. Interpretive publications are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of the ASB after all ASB members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSAEs, commonly referred to as the attestation standards. The members of the ASB have found this SOP to be consistent with the attestation standards. Although interpretive publications are not attestation standards, AT-C section 105 requires the practitioner to consider applicable interpretive publications in planning and performing an attestation engagement because interpretive publications are relevant to the proper application of the SSAEs in specific circumstances.

When applying SSAE No. 19, *Agreed-Upon Procedures Engagements*, in an agreed-upon procedures engagement that addresses rated Exchange Act asset-backed securities third-party due diligence services as defined by SEC Release No. 34-72936, this SOP supersedes SOP 17-1, *Performing Agreed-Upon Procedures Related to Rated Exchange Act Asset-Backed Securities Third-Party Due Diligence Services as Defined by SEC Release No. 34-72936*.

Why SOP 17-1 Has Been Superseded

In December 2019, the AICPA Auditing Standards Board issued Statement on Standards for Attestation Engagements (SSAE) No. 19, *Agreed-Upon Procedures Engagements*, which supersedes AT-C section 215 of SSAE No. 18, *Attestation Standards, Clarification and Recodification*, and amends certain provisions of AT-C section 105, *Concepts Common to All Attestation Engagements*. SSAE No. 19 is effective for agreed-upon procedures reports dated on or after July 15, 2021, with early implementation permitted. SOP 17-1 has been revised to reflect the changes to agreed-upon procedures engagements introduced by SSAE No. 19 and is now being issued as SOP 21-1.

Introduction and Background

.01 This Statement of Position (SOP) provides practitioners with guidance and considerations for performing agreed-upon procedures (AUP) engagements related to rated asset-backed securities (ABS) issued in accordance with the Securities Exchange Act of 1934, as amended (Exchange Act), when those AUP engagements fall within the definition and scope of *third-party due diligence services* (hereinafter referred to as "covered services") as defined in the SEC rules as amended or adopted by SEC Release No. 34-72936, *Nationally Recognized Statistical Rating Organizations*, and the SEC Release No. 34-72936 accompanying text (the release). The release adopts SEC Rules 17g-10 and 15Ga-2; amends Form ABS-15G, *Asset-Backed Securitization Report Pursuant to Section 15G of the Securities Exchange Act of 1934*; provides nonauthoritative narrative on the rule changes; and adds Form ABS Due Diligence-15E, *Certification of Provider of Third-Party Due Diligence Services for Asset-Backed Securities* (Form 15E).

.02 This SOP addresses the following topics when the practitioner is engaged to perform covered services in accordance with Statements on Standards for Attestation Engagements (hereinafter referred to as "the attestation standards"):

- a. AUP engagements and related professional standards
- b. Applicability of this SOP
- c. ABS terminology
- d. Preconditions for an agreed-upon procedures engagement
- e. Agreeing on the terms of the engagement
- f. Subject matter and procedures to be performed
- g. Reporting considerations
- h. Written representations
- i. Effective date

.03 Practitioners have commonly performed AUP engagements related to securitization transactions. Generally, securitization transactions are structured financings in which the cash flows and related risks (for example, credit, prepayment, and liquidity risk) of a pool of financial assets are redistributed by the issuance of new securities backed by the same financial asset or pool of financial assets. The securities are commonly referred to as ABS.

.04 In 2014, the SEC issued the release with an effective date of June 15, 2015, for third-party due diligence services. In response to the SEC's initial proposal, commenters noted that relevant AUP engagements performed by practitioners generally include one or more of the following procedures:

- a. Comparing a loan tape (data file) to the loan file, other sources, or both
- b. Recalculating projected future cash flows of the securitized assets and the ABS
- c. Performing procedures that address other information included in the ABS offering document(s)

.05 In the release, the SEC states that "comparing the information on a loan tape with the information contained on the hard-copy documents in a loan file is an activity that falls within the definition of due diligence services in Rule 17g-10 because the work undertaken involves reviewing the accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets." In this SOP, these procedures are referred to as "covered services" and the practitioner's AUP report that includes these covered services is referred to as the "covered services report."

.06 In the release, the SEC indicates that the procedures set forth in items (b) and (c) in paragraph 4 of this SOP performed as part of an AUP engagement and for the purpose referenced in the release are not commonly understood as being due diligence services. Accordingly, such services are not covered services and, therefore, are not within the scope of this SOP.

.07 When a practitioner performs covered services and issues a covered services report, Rule 17g-10 and the related release identify the following requirements and conditions:

- a. The issuer, sponsor, or underwriter of any rated ABS will make publicly available the findings and conclusions of any covered services report obtained by the issuer, sponsor, or underwriter. The release indicates that the disclosure of the findings and conclusions includes, but is not limited to, disclosure of the criteria against which the assets were evaluated, and how the evaluated assets compare to those criteria, along with the basis for including any assets not meeting those criteria. This is accomplished by the issuer, sponsor, or underwriter including such information in a Form ABS-15G, which the issuer, sponsor, or underwriter is required to furnish to the SEC through the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system at least five business days before the first sale of the rated ABS (assumed to be the pricing date).
- b. Any provider of covered services is required to complete Form 15E. Form 15E requires information about the covered services performed (Item 4 of Form 15E) and a summary of findings and conclusions that resulted from the covered services (Item 5 of Form 15E). The instructions for completing Form 15E allow the practitioner to provide the requested items on the form or by referring to the attached practitioner's report. Therefore, practitioners may be submitting either Form 15E as a stand-alone form with its contents completed, or Form 15E with the attached practitioner's report as a combined submission.
- c. The release indicates that the covered services provider will have been deemed to have met its obligation by providing Form 15E in the following ways: (a) in response to a written request from a nationally recognized statistical rating organization (NRSRO), if received; or (b) to the issuer, sponsor, or underwriter of the securitization maintaining the Rule 17g-5 website, as described in

paragraph (a)(3)(iii) of Rule 17g-5 (Rule 17g-5 website). The issuer, sponsor, or underwriter of the securitization is then required to post Form 15E to the Rule 17g-5 website. The purpose of the Rule 17g-5 website is to make information related to rated ABS transactions accessible to all NRSROs.

- d. When the NRSRO produces a credit rating, it must publicly disclose each Form 15E that was posted to the Rule 17g-5 website for the related ABS.

.08 A practitioner is not permitted to prohibit, or require consent for, the inclusion of the procedures or findings, or both, contained in the covered services report that will be disclosed in Form ABS-15G and Form 15E. In this situation, such information must be provided to the SEC through the EDGAR system (for Form ABS-15G) and posted to the Rule 17g-5 website for access by the NRSROs (for Form 15E). In this regard, paragraph .A68 of AT-C section 215 recognizes that law or regulation may require that a practitioner's report be made available to the public as a matter of public record. In addition, the report may be distributed in other scenarios as described in the release (for example, upon a written request by an NRSRO).

AUP Engagements and Related Professional Standards

.09 Paragraph .09 of AT-C section 215 states, "In performing an agreed-upon procedures engagement, the practitioner should comply with this section, AT-C section 105, and any subject-matter section that is relevant to the engagement." This SOP includes guidance and considerations to assist practitioners in applying certain aspects of AT-C sections 105 and 215 to covered services engagements. Although not all of the provisions of AT-C sections 105 and 215 are discussed in this SOP, all of the provisions of those AT-C sections are applicable to such engagements.

Applicability of this SOP

.10 This SOP has been developed to provide practitioners with guidance and considerations regarding the application of the attestation standards to engagements in which a practitioner is engaged to issue or does issue an AUP covered services report.

.11 Nothing in this SOP precludes the practitioner from performing other attestation services for the same ABS transaction, for example, performing an AUP engagement that is not considered to be covered services (hereinafter referred to as "noncovered services"). An example of a noncovered service is performing AUP related to the ABS offering document that are not related to due diligence.

.12 Although a practitioner may be engaged to perform both covered services and noncovered services, and report on each type of service separately, the guidance in this SOP is only required to be considered by a practitioner for the covered services portion of the engagement. Although not required, a practitioner may consider the guidance in this SOP and its applicability when performing a noncovered services AUP engagement in connection with an ABS transaction.

ABS Terminology

.13 Appendix C, "Glossary," of this SOP contains definitions of common terms used in AUP engagements related to covered services.

Preconditions for an Agreed-Upon Procedures Engagement

.14 In order to establish that the preconditions for an AUP engagement are present, the practitioner should determine that the following preconditions, in addition to the preconditions identified in paragraphs .26–.30 of AT-C section 105, are present:

- The practitioner determines that procedures can be designed, performed, and reported on in accordance with AT-C section 215.
- The engaging party agrees, or will be able to agree, to the procedures and acknowledges that the procedures are appropriate for the intended purpose of the engagement.
- The procedures to be applied to the subject matter are expected to result in reasonably consistent findings.
- When applicable, the practitioner agrees to apply a threshold for reporting exceptions established by the engaging party.

For engagements related to covered services, certain additional conditions, such as the following, are relevant to the engagement:

- Whether the engaging party and the practitioner have the appropriate knowledge of the relevant SEC rules and regulations (for example: Form ABS-15G, Form 15E)
- Whether the engaging party, or another appropriate party, will agree to have Form 15E posted on the applicable Rule 17g-5 website after the practitioner completes and signs Form 15E and provides it to the engaging party or another appropriate party
- Whether adequate time will be provided to perform the procedures and promptly provide Form 15E¹

.15 Additionally, the practitioner is required to be independent of the responsible party in the performance of professional services as required by standards promulgated by bodies designated by [AICPA] Council, under the "Independence Rule" (ET sec. 1.200.001) of the AICPA's Code of Professional Conduct and its interpretations, as modified by the "Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation (ET sec. 1.297.010), and in accordance with the "Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs" interpretation (ET sec. 1.297.020). If the engaging party is not the responsible party, the practitioner need not be independent of the engaging party. However, the practitioner is required to consider the "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) of the "Integrity and Objectivity Rule" (ET sec. 1.100.001), with regard to any relationships that may exist with the engaging party.

¹ Page 350 of the release states, "a person employed to provide third-party due diligence services can meet its statutory obligation to provide the written certification relating to those services to any NRSRO that produces a credit rating to which such services relate by promptly responding to a written request from an NRSRO for the executed Form ABS Due Diligence-15E and promptly delivering the Form ABS Due Diligence-15E to the issuer, sponsor, or underwriter of the security or money market instrument that maintains the relevant Internet website pursuant to Rule 17g-5."

Agreeing on the Terms of the Engagement

.16 Paragraph .14 of AT-C section 215 requires that the practitioner agree upon the terms of the engagement with the engaging party in sufficient detail in an engagement letter or other suitable form of written agreement. Paragraph .15 of AT-C section 215 identifies the matters that are required to be included in the written agreement.

.17 Paragraph .22 of AT-C section 215 requires the practitioner to obtain, prior to the issuance of the practitioner's AUP report, a written agreement of the procedures, and acknowledgment from the engaging party that the procedures performed are appropriate for the intended purpose of the engagement. Paragraph .A35 of AT-C section 215 indicates that this agreement may be documented in the engagement letter, an addendum to the engagement letter, a representation letter, or some other form of written communication. Paragraphs .A13–.A14 of AT-C section 215 identify a situation in which all intended users of the practitioner's report ordinarily would be asked to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes (see paragraph .23 of this SOP).

.18 A factor to consider in determining whether to accept an ABS AUP engagement is whether the practitioner will have sufficient time to complete the covered services. The release requires an issuer, sponsor, or underwriter to furnish Form ABS-15G to the SEC through the EDGAR system at least five business days prior to the first sale of the offering.² Because the findings of the practitioner's AUP (for procedures determined to be covered services performed prior to the first sale of the offering) are to be included within Form ABS-15G, the practitioner may determine from the engaging party during engagement acceptance when the engaging party expects the covered services report to be provided by the practitioner.

.19 Although AT-C section 215 does not require the practitioner to enumerate the procedures in an engagement letter or other suitable form of written agreement, in a covered services engagement, it may be efficient to do so because

- the engagement is performed quickly due to the nature of security issuance as described in paragraph .18 of this SOP.
- it is unlikely that there will be a significant evolution of, or change to, the procedures because they are based on market practice for the type of asset being securitized and are therefore fairly standardized.
- obtaining agreement to the procedures before the work has begun helps to eliminate misunderstanding regarding the procedures to be performed.

.20 In addition to the items listed in paragraph .12 of AT-C section 215, other matters that may be relevant when agreeing on the terms of the engagement with the engaging party may include the following:

- The securitized assets, other ABS characteristics, or both, subject to the covered services (the characteristics) and the source documents against which the practitioner will compare such characteristics

² Page 649 of the release describes Rule 15Ga-2, which states, in part, "... the Commission has decided to adopt, as proposed, the requirement that an issuer or underwriter must furnish Form ABS-15G at least five business days prior to the first sale in the offering."

- Whether the procedures are limited to a sample of assets and, if so,
 - the number of assets to be selected for testing,
 - how the assets are to be selected, and
 - who will select the assets
- That the covered services report does not include an expression of an "opinion" or "conclusion," as described in items (o)–(p) of paragraph .34 of AT-C section 215
- The type of information to be provided to the specified parties, other than the covered services report, if any, that would be considered an "interim report" (for which the implications of use are described in the release)
- That the covered services report and practitioner may not be referred to in an unauthorized manner (for example, referred to in the ABS offering document)
- The party responsible for posting Form 15E on the applicable Rule 17g-5 website or equivalent (for example, Electronic Municipal Market Access [EMMA] for municipal securities; see paragraph 63 of this SOP regarding municipal issuers of rated ABS) (the underwriter, rather than the engaging party or responsible party, as appropriate, may be responsible for Form ABS-15G and Form 15E requirements)
- How the description of the procedures performed and any related findings will be included in Form ABS-15G
- Identification by the engaging party or responsible party, as applicable, of personally identifiable information and other information that is deemed to be confidential in nature (collectively referred to as "sensitive information" for the purpose of this SOP) and how, or if, such information will be disclosed in the covered services report, Form ABS-15G, or Form 15E
- If applicable, that any covered services are not intended to satisfy any criteria for due diligence published by an NRSRO
- The amount of time that will be necessary to complete the covered services and the date the practitioner expects to deliver the covered services report to the engaging party
- If applicable, that the covered services report is not intended for distribution to parties other than those specified in the report, when the report is included or referenced in Form ABS-15G or Form 15E (see paragraph .52 of this SOP)
- If applicable, that the covered services report is intended solely for the information and use of the specified parties and is not intended to be, and should not be, used by anyone other than the specified parties that may have access to the covered services report (for example, a rating agency or investor) (see paragraph .50 of this SOP)
- If applicable, which of the AUP performed by the practitioner are considered covered services (see paragraph .12 of this SOP)
- If the engaging party is not the responsible party, that the responsible party will provide any written representations requested by the practitioner

.21 In ABS transactions covered by this SOP, the determination of the responsible party can be complex and may require professional judgment. ABS transactions include different asset classes, different structural arrangements, and multiple parties participating in the transaction, commonly a sponsor, loan seller, depositor, issuing entity, and underwriter. In addition, such parties may be acting as a principal or agent on behalf of other parties to the transaction based on the transaction agreements. When the engaging party may not be the responsible party, careful consideration is needed in determining who will be deemed the responsible party. Gaining an understanding of the roles and responsibilities of the parties to the transaction may be helpful in identifying the responsible party. Reading draft legal agreements and ABS offering document(s), holding discussions with relevant parties, and considering the roles and responsibilities of the responsible party identified in paragraph .08 of AT-C preface, "Preface to the Attestation Standards," may further assist in identifying the responsible party. Furthermore, the definition of *responsible party* in AT-C section 105 indicates that the responsible party is the party responsible for the subject matter, which is a party other than the practitioner. If the nature of the subject matter is such that no such party exists, a party who has a reasonable basis for making a written assertion about the subject matter may be deemed to be the responsible party. Therefore, although the practitioner is not required to obtain an assertion from the responsible party, requesting or obtaining an assertion may assist the practitioner in determining who the responsible party is. For example, the responsible party (the appropriate party to make an assertion, if an assertion were requested) may be the party who owns the loans at the time of the performance of the procedures (e.g., loan seller, sponsor) or the depositor or issuer of the securities or purchaser of the loans. Practitioners may come to different conclusions as to which party is deemed to be the responsible party, based on the particular circumstances and the practitioner's professional judgment.

Subject Matter and Procedures to Be Performed

.22 Paragraph .02 of AT-C section 215 states in part, "Because the needs of an engaging party may vary widely, the nature, timing, and extent of the agreed-upon procedures and findings may vary, as well." Paragraph .03 of AT-C section 215 states in part, "Because the engaging party best understands its own needs, the engaging party is required to agree to the procedures and acknowledge that the procedures performed are appropriate for the intended purpose of the engagement prior to issuance of the practitioner's agreed-upon procedures report. Engagement circumstances may be such that it is appropriate for parties in addition to the engaging party to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes."

.23 AT section 215 does not require that any users of the practitioner's report in addition to the engaging party agree to the procedures performed and acknowledge the appropriateness of the procedures for the purpose of the engagement (or for their purposes). However, paragraph .A13 of AT-C section 215 indicates that if a contract requires that an AUP engagement be performed to satisfy the obligations or expectations of the parties to the contract, unless the procedures, or a detailed description of the nature of the procedures, are included in the contract, all intended users of the practitioner's AUP report ordinarily would agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes. Paragraph .A14 of AT-C section 215 indicates that an example of this situation is a practitioner engaged to

perform procedures relating to a securitization transaction. Paragraph .A14 goes on to state that, in such circumstances, the practitioner and engaging party may identify other parties, such as underwriters, to request to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes. Based on paragraphs .A13–.A14 of AT-C section 215, when performing covered services, the practitioner ordinarily would request that all intended users of the practitioner's AUP report also agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes. The following are examples of factors to consider in determining whether and which parties other than the engaging party would be asked to agree to the procedures in a covered services engagement:

- The fact that it is market practice to do so
- The role of the other parties — for example, an underwriter, asset contributor, or trustee — such that it is appropriate and expected to obtain agreement from other intended users
- The nature and extent of the procedures
- The nature of the subject matter; for example, type or source of loan attributes included in the data file

.24 Covered services are typically performed as of a specified date on either a sample or on the entire pool of financial assets that will be securitized. The specifics of date and population are to be determined by the engaging party and, if applicable, the other specified parties.

.25 The characteristics subjected to the covered services procedures are agreed upon by the engaging party and, if applicable, other specified parties. In a covered services engagement, the practitioner has no responsibility to determine whether the characteristics have implications for the future performance of the assets, underwritten value of the assets, credit quality of the assets, likelihood of return to investors, or any other implications related to the assets or the related asset-backed securities.

.26 In most cases, the intended purpose of covered services is principally to assist users of the report in assessing the accuracy of the data file. The procedures performed by the practitioner generally consist of comparing information about the assets contained in a data file provided by, or on behalf of, the responsible party, to the corresponding information contained in, or calculated using information contained in, copies of various third-party documents relating to the assets including, but not limited to, contracts, mortgages, notes, appraisals, and lease agreements also provided by, or on behalf of, the responsible party (the source documents). The practitioner is not required to perform any procedures on, and is not responsible for, the accuracy, completeness, or reasonableness of the information contained in the source documents and the data file, except as it relates to procedures described as having been performed in the covered services report. However, as explained in paragraph .40 of AT-C section 215, the practitioner is responsible for appropriately responding to matters that come to the practitioner's attention by means other than the application of the procedures that significantly contradict the subject matter — for example, a source document that appears to be fictitiously developed. As indicated in paragraph .43 of AT-C section 105, the practitioner is required to maintain professional skepticism.

.27 Under certain circumstances, the engaging party and, if applicable, other specified parties may agree on the use of specified thresholds for reporting exceptions when performing the covered services. Such thresholds are the

responsibility of the engaging party and, if applicable, the other specified parties, and if applicable should be included in the covered services report, as required by paragraph .34m of AT-C section 215.

Written Representations

.28 Written representations primarily provide confirmation of the appropriate party's oral representations obtained during the engagement and are intended to reduce the possibility of a misunderstanding. Paragraph .27 of AT-C section 215 requires the practitioner to request from the engaging party written representations in the form of a letter addressed to the practitioner. Such written representations are requested for each covered services report issued. Paragraph .29 of AT-C section 215 requires that the date of the written representations be as of the date of the practitioner's covered services report.

.29 When the engaging party is not the responsible party, paragraph .28 of AT-C section 215 requires the practitioner to consider requesting the relevant written representations in paragraph .27 of AT-C section 215 from the responsible party. For example, if the practitioner is relying on certain representations made by the responsible party and does not have a contract or written agreement with the responsible party, the practitioner may find it appropriate to require the responsible party to provide written representations prior to issuing the practitioner's report. The practitioner may conclude that written representations from the responsible party are necessary, for example, when the practitioner is relying on documentation and oral representations made by the responsible party during the engagement. Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the responsible party.

.30 As indicated in paragraph .30 of AT-C section 215, when one or more of the written representations that the practitioner has requested are not provided, or the practitioner concludes there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or the practitioner concludes that the written representations are otherwise not reliable, the practitioner is required to do the following:

- a. Discuss the matter with the engaging party or responsible party, as applicable.
- b. Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations and evidence in general.
- c. If any of the matters are not resolved to the practitioner's satisfaction, take appropriate action, including determining the possible effect on the practitioner's covered services report.

Paragraph .A45 of AT-C section 215 indicates that appropriate actions the practitioner may consider in the circumstances described in paragraph .30c include

- determining the effect on the practitioner's report, including whether to restrict the use of the practitioner's report or whether to disclose in the practitioner's report that the engaging party or the responsible party did not provide one or more of the requested written representations
- withdrawing from the engagement

.31 The representations that a practitioner deems appropriate will depend on the specific nature of the engagement. In addition to the required

representations in paragraph .27 of AT-C section 215, the practitioner may consider requesting the following representations from the appropriate party:

- a.* The information included in the data file provided related to the characteristics of the securitized assets is complete and accurate.
- b.* The covered services are not intended to satisfy any criteria for due diligence published by an NRSRO, if applicable.
- c.* The responsible party or another appropriate party is responsible for compliance with the regulations under Rule 15Ga-2 and Rule 17g-10, as appropriate.
- d.* The responsible party or another appropriate party is responsible for the accuracy, completeness, and furnishing of Form ABS-15G, if applicable, and the posting of Form 15E to the Rule 17g-5 website, as appropriate.
- e.* The appropriate party has disclosed to the practitioner any knowledge of any actual, suspected, or alleged noncompliance with the laws and regulations affecting the data file.
- f.* Whether the procedures include those performed for the purpose of reporting findings with respect to the following:
 - i.* The conformity of the origination of the assets to, or derivation from, stated underwritings or credit extension guidelines, standards, criteria, or other requirements
 - ii.* The value of the collateral securing the assets
 - iii.* Compliance by the originator of the collateral obligations with federal, state, or local laws or regulations
 - iv.* Any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the ABS will pay interest and principal in accordance with the applicable terms and conditions
- g.* Whether any information is deemed to be sensitive information by the responsible party or another appropriate party based on the provisions specified in the engagement letter or other suitable form of written agreement.
- h.* The responsible party is responsible for any assumptions, methodologies, and instructions provided by the responsible party or another appropriate party on behalf of the responsible party.
- i.* The appropriate party has disclosed to the practitioner any known events subsequent to the practitioner receiving the data file that would have a material impact on the data file.

.32 The release indicates both that

- the issuer, sponsor, or underwriter of any rated ABS will make publicly available the findings and conclusions of any covered services report obtained by the issuer, sponsor, or underwriter; and that
- the disclosure of the findings and conclusions includes, but is not limited to, disclosure of the criteria against which the assets were evaluated, and how the evaluated assets compare to those criteria, along with the basis.

For that reason, the practitioner may obtain a written representation from the appropriate party that the evaluated assets are in accordance with the criteria against which the assets were evaluated.

Reporting Considerations

Content of the Practitioner's Agreed-Upon Procedures Report

.33 Paragraph .34 of AT-C section 215 identifies the required elements of a practitioner's AUP report. Appendix A of this SOP contains an illustrative covered services report and paragraphs .34–.39 of this SOP provide further guidance with respect to a covered services report.

General

.34 SEC Rules 15Ga-2 and 17g-10 require the disclosure in Form 15E and Form ABS-15G, as applicable, of the procedures or findings, or both, of the practitioner's covered services. As described in items (k) and (l) of paragraph .34 of AT-C section 215, the practitioner's report is required to include a description of the procedures performed (or referenced thereto) and related findings.

Findings

.35 Paragraphs .24–.25 of AT-C section 215 require a practitioner to present the results of applying procedures in the form of findings, and to report all findings from the application of the procedures. For certain covered services engagements, particularly for AUP engagements in which the practitioner performs procedures on a sample of assets in the pool that will be securitized, it is common practice for the practitioner to report all individual findings in the AUP report, regardless of whether the data file was later revised. For certain other covered services engagements, such as those in which procedures are performed on the entire pool of financial assets that will be securitized, it is common practice for the practitioner to perform procedures on a preliminary data file, which would then be updated based on the differences identified. For these engagements, the findings reported in the AUP report would be the results of performing procedures on the final data file.

.36 It would not be appropriate for the practitioner to modify the agreed-upon procedures to circumvent reporting a finding. However, including disclosure in the report when the responsible party has revised the subject matter as a result of initial differences identified from procedures performed by the practitioner may prevent information in the report from being misleading. As addressed in paragraph .A47 of AT-C section 215, in such instances, the report may indicate that the subject matter was revised as a result of initial differences identified from the procedures performed and that the practitioner reported findings based on the final subject matter. See paragraph .54 of this SOP for illustrative language for this disclosure.

Dating of the Report

.37 As stated in paragraph .34w of AT-C section 215, the attestation standards require that the date of the practitioner's report be no earlier than the date on which the practitioner completed the procedures and determined the findings, including that

- a. the attestation documentation has been reviewed;³ and

³ Documentation requirements for an agreed-upon procedures engagement are included in paragraph .42 of AT-C section 215.

- b. if applicable, the written presentation of the subject matter has been prepared.

.38 Paragraph .42a of AT-C section 105 also requires that the covered services report not be released prior to the completion of the engagement quality control review, if applicable.

.39 The practitioner is permitted to reference other dates in the report, such as in the report title or subject line (if different from the date of the covered services report; for example, the date of the pricing for the transaction).

Form 15E and Covered Services Reports

.40 Paragraph .34 of AT-C section 215 describes the required elements of the practitioner's covered services report, which includes the procedures performed (or reference thereto) and related findings. The instructions on Form 15E allow the practitioner to address the requested items on the form or by referring to the attached practitioner's report. To the extent that the practitioner intends to refer to the practitioner's report when completing Form 15E, the practitioner is responsible for determining that the procedures and findings described in the covered services report include, where relevant, the topics identified in Item 4 of Form 15E, which are described in the release as follows:⁴

- a. The type of assets that were reviewed
- b. The sample size of the assets reviewed
- c. How the sample size was determined and, if applicable, computed
- d. Whether the accuracy of information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted
- e. Whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria, or other requirements was reviewed and, if so, how the review was conducted
- f. Whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted
- g. Whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted
- h. Any other type of review that was part of the due diligence services conducted by the person executing this form

.41 Item 5 of Form 15E requires that the practitioner provide a summary of findings and conclusions that is sufficiently detailed. When referring to the attached practitioner's report, the covered services report should include all findings that resulted from the covered services, which fulfills the practitioner obligation under Item 5.⁵

.42 If the practitioner does not intend to refer to the covered services report in Form 15E, then all the information required under Item 4 of Form 15E (see paragraph .41 of this SOP) should be included in the covered services report.

⁴ Pages 410–411 of the release outline these Item 4 requirements.

⁵ Page 412 of the release states that "As proposed, Item 5 of the form would require the provider of third-party due diligence services to provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person identified in Item 2 (that is, conveyed to the issuer, underwriter, or NRSRO that employed the third party to perform due diligence services)."

Item 4 of Form 15E indicates that the description of the scope and manner of the covered services performed should be sufficiently detailed to provide an understanding of the steps taken in performing the engagement.

.43 Item 5 of Form 15E requires that the person providing covered services provide a summary of the findings that resulted from the covered services that is sufficiently detailed to provide an understanding of the findings that were conveyed to the engaging party.⁶

.44 In the release,⁷ the SEC acknowledges that there may be particular considerations that would need to be taken into account under applicable professional standards that govern certain services provided by the accounting profession. Additionally, the SEC acknowledges in the release that the requirements and limitations resulting from relevant professional standards generally are described within the reports issued and, to the extent such requirements or limitations are based upon professional standards, the SEC would not object to the inclusion of the same description in the written certifications on Form 15E required under Rule 17g-10.

.45 Based on the SEC guidance described in paragraph .44 of this SOP, a practitioner may clarify on Form 15E that the procedures performed did not constitute an examination or review conducted under the attestation standards, as described in paragraph .49 of this SOP.

.46 The practitioner may also consider whether to include additional information in Form 15E that could assist the reader in understanding the scope of procedures performed and any corresponding limitations of services. This may be accomplished by including certain elements of the covered services report in Form 15E or by attaching the complete covered services report to Form 15E.

.47 A practitioner engaged to provide covered services will be deemed to have satisfied its obligations under Section 15E(s)(4)(B) of the Exchange Act (*Commerce and Trade, U.S. Code* [USC] 15, Section 78o-7(s)(4)(B)) if the practitioner promptly delivers an executed Form 15E after completion of the covered services to the following:

- a. An NRSRO that provided a written request for Form 15E either prior to or after the completion of the covered services stating that the services relate to a credit rating the NRSRO is producing, as applicable
- b. The issuer, sponsor, or underwriter of the ABS for which the covered services relate that maintains the Rule 17g-5 website with respect to the ABS pursuant to Section 240.17g-5(a)(3) of the Exchange Act

.48 Form 15E is required to be certified, as defined in the release.⁸ The certification will include the person/firm providing the third-party due diligence services in Item 1 of Form 15E (in most cases, the firm), the printed name of an individual who is duly authorized by the person/firm identified in Item 1 of

⁶ See footnote 5.

⁷ Page 400 of the release states that "[t]he Commission understands there may be particular considerations that would need to be taken into account under applicable professional standards that govern certain services provided by the accounting profession. The requirements and limitations resulting from relevant professional standards generally are described within the reports issued and, to the extent such requirements or limitations are based upon professional standards, the Commission would not object to the inclusion of the same description in the written certifications on Form ABS Due Diligence-15E required under Rule 17g-10."

⁸ Section 240.17g-10(b) of the Securities Exchange Act of 1934, as amended, states that "the written certification must be signed by an individual who is duly authorized by the person providing the third-party due diligence services to make such a certification."

Form 15E to make such a certification on the covered services, and the signature of such person. The individual identified on Form 15E need not be the same individual authorizing the firm signature on the covered services report.

.49 Paragraph .18 of AT-C section 105 states that if the practitioner is required by law or regulation to use a specific layout, form, or wording of the practitioner's report and the prescribed form of report is not acceptable or would cause a practitioner to make a statement that the practitioner has no basis to make, the practitioner should reword the prescribed form of report or attach an appropriately worded separate report. In this instance, Form 15E includes a section for "Summary of findings and conclusions of review" that is not consistent with paragraph .34p of AT-C section 215, which requires that the practitioner's report include a statement that the practitioner does not express an opinion or conclusion in an agreed-upon procedures engagement. This statement is not included in Form 15E. Therefore, rather than rewording the prescribed SEC form, a practitioner may consider stating on Form 15E that there are no conclusions that resulted from the covered services performed, and that the procedures performed did not constitute an examination or review in accordance with paragraph .34o of AT-C section 215. An illustrative Form 15E is presented in appendix B, "Illustrative Form ABS Due Diligence-15E," of this SOP.

Restricted Use

.50 Although AT-C section 215 does not require the practitioner to restrict the use of a practitioner's AUP report, paragraph .35 of AT-C section 215 requires the practitioner to consider restricting the use of the report after taking into account the intended purpose of the engagement and the intended users of the practitioner's AUP report. Because a covered services report, when attached to Form ABS-15G, will be available to the general public under the SEC EDGAR system, but is intended solely for use by the parties specified in the report and is not intended to be used by any other parties (for example, NRSROs and investors), the practitioner ordinarily would restrict the use of the report. This is consistent with the application guidance in paragraph .A65 of AT-C section 215, which provides examples of situations in which the practitioner, using professional judgment, may decide to include an alert that restricts the use of the report. One such example is when procedures are performed on subject matter that is intended to be used by, or is only available to, a limited number of parties, which generally is the nature of the subject matter in a covered services engagement. When restricting the use of the practitioner's AUP report, an alert is included in a separate paragraph of the report. As required by paragraph .36 of AT-C section 215, the alert should

- a. state that the practitioner's report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the report is not intended to be, and should not be, used by anyone other than the specified parties.

The following is an example of the alert that would be added to the practitioner's covered services report:

This report is intended solely for the information and use of the specified parties identified in this report. It is not intended to be and should not be used by anyone other than the specified parties, including investors and rating agencies, who are not specified parties but who may have access to this report as required by law or regulation.

Statement in the Report That the Practitioner Did Not Agree to the Appropriateness of the Procedures

.51 In addition, because the covered services report will be available to the general public under the SEC EDGAR system via Form ABS-15G and from the NRSROs via Form 15E, and to address the risk that report users may incorrectly conclude that the practitioner has determined that the procedures performed are appropriate for the intended purpose of the engagement or for any other purpose, paragraph .A54 of AT-C section 215 indicates that a practitioner may make an explicit statement in the report that the practitioner makes no representation regarding the appropriateness of the procedures either for the purpose for which the practitioner's report has been requested or for any other purpose. The following is an example of such a statement:

The appropriateness of these procedures for the intended purpose is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the appropriateness of the procedures enumerated in [location of procedure description] either for the purpose for which this report has been requested or for any other purpose.

Explanatory Language

.52 Because the covered services report will be available to the general public under the SEC EDGAR system via Form ABS-15G and from the NRSROs via Form 15E, the practitioner may consider adding language to further clarify what the covered services report does not address. For example, the practitioner may indicate any or all of the following:

- The covered services report is not intended to address one or more of the following items (if applicable):
 - The conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria, or other requirements
 - The value of collateral securing such assets
 - The compliance of the originator of the assets with federal, state, and local laws and regulations
 - Any criteria for due diligence published by an NRSRO
- Any other asset factor or characteristic, not subjected to procedures, that would be material to the likelihood that the issuer of the ABS will pay interest and principal in accordance with applicable terms and conditions.
- The practitioner is not responsible for, and has not agreed to, the appropriateness of the procedures for the intended purpose.
- The practitioner has no responsibility to update the covered services report for events and circumstances occurring after the [issuance] or [as of] [period-end date].
- Procedures were not performed to determine whether the originator of the assets complied with federal, state, or local laws or regulations.

- The responsible party is responsible for the source documents,⁹ and as such, the practitioner has not performed procedures, or made any representation as to, the accuracy, completeness, or reasonableness of the source documents.

The practitioner may add other items to the report that are not precluded by the attestation standards (for example, that the practitioner used a nonstatistical sampling approach and that there is a risk that the items selected were not representative of the population).

Distribution of the Report

.53 Paragraph .A69 of AT-C section 215 indicates that a practitioner is not responsible for controlling, and cannot control, the distribution of the practitioner's report after its release. A practitioner may consider informing the engaging party or other specified parties that the practitioner's report is not intended for distribution to parties other than those specified in the practitioner's report. The practitioner may, in connection with establishing the terms of the engagement, reach an understanding with the engaging party that the intended use of the practitioner's report will be restricted and may obtain the engaging party's agreement that the engaging party and specified parties will not distribute such practitioner's report to parties other than those identified therein.

Disclosure That Practitioner Performed Procedures on Preliminary Subject Matter

.54 As discussed in paragraphs .35–.36 of this SOP, in instances in which procedures are performed on the entire pool of financial assets that will be securitized, the practitioner may initially perform certain procedures on preliminary subject matter (for example, the data file) prior to performing the agreed-upon procedures on the final subject matter. In some situations, performing procedures on the preliminary subject matter identifies differences that are communicated to the appropriate party, resulting in changes to the subject matter. In such situations, in meeting the requirement to disclose the procedures performed, the practitioner may determine it is appropriate to disclose the practitioner's involvement with the preliminary subject matter in order for the practitioner's report to not be misleading. If such a determination is made, the following are examples of language that could be included in the report: Prior to performing the procedures [*identify the procedures; for example, set forth below / in attachment X / in this report*] on the data file, we performed certain procedures on earlier versions of the data file and provided the identified differences to the [*identify the appropriate party*], who then provided us with the final data file on which the above procedures were performed.

- a. In performing this engagement, we received one or more preliminary data files related to procedures [*identify the procedures; for example, procedures 1–5, 9, 17, and 24*] and performed the procedures [*identify the procedures; for example, as set forth below / in attachment X / in this report*]. The procedures identified differences, which were communicated to [*identify the appropriate*

⁹ The glossary of this SOP defines *source documents* as various documents provided by or on behalf of the responsible party for the purpose of comparing or calculating information related to asset characteristics selected by the responsible party. The documents typically include, but are not limited to, copies of contracts, mortgages, notes, appraisals, and lease agreements.

party]. [Identify the appropriate party] revised one or more of the [data files] based on such communicated differences, where they determined it to be appropriate. We performed the procedures on the final data file, and the results of those procedures are reflected herein.

- b. Between [identify the date of the first data file] and [identify the date of the last data file], we received one or more data files on which to perform our procedures. In performing a comparison of the attributes in the preliminary data file(s) to the corresponding information set forth in the source documents, we identified differences, which were communicated to [identify the appropriate party]. The final data file reflects the resolution of differences communicated as determined appropriate by [identify the appropriate party]. We performed the procedures on the final data file, and the results of those procedures are reflected herein.

Sensitive Information

.55 The "Confidential Client Information Rule" (ET sec. 1.700.001) of the AICPA Code of Professional Conduct states that a member in public practice shall not disclose any confidential client information without the specific consent of the client. Because engagement documentation and, in certain cases, the covered services report prepared by a practitioner often contain sensitive information, the practitioner should adopt reasonable procedures to maintain the confidentiality of that information, as stated in paragraph .39 of AT-C section 105. The following are examples of procedures the practitioner may perform to mitigate the risk that such sensitive information is publicly disclosed:

- Writing the covered services report in a manner that does not disclose sensitive information
- Summarizing the information where appropriate so that sensitive information is not disclosed
- Creating two versions of the exhibit of findings: one detailed version that includes sensitive information, which is provided only to the specified parties for their purposes; and a more summarized version that excludes any sensitive information and is available for Form ABS-15G and Form 15E postings (the practitioner cautiously summarizes the information to avoid altering the meaning of the finding)
- Redacting sensitive information contained in the covered services report attached to Form ABS-15G and Form 15E (cautious redaction of the information is needed to avoid altering the meaning of the findings)

Reissuing a Covered Services Report

.56 Practitioners do not have responsibilities subsequent to the issuance of the covered services report. However, practitioners may be requested to reissue a covered services report for various reasons. For example, the composition of the portfolio has changed, requiring additional procedures; or an item needing a correction may be identified after the covered services report has been issued. In this instance, the practitioner may agree to a new or amended covered services report that would be provided to the engaging party and, if applicable, other specified parties. Practitioners may consider whether the changes to the covered services report would require that a new Form 15E be completed.

In determining whether to complete a new Form 15E along with the reissued covered services report, some considerations include whether

- the information that the practitioner provided in Form 15E remains correct and complete (for example, if a subsequently discovered fact is brought to the practitioner's attention that if known at the time of the issuance of Form 15E would have affected the information required by Form 15E, it will likely result in a reissued Form 15E);
- there are changes to the procedures, findings, or any of the attributes in Item 4 of Form 15E that need to be reflected in an updated covered services report; and
- the issuer, sponsor, or underwriter will furnish a new Form ABS-15G with the reissued covered services report, resulting in two versions of the practitioner's report being publicly available.

.57 If the practitioner determines that a new or amended covered services report is to be issued, the practitioner may consider communicating the rationale in writing to the engaging party and, if applicable, other specified parties. Such communication would make it clear that the new or amended covered services report supersedes the initial covered services report. The practitioner may provide the engaging party with another Form 15E that will have the new or amended covered services report attached. Such Form 15E would include wording that Form 15E is being submitted for the amended report, which supersedes the covered services report submitted with the previously issued Form 15E. Both Form 15E and the new or amended covered services report may include wording that states the reason that the new or amended covered services report has been issued, and that the previously issued covered services report should no longer be used or relied upon.

The following is an example of the wording for the new or amended covered services report:

On *[date of previously issued covered services report being rescinded]*, we issued an independent accountants' report on applying agreed-upon procedures relating to certain information with respect to a portfolio of *[describe the assets being securitized; for example, consumer loans, commercial real estate loans, auto leases]*. *[Responsible party]* informed us that *[describe the circumstances that are causing the reissuance of the practitioner's report; for example, the composition of the portfolio changed, the deal name changed, the cutoff date changed]* and requested that a new report be issued. The independent accountants' report on applying agreed-upon procedures described herein supersedes the report issued on *[date of previously issued covered services report being rescinded]*. Furthermore, the specified parties have been instructed to no longer use or rely upon the report issued on *[date of previously issued covered services report being rescinded]*.

The following is an example of the wording for Form 15E with the new or amended report:

This Form ABS Due Diligence-15E supersedes our Form ABS Due Diligence-15E dated *[date of previously issued covered services report being rescinded]* pertaining to *[full deal name]*. Since Form ABS Due Diligence-15E dated *[date of previously issued covered services report]* was issued, *[describe the reasons that are causing the report to be reissued]*. Therefore, we have issued the attached independent accountant's report on applying agreed-upon procedures dated *[date of new covered services report]* pertaining to *[full deal name]*. The previously issued independent accountants' report on applying agreed-upon procedures should no longer be used or relied upon by the specified parties.

Adding a Specified Party

.58 When the practitioner issues a covered services report that includes an alert restricting the use of the practitioner's report to certain specified parties, and the engaging party subsequently requests the practitioner to add an additional party as a specified party, paragraph .37 of AT-C section 215 requires the practitioner to determine whether to add the additional party as a specified party. As part of this determination, the practitioner is required to consider whether

- a. the proposed additional specified party has acknowledged or will be requested to acknowledge that the procedures performed are appropriate for their purpose. If the practitioner determines that the acknowledgment is necessary, the practitioner should either obtain such acknowledgment directly from the additional specified party or obtain a representation from the engaging party that the additional specified party has agreed to the procedures and acknowledged that the procedures performed are appropriate for their purposes and
- b. the report will be reissued to identify the additional specified party.

The practitioner may agree to add the other party as a specified party based on the practitioner's consideration of factors such as the identity of the other parties and the intended use of the practitioner's report.

.59 The practitioner is not required to reissue the covered services report to identify any additional specified parties included in the alert that restricts the use of the report or, if applicable, to indicate that the additional specified party agreed to and acknowledged the appropriateness of the procedures for their purposes. If the practitioner's report is reissued, the practitioner is not required to change the date of the report. If the practitioner provides a written acknowledgment to the engaging party and the additional party that such party has been added as a specified party, paragraph .38 of AT-C section 215 requires the practitioner to state in the acknowledgment that no procedures were performed subsequent to the original date of the practitioner's AUP report.

Form ABS-15G

.60 The issuer, sponsor, or underwriter's Form ABS-15G must contain the "findings and conclusions" of any covered services report obtained by the issuer, sponsor, or underwriter, as well as the criteria against which the assets were evaluated and how the evaluated assets compare to those criteria. As such, the practitioner and the engaging party may consider the following:

- a. Reaching agreement that the issuer, sponsor, or underwriter will attach the practitioner's covered services report to Form ABS-15G, and that the issuer, sponsor, or underwriter may not alter in any way or summarize the covered services report provided by the practitioner (except in certain cases with respect to the removal or redaction of sensitive information in the covered services report attached to Form ABS-15G, when agreed to by the practitioner). (See paragraph .55 of this SOP for a discussion of sensitive information.)
- b. If the issuer, sponsor, or underwriter will not attach the practitioner's covered services report to Form ABS-15G and instead references the practitioner's covered services or summarizes the covered services report, the practitioner and engaging party may

agree that the practitioner will be provided with an opportunity to review the issuer, sponsor, or underwriter's Form ABS-15G prior to submission in order to determine whether it accurately describes the covered services and related findings, if any.

.61 Consistent with the attestation standards, procedures and findings of the practitioner are not considered part of any report until all such standards are met and the report is signed and released. Therefore, draft, unsigned versions of the covered services report provided to the issuer, sponsor, or underwriters prior to the issuance of the final, signed covered services report are not typically considered "interim" reports and should not be attached to Form ABS-15G.¹⁰

.62 Typically, Form ABS-15G will be furnished through the EDGAR system either prior to or at the same time Form 15E is posted to the Rule 17g-5 website.

Exception Related to Municipal Issuers

.63 Form ABS-15G is not required to be furnished to EDGAR by municipal issuers of rated ABS. Municipal issuers are required to make such information available through any means reasonably accessible to the public, including, for example, by posting the information on an issuer-, sponsor-, or underwriter-sponsored website, by voluntarily furnishing Form ABS-15G on EDGAR, or by voluntarily submitting a Form ABS-15G on EMMA.¹¹ Practitioners follow the same guidelines herein for Form ABS-15G, regardless of the type of securitized assets.

Exception Related to Certain Foreign-Based ABS Issuances

.64 Certain foreign issuances (that is, certain non-U.S. transactions) are exempt from the release requirements related to Form ABS-15G and Form 15E if the following conditions are met:¹²

- a. The offering is not required to be, and is not, registered under the Securities Act of 1933, as amended (the Securities Act).
- b. The issuer of the rated security is not a U.S. person (as defined under Securities Act Rule 902(k)).
- c. The security issued by the issuer will be offered and sold upon issuance, and any underwriter or arranger linked to the security will effect transactions of the security after issuance, only in transactions that occur outside the United States.

¹⁰ Page 374 of the release states, in part, "... all third-party due diligence reports obtained by the issuer or underwriter, including interim reports, related to an offering of asset-backed securities should be made publicly available in order for users of credit ratings to more thoroughly evaluate the level of due diligence obtained by the issuer or underwriter as compared to the due diligence services used by an NRSRO rating the Exchange Act-ABS." Reports that are not considered final due diligence reports or interim reports do not result in a Form ABS-15G filing.

¹¹ Page 382 of the release states that "Consequently, although municipal issuers and underwriters will not be required to furnish Form ABS-15G pursuant to Rule 15Ga-2, they are subject to the statutory requirement under Section 15E(s)(4)(A) to make publicly available the findings and conclusions of any third-party due diligence report they obtain. Municipal issuers and underwriters may make such information available through any means reasonably accessible to the public, including, for example, by posting the information on an issuer or underwriter sponsored Internet website, by voluntarily furnishing Form ABS-15G on EDGAR, or by voluntarily submitting a Form ABS-15G on EMMA."

¹² Page 370 of the release.

Considerations Regarding EDGAR

.65 As noted previously, a covered services report may be attached to a Form ABS-15G furnished through the EDGAR system. The EDGAR system does not currently allow files in PDF format. A handwritten or electronic signature included in non-PDF format on EDGAR may be easily obtained by a third party from the publicly available report. Therefore, practitioners may consider using a conformed signature on the covered services report that is attached to Form ABS-15G (for example, /s/ Firm Name). Practitioners may consider implementing procedures to reconcile the final posted Form ABS-15G with the document provided to the responsible party to determine that the covered services report has not been modified.

Effective Date

.66 This SOP is effective for AUP reports dated on or after July 15, 2021. Early implementation is permitted.

Appendix A — Illustrative Covered Services Report

The following is an illustrative practitioner's report for the AUP engagement described in this SOP. It is illustrative only and is not intended to be applicable to, or comprehensive for, all engagements. Accordingly, it may not include items that are relevant to a specific engagement and therefore would be tailored to the facts and circumstances of the particular engagement.

Circumstances include the following:

- Use of the report is restricted to the specified parties (for example, underwriters).
- The report includes additional language acknowledging the appropriateness of the procedures for the intended purpose and the limitations of the procedures performed.
- Other parties have agreed to and acknowledged that the procedures performed are appropriate for their purposes.

Independent Accountant's Report on Applying [Agreed-Upon] Procedures

[Appropriate Addressee]

We have performed the procedures enumerated in Attachment A, on *[identify the subject matter; for example, certain information with respect to attributes of the (identify the asset type) relating to (name of transaction)]*. *[The responsible party, for example, XYZ Company]* is responsible for the data file accurately representing the information included in the underlying asset documents and the disclosed assumptions and methodologies.

[The engaging party, for example, XYZ Fund] has agreed to and acknowledged that the procedures performed are appropriate to meet the intended purpose of *[identify the intended purpose of the engagement, for example, assisting specified parties in evaluating]* *[identify the subject matter; for example, certain information with respect to attributes of the]* *[identify the asset type]* relating to *[name of transaction]*. This report may not be suitable for any other purpose. Additionally, *[identify the other parties that have agreed to and acknowledged that the procedures performed are appropriate for their purposes; for example, the Trustee of XYZ Company]* has agreed to and acknowledged that the procedures performed are appropriate for their purposes. The procedures performed may not address all the items of interest to a user of this report and may not meet the needs of all users of this report and, as such, users are responsible for determining whether the procedures performed are appropriate for their purposes.

Consequently, we make no representation regarding the appropriateness of the procedures enumerated in Attachment A either for the purpose for which this report has been requested or for any other purpose.

The procedures and associated findings are included in Attachment A.

We were engaged by *[identify the engaging party; for example, XYZ Fund]* to perform this agreed-upon procedures engagement and conducted our engagement in accordance with attestation standards established by the AICPA. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or a conclusion, respectively, on *[identify the subject matter; for example, certain information with respect to the attributes of the]* *[identify asset type]* relating to *[name of transaction]*. Accordingly, we do not express such opinion or conclusion. Had we performed

additional procedures, other matters might have come to our attention that would have been reported to you.

[The practitioner may include additional explanatory paragraphs to clarify the scope of the engagement, such as the following:]

Our agreed-upon procedures engagement was not conducted for the purpose of the following:

- Addressing the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria, or other requirements
- Addressing the value of collateral securing any such assets being securitized
- Addressing the compliance of the originator of the assets with federal, state, and local laws and regulations
- Satisfying any criteria for due diligence published by a nationally recognized statistical rating organization
- Addressing any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the asset-backed security will pay interest and principal in accordance with applicable terms and conditions
- Forming any conclusions
- Any other terms or requirements of the transaction that do not appear in the report]

We are required to be independent of *[identify the responsible party; for example, XYZ Company]* and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our agreed-upon procedures engagement.

This report is intended solely for the information and use of *[identify or state the specified parties]*. It is not intended to be and should not be used by anyone other than the specified parties, including investors and rating agencies who are not identified as specified parties but who may have access to this report as required by law or regulation.

[Signature of the practitioner's firm]

[City and state where the practitioner's report is issued]

[Date of the practitioner's report]

[Include as an attachment an enumeration of the procedures and findings.]

Attachment A — Illustrative Procedures and Findings

Attachment A presents the procedures and findings referred to in the practitioner's AUP report. These are illustrative procedures a practitioner might perform and findings that a practitioner might report as part of the AUP engagement described in this SOP. They are not intended to be applicable to, or comprehensive for, all engagements.

1. As instructed by the sponsors, on behalf of the depositor, we randomly selected a sample of XXX mortgage loans listed on the loan file comparison data file (the data file). The sample subjected to the procedures described below are referred to as the "sample mortgage loans." For the purpose of this procedure, the sponsors, on behalf of the depositor, did not inform us as to the basis for how they selected the number of mortgage loans that we were instructed to randomly select from the data file.

2. For each sample mortgage loan, we compared the characteristics listed on Exhibit 1 (the characteristics), as shown on the data file, to the corresponding information located on the source documents listed on Exhibit 1 that were provided by the sponsors, on behalf of the depositor, subject to the qualifications, assumptions, and methodologies provided by the sponsors, on behalf of the depositor, that are stated in the notes to Exhibit 1. Except for the information shown on Exhibit 2, all such compared information was in agreement. Where recomputation was required, the recomputations are described in the notes to Exhibit 1.

Appendix B¹ — Illustrative Form ABS Due Diligence-15E

The following is a Form ABS Due Diligence-15E that includes partial illustrative responses and instructions to the practitioner.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM ABS DUE DILIGENCE-15E

CERTIFICATION OF PROVIDER OF THIRD-PARTY DUE DILIGENCE SERVICES FOR ASSET-BACKED SECURITIES

Pursuant 17 CFR 240.17g-10, this Form must be used by a person providing third-party due diligence services in connection with an asset-backed security to comply with section 15E(s)(4)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-7(s)(4)(B)). Section 15E(s)(4)(B) of the Securities Exchange Act of 1934 requires a person providing the due diligence services to provide a written certification to any nationally recognized statistical rating organization that produces a credit rating to which such due diligence services relate.

Item 1. Identity of the person providing third-party due diligence services

Legal Name: *Firm legal name*

Business Name (if different):

Principal Business Address: *Firm business address*

Item 2. Identity of the person who paid the person to provide third-party due diligence services

Legal Name: *Engaging party legal name*

Business Name (if different):

Principal Business Address: *Engaging party business address*

Item 3. Credit rating criteria

If the due diligence performed by the third party is intended to satisfy the criteria for due diligence published by a nationally recognized statistical rating organization, identify the nationally recognized statistical rating organization and the title and date of the published criteria (more than one nationally recognized statistical rating organization may be identified).

[Firm name] was not engaged to perform procedures that were intended to satisfy any criteria for due diligence published by a nationally recognized statistical rating organization.

Item 4. Description of the due diligence performed

Provide a description of the scope and manner of the due diligence services performed in connection with the review of assets that is sufficiently detailed to provide an understanding of the steps taken in performing the review. Include in the description: (1) the type of assets that were reviewed; (2) the sample size of the assets reviewed; (3) how the sample size was determined and, if applicable, computed; (4) whether the accuracy of information or data about the assets

¹ Italicized material in this appendix is added for illustrative purposes.

provided, directly or indirectly, by the securitizer or originator of the assets was reviewed and, if so, how the review was conducted; (5) whether the conformity of the origination of the assets to stated underwriting or credit extension guidelines, standards, criteria, or other requirements was reviewed and, if so, how the review was conducted; (6) whether the value of collateral securing such assets was reviewed and, if so, how the review was conducted; (7) whether the compliance of the originator of the assets with federal, state, and local laws and regulations was reviewed and, if so, how the review was conducted; and (8) any other type of review that was part of the due diligence services conducted by the person executing this Form. This description should be attached to the Form and contain the heading "Item 4." Provide this description regardless of whether the due diligence performed is intended to satisfy the criteria for due diligence published by a nationally recognized statistical rating organization.

[Note to practitioner: You may either address the requested items here or as an attachment, depending on preference.]

The following numbered items are intended to address the numerically requested items of Item 4.

- (1) See attached Independent Accountant's Report on Applying Agreed-Upon Procedures dated _____ pertaining to [transaction name].*
- (2) See attached Independent Accountant's Report on Applying Agreed-Upon Procedures dated _____ pertaining to [transaction name].*
- (3) See attached Independent Accountant's Report on Applying Agreed-Upon Procedures dated _____ pertaining to [transaction name].*
- (4) See attached Independent Accountant's Report on Applying Agreed-Upon Procedures dated _____ pertaining to [transaction name].*
- (5) Not applicable / addressed*
- (6) Not applicable / addressed*
- (7) Not applicable / addressed*
- (8) None*

Item 5. Summary of findings and conclusions of review

Provide a summary of the findings and conclusions that resulted from the due diligence services that is sufficiently detailed to provide an understanding of the findings and conclusions that were conveyed to the person identified in Item 2. This summary should be attached to the Form and contain the heading "Item 5."

The findings can be found in the attached Independent Accountant's Report on Applying Agreed-Upon Procedures dated [date] pertaining to [transaction name]. Consistent with attestation standards established by the American Institute of Certified Public Accountants, there were no conclusions that resulted from the due diligence services. We were not engaged to, and did not conduct an examination to, express an opinion or a review to express a conclusion on [identify the subject matter of the engagement].

CERTIFICATION

The undersigned has executed this Form ABS Due Diligence-15E on behalf of, and on the authority of, the person identified in Item 1 of the Form. The undersigned, on behalf of the person, represents that the person identified in Item 1 of the Form conducted a thorough review in performing the due diligence

described in Item 4 attached to this Form and that the information and statements contained in this Form, including Items 4 and 5 attached to this Form, which are part of this Form, are accurate in all significant respects on and as of the date hereof.

For purposes of this certification, consistent with attestation standards established by the American Institute of Certified Public Accountants, we were not engaged to, and did not conduct an examination to express an opinion or a review to express a conclusion on the [identify the subject matter of the engagement].

Name of Person Identified in Item 1: [Firm name]

*By: [Name of duly authorized person]
(Print name of duly authorized person)*

*[Affix signature]
(Signature)*

Date: [Not earlier than date of the Covered Services Report]

Appendix C — Glossary

The following is a glossary of common terms specifically relating to engagements described by this SOP.

asset-backed security (ABS). As defined by Section 3(a)(79) of the Securities Exchange Act of 1934, an asset-backed security (ABS) means a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including the following:

- a. A collateralized mortgage obligation
- b. A collateralized debt obligation
- c. A collateralized bond obligation
- d. A collateralized debt obligation of asset-backed securities
- e. A collateralized debt obligation of collateralized debt obligations
- f. A security that the SEC, by rule, determines to be an asset-backed security

The definition of ABS does not include a security issued by a finance subsidiary held by the parent company or a company controlled by the parent company if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company.

characteristics. The asset attributes selected by the responsible party on which the practitioner performs procedures. The characteristics may be subject to procedures for a sample of assets, or all, and specified in the covered services report.

covered services. For purposes of this SOP, procedures performed by the practitioner that are considered to be third-party due diligence services in accordance with the release. For example, comparing the information on a data file with the information contained in the hard-copy documents in a loan file is an activity that falls within the definition of due diligence services in the release.

covered services report. The agreed-upon procedures report issued by the practitioner resulting from covered services.

data file. An electronic file provided by, or on behalf of, the responsible party that comprises various characteristics of the asset(s) within the scope of the agreed-upon procedures.

depositor. Defined as either

- a. the entity that receives or purchases the underlying financial assets from the originator and subsequently transfers or sells the financial assets to the issuing entity;
- b. the sponsor, in the case of a securitization transaction where there is not an intermediate transfer of the assets from the sponsor to the issuing entity; or
- c. the entity that receives or purchases the underlying financial assets from the originator and subsequently transfers or sells the financial assets to the issuing entity in the case

of a securitization transaction in which the entity transferring or selling the financial assets directly to the issuing entity is itself a trust.

due diligence services. Rule 17g-10 of the release defines due diligence services as a review of the assets underlying an asset-backed security (as defined in this glossary) for the purpose of making findings with respect to the following:

- a. The accuracy of the information or data about the assets provided, directly or indirectly, by the securitizer or originator of the assets
- b. Whether the origination of the assets conformed to, or deviated from, stated underwriting or credit extension guidelines, standards, criteria, or other requirements
- c. The value of collateral securing the assets
- d. Whether the originator of the assets complied with federal, state, or local laws or regulations
- e. Any other factor or characteristic of the assets that would be material to the likelihood that the issuer of the asset-backed security will pay interest and principal in accordance with applicable terms and conditions

Form ABS-15G. Asset-backed securitizer report pursuant to Section 15G of the Securities Exchange Act of 1934.

Form ABS Due Diligence-15E. Certification of third-party provider of due diligence services for asset-backed securities. For purposes of this SOP, this form is also referred to as Form 15E.

issuer. The entity that organizes and initiates the offering of the asset-backed security (for example, the sponsor or depositor).

NRSRO. Nationally recognized statistical rating organization.

noncovered services. For purposes of this SOP, procedures performed by the practitioner that are not considered to be third-party due diligence services in accordance with the release.

originator. An entity that

- a. through an extension of credit or otherwise, creates an asset that collateralizes an asset-backed security; and
- b. sells the asset directly or indirectly to a securitizer or issuing entity (Section 15G(a)(4) of the Securities Exchange Act of 1934 (15 USC 78o-9(a)(4))).

release. For purposes of this SOP, SEC Release No. 34-72936, *Nationally Recognized Statistical Rating Organizations*.

securitizer. With respect to a securitization transaction, this is either

- a. the depositor of the asset-backed securities (if the depositor is not the sponsor); or
- b. the sponsor of the asset-backed securities (Section 15G(a)(3) of the Securities Exchange Act of 1934 (15 USC 78o-9(a)(3))).

sensitive information. (1) Personally identifiable information and (2) other information that is deemed by the engaging party to be confidential in nature and does not materially alter the findings of the agreed-upon procedures engagement.

source documents. Various documents provided by, or on behalf of, the responsible party for the purpose of comparing or calculating information related to asset characteristics selected by the responsible party. The documents typically include, but are not limited to, copies of contracts, mortgages, notes, appraisals, and lease agreements.

sponsor. The entity that organizes and initiates the asset-backed securities transaction by transferring the assets underlying an asset-backed security directly or indirectly to the issuing entity.

third-party due diligence report. Any report containing findings and conclusions of any due diligence services performed by a practitioner.

underwriter. The entity that underwrites the offering of asset-backed securities and sells them to investors.

**Auditing Standards Board
(2021–2022)**

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The task force gratefully acknowledges the substantial contributions of James Carey, Halie Creps, Elie Doft, Courtney Lazzari, Eli Stern, and Tina Stoliar.

ACC Section**STATEMENT OF POSITION—ACCOUNTING**

INTRODUCTION

As explained in the "Special Note About FASB *Accounting Standards Codification*®" section of this publication, the FASB *Accounting Standards Codification* (ASC) codified thousands of nongovernmental accounting pronouncements (including those of the FASB, EITF, and the AICPA) into FASB ASC, which reduced the generally accepted accounting principles (GAAP) hierarchy to two levels: one that is authoritative (in FASB ASC) and one that is not (not in FASB ASC). FASB ASC codified all AICPA accounting SOPs. This guidance became nonauthoritative on July 1, 2009, in its native form. The authoritative source of this guidance beginning from July 1, 2009, is FASB ASC.

Although AICPA Statement of Position (SOP) 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, was codified for nongovernmental entities as FASB ASC 958-720, it remains authoritative in its native form for governmental entities. GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, identifies AICPA Statements of Positions that have specifically been made applicable to state and local governmental entities by the AICPA and cleared by GASB as sources of established accounting principles in category *b* of the GAAP hierarchy for state and local governmental entities. GASB previously made this SOP, as originally issued, applicable to governmental entities; as such, it is still authoritative for those entities. The SOP is presented here for application by governmental entities as authoritative guidance permitted by GASB.

GASB's exposure draft on *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* is currently out for comment with comments due December 31, 2014. The anticipated effective date is for periods beginning after June 15, 2015. For more information, www.gasb.org/.

Statements of Position of the Accounting Standards Division present the conclusions of the Accounting Standards Executive Committee, which is the senior technical body of the AICPA authorized to speak for the Institute in the areas of financial accounting and reporting.

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ACC Section 10

Statement of Position 98-2 Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising

This statement of position contains authoritative GASB material.

Statement of Position (SOP) 98-2 includes governmental entities in its scope, and its accounting and financial reporting requirements were cleared by GASB and, thus, those portions are category B accounting and financial reporting guidance for state and local governmental entities. Portions that are category B accounting and financial reporting guidance for state and local governmental entities appear in orange font.

March 11, 1998

NOTE

Statements of Position (SOPs) on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, identifies AICPA literature that has specifically been made applicable to state and local governmental entities and cleared by GASB as a source of authoritative accounting principles in category B of the generally accepted accounting principles (GAAP) hierarchy for state and local governmental entities. AICPA members should consider the accounting principles in this SOP if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by this SOP should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

[Revised, October 2009, to reflect conforming changes necessary due to the withdrawal of SAS No. 69; Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Summary

This Statement of Position (SOP) applies to all nongovernmental not-for-profit organizations (NPOs) and all state and local governmental entities that solicit contributions.

This SOP requires—

- If the criteria of purpose, audience, and content as defined in this SOP are met, the costs of joint activities that are identifiable with a particular function should be charged to that function and joint costs should be allocated between fund raising and the appropriate program or management and general function.
- If any of the criteria of purpose, audience, and content are not met, all costs of the activity should be reported as fund-raising costs, including costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity, subject to the exception in the following sentence. Costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event (for example, a meal), should not be reported as fund raising.
- Certain financial statement disclosures if joint costs are allocated.
- Some commonly used and acceptable allocation methods are described and illustrated although no methods are prescribed or prohibited.

This SOP amends existing guidance in AICPA Audit and Accounting Guides *Health Care Organizations*, *Not-for-Profit Organizations* (which was issued in August 1996 and supersedes SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*, because the provisions of SOP 87-2 are incorporated into the Guide), and *Audits of State and Local Governmental Units*.*

This SOP is effective for financial statements for years beginning on or after December 15, 1998. Earlier application is encouraged in fiscal years for which financial statements have not been issued. If comparative financial statements are presented, retroactive application is permitted but not required.

Foreword

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB) and the Governmental Accounting Standards Board (GASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB and the GASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least

* The AICPA Audit and Accounting Guide *State and Local Governments* supersedes the 1994 AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* and subsequent editions of that Guide with conforming changes made by the AICPA staff. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance on the application of this Statement of Position (SOP) to state and local governments. [Footnote added, June 2004, to reflect conforming changes necessary due to the issuance of the AICPA Audit and Accounting Guide *State and Local Governments*.]

ten of AcSEC's fifteen members. The document is cleared if at least five of the seven FASB members and three of the five GASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.[†]

The criteria applied by the FASB and the GASB in their review of proposed projects and proposed documents include the following:

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB and the GASB will propose suggestions, many of which are included in the documents.

Introduction

.01 Some nongovernmental not-for-profit organizations (NPOs) and some state and local governmental entities,¹ such as governmental colleges and universities and governmental health care providers, solicit support through a variety of **fund-raising activities**.² These activities include direct mail, telephone solicitation, door-to-door canvassing, telethons, special events, and others. Sometimes fund-raising activities are conducted with activities related to other functions, such as **program activities** or supporting services, such as **management and general activities**.³ Sometimes fund-raising activities include components that would otherwise be associated with program or supporting services, but in fact support fund raising.

[†] This document was cleared prior to July 1, 1997. In July 1997, the GASB increased to seven members. Documents considered by the GASB after July 1, 1997 are cleared if at least four of the seven GASB members do not object. [Footnote renumbered, June 2004, to reflect conforming changes necessary due to the issuance of the AICPA Audit and Accounting Guide *State and Local Governments*.]

¹ This Statement of Position (SOP) uses the term *entity* to refer to both nongovernmental not-for-profit organizations (NPOs) and state and local governments.

² Terms that appear in the Glossary [paragraph .30] are set in **boldface type** the first time they appear.

³ The functional classifications of fund raising, program, and management and general are discussed throughout this SOP for purposes of illustrating how the guidance in this SOP would be applied by entities that use those functional classifications. Some entities have a functional structure that does not include fund raising, program, or management and general, or that includes other functional classifications, such as **membership development**. This SOP is not intended to require reporting the functional classifications of fund raising, program, and management and general. In circumstances in which entities that have a functional structure that includes other functional classifications conduct joint activities, all costs of those joint activities should be charged to fund raising (or the category in which fund raising is reported—see the following two parenthetical sentences), unless the purpose, audience, and content of those joint activities are appropriate for achieving those other functions. (An example of an entity that reports fund raising in a category other than fund raising is a state and local governmental entity applying the accounting and financial reporting principles in the AICPA Industry Audit Guide *Audits of Colleges and Universities*, as amended by SOP 74-8. As discussed in paragraph D.5 of this SOP [paragraph .24], those entities are required to report fund raising as part of the "institutional support" function. See also footnote # to paragraph D.5.) [Footnote revised, June 2004, to reflect conforming changes necessary due to the issuance of GASB Statements No. 34 and No. 35.]

.02 External users of financial statements—including contributors, creditors, accreditation agencies, and regulators—want assurance that fund-raising costs, as well as program costs and management and general costs, are stated fairly.

.03 In 1987, the AICPA issued Statement of Position (SOP) 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*.⁴ SOP 87-2 required that all circumstances concerning informational materials and activities that include a fund-raising appeal be considered in accounting for **joint costs** of those materials and activities and that certain criteria be applied in determining whether joint costs of those materials and activities should be charged to fund raising or allocated to program or management and general. Those criteria include requiring verifiable indications of the reasons for conducting the activity, such as the content, audience, and action, if any, requested of the participant, as well as other corroborating evidence. Further, SOP 87-2 required that all joint costs of those materials and activities be charged to fund raising unless the appeal is designed to motivate its audience to action other than providing financial support to the organization.

.04 The provisions of SOP 87-2 have been difficult to implement and have been applied inconsistently in practice. (Appendix B [paragraph .22], "Background," discusses this further.)

.05 This SOP establishes financial accounting standards for accounting for **costs of joint activities**. In addition, this SOP requires financial statement disclosures about the nature of the activities for which joint costs have been allocated and the amounts of joint costs. Appendix F [paragraph .26] provides explanations and illustrations of some acceptable allocation methods.

Scope

.06 This SOP applies to all nongovernmental NPOs and all state and local governmental entities that solicit **contributions**.

Conclusions

Accounting for Joint Activities

.07 If the criteria of purpose, audience, and content are met, the costs of a **joint activity** that are identifiable with a particular function should be charged to that function and joint costs should be allocated between fund raising and the appropriate program or management and general function. If any of the criteria are not met, all costs of the joint activity should be reported as fund-raising costs, including costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity, subject to the exception in the following sentence. Costs of goods or services

⁴ In August 1996, the AICPA issued the Audit and Accounting Guide *Not-for-Profit Organizations*. The Guide supersedes SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*, because the provisions of SOP 87-2 are incorporated into paragraphs 13.36 to 13.45 of *Not-for-Profit Organizations*. *Not-for-Profit Organizations* applies to all nongovernmental NPOs other than those required to follow the Audit and Accounting Guide *Health Care Organizations*. The discussion in this SOP of SOP 87-2 refers to both SOP 87-2 and the guidance included in paragraphs 13.36 to 13.45 of *Not-for-Profit Organizations*. Also, SOP 87-2 was not applicable to entities that are within the scope of Governmental Accounting Standards Board (GASB) Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*.

provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event (for example, a meal), should not be reported as fund raising.

Purpose

.08 The purpose criterion is met if the purpose of the joint activity includes accomplishing program or management and general functions. (Paragraphs .09 and .10 provide guidance that should be considered in determining whether the purpose criterion is met. Paragraph .09 provides guidance pertaining to program functions only. Paragraph .10 provides guidance pertaining to both program and management and general functions.)

.09 Program functions. To accomplish program functions, the activity should call for specific action by the audience that will **help accomplish the entity's mission**. For purposes of applying the guidance in this SOP, the following are examples of activities that do and do not call for specific action by the audience that will help accomplish the entity's mission:

- An entity's mission includes improving individuals' physical health. For that entity, motivating the audience to take specific action that will improve their physical health is a call for specific action by the audience that will help accomplish the entity's mission. An example of an activity that motivates the audience to take specific action that will improve their physical health is sending the audience a brochure that urges them to stop smoking and suggests specific methods, instructions, references, and resources that may be used to stop smoking.
- An entity's mission includes educating individuals in areas other than the causes, conditions, needs, or concerns that the entity's programs are designed to address (referred to hereafter in this SOP as "causes"). For that entity, educating the audience in areas other than causes or motivating the audience to otherwise engage in specific activities that will educate them in areas other than causes is a call for specific action by the audience that will help accomplish the entity's mission. Examples of entities whose mission includes educating individuals in areas other than causes are universities and possibly other entities. An example of an activity motivating individuals to engage in education in areas other than causes is a university inviting individuals to attend a lecture or class in which the individuals will learn about the solar system.
- Educating the audience about causes or motivating the audience to otherwise engage in specific activities that will educate them about causes is not a call for specific action by the audience that will help accomplish the entity's mission. Such activities are considered in support of fund raising. (However, some educational activities that might otherwise be considered as educating the audience about causes may implicitly call for specific action by the audience that will help accomplish the entity's mission. For example, activities that educate the audience about environmental problems caused by not recycling implicitly call for that audience to increase recycling. If the need for and benefits of the specific action are clearly evident from the educational message, the message is considered to include an implicit call for specific action by the audience that will help accomplish the entity's mission.)

- Asking the audience to make contributions is not a call for specific action by the audience that will help accomplish the entity's mission.

If the activity calls for specific action by the audience that will help accomplish the entity's mission, the guidance in paragraph .10 should also be considered in determining whether the purpose criterion is met.

.10 Program and management and general functions. The following factors should be considered, in the order in which they are listed,⁵ to determine whether the purpose criterion is met:

- a. Whether **compensation or fees** for performing the activity are based on contributions raised. The purpose criterion is *not* met if a majority of compensation or fees for any party's performance of any component of the discrete joint activity varies based on contributions raised for that discrete joint activity.^{6, 7}
- b. Whether a similar program or management and general activity is conducted separately and on a similar or greater scale. The purpose criterion is met if either of the following two conditions is met:

(1) *Condition 1:*

- The program component of the joint activity calls for specific action by the recipient that will help accomplish the entity's mission and
- A similar program component is conducted without the fund-raising component using the same **medium** and on a scale that is similar to or greater than the scale on which it is conducted with the fund raising.⁸

(2) *Condition 2:*

A management and general activity that is similar to the management and general component of the joint activity being accounted for is conducted without the fund-raising component using the same medium and on a scale that is

⁵ In considering the guidance in paragraph .10, the factor in paragraph .10a (the compensation or fees test) is the preeminent guidance. If the factor in paragraph .10a is not determinative, the factor in paragraph .10b (whether a similar program or management and general activity is conducted separately and on a similar or greater scale) should be considered. If the factor in paragraph .10b is not determinative, the factor in paragraph .10c (other evidence) should be considered.

⁶ Some compensation contracts provide that compensation for performing the activity is based on a factor other than contributions raised, but not to exceed a specified portion of contributions raised. For example, a contract may provide that compensation for performing the activity is \$10 per contact hour, but not to exceed 60 percent of contributions raised. In such circumstances, compensation is not considered based on amounts raised, unless the stated maximum percentage is met. In circumstances in which it is not yet known whether the stated maximum percentage is met, compensation is not considered based on amounts raised, unless it is probable that the stated maximum percentage will be met.

⁷ The *compensation or fees test* is a negative test in that it either (a) results in failing the purpose criterion or (b) is not determinative of whether the purpose criterion is met. Therefore, if the activity fails the purpose criterion based on this factor (the compensation or fees test), the activity fails the purpose criterion and the factor in paragraph .10b should not be considered. If the purpose criterion is not failed based on this factor, this factor is not determinative of whether the purpose criterion is met and the factor in paragraph .10b should be considered.

⁸ Determining the scale on which an activity is conducted may be a subjective determination. Factors to consider in determining the scale on which an activity is conducted may include dollars spent, the size of the audience reached, and the degree to which the characteristics of the audience are similar to the characteristics of the audience of the activity being evaluated.

similar to or greater than the scale on which it is conducted with the fund raising

If the purpose criterion is met based on the factor in paragraph .10b, the factor in paragraph .10c should not be considered.

- c. *Other evidence.* If the factors in paragraph .10a or .10b do not determine whether the purpose criterion is met, other evidence may determine whether the criterion is met. All available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, the purpose criterion is met.

.11 The following are examples of indicators that provide evidence for determining whether the purpose criterion is met:

- a. Evidence that the purpose criterion may be met includes—
 - *Measuring program results and accomplishments of the activity.* The facts may indicate that the purpose criterion is met if the entity measures program results and accomplishments of the activity (other than measuring the extent to which the public was educated about causes).
 - *Medium.* The facts may indicate that the purpose criterion is met if the program component of the joint activity calls for specific action by the recipient that will help accomplish the entity's mission and if the entity conducts the program component without a significant fund-raising component in a different medium. Also, the facts may indicate that the purpose criterion is met if the entity conducts the management and general component of the joint activity without a significant fund-raising component in a different medium.
- b. Evidence that the purpose criterion may not be met includes—
 - *Evaluation or compensation.* The facts may indicate that the purpose criterion is not met if (a) the evaluation of any party's performance of any component of the discrete joint activity varies based on contributions raised for that discrete joint activity or (b) some, but less than a majority, of compensation or fees for any party's performance of any component of the discrete joint activity varies based on contributions raised for that discrete joint activity.
- c. Evidence that the purpose criterion may be either met or not met includes—
 - *Evaluation of measured results of the activity.* The entity may have a process to evaluate measured program results and accomplishments of the activity (other than measuring the extent to which the public was educated about causes). If the entity has such a process, in evaluating the effectiveness of the joint activity, the entity may place significantly greater weight on the activity's effectiveness in accomplishing program goals or may place significantly greater weight on the activity's effectiveness in raising contributions. The former may indicate that the purpose criterion is met. The latter may indicate that the purpose criterion is not met.

- *Qualifications.* The qualifications and duties of those performing the joint activity should be considered.
 - If a third party, such as a consultant or contractor, performs part or all of the joint activity, such as producing brochures or making telephone calls, the third party's experience and the range of services provided to the entity should be considered in determining whether the third party is performing fund-raising, program (other than educating the public about causes), or management and general activities on behalf of the entity.
 - If the entity's employees perform part or all of the joint activity, the full range of their job duties should be considered in determining whether those employees are performing fund-raising, program (other than educating the public about causes), or management and general activities on behalf of the entity. For example, (a) employees who are not members of the fund-raising department and (b) employees who are members of the fund-raising department but who perform non-fund-raising activities are more likely to perform activities that include program or management and general functions than are employees who otherwise devote significant time to fund raising.
- *Tangible evidence of intent.* Tangible evidence indicating the intended purpose of the joint activity should be considered. Examples of such tangible evidence include
 - The entity's written mission statement, as stated in its fund-raising activities, bylaws, or annual report.
 - Minutes of board of directors', committees', or other meetings.
 - Restrictions imposed by donors (who are not related parties) on gifts intended to fund the joint activity.
 - Long-range plans or operating policies.
 - Written instructions to other entities, such as script writers, consultants, or list brokers, concerning the purpose of the joint activity, audience to be targeted, or method of conducting the joint activity.
 - Internal management memoranda.

Audience

.12 A rebuttable presumption exists that the audience criterion is not met if the audience includes prior donors or is otherwise selected based on its ability or likelihood to contribute to the entity. That presumption can be overcome if the audience is also selected for one or more of the reasons in paragraph .13a, .13b, or .13c. In determining whether that presumption is overcome, entities should consider the extent to which the audience is selected based on its ability or likelihood to contribute to the entity and contrast that with the extent to which it is selected for one or more of the reasons in paragraph .13a, .13b, or .13c. For example, if the audience's ability or likelihood to contribute is a significant factor in its selection and it has a need for the action related to the program component of the joint activity, but having that need is an insignificant factor in its selection, the presumption would not be overcome.

.13 In circumstances in which the audience includes no prior donors and is not otherwise selected based on its ability or likelihood to contribute to the entity, the audience criterion is met if the audience is selected for one or more of the following reasons:

- a. The audience's need to use or reasonable potential for use of the specific action called for by the program component of the joint activity
- b. The audience's ability to take specific action to assist the entity in meeting the goals of the program component of the joint activity
- c. The entity is required to direct the management and general component of the joint activity to the particular audience or the audience has reasonable potential for use of the management and general component

Content

.14 The content criterion is met if the joint activity supports program or management and general functions, as follows:

- a. *Program.* The joint activity calls for specific action by the recipient that will help accomplish the entity's mission. If the need for and benefits of the action are not clearly evident, information describing the action and explaining the need for and benefits of the action is provided.
- b. *Management and general.* The joint activity fulfills one or more of the entity's management and general responsibilities through a component of the joint activity.⁹

.15 Information identifying and describing the entity, causes, or how the contributions provided will be used is considered in support of fund raising.

Allocation Methods

.16 The cost allocation methodology used should be rational and systematic, it should result in an allocation of joint costs that is reasonable, and it should be applied consistently given similar facts and circumstances.

Incidental Activities

.17 Some fund-raising activities conducted in conjunction with program or management and general activities are incidental to such program or management and general activities. For example, an entity may conduct a fund-raising activity by including a generic message, "Contributions to Organization X may be sent to [address]" on a small area of a message that would otherwise be considered a program or management and general activity based on its purpose, audience, and content. That fund-raising activity likely would be considered incidental to the program or management and general activity being conducted. Similarly, entities may conduct program or management and general activities in conjunction with fund-raising activities that are incidental to such fund-raising activities. For example, an entity may conduct a program activity by including a generic program message such as "Continue to pray for [a particular cause]" on a small area of a message that would otherwise be considered

⁹ Some states or other regulatory bodies require that certain disclosures be included when soliciting contributions. For purposes of applying the guidance in this SOP, communications that include such required disclosures are considered fund-raising activities and are not considered management and general activities.

fund raising based on its purpose, audience, and content. That program activity would likely be considered incidental to the fund-raising activity being conducted. Similarly, an entity may conduct a management and general activity by including a brief management and general message—"We recently changed our phone number. Our new number is 123-4567"—on a small area of a message that would otherwise be considered a program or fund-raising activity based on its purpose, audience, and content. That management and general activity would likely be considered incidental to the program or fund-raising activity being conducted. In circumstances in which a fund-raising, program, or management and general activity is conducted in conjunction with another activity and is incidental to that other activity, and the conditions in this SOP for allocation are met, joint costs are permitted but not required to be allocated and may therefore be charged to the functional classification related to the activity that is not the incidental activity. However, in circumstances in which the program or management and general activities are incidental to the fund-raising activities, it is unlikely that the conditions required by this SOP to permit allocation of joint costs would be met.

Disclosures

.18 Entities that allocate joint costs should disclose the following in the notes to their financial statements:

- a. The types of activities for which joint costs have been incurred
- b. A statement that such costs have been allocated
- c. The total amount allocated during the period and the portion allocated to each functional expense category

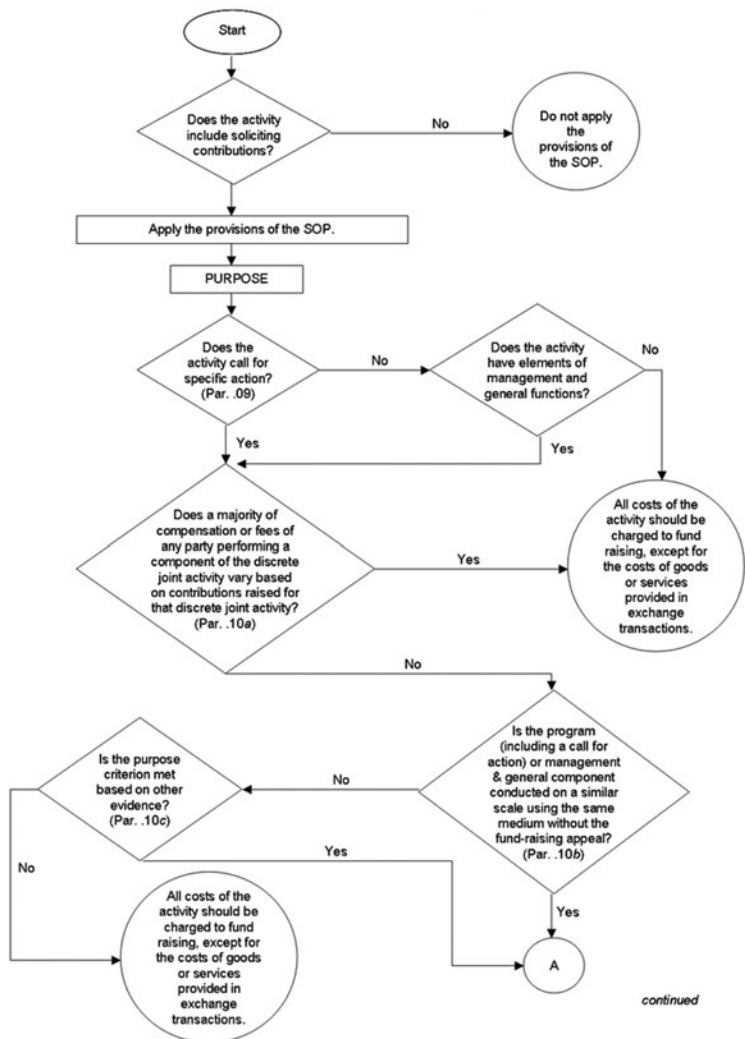
.19 This SOP encourages, but does not require, that the amount of joint costs for each kind of joint activity be disclosed, if practical.

Effective Date

.20 This SOP is effective for financial statements for years beginning on or after December 15, 1998. Earlier application is encouraged in fiscal years for which financial statements have not been issued. If comparative financial statements are presented, retroactive application is permitted but not required.

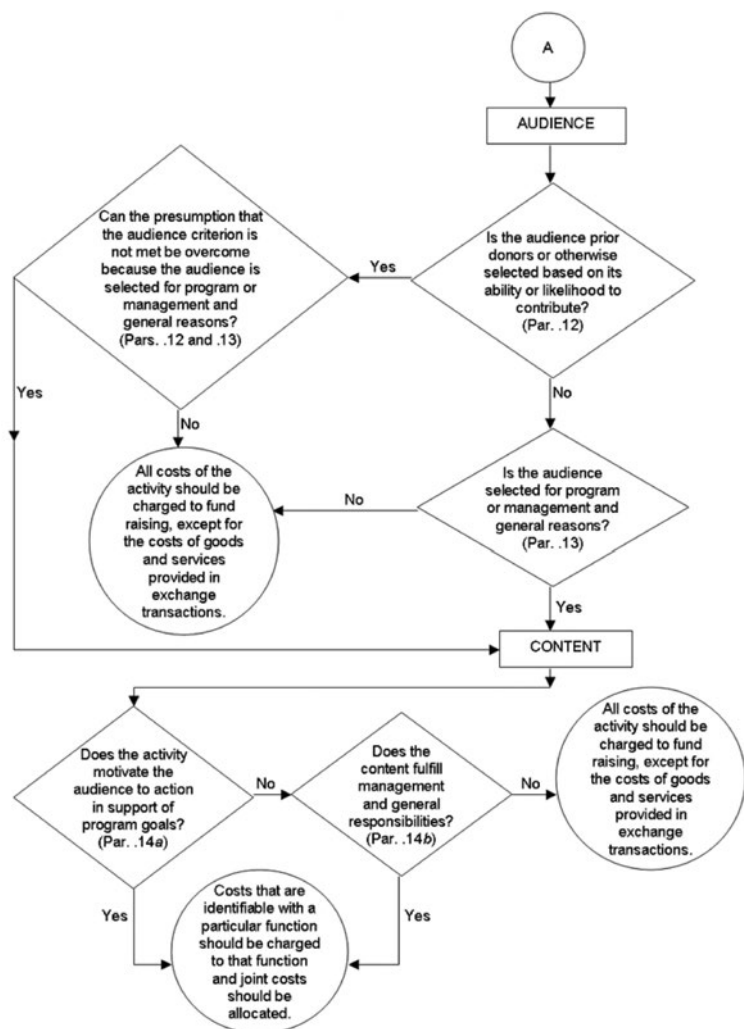
The provisions of this Statement of Position need not be applied to immaterial items.

Appendix A
Accounting for Joint Activities¹⁰



¹⁰ **Note:** This flowchart summarizes certain guidance in this SOP and is not intended as a substitute for the SOP.

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Appendix B

Background

B.1. As stated in paragraph .04, the provisions of Statement of Position (SOP) 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*, have been difficult to implement and applied inconsistently in practice. That difficulty has been due in part to the following:

- The second sentence of paragraph 1 of SOP 87-2 stated that "some of the costs incurred by such organizations are clearly identifiable with fundraising, such as the cost of fund-raising consulting services." It is unclear whether activities that would otherwise be considered program activities should be characterized as program activities if they are performed or overseen by professional fund raisers. Also, it is unclear whether activities would be reported differently (for example, as program rather than fund raising) depending on whether the fund-raising consultant is compensated by a predetermined fee or by some other method, such as a percentage of contributions raised.
- SOP 87-2 was unclear about whether allocation of costs to fund-raising expense is required if the activity for which the costs were incurred would not have been undertaken without the fund-raising component.
- SOP 87-2 defined joint costs through examples, and it is therefore unclear what kinds of costs were covered by SOP 87-2. For example, it is unclear whether salaries and indirect costs can be joint costs.
- Some believe the guidance in SOP 87-2 was inadequate to determine whether joint activities, such as those that request contributions and also list the warning signs of a disease, are designed to motivate their audiences to action other than to provide contributions to the entity. It is unclear what attributes the targeted audience should possess in order to conclude that a program function is being conducted.

B.2. In 1992, the Accounting Standards Executive Committee (AcSEC) undertook a project to supersede SOP 87-2, to provide clearer guidance than that provided by SOP 87-2, as well as to provide guidance that would improve on the guidance in SOP 87-2. In September 1993, AcSEC released an exposure draft of a proposed SOP, *Accounting for Costs of Materials and Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include a Fund-Raising Appeal*, for public comment. AcSEC received more than 300 comment letters on the exposure draft. AcSEC redeliberated the issues based on the comments received.

B.3. In 1996, after redeliberating the issues based on the comments received and making certain revisions to the draft SOP, AcSEC conducted a field test of the draft SOP. The objectives of the field test were to determine whether the provisions of the draft SOP were sufficiently clear and definitive to generate consistent and comparable application of the SOP. Based on the field test results, AcSEC concluded that the provisions of the draft SOP, with certain revisions,

were sufficiently clear and definitive to generate consistent and comparable application of the SOP.

B.4. Some respondents who commented on the exposure draft, as well as some interested parties who followed the project through its due process subsequent to the exposure draft, commented that the SOP should be reexposed for public comment. Reasons cited include:

- Approximately three years had passed between the end of the comment period and AcSEC's decision to issue the SOP.
- AcSEC made significant revisions to the SOP subsequent to re-releasing the exposure draft for comment.

Considering whether a proposed standard should be reexposed for public comment is inherently a subjective process. Factors that AcSEC considered include—

- The significance of changes made to the exposure draft and whether those changes result in guidance that the public did not have an opportunity to consider.
- Whether the scope was revised in such a way that affected entities did not have an opportunity to comment.
- New information about or changes in the nature of the transactions being considered, practice, or other factors.

AcSEC believes that the length of time between exposure and final issuance is not pertinent to whether the SOP should be reexposed for public comment.

B.5. Based on consideration of the factors identified, AcSEC believes that the SOP should not be reexposed for public comment. AcSEC notes that although the SOP has been revised based on comments received on the exposure draft, those revisions do not change the overall model in the SOP. Those revisions were made primarily to clarify the SOP and improve its operationality. Further, AcSEC believes that the project received a high level of attention from interested parties. AcSEC provided working drafts to interested parties and those parties provided input throughout the process, up to and including the Financial Accounting Standard Board's and the Governmental Accounting Standards Board's clearance of the SOP for issuance.

B.6. Appendix C [paragraph .23] discusses the key issues in the exposure draft and comments received on those issues, as well as the basis for AcSEC's conclusions on those and certain other issues.

Appendix C

Basis for Conclusions

C.1. This section discusses considerations that were deemed significant by members of the Accounting Standards Executive Committee (AcSEC) in reaching the conclusions in this Statement of Position (SOP). It includes reasons for accepting certain views and rejecting others. Individual AcSEC members gave greater weight to some factors than to others.

Overall Framework

C.2. This SOP uses the model in SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*, as a starting point and clarifies guidance that was unclear, provides more detailed guidance, revises some guidance, and expands the scope of costs covered to include all costs of joint activities. The model established by SOP 87-2 was to account for joint costs as fund raising unless an entity could demonstrate that a program or management and general function had been conducted. SOP 87-2 used verifiable indications of the reasons for conducting the activity, such as content, audience, the action requested, if any, and other corroborating evidence as a basis for determining whether a program or management and general function had been conducted.

C.3. On an overall basis, the majority of respondents who commented on the September 1993 exposure draft of a proposed SOP, *Accounting for Costs of Materials and Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include a Fund-Raising Appeal*, opposed it, for various reasons, including the following:

- The guidance in SOP 87-2 is operational, results in sound financial reporting, and should be retained.
- The guidance in SOP 87-2 should be retained but clarified.
- The guidance proposed in the exposure draft should be revised. (Some commented that it overstates fund raising; others commented that it understates fund raising.)

C.4. AcSEC concluded that it supports the model in the exposure draft, subject to certain revisions. AcSEC believes that this SOP provides clear, detailed accounting guidance that, when applied, will increase comparability of financial statements. Those statements will also include more meaningful disclosures without incurring increased costs.

C.5. Some respondents commented that the model in the exposure draft would adversely affect entities both financially and operationally. Various reasons were given, including the following:

- It would inhibit the ability of entities, particularly small entities and entities that raise contributions through direct solicitations, to generate the necessary revenue to perform their program services.
- Most entities would not meet the criteria in this SOP for reporting costs of joint activities as program or management and general,

because they must combine their mission statements, public information and education, and fund-raising appeals due to a lack of resources. Some noted that this may result in unsatisfactory ratings from public watchdog groups.

AcSEC did not find these arguments compelling. This SOP provides accounting guidance; it provides no guidance concerning how entities should undertake their activities. Also, this SOP does not prohibit allocation merely because activities carrying out different functions are combined. In fact, this SOP provides guidance for reporting costs as program or management and general in circumstances in which those activities are combined with fund-raising. Moreover, actions taken by financial statement users are not the direct result of the requirements of this SOP. Rather, those actions may result from more relevant and useful information on which to base decisions.

C.6. Some respondents commented that the exposure draft is biased toward reporting expenses as fund raising. AcSEC believes that determining whether the costs of joint activities should be classified as program, management and general, or fund raising sometimes is difficult, and such distinctions sometimes are subject to a high degree of judgment. AcSEC believes that external financial statement users focus on and have perceptions about amounts reported as program, management and general, and fund raising. That focus and those perceptions provide incentives for entities to report expenses as program or management and general rather than fund raising. Therefore, in circumstances in which joint activities are conducted, a presumption exists that expenses should be reported as fund raising rather than as program or management and general. The criteria in this SOP provide guidance for entities to overcome that presumption.

Accounting for Joint Activities

C.7. This SOP requires that if any of the criteria of purpose, audience, and content are not met, all costs of the activity should be reported as fund raising, including costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity, subject to the exception in the following sentence. Costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event (for example, a meal), should not be reported as fund raising. (This SOP expands on the model established by SOP 87-2 by including all costs of joint activities other than costs of goods or services provided in exchange transactions, rather than merely joint costs.) AcSEC believes that the criteria of purpose, audience, and content are each relevant in determining whether a joint activity should be reported as fund raising, program, or management and general because each provides significant evidence about the benefits expected to be obtained by undertaking the activity.

C.8. Some respondents commented that reporting costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity as fund raising is misleading and that the scope of the SOP should include only joint costs of joint activities. Some commented that reporting costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity as fund raising conflicts with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations*, which defines fund raising, program, and management and general and requires not-for-profit organizations (NPOs) to report information about expenses using those functional classifications.

C.9. AcSEC believes that the purpose for which costs other than joint costs are incurred may be fund raising, program, or management and general, depending on the context in which they are used in the activity undertaken. For example, a program-related pamphlet may be sent to an audience in need of the program. In that context, the pamphlet is used for program purposes. However, in order to demonstrate to potential donors that the entity's programs are worthwhile, that same pamphlet may be sent to an audience that is likely to contribute, but that has no need or reasonable potential for use of the program. In that context, the pamphlet is used for fund raising. AcSEC believes this broader scope will result in more comparability and more meaningful financial reporting by covering all costs of activities that include fund raising and by assigning those costs to the function for which they are incurred, consistent with the guidance in Statement No. 117.

C.10. AcSEC believes that costs of goods or services provided in exchange transactions should not be charged to fund raising because those costs are incurred in exchange for revenues other than contributions.

Criteria of Purpose, Audience, and Content

Call For Action

C.11. The definition of *program* in FASB Statement No. 117 includes public education. As noted in paragraph C.6, AcSEC believes that in circumstances in which joint activities are conducted, a presumption exists that expenses should be reported as fund raising rather than as program or management and general. AcSEC believes that in order to overcome that presumption, it is not enough that (a) the purpose of the activity include educating the public about causes, (b) the audience has a need or reasonable potential for use of any educational component of the activity pertaining to causes, or (c) the audience has the ability to assist the entity in meeting the goals of the program component of the activity by becoming educated about causes. Therefore, AcSEC concluded that for purposes of this SOP, in order to conclude that the criteria of purpose, audience, and content are met program activities are required to call for specific action by the recipient (other than becoming educated about causes) that will help accomplish the entity's mission. As discussed in paragraph .09, in certain circumstances educational activities may call for specific action by the recipient that will help accomplish the entity's mission.

Purpose

C.12. AcSEC believes meeting the purpose criterion demonstrates that the purpose of the activity includes accomplishing program or management and general functions. Inherent in the notion of a joint activity is that the activity has elements of more than one function. Accordingly, the purpose criterion provides guidance for determining whether the purpose of the activity includes accomplishing program or management and general functions in addition to fund raising.

Compensation and Evaluation Tests

C.13. The exposure draft proposed that all costs of the joint activity should be charged to fund raising if (a) substantially all compensation or fees for performing the activity are based on amounts raised or (b) the evaluation of the party performing the activity is based on amounts raised. Some respondents commented that basing the method of compensation or evaluating the performance

of the party performing the activity based on contributions raised should not lead to the conclusion that all costs of the activity should be charged to fund raising. Others commented that the method of compensation is unrelated to whether the purpose criterion is met. The reasons given included the following:

- It is counterintuitive to imply that those performing multipurpose activities that include fund raising would not be compensated or evaluated based on amounts raised.
- Such guidance would create a bias toward entities that use employees to raise contributions and against entities that hire professional fund raisers and public relations firms and is therefore not neutral.

Some respondents gave examples of circumstances in which substantially all compensation is based on contributions raised and asserted that the activity was nevertheless a program activity. In each of those examples, AcSEC considered all the facts presented and concluded that the activity was fund raising.

C.14. AcSEC continues to support the spirit of the proposed guidance, because AcSEC believes that basing a majority of compensation on funds raised is persuasive evidence that the activity is a fund-raising activity. Nevertheless, AcSEC believes that the proposed guidance was unclear and would be difficult to implement, primarily because of the broad definition of "based on contributions raised" included in the glossary of the exposure draft. In connection with that issue, AcSEC was concerned that any joint activities performed by a fund-raising department or by individuals whose duties include fund raising, such as executive officers of small NPOs who are employed based on their ability to raise contributions, would be required to be reported as fund raising because the compensation of the parties performing those activities is based on amounts raised. Also, AcSEC had concerns that it would be difficult to determine whether fixed contract amounts were negotiated based on expected contributions. Therefore, AcSEC concluded that the compensation test should be revised to provide that the purpose criterion is not met if a majority of compensation or fees for any party's performance of any component of the discrete joint activity varies based on contributions raised for that discrete joint activity. AcSEC believes that guidance is sound and is operational.

C.15. AcSEC believes that the guidance in paragraph .10a is not biased against entities that hire professional fund raisers, because it applies to the entity's employees as well as professional fund raisers. For example, if a majority of an employee's compensation or fees for performing a component of a discrete joint activity varies based on contributions raised for that discrete joint activity, the purpose criterion is not met.

Similar Function-Similar Medium Test

C.16. Some respondents misinterpreted the exposure draft as providing that, in order to meet the purpose criterion, the program or management and general activity must be conducted without the fund-raising component, using the same medium and on a scale that is similar to or greater than the program or management and general component of the activity being accounted for. That was not a requirement proposed by the exposure draft. The exposure draft proposed that meeting that condition would result in meeting the purpose criterion. Failing the criterion merely leads to consideration of other evidence, such as the indicators in paragraph .11. AcSEC has revised the SOP to state this more clearly.

Other Evidence

C.17. The compensation test and the similar function-similar medium test may not always be determinative because the attributes that they consider may not be present. Therefore, this SOP includes indicators that should be considered in circumstances in which the compensation test and the similar function-similar medium test are not determinative. The nature of those indicators is such that they may be present in varying degrees. Therefore, all available evidence, both positive and negative, should be considered to determine whether, based on the weight of that evidence, the purpose criterion is met.

Audience

C.18. The exposure draft proposed that if the audience for the materials or activities is selected principally on its ability or likelihood to contribute, the audience criterion is not met and all the costs of the activity should be charged to fund raising. Further, the exposure draft proposed that if the audience is selected principally based on its need for the program or because it can assist the entity in meeting its program goals other than by financial support provided to the entity, the audience criterion is met. Some respondents commented that that audience criterion is too narrow, because it is based on the principal reason for selecting the audience. They asserted that for some activities no principal reason exists for selecting an audience; entities select the audience for those activities for multiple reasons, such as both the audience's ability to contribute and its ability to help meet program goals. Some commented that for some activities, entities select audiences that have provided past financial support because, by providing financial support, those audiences have expressed an interest in the program.

C.19. AcSEC believes that meeting the audience criterion should demonstrate that the audience is selected because it is a suitable audience for accomplishing the activity's program or management and general functions. Therefore, the reasons for selecting the audience should be consistent with the program or management and general content of the activity. However, AcSEC believes it is inherent in the notion of joint activities that the activity has elements of more than one function, including fund raising, and acknowledges that it may be difficult to determine the principal reason for selecting the audience. Accordingly, AcSEC concluded that if the audience includes prior donors or is otherwise selected based on its ability or likelihood to contribute, a rebuttable presumption should exist that the audience was selected to raise funds. AcSEC believes that the reasons for selecting the audience that can overcome that presumption, which are included in paragraph .13 of this SOP, demonstrate that the audience is selected because it is a suitable audience for accomplishing the activity's program or management and general functions based on the program or management and general content of the activity.

Content

C.20. AcSEC believes that meeting the content criterion demonstrates that the content of the activity supports program or management and general functions. AcSEC believes that accounting guidance should not impose value judgments about whether the entity's mission, programs, and responsibilities are worthwhile. Therefore, whether the content criterion is met depends on the relationship of the content to the entity's mission, programs, and management and general responsibilities.

C.21. Paragraph .14 provides that, to meet the content criterion, program activities should call for specific action by the recipient that will help accomplish

the entity's mission. The exposure draft proposed that slogans, general calls to prayer, and general calls to protest do not meet the content criterion; some respondents disagreed. AcSEC concluded that this SOP should be silent concerning whether slogans, general calls to prayer, and general calls to protest are calls to action that meet the content criterion. AcSEC believes that determining whether those items are calls to action that meet the content criterion requires judgments based on the particular facts and circumstances.

C.22. Some respondents commented that educating the public about causes without calling for specific action should satisfy the content criterion. They noted that this is particularly relevant for NPOs subject to Internal Revenue Code (IRC) Section 501(c)4, because those NPOs are involved in legislative reform. Also, some noted that it may be the entity's mission or goal to educate the public about causes. They believe that, in those cases, the NPO's program is to educate the public about causes without necessarily calling for specific action by the recipient.

C.23. As discussed in paragraph C.11, AcSEC concluded that education that does not motivate the audience to action is in fact done in support of fund raising. However, this SOP acknowledges that some educational messages motivate the audience to specific action, and those messages meet the content criterion. AcSEC believes that that provision will result in the activities of some NPOs subject to IRC Section 501(c)4 (and some other entities, whose mission or goal is to educate the public) meeting the content criterion.

C.24. Paragraph .13c provides that one way that the audience criterion is met is if the entity is required to direct the management and general component of the activity to the particular audience. Further, as discussed in paragraph D.13, in *Discussion of Conclusions*, an audience that includes prior donors and is selected because the entity is required to send them certain information to comply with requirements of the Internal Revenue Service (IRS) is an example of an audience that is selected because the entity is required to direct the management and general component of the activity to that audience. Paragraph .14b provides that one way that the content criterion is met is if the activity fulfills one or more of the entity's management and general responsibilities through a component of the joint activity. However, footnote 9 to paragraph .14b provides that disclosures made when soliciting contributions to comply with requirements of states or other regulatory bodies are considered fund-raising activities, and are not considered management and general activities. AcSEC considered whether it is inconsistent to conclude both that (a) activities conducted to comply with requirements of regulatory bodies concerning contributions that have been received are management and general activities, and that (b) activities conducted to comply with requirements of regulatory bodies concerning soliciting contributions are fund-raising activities. AcSEC believes that those provisions are not inconsistent. AcSEC believes there is a distinction between (a) requirements that must be met as a result of receiving contributions and (b) requirements that must be met in order to solicit contributions. AcSEC believes that activities that are undertaken as a result of receiving contributions are management and general activities while activities that are undertaken in order to solicit contributions are fund-raising activities.

Incidental Activities

C.25. Many entities conduct fund-raising activities in conjunction with program or management and general activities that are incidental to such program or management and general activities. Similarly, entities may conduct program or management and general activities in conjunction with fund-raising

activities that are incidental to such fund-raising activities. Such efforts may be a practical and efficient means for entities to conduct activities, although the principal purpose of the activity may be to fulfill either fund-raising, program, or management and general functions. The exposure draft proposed that incidental activities need not be considered in applying this SOP. Some respondents disagreed with that guidance, while others commented that it was confusing. AcSEC continues to support that guidance. AcSEC believes that guidance is necessary to avoid requiring complex allocations in circumstances in which the criteria of purpose, audience, and content are met but the activity is overwhelmingly either fund raising, program, or management and general.

Allocation Methods

C.26. Respondents had various comments concerning allocation methods, including the following:

- The SOP should focus on allocation methods rather than on circumstances in which entities should allocate.
- The SOP should prescribe allocation methods.
- The approach taken in the SOP—discussing, rather than requiring or prohibiting allocation methods—is sound.
- Certain allocation methods should be prohibited.
- The SOP should set maximum allocation percentages.

AcSEC believes that no particular allocation method or methods are necessarily more desirable than other methods in all circumstances. Therefore, this SOP neither prescribes nor prohibits any particular allocation methods. AcSEC believes entities should apply the allocation methods that result in the most reasonable cost allocations for their activities. Appendix F [paragraph .26] of this SOP illustrates several allocation methods, any one of which may result in a reasonable or unreasonable allocation of costs in particular circumstances. The methods illustrated are not the only acceptable methods. However, AcSEC believes that the methods illustrated in this SOP are among those most likely to result in meaningful cost allocations.

C.27. Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*, states in paragraph 7 that "the term *accounting principle* includes 'not only accounting principles and practices but also the methods of applying them.'" APB Opinion 20 also states in paragraphs 15 and 16 that

...In the preparation of financial statements there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type....The presumption that an entity should not change an accounting principle may be overcome only if the enterprise justifies the use of an alternative acceptable accounting principle [*allocation method*] on the basis that it is preferable.

A change in cost allocation methodology may be a change in accounting principle for entities covered by this SOP. Accordingly, paragraph .16 of this SOP provides that the cost allocation methodology used should be applied consistently, given similar facts and circumstances.

Disclosures

C.28. Respondents made various comments concerning the required and encouraged disclosures, including recommendations for additional disclosures and

recommendations that certain disclosures be deleted. AcSEC was not persuaded that the costs of the other disclosures recommended by respondents are justified by their benefits. AcSEC believes that, with the exception of one disclosure, the disclosures prescribed by the exposure draft provide relevant information about the kinds of activities for which joint costs have been incurred and the manner in which those costs are reported in the financial statements. In considering disclosures proposed by the exposure draft about the allocation method, AcSEC observed that there are no requirements to disclose methods of allocating other expenses and questioned the utility of disclosing the allocation method in this circumstance. AcSEC concluded that the requirement to disclose the allocation method should be deleted.

C.29. Paragraph .19 encourages, but does not require, certain disclosures. AcSEC believes those disclosures provide useful information but that they should be encouraged rather than required because the costs of making them may not be justified by the benefits in all cases.

Effective Date

C.30. Some respondents commented that the effective date should be deferred. AcSEC believes that the accounting systems required to implement this SOP are already in place and that implementation should be relatively straightforward. However, AcSEC acknowledges that some entities may change their operations based on the reporting that would result from this SOP. Therefore, AcSEC concluded that this SOP should be effective for financial statements for years beginning on or after December 15, 1998.

Cost-Benefit

C.31. Some respondents commented that the guidance would increase record keeping costs. AcSEC believes that implementing this SOP will not significantly increase record keeping costs, which are primarily the costs of documenting reasons for undertaking joint activities. Further, AcSEC believes that the costs of making the disclosures required by this SOP should be minimal, because entities should already have the information that is required to be disclosed. AcSEC believes that implementing this SOP will result in more relevant, meaningful, and comparable financial reporting and that the cost of implementing this SOP will be justified by its benefits.

Appendix D

Discussion of Conclusions

Scope

D.1. This Statement of Position (SOP) applies only to costs of joint activities. It does not address allocations of costs in other circumstances.

Reporting Models and Related Requirements

D.2. Paragraph 26 of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations*, specifies that a statement of activities or notes to the financial statements should provide information about expenses reported by their functional classification, such as major classes of program services and supporting activities. Paragraph 13.34 of the AICPA Audit and Accounting Guide *Not-for-Profit Organizations* provides that the financial statements of not-for-profit organizations (NPOs) should disclose the total fund-raising expenses. [Revised, June 2004, to reflect conforming changes necessary due to conforming changes made to the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*.]

D.3. Governmental Accounting Standards Board (GASB) Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*, provides that governmental entities should not change their accounting and financial reporting to apply the provisions of FASB Statements No. 116, *Accounting for Contributions Received and Contributions Made*, and No. 117. GASB Statement No. 29 permits governmental entities that have applied the accounting and financial reporting principles in SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*, or in the AICPA Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations* modified by all applicable FASB pronouncements issued through November 30, 1989, and by most applicable GASB pronouncements) to continue to do so, pending GASB pronouncements on the accounting and financial reporting model for governmental entities. Alternatively, those governmental entities are permitted to change to the current governmental financial reporting model.[‡]

D.4. GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*, requires governmental colleges and universities to use one of two accounting and financial reporting models. One model, referred to as the "AICPA College Guide Model," encompasses the accounting and financial reporting guidance in the 1973 AICPA Industry Audit Guide *Audits of*

[‡] GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, supersedes the provisions of GASB Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*, relating to the use of the AICPA Not-for-Profit model. See GASB Statement No. 34, including paragraph 147. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance on the application of this SOP to state and local governments. [Footnote revised, June 2004, to reflect conforming changes necessary due to the issuance of GASB Statement No. 34.]

Colleges and Universities, as amended by SOP 74-8, *Financial Accounting and Reporting by Colleges and Universities*, and as modified by applicable FASB pronouncements issued through November 30, 1989, and all applicable GASB pronouncements. (The other model, referred to as the "Governmental Model," is based on the pronouncements of the National Council on Governmental Accounting [NCGA] and the GASB.)¹¹

D.5. For state and local governmental entities, some are required to report expenses by function using the functional classifications of program, management and general, and fund raising. Other state and local governmental entities that report expenses or expenditures by function have a functional structure that does not include fund raising, program, or management and general. Still other state and local governmental entities do not report expenses or expenditures by function. Examples of those various reporting requirements are as follows:[#]

- Entities applying the accounting and financial reporting principles in the AICPA Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations*, as well as those that follow SOP 78-10 and that receive significant amounts of contributions from the public, are required to report separately the costs of the fund-raising, program, and management and general functions.
- Entities applying the accounting and financial reporting principles in the AICPA Industry Audit Guide *Audits of Colleges and Universities*, as amended by SOP 74-8, are required to report fund raising as part of the "institutional support" function.

D.6. As discussed in footnote 3 to paragraph .01 of this SOP, this SOP is not intended to require reporting the functional classifications of fund raising, program, and management and general. Rather, those functional classifications are discussed throughout this SOP for purposes of illustrating how the guidance in this SOP would be applied by entities that use those functional classifications. Entities that do not use the functional classifications of fund raising, program, and management and general should apply the guidance in this SOP for purposes of accounting for joint activities, using their reporting model. For example, some entities may conduct membership-development activities. As discussed in the Glossary [paragraph .30] of this SOP, if there are no significant benefits or duties connected with membership, the substance of the membership-development activities may, in fact, be fund raising. In such circumstances, the costs of those activities should be charged to fund raising. To the extent that member benefits are received, membership is an exchange transaction. In circumstances in which membership development is in part soliciting revenues from exchange transactions and in part soliciting contributions and the purpose, audience, and content of the activity are appropriate for achieving membership development, joint costs should be allocated between fund raising and the exchange transaction.

¹¹ GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, supersedes GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*. See GASB Statements No. 34 and No. 35. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance on the application of this SOP to governmental (public) colleges and universities. [Footnote revised, June 2004, to reflect conforming changes necessary due to the issuance of GASB Statement No. 35.]

[#] This discussion is no longer applicable. See footnotes ‡ and || in paragraphs D.3 and D.4, respectively. [Footnote added, June 2004, to reflect conforming changes necessary due to the issuance of GASB Statements No. 34 and No. 35.]

Assigning Costs of Joint Activities

D.7. Paragraph .07 provides: "If the criteria of purpose, audience, and content are met, the costs of a joint activity that are identifiable with a particular function should be charged to that function and joint costs should be allocated between fund raising and the appropriate program or management and general function. If any of the criteria are not met, all costs of the joint activity should be reported as fund-raising costs, including costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity...." For example, if the criteria are met, the costs of materials that accomplish program goals and that are unrelated to fund raising, such as the costs of a program-related pamphlet included in a joint activity, should be charged to program, while joint costs, such as postage, should be allocated between fund raising and program. However, if the pamphlet is used in fund-raising packets and the criteria are not met, the costs of the pamphlets used in the fund-raising packets, as well as the joint costs, should be charged to fund raising. (If some pamphlets are used in program activities that include no fund raising, the cost of the pamphlets used in those separate program activities that include no fund raising should be charged to program.)

Educational Activities

D.8. Some entities have missions that include educating the public (students) in areas other than causes. Paragraph .09 provides that, for those entities, educating the audience in areas other than causes or motivating the audience to engage in specific activities, such as attending a lecture or class, that will educate them in areas other than causes is considered a call for specific action by the recipients that will help accomplish the entity's mission. Educating the audience about causes or motivating the audience to engage in specific activities that will educate them about causes without educating them in other subjects is not considered a call for specific action by the audience that will help accomplish the entity's mission. An example of a lecture or class that will educate students in an area other than causes is a lecture on the nesting habits of the bald eagle, given by the Save the Bald Eagle Society, an NPO whose mission is to save the bald eagle from extinction and educate the public about the bald eagle. An example of a lecture or class that will address particular causes is a lecture by the Bald Eagle Society on the potential extinction of bald eagles and the need to raise contributions to prevent their extinction. For purposes of applying the guidance in this SOP, motivating the audience to attend a lecture on the nesting habits of the bald eagle is a call for specific action that will help accomplish the entity's mission. If the lecture merely addresses the potential extinction of bald eagles and the need to raise contributions to prevent their extinction, without addressing the nesting habits of the bald eagle, motivating the audience to attend the lecture is not considered a call for specific action by the recipient that will help accomplish the entity's mission.

D.9. AcSEC notes that most transactions in which a student attends a lecture or class are exchange transactions and are not joint activities. Such transactions are joint activities only if the activity includes fund raising.

Audience

D.10. Paragraph .12 provides that a rebuttable presumption exists that the audience criterion is not met if the audience includes prior donors or is otherwise selected based on its ability or likelihood to contribute to the entity. That presumption can be overcome if the audience is also selected for the program

or management and general reasons specified in paragraph .13. Further, paragraph .12 provides that in determining whether that presumption is overcome, entities should consider the extent to which the audience is selected based on its ability or likelihood to contribute to the entity and contrast that with the extent to which it is selected for the reasons that may overcome that presumption. Some organizations conduct joint activities that are special events, such as symposia, dinners, dances, and theater parties, in which the attendee receives a direct benefit (for example, a meal or theater ticket) and for which the admission price includes a contribution. For example, it may cost \$500 to attend a dinner with a fair value of \$50. In that case, the audience is required to make a \$450 contribution in order to attend. In circumstances in which the audience is required to make a contribution to participate in a joint activity, such as attending a special event, the audience's ability or likelihood to contribute is a significant factor in its selection. Therefore, in circumstances in which the audience is required to make a contribution to participate in a joint activity, the extent to which the audience is selected for the program or management and general reasons in paragraph .13 must be overwhelmingly significant in order to rebut the presumption that the audience criterion is not met.

D.11. The source of the names and the characteristics of the audience should be considered in determining the reason for selecting the audience. Some entities use lists compiled by others to reach new audiences. The source of such lists may indicate the purpose or purposes for which they were selected. For example, lists acquired from entities with similar or related programs are more likely to meet the audience criterion than are lists acquired from entities with dissimilar or unrelated programs. Also, the characteristics of those on the lists may indicate the purpose or purposes for which they were selected. For example, a list based on a consumer profile of those who buy environmentally friendly products may be useful to an entity whose mission addresses environmental concerns and could therefore indicate that the audience was selected for its ability to take action to assist the entity in meeting program goals. However, a list based on net worth would indicate that the audience was selected based on its ability or likelihood to contribute, unless there was a correlation between net worth and the program or management and general components of the activity.

D.12. Some audiences may be selected because they have an interest in or affinity to the program. For example, homeowners may have an interest in the homeless because they are sympathetic to the plight of the homeless. Nevertheless, including homeowners in the audience of a program activity to provide services to the homeless would not meet the audience criterion, because they do not have a need or reasonable potential for use of services to the homeless.

D.13. Paragraph .13c provides that the audience criterion is met if the entity is required to direct the management and general component of the joint activity to the particular audience or the audience has reasonable potential for use of the management and general component. An example of a joint activity in which the audience is selected because the entity is required to direct the management and general component of the joint activity to the particular audience is an activity in which the entity sends a written acknowledgment or other information to comply with requirements of the Internal Revenue Service to prior donors and includes a request for contributions. An example of a joint activity in which the audience is selected because the audience has reasonable potential for use of the management and general component is an activity in which the entity sends its annual report to prior donors and includes a request for contributions.

Content

D.14. Paragraph .14 provides that, to meet the content criterion, program activities should call for specific action by the recipient that will help accomplish the entity's mission. As discussed in the Glossary [paragraph .30], the action should benefit the recipient or society. Examples of actions that benefit the recipient (such as by improving the recipient's physical, mental, emotional, or spiritual health and well-being) or society (such as by addressing societal problems) include the following:

- a. Actions that benefit the recipient:
 - *Stop smoking.* Specific methods, instructions, references, and resources should be suggested.
 - *Do not use alcohol or drugs.* Specific methods, instructions, references, and resources should be suggested.
- b. Actions that benefit society:
 - *Write or call.* The party to communicate with and the subject matter to be communicated should be specified.
 - *Complete and return the enclosed questionnaire.* The results of the questionnaire should help the entity achieve its mission. For example, if the entity discards the questionnaire, it does not help the entity achieve its mission.
 - *Boycott.* The particular product or company to be boycotted should be specified.

D.15. Paragraph .14b provides that to meet the content criterion, management and general functions are required to fulfill one or more of the entity's management and general responsibilities through a component of the joint activity. Some states or other regulatory bodies require that certain disclosures be included when soliciting contributions. Paragraph .14, footnote 9, of this SOP provides that for purposes of applying the guidance in this SOP, communications that include such required disclosures are considered fund-raising activities and are not considered management and general activities. Some examples of such disclosures include the following:

- Information filed with the attorney general concerning this charitable solicitation may be obtained from the attorney general of [*the state*] by calling 123-4567. Registration with the attorney general does not imply endorsement.
- A copy of the registration and financial information may be obtained from the Division of Consumer Services by calling toll-free, within [*the state*], 1-800-123-4567. Registration does not imply endorsement, approval, or recommendation by [*the state*].
- Information about the cost of postage and copying, and other information required to be filed under [*the state*] law, can be obtained by calling 123-4567.
- The organization's latest annual report can be obtained by calling 123-4567.

Allocation Methods

D.16. Paragraph .16 of this SOP states, "The cost allocation methodology used should be rational and systematic, it should result in an allocation of joint costs

that is reasonable, and it should be applied consistently given similar facts and circumstances." The allocation of joint costs should be based on the degree to which costs were incurred for the functions to which the costs are allocated (that is, program, management and general, or fund raising). For purposes of determining whether the allocation methodology for a particular joint activity should be consistent with methodologies used for other particular joint activities, facts and circumstances that may be considered include factors related to the content and relative costs of the components of the activity. The audience should not be considered in determining whether the facts and circumstances are similar for purposes of determining whether the allocation methodology for a particular joint activity should be consistent with methodologies used for other particular joint activities.

Practicability of Measuring Joint Costs

D.17. The Glossary [paragraph .30] of this SOP includes a definition of joint costs. Some costs, such as utilities, rent, and insurance, commonly referred to as indirect costs, may be joint costs. For example, the telephone bill for a department that, among other things, prepares materials that include both fund-raising and program components may commonly be referred to as an indirect cost. Such telephone bills may also be joint costs. However, for some entities, it is impracticable to measure and allocate the portion of the costs that are joint costs. Considerations about which joint costs should be measured and allocated, such as considerations about materiality and the costs and benefits of developing and providing the information, are the same as considerations about cost allocations in other circumstances.

Appendix E

Illustrations of Applying the Criteria of Purpose, Audience, and Content to Determine Whether a Program or Management and General Activity Has Been Conducted

Illustration 1

Facts

E.1. Entity A's mission is to prevent drug abuse. Entity A's annual report states that one of its objectives in fulfilling that mission is to assist parents in preventing their children from abusing drugs.

E.2. Entity A mails informational materials to the parents of all junior high school students explaining the prevalence and dangers of drug abuse. The materials encourage parents to counsel children about the dangers of drug abuse and inform them about how to detect drug abuse. The mailing includes a request for contributions. Entity A conducts other activities informing the public about the dangers of drug abuse and encouraging parents to counsel their children about drug abuse that do not include requests for contributions and that are conducted in different media. Entity A's executive director is involved in the development of the informational materials as well as the request for contributions. The executive director's annual compensation includes a significant bonus if total annual contributions exceed a predetermined amount.

Conclusion

E.3. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.4. The activity calls for specific action by the recipient (encouraging parents to counsel children about the dangers of drug abuse and informing them about how to detect drug abuse) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10*a* or .10*b* is determinative of whether the purpose criterion is met. (Although Entity A's executive director's annual compensation varies based on annual contributions, the executive director's compensation does not vary based on contributions raised for this discrete joint activity.) Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) the program component of this activity calls for specific action by the recipient (encouraging parents to counsel children about the dangers of drug abuse) that will help accomplish the entity's mission, and it otherwise conducts the program activity in this illustration without a request for contributions, and (b) performing such programs helps accomplish Entity A's mission. (Note that had Entity A conducted the activity using the same medium on a scale that is similar to or greater than the scale on which it is conducted with the request for contributions, the purpose criterion would have been met under paragraph .10*b*.)

E.5. The audience criterion is met because the audience (parents of junior high school students) is selected based on its need to use or reasonable potential for use of the action called for by the program component.

E.6. The content criterion is met because the activity calls for specific action by the recipient (encouraging parents to counsel children about the dangers of drug abuse and informing them about how to detect drug abuse) that will help accomplish the entity's mission (assisting parents in preventing their children from abusing drugs), and it explains the need for and benefits of the action (the prevalence and dangers of drug abuse).

Illustration 2

Facts

E.7. Entity B's mission is to reduce the incidence of illness from ABC disease, which afflicts a broad segment of the population. One of Entity B's objectives in fulfilling that mission is to inform the public about the effects and early warning signs of the disease and specific action that should be taken to prevent the disease.

E.8. Entity B maintains a list of its prior donors and sends them donor renewal mailings. The mailings include messages about the effects and early warning signs of the disease and specific action that should be taken to prevent it. That information is also sent to a similar-sized audience but without the request for contributions. Also, Entity B believes that recent donors are more likely to contribute than nondonors or donors who have not contributed recently. Prior donors are deleted from the mailing list if they have not contributed to Entity B recently, and new donors are added to the list. There is no evidence of a correlation between recent contributions and participation in the program component of the activity. Also, the prior donors' need to use or reasonable potential for use of the messages about the effects and early warning signs of the disease and specific action that should be taken to prevent it is an insignificant factor in their selection.

Conclusion

E.9. The purpose and content criteria are met. The audience criterion is not met.¹¹ All costs, including those that might otherwise be considered program or management and general costs if they had been incurred in a different activity, should be charged to fund raising.

E.10. The activity calls for specific action by the recipient (action that should be taken to prevent ABC disease) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. The purpose criterion is met because (a) the program component of the activity calls for specific action by the recipient that will help accomplish the entity's mission (to reduce the incidence of illness from the disease), and (b) the program is also conducted using the same medium on a scale that is similar to or greater than the scale on which it is conducted with the request for contributions (a similar mailing is done without the request for contributions, to a similar-sized audience).

E.11. The audience criterion is not met. The rebuttable presumption that the audience criterion is not met because the audience includes prior donors is not

¹¹ Paragraph .07 of this SOP provides that all costs of joint activities, except for costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event (for example, a meal), should be charged to fund raising if any of the criteria of purpose, audience, or content are not met. Accordingly, if one or more criteria are not met, the other criteria need not be considered. However, the illustrations in this Appendix provide conclusions about whether each of the criteria would be met in circumstances in which one or more criteria are not met in order to provide further guidance.

overcome in this illustration. Although the audience has a need to use or reasonable potential for use of the program component, that was an insignificant factor in its selection.

E.12. The content criterion is met because the activity calls for specific action by the recipient (actions to prevent ABC disease) that will help accomplish the entity's mission (to reduce the incidence of ABC disease), and it explains the need for and benefits of the action (to prevent ABC disease).

Illustration 3

Facts

E.13. Entity C's mission is to reduce the incidence of illness from ABC disease, which afflicts a broad segment of the population. One of Entity C's objectives in fulfilling that mission is to increase governmental funding for research about ABC disease.

E.14. Entity C maintains a list of its prior donors and its employees call them on the telephone reminding them of the effects of ABC disease, asking for contributions, and encouraging them to contact their elected officials to urge increased governmental funding for research about ABC disease. The callers are educated about ABC, do not otherwise perform fund-raising functions, and are not compensated or evaluated based on contributions raised. Entity C's research indicates that recent donors are likely to contact their elected officials about such funding while nonrecent donors are not. Prior donors are deleted from the calling list if they have not contributed to Entity C recently, and new donors are added to the list.

Conclusion

E.15. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.16. The activity calls for specific action by the recipient (contacting elected officials concerning funding for research about ABC disease) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) the qualifications and duties of the personnel performing the activity indicate that it is a program activity (the callers are educated about ABC and do not otherwise perform fund-raising functions), (b) the method of compensation for performing the activity does not indicate that it is a fund-raising activity (the employees are not compensated or evaluated based on contributions raised), and (c) performing such programs helps accomplish Entity C's mission.

E.17. The audience criterion is met because the audience (recent donors) is selected based on its ability to assist Entity C in meeting the goals of the program component of the activity (recent donors are likely to contact their elected officials about such funding while nonrecent donors are not).

E.18. The content criterion is met because the activity calls for specific action by the recipient (contacting elected officials concerning funding for research about ABC disease) that will help accomplish the entity's mission (to reduce the incidence of ABC disease), and it explains the need for and benefits of the action (to prevent ABC disease).

Illustration 4

Facts

E.19. Entity D's mission is to improve the quality of life for senior citizens. One of Entity D's objectives included in that mission is to increase the physical activity of senior citizens. One of Entity D's programs to attain that objective is to send representatives to speak to groups about the importance of exercise and to conduct exercise classes.

E.20. Entity D mails a brochure on the importance of exercise that encourages exercise in later years to residents over the age of sixty-five in three zip code areas. The last two pages of the four-page brochure include a perforated contribution remittance form on which Entity D explains its program and makes an appeal for contributions. The content of the first two pages of the brochure is primarily educational; it explains how seniors can undertake a self-supervised exercise program and encourages them to undertake such a program. In addition, Entity D includes a second brochure on various exercise techniques that can be used by those undertaking an exercise program.

E.21. The brochures are distributed to educate people in this age group about the importance of exercising, to help them exercise properly, and to raise contributions for Entity D. These objectives are documented in a letter to the public relations firm that developed the brochures. The audience is selected based on age, without regard to ability to contribute. Entity D believes that most of the recipients would benefit from the information about exercise.

Conclusion

E.22. The purpose, audience, and content criteria are met, and the joint costs should be allocated. (Note that the costs of the second brochure should be charged to program because all the costs of the brochure are identifiable with the program function.)

E.23. The activity calls for specific action by the recipient (exercising) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10*a* or .10*b* is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) performing such programs helps accomplish Entity D's mission, and (b) the objectives of the program are documented in a letter to the public relations firm that developed the brochure.

E.24. The audience criterion is met because the audience (residents over sixty-five in certain zip codes) is selected based on its need to use or reasonable potential for use of the action called for by the program component.

E.25. The content criterion is met because the activity calls for specific action by the recipient (exercising) that will help accomplish the entity's mission (increasing the physical activity of senior citizens), and the need for and benefits of the action are clearly evident (explains the importance of exercising).

Illustration 5

Facts

E.26. The facts are the same as those in Illustration 4, except that Entity E employs a fund-raising consultant to develop the first brochure and pays that consultant 30 percent of contributions raised.

Conclusion

E.27. The content and audience criteria are met. The purpose criterion is not met, however, because a majority of compensation or fees for the fund-raising consultant varies based on contributions raised for this discrete joint activity (the fund-raising consultant is paid 30 percent of contributions raised). All costs should be charged to fund raising, including the costs of the second brochure and any other costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity.

Illustration 6

Facts

E.28. Entity F's mission is to protect the environment. One of Entity F's objectives included in that mission is to take action that will increase the portion of waste recycled by the public.

E.29. Entity F conducts a door-to-door canvass of a community that recycles a low portion of its waste. The purpose of the activity is to help increase recycling by educating the community about environmental problems created by not recycling, and to raise contributions. Based on the information communicated by the canvassers, the need for and benefits of the action are clearly evident. The ability or likelihood of the residents to contribute is not a basis for communities selected, and all neighborhoods in the geographic area are covered if their recycling falls below a predetermined rate. The canvassers are selected from individuals who are well-informed about the organization's environmental concerns and programs and who previously participated as volunteers in program activities such as answering environmental questions directed to the organization and developing program activities designed to influence legislators to take actions addressing those concerns. The canvassers have not previously participated in fund-raising activities.

Conclusion

E.30. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.31. The activity calls for specific action by the recipient (implicitly—to help increase recycling) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) the qualifications and duties of the personnel performing the activity indicate that it is a program activity (the canvassers are selected from individuals who are well-informed about the organization's environmental concerns and programs and who previously participated as volunteers in program activities such as answering environmental questions directed to the organization and developing program activities designed to influence legislators to take actions addressing those concerns), and (b) performing such programs helps accomplish Entity F's mission (to protect the environment).

E.32. The audience criterion is met because the audience (neighborhoods whose recycling falls below a predetermined rate) is selected based on its need to use or reasonable potential for use of the action called for by the program component.

E.33. The content criterion is met because the activity calls for specific action by the recipient (implicitly—to help increase recycling) that will help

accomplish the entity's mission (to protect the environment), and the need for and benefits of the action are clearly evident (increased recycling will help alleviate environmental problems).

Illustration 7

Facts

E.34. Entity G's mission is to provide summer camps for economically disadvantaged youths. Educating the families of ineligible youths about the camps is not one of the program objectives included in that mission.

E.35. Entity G conducts a door-to-door solicitation campaign for its camp programs. In the campaign, volunteers with canisters visit homes in middle-class neighborhoods to collect contributions. Entity G believes that people in those neighborhoods would not need the camp's programs but may contribute. The volunteers explain the camp's programs, including why the disadvantaged children benefit from the program, and distribute leaflets to the residents regardless of whether they contribute to the camp. The leaflets describe the camp, its activities, who can attend, and the benefits to attendees. Requests for contributions are not included in the leaflets.

Conclusion

E.36. The purpose, audience, and content criteria are not met. All costs should be charged to fund raising.

E.37. The activity does not include a call for specific action because it only educates the audience about causes (describing the camp, its activities, who can attend, and the benefits to attendees). Therefore, the purpose criterion is not met.

E.38. The audience criterion is not met, because the audience is selected based on its ability or likelihood to contribute, rather than based on (a) its need to use or reasonable potential for use of the action called for by the program component, or (b) its ability to take action to assist the entity in meeting the goals of the program component of the activity. (Entity G believes that people in those neighborhoods would not need the camp's programs but may contribute.)

E.39. The content criterion is not met because the activity does not call for specific action by the recipient. (The content educates the audience about causes that the program is designed to address without calling for specific action.)

Illustration 8

Facts

E.40. Entity H's mission is to educate the public about lifesaving techniques in order to increase the number of lives saved. One of Entity H's objectives in fulfilling that mission, as stated in the minutes of the board's meetings, is to produce and show television broadcasts including information about lifesaving techniques.

E.41. Entity H conducts an annual national telethon to raise contributions and to reach the American public with lifesaving educational messages, such as summary instructions concerning dealing with certain life-threatening situations. Based on the information communicated by the messages, the need for and benefits of the action are clearly evident. The broadcast includes segments describing Entity H's services. Entity H broadcasts the telethon to the entire country, not merely to areas selected on the basis of giving potential or prior

fund raising results. Also, Entity H uses national television broadcasts devoted entirely to lifesaving educational messages to conduct program activities without fund raising.

Conclusion

E.42. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.43. The activity calls for specific action by the recipient (implicitly—to save lives) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. The purpose criterion is met because (a) the program component of the activity calls for specific action by the recipient that will help accomplish Entity H's mission (to save lives by educating the public), and (b) a similar program activity is conducted without the fund raising using the same medium and on a scale that is similar to or greater than the scale on which it is conducted with the appeal (Entity H uses national television broadcasts devoted entirely to lifesaving educational messages to conduct program activities without fund raising).

E.44. The audience criterion is met because the audience (a broad segment of the population) is selected based on its need to use or reasonable potential for use of the action called for by the program activity.

E.45. The content criterion is met because the activity calls for specific action by the recipient (implicitly—to save lives) that will help accomplish the entity's mission (to save lives by educating the public), and the need for and benefits of the action are clearly evident (saving lives is desirable).

Illustration 9

Facts

E.46. Entity I's mission is to provide food, clothing, and medical care to children in developing countries.

E.47. Entity I conducts television broadcasts in the United States that describe its programs, show the needy children, and end with appeals for contributions. Entity I's operating policies and internal management memoranda state that these programs are designed to educate the public about the needs of children in developing countries and to raise contributions. The employees producing the programs are trained in audiovisual production and are familiar with Entity I's programs. Also, the executive producer is paid \$25,000 for this activity, with a \$5,000 bonus if the activity raises over \$1,000,000.

Conclusion

E.48. The purpose, audience, and content criteria are not met. All costs should be charged to fund raising.

E.49. The activity does not include a call for specific action because it only educates the audience about causes (describing its programs and showing the needy children). Therefore, the purpose criterion is not met. (Also, note that if the factor in paragraph .10a were considered, it would not be determinative of whether the purpose criterion is met. Although the executive producer will be paid \$5,000 if the activity raises over \$1,000,000, that amount would not be a majority of the executive producer's total compensation for this activity, because \$5,000 would not be a majority of the executive producer's total compensation of \$30,000 for this activity. Also, note that if other evidence, such as the indicators in paragraph .11, were considered, the purpose criterion would not be met based

on the other evidence. Although the qualifications and duties of the personnel performing the activity indicate that the employees producing the program are familiar with Entity I's programs, the facts that some, but less than a majority, of the executive producer's compensation varies based on contributions raised, and that the operating policies and internal management memoranda state that these programs are designed to educate the public about the needs of children in developing countries [with no call for specific action by recipients] and to raise contributions, indicate that the purpose is fund raising.)

E.50. The audience criterion is not met because the audience is selected based on its ability or likelihood to contribute, rather than based on (a) its need to use or reasonable potential for use of the action called for by the program component, or (b) its ability to take action to assist the entity in meeting the goals of the program component of the activity. (The audience is a broad segment of the population of a country that is not in need of or has no reasonable potential for use of the program activity.)

E.51. The content criterion is not met because the activity does not call for specific action by the recipient that will help accomplish the entity's mission. (The content educates the audience about the causes without calling for specific action.)

Illustration 10

Facts

E.52. Entity J is a university that distributes its annual report, which includes reports on mission accomplishments, to those who have made significant contributions over the previous year, its board of trustees, and its employees. The annual report is primarily prepared by management and general personnel, such as the accounting department and executive staff. The activity is coordinated by the public relations department. Internal management memoranda indicate that the purpose of the annual report is to report on how management discharged its stewardship responsibilities, including the university's overall performance, goals, financial position, cash flows, and results of operations. Included in the package containing the annual report are requests for contributions and donor reply cards.

Conclusion

E.53. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.54. The activity has elements of management and general functions. Therefore, no call for specific action is required. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) the employees performing the activity are not members of the fund-raising department and perform other non-fund-raising activities and (b) internal management memoranda indicate that the purpose of the annual report is to fulfill one of the university's management and general responsibilities.

E.55. The audience criterion is met because the audience is selected based on its reasonable potential for use of the management and general component. Although the activity is directed primarily at those who have previously made significant contributions, the audience was selected based on its presumed interest in Entity J's annual report (prior donors who have made significant

contributions are likely to have an interest in matters discussed in the annual report).

E.56. The content criterion is met because the activity (distributing annual reports) fulfills one of the entity's management and general responsibilities (reporting concerning management's fulfillment of its stewardship function).

Illustration 11

Facts

E.57. Entity K is an NPO. In accordance with internal management memoranda documenting its policies requiring it to comply with Internal Revenue Service (IRS) regulations, it mails prior donors who have made quid pro quo payments in excess of \$75 documentation required by the IRS. The documentation is included on a perforated piece of paper. The information above the perforation line pertains to the documentation required by the IRS. The information below the perforation line includes a request for contributions and may be used as a donor reply card.

Conclusion

E.58. The purpose, audience, and content criteria are met, and the joint costs should be allocated. (Note that the costs of the information below the perforation line are identifiable with fund raising and therefore should be charged to fund raising.)

E.59. The activity has elements of management and general functions. Therefore, no call for specific action is required. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because internal management memoranda indicate that the purpose of the activity is to fulfill one of Entity K's management and general responsibilities.

E.60. The audience criterion is met because the entity is required to direct the management and general component of the activity to the particular audience. Although the activity is directed at those who have previously contributed, the audience was selected based on its need for the documentation.

E.61. The content criterion is met because the activity (sending documentation required by the IRS) fulfills one of the entity's management and general responsibilities (complying with IRS regulations).

Illustration 12

Facts

E.62. Entity L is an animal rights organization. It mails a package of material to individuals included in lists rented from various environmental and other organizations that support causes that Entity L believes are congruent with its own. In addition to donor response cards and return envelopes, the package includes (a) materials urging recipients to contact their legislators and urge the legislators to support legislation to protect those rights, and (b) post-cards addressed to legislators urging support for legislation restricting the use of animal testing for cosmetic products. The mail campaign is part of an overall strategy that includes magazine advertisements and the distribution of similar materials at various community events, some of which are undertaken without

fund-raising appeals. The advertising and community events reach audiences similar in size and demographics to the audience reached by the mailing.

Conclusion

E.63. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.64. The activity calls for specific action by the recipient (mailing postcards to legislators urging support for legislation restricting the use of animal testing for cosmetic products) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) the program component of this activity calls for specific action by the recipient that will help accomplish the entity's mission, and it otherwise conducts the program activity in this illustration without a request for contributions, and (b) performing such programs helps accomplish Entity L's mission.

E.65. The audience criterion is met because the audience (individuals included in lists rented from various environmental and other organizations that support causes that Entity L believes are congruent with its own) is selected based on its ability to take action to assist the entity in meeting the goals of the program component of the activity.

E.66. The content criterion is met because the activity calls for specific action by the recipient (mailing postcards to legislators urging support for legislation restricting the use of animal testing for cosmetic products) that will help accomplish the entity's mission (to protect animal rights), and the need for and benefits of the action are clearly evident (to protect animal rights).

Illustration 13

Facts

E.67. Entity M is a performing arts organization whose mission is to make the arts available to residents in its area. Entity M charges a fee for attending performances and sends advertisements, including subscription forms, for the performances to residents in its area. These advertisements include a return envelope with a request for contributions. Entity M evaluates the effectiveness of the advertising based on the number of subscriptions sold as well as contributions received. In performing that evaluation, Entity M places more weight on the number of subscriptions sold than on the contributions received. Also, Entity M advertises the performances on local television and radio without a request for contributions but on a smaller scale than the mail advertising.

Conclusion

E.68. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.69. The activity calls for specific action by the recipient (attending the performances) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) the entity measures program results and accomplishments of the joint activity and

in evaluating the effectiveness of the activity, the entity places significantly greater weight on the activity's effectiveness in accomplishing program goals than on the activity's effectiveness in raising contributions (Entity M evaluates the effectiveness of the advertising based on the number of subscriptions sold as well as contributions received and places more weight on the number of subscriptions sold than on the contributions received), (b) it otherwise conducts the program activity without a request for contributions, and (c) performing such programs helps accomplish Entity M's mission (to make the arts available to residents in its area).

E.70. The audience criterion is met because the audience (a broad segment of the population in Entity M's area) is selected based on its need to use or reasonable potential for use of the action called for by the program component.

E.71. The content criterion is met because the activity calls for specific action by the recipient (attending the performances) that will help accomplish the entity's mission (making the arts available to area residents), and the need for and benefits of the action are clearly evident (attending the performance is a positive cultural experience). (Note that the purchase of subscriptions is an exchange transaction and, therefore, is not a contribution.)

Illustration 14

Facts

E.72. Entity N is a university whose mission is to educate the public (students) in various academic pursuits. Entity N's political science department holds a special lecture series in which prominent world leaders speak about current events. The speakers command relatively high fees and, in order to cover costs and make a modest profit, the university sets a relatively expensive fee to attend. However, the tickets are priced at the fair value of the lecture and no portion of the ticket purchase price is a contribution. Entity N advertises the lectures by sending invitations to prior attendees and to prior donors who have contributed significant amounts, and by placing advertisements in local newspapers read by the general public. At some of the lectures, including the lecture being considered in this illustration, deans and other faculty members of Entity N solicit significant contributions from attendees. Other lectures in the series are conducted on a scale similar to the scale of the lecture in this illustration without requesting contributions. Entity N's records indicate that historically 75 percent of the attendees have attended prior lectures. Of the 75 percent who have attended prior lectures, 15 percent have made prior contributions to Entity N. Of the 15 percent who have made prior contributions to Entity N, 5 percent have made contributions in response to solicitations made at the events. (Therefore, one-half of one percent of attendees make contributions in response to solicitations made at the events. However, those contributions are significant.) Overall, the audience's ability or likelihood to contribute is an insignificant factor in its selection. Entity N evaluates the effectiveness of the activity based on the number of tickets sold, as well as contributions received. In performing that evaluation, Entity N places more weight on the number of tickets sold than on the contributions received.

Conclusion

E.73. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

E.74. The activity calls for specific action by the recipient (attending the lecture) that will help accomplish the entity's mission. Therefore, the guidance in

paragraph .10 should be considered. The purpose criterion is met because (a) the program component of the activity calls for specific action by the recipient that will help accomplish the entity's mission (educating the public [students] in various academic pursuits), and (b) the program is also conducted using the same medium on a scale that is similar to or greater than the scale on which it is conducted with the request for contributions (other lectures in the series are conducted on a scale similar to the scale of the lecture in this illustration without requesting contributions).

E.75. The audience criterion is met. The rebuttable presumption that the audience criterion is not met because the audience includes prior donors is overcome in this illustration because the audience (those who have shown prior interest in the lecture series, prior donors, a broad segment of the population in Entity N's area, and those attending the lecture) is also selected for its reasonable potential for use of the program component (attending the lecture). Although the audience may make significant contributions, that was an insignificant factor in its selection.

E.76. The content criterion is met because the activity calls for specific action by the recipient (attending the lecture) that will help accomplish the entity's mission (educating the public [students] in various academic pursuits), and the need for and benefits of the action are clearly evident (attending the lecture is a positive educational experience). (Note that the purchase of the tickets is an exchange transaction and, therefore, is not a contribution. As discussed in paragraph .07 of this SOP, costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event, should not be reported as fund raising.¹²)

Illustration 15

Facts

E.77. Entity O is a university whose mission is to educate the public (students) in various academic pursuits. Entity O's political science department holds a special lecture series in which prominent world leaders speak about current events. Admission is priced at \$250, which is above the \$50 fair value of the lecture and, therefore, \$200 of the admission price is a contribution. Therefore, the audience's likelihood to contribute to the entity is a significant factor in its selection. Entity O advertises the lectures by sending invitations to prior attendees and to prior donors who have contributed significant amounts, and by placing advertisements in local newspapers read by the general public. Entity O presents similar lectures that are priced at the fair value of those lectures.

Conclusion

E.78. The purpose and content criteria are met. The audience criterion is not met. All costs, including those that might otherwise be considered program or management and general costs if they had been incurred in a different activity, except for the costs of the direct donor benefit (the lecture), should be charged to fund raising.

E.79. The activity calls for specific action by the recipient (attending the lecture) that will help accomplish the entity's mission. Therefore, the guidance in

¹² Paragraphs 13.21-13.26 of the Audit and Accounting Guide *Not-for-Profit Organizations* provide guidance concerning reporting special events. [Footnote revised, June 2004, to reflect conforming changes necessary due to conforming changes made to the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*.]

paragraph .10 should be considered. The purpose criterion is met because (a) the program component of the activity calls for specific action by the recipient that will help accomplish the entity's mission (educating the public [students] in various academic pursuits), and (b) the program is also conducted using the same medium on a scale that is similar to or greater than the scale on which it is conducted with the request for contributions (other lectures in the series are conducted on a scale similar to the scale of the lecture in this illustration without including a contribution in the admission price.)

E.80. The audience criterion is not met. The rebuttable presumption that the audience criterion is not met because the audience is selected based on its likelihood to contribute to the entity is not overcome in this illustration. The fact that the \$250 admission price includes a \$200 contribution leads to the conclusion that the audience's ability or likelihood to contribute is an overwhelmingly significant factor in its selection, whereas there is no evidence that the extent to which the audience is selected for its need to use or reasonable potential for use of the action called for by the program component (attending the lecture) is overwhelmingly significant.

E.81. The content criterion is met because the activity calls for specific action by the recipient (attending the lecture) that will help accomplish the entity's mission (educating the public [students] in various academic pursuits), and the need for and benefits of the action are clearly evident (attending the lecture is a positive educational experience). (Note that the purchase of the tickets is an exchange transaction and, therefore, is not a contribution. As discussed in paragraph .07 of this SOP, costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event, should not be reported as fund raising.¹³)

Illustration 16

Facts

E.82. Entity P's mission is to reduce the incidence of illness from ABC disease, which primarily afflicts people over sixty-five years of age. One of Entity P's objectives in fulfilling that mission is to have all persons over sixty-five screened for ABC disease.

E.83. Entity P rents space at events attended primarily by people over sixty-five years of age and conducts free screening for ABC disease. Entity P's employees, who are educated about ABC disease and screening procedures and do not otherwise perform fund-raising functions, educate interested parties about the effects of ABC disease and the ease and benefits of screening for it. Entity P also solicits contributions at the events. The effectiveness of the activity is evaluated primarily based on how many screening tests are performed, and only minimally based on contributions raised. The employees are not compensated or evaluated based on contributions raised.

Conclusion

E.84. The purpose, audience, and content criteria are met, and the joint costs should be allocated.

¹³ Paragraphs 13.21-13.26 of the Audit and Accounting Guide *Not-for-Profit Organizations* provide guidance concerning reporting special events. [Footnote revised, June 2004, to reflect conforming changes necessary due to conforming changes made to the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*.]

E.85. The activity calls for specific action by the recipient (being screened for ABC disease) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. Neither of the factors in paragraph .10a or .10b is determinative of whether the purpose criterion is met. Therefore, other evidence, such as the indicators in paragraph .11, should be considered. The purpose criterion is met based on the other evidence, because (a) a process exists to evaluate measured program results and accomplishments and in evaluating the effectiveness of the joint activity, the entity places significantly greater weight on the activity's effectiveness in accomplishing program goals than on the activity's effectiveness in raising contributions (Entity P evaluates the effectiveness of the activity based on the number of screening tests conducted as well as contributions received and places more weight on the number of tests conducted than on the contributions received); (b) the qualifications and duties of the personnel performing the activity indicate that it is a program activity (the employees are educated about ABC disease and the testing procedures and do not otherwise perform fund-raising functions); (c) the method of compensation for performing the activity does not indicate that it is a fund-raising activity (the employees are not compensated or evaluated based on contributions raised); and (d) performing such programs helps accomplish Entity P's mission (to prevent ABC disease).

E.86. The audience criterion is met because the audience (people over sixty-five years of age) is selected based on its need to use or reasonable potential for use of the action called for by the program component.

E.87. The content criterion is met because the activity calls for specific action by the recipient (being screened for ABC disease) that will help accomplish the entity's mission (to reduce the incidence of ABC disease), and it explains the need for and benefits of the action (to prevent ABC disease).

Illustration 17

Facts

E.88. Entity Q's mission is to provide cultural and educational television programming to residents in its area. Entity Q owns a public television station and holds a membership drive in which it solicits new members. The drive is conducted by station employees and consists of solicitations that are shown during long breaks between the station's regularly scheduled programs. Entity Q's internal management memoranda state that these drives are designed to raise contributions. Entity Q evaluates the effectiveness of the activity based on the amount of contributions received. Entity Q shows the programs on a similar scale, without the request for contributions. The audience is members of the general public who watch the programs shown during the drive. Station member benefits are given to those who contribute and consist of tokens of appreciation with a nominal value.

Conclusion

E.89. The purpose, audience, and content criteria are met, and the joint costs should be allocated. (Note that there would be few, if any, joint costs. Costs associated with the fund-raising activities, such as costs of airtime, would be separately identifiable from costs of the program activities, such as licensing costs for a particular television program. Also, note that because no significant benefits or duties are associated with membership, member dues are contributions. Therefore, the substance of the membership-development activities is, in fact, fund raising.)

E.90. The activity calls for specific action by the recipient (watching the television program) that will help accomplish the entity's mission. Therefore, the guidance in paragraph .10 should be considered. The purpose criterion is met because (a) the program component of the activity calls for specific action by the recipient that will help accomplish the entity's mission, and (b) the program is also conducted using the same medium on a scale that is similar to or greater than the scale on which it is conducted with the request for contributions (Entity Q shows the television programs on a similar scale, without the request for contributions).

E.91. The audience criterion is met. The rebuttable presumption that the audience criterion is not met because the audience is selected based on its likelihood to contribute is overcome in this illustration because the audience (members of the general public who watch the television programs shown during the drive) is also selected for its reasonable potential for use of the program component (watching the television programs). Although the audience may make contributions, that was an insignificant factor in its selection.

E.92. The content criterion is met because the activity calls for specific action by the recipient (watching the television programs) that will help accomplish the entity's mission (providing cultural and educational television programming to residents in its area), and the need for and benefits of the action are clearly evident (watching the programs is a positive cultural and educational experience).

Appendix F

Illustrations of Allocation Methods

F.1. Some commonly used cost allocation methods follow.

Physical Units Method

F.2. Joint costs are allocated to materials and activities in proportion to the number of units of output that can be attributed to each of the materials and activities. Examples of units of output are lines, square inches, and physical content measures. This method assumes that the benefits received by the fund-raising, program, or management and general component of the materials or activity from the joint costs incurred are directly proportional to the lines, square inches, or other physical output measures attributed to each component of the activity. This method may result in an unreasonable allocation of joint costs if the units of output, for example, line counts, do not reflect the degree to which costs are incurred for the joint activity. Use of the physical units method may also result in an unreasonable allocation if the physical units cannot be clearly ascribed to fund raising, program, or management and general. For example, direct mail and telephone solicitations sometimes include content that is not identifiable with fund raising, program, or management and general; or the physical units of such content are inseparable.

Illustration

F.3. Assume a direct mail campaign is used to conduct programs of the entity and to solicit contributions to support the entity and its programs. Further, assume that the appeal meets the criteria for allocation of joint costs to more than one function.

F.4. The letter and reply card include a total of one hundred lines. Forty-five lines pertain to program because they include a call for action by the recipient that will help accomplish the entity's mission, while fifty-five lines pertain to the fund-raising appeal. Accordingly, 45 percent of the costs are allocated to program and 55 percent to fund-raising.

Relative Direct Cost Method

F.5. Joint costs are allocated to each of the components on the basis of their respective direct costs. Direct costs are those costs that are incurred in connection with the multipurpose materials or activity and that are specifically identifiable with a function (program, fund raising, or management and general). This method may result in an unreasonable allocation of joint costs if the joint costs of the materials and activity are not incurred in approximately the same proportion and for the same reasons as the direct costs of the materials and activity. For example, if a relatively costly booklet informing the reader about the entity's mission (including a call for action by the recipient that will help accomplish the entity's mission) is included with a relatively inexpensive fund-raising letter, the allocation of joint costs based on the cost of these pieces may be unreasonable, particularly if the booklet and letter weigh approximately the same and therefore contribute equally to the postage costs.

Illustration

F.6. The costs of a direct mail campaign that can be specifically identified with program services are the costs of separate program materials and a postcard which calls for specific action by the recipient that will help accomplish the entity's mission. They total \$20,000. The direct costs of the fund-raising component of the direct mail campaign consist of the costs to develop and produce the fund-raising letter. They total \$80,000. Joint costs associated with the direct mail campaign total \$40,000 and would be allocated as follows under the relative direct cost method:

$$\text{Program } \$20,000/\$100,000 \times \$40,000 = \$8,000$$

$$\text{Fund raising } \$80,000/\$100,000 \times \$40,000 = \$32,000$$

Stand-Alone Joint-Cost-Allocation Method

F.7. Joint costs are allocated to each component of the activity based on a ratio that uses estimates of costs of items included in joint costs that would have been incurred had the components been conducted independently. The numerator of the ratio is the cost (of items included in joint costs) of conducting a single component independently; the denominator is the cost (of items included in joint costs) of conducting all components independently. This method assumes that efforts for each component in the stand-alone situation are proportionate to the efforts actually undertaken in the joint cost situation. This method may result in an unreasonable allocation because it ignores the effect of each function, which is performed jointly with other functions, on other such functions. For example, the programmatic impact of a direct mail campaign or a telemarketing phone message may be significantly lessened when performed in conjunction with a fund-raising appeal.

Illustration

F.8. Assume that the joint costs associated with a direct mail campaign including both program and fund-raising components are the costs of stationery, postage, and envelopes at a total of \$100,000. The costs of stationery, postage, and envelopes to produce and distribute each component separately would have been \$90,000 for the program component and \$70,000 for the fund-raising component. Under the stand-alone joint-cost-allocation method, the \$100,000 in joint costs would be allocated as follows: $\$90,000/\$160,000 \times \$100,000 = \$56,250$ to program services and $\$70,000/\$160,000 \times \$100,000 = \$43,750$ to fund raising.

.27

Appendix G

Illustrations of Disclosures

G.1. The disclosures discussed in paragraphs .18 and .19 are illustrated below. Alternative 1 reports the required and encouraged information in narrative format. Alternative 2 reports that information in tabular format, as well as information concerning joint costs incurred for each kind of activity by functional classification, which is neither required nor encouraged, but which is not prohibited.

Alternative 1

Note X. Allocation of Joint Costs

In 19XX, the organization conducted activities that included requests for contributions, as well as program and management and general components. Those activities included direct mail campaigns, special events, and a telethon. The costs of conducting those activities included a total of \$310,000 of joint costs, which are not specifically attributable to particular components of the activities (joint costs). *[Note to reader: The following sentence is encouraged but not required.]* Joint costs for each kind of activity were \$50,000, \$150,000, and \$110,000 respectively. These joint costs were allocated as follows:

Fund raising	\$180,000
Program A	80,000
Program B	40,000
Management and general	10,000
Total	<u>\$310,000</u>

Alternative 2

Note X. Allocation of Joint Costs

In 19XX, the organization conducted activities that included appeals for contributions and incurred joint costs of \$310,000. These activities included direct mail campaigns, special events, and a telethon. Joint costs were allocated as follows:

	<u>Direct Mail</u>	<u>Special Events</u>	<u>Telethon</u>	<u>Total</u>
Fund raising	\$40,000	\$50,000	\$90,000	\$180,000
Program A	10,000	65,000	5,000	80,000
Program B		25,000	15,000	40,000
Management and general		10,000		10,000
Total	<u>\$50,000</u>	<u>\$150,000</u>	<u>\$110,000</u>	<u>\$310,000</u>

[Note to reader: Shading is used to highlight information that is neither required nor encouraged, but which is not prohibited. However, entities may prefer to disclose it. Disclosing the total joint costs for each kind of activity (\$50,000, \$150,000, and \$110,000) is encouraged but not required.]

Appendix H

Contrast of Guidance in This SOP With the Guidance in SOP 87-2^{14, **}

<u>This SOP</u>	<u>SOP 87-2</u>
Applies to all entities that solicit contributions, including state and local governments.	Applied to entities that follow the AICPA Industry Audit Guide <i>Audits of Voluntary Health and Welfare Organizations</i> or SOP 78-10. (SOP 87-2 was not applicable to entities that are within the scope of Governmental Accounting Standards Board Statement No. 29, <i>The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities</i> .)
Covers <i>all</i> costs of joint activities. (Costs that otherwise might be considered program or management and general costs if they had been incurred in a different activity, except for costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event [for example, a meal], should be charged to fund raising unless the criteria in the SOP are met.)	Covers only joint costs of joint activities.
Criteria of purpose, audience, and content should all be met in order to charge costs of the activity to program or management and general.	Unclear concerning whether all criteria should be met in order to charge costs of the activity to program or management and general.
Neither prescribes nor prohibits any allocation methods. Includes a discussion to help users determine whether an allocation is reasonable, and provides some illustrations.	Neither prescribes nor prohibits any allocation methods. No illustrations are provided.
Requires note disclosures about the types of activities for which joint costs have been incurred, amounts allocated during the period, and amounts allocated to each functional expense or expenditure category.	Requires less extensive note disclosures: total amount allocated during the period and amounts allocated to each functional expense category.

¹⁴ In August 1996, the AICPA issued the Audit and Accounting Guide *Not-for-Profit Organizations*, which superseded SOP 87-2, *Accounting for Joint Costs of Informational Materials and Activities of Not-for-Profit Organizations That Include a Fund-Raising Appeal*, because the guidance in SOP 87-2 is incorporated into paragraphs 13.36 to 13.45 of the Guide. Also, *Not-for-Profit Organizations* superseded the AICPA Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations* and SOP 78-10. *Not-for-Profit Organizations* applies to all nongovernmental not-for-profit organizations other than those required to follow the Audit and Accounting Guide *Health Care Organizations*. Therefore, incorporating the guidance in SOP 87-2 into *Not-for-Profit Organizations* broadened the scope of the guidance previously included in SOP 87-2 to all not-for-profit organizations other than those required to follow *Health Care Organizations*. The discussion in this SOP of SOP 87-2 refers to both SOP 87-2 and the guidance included in paragraphs 13.36 to 13.45 of *Not-for-Profit Organizations*, except that the guidance in *Not-for-Profit Organizations* applies to all not-for-profit organizations other than those required to follow *Health Care Organizations*.

^{**} See footnotes ‡ and || in paragraphs D.3 and D.4, respectively. [Footnote revised, June 2004, to reflect conforming changes necessary due to the issuance of GASB Statements No. 34 and No. 35.]

Appendix I

Effects on Other Guidance

I.1. For nongovernmental organizations, this Statement of Position (SOP) amends the AICPA Audit and Accounting Guide *Health Care Organizations* and paragraphs 13.35 to 13.44 of the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*. [Revised, June 2004, to reflect conforming changes necessary due to conforming changes made to the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*.]

I.2. Also, this SOP amends the AICPA Audit and Accounting Guide *Not-for-Profit Organizations* to clarify that costs of goods or services provided in exchange transactions that are part of joint activities, such as costs of direct donor benefits of a special event (for example, a meal), should not be reported as fund-raising. In particular, paragraphs 13.21, 13.23, and 13.24 of *Not-for-Profit Organizations* are amended as follows:

13.21 Some organizations conduct joint activities ^{fn 9} that are special events, including special social and educational events (such as symposia, dinners, dances, and theater parties) in which the attendee receives a direct benefit (for example, a meal or theater ticket). FASB Statement No. 117 requires the reporting of the gross amounts of revenues and expenses from special events and other fund-raising activities that are ongoing major or central activities, but permits (but does not require) reporting net amounts if the receipts and related costs result from special events that are peripheral or incidental activities.

13.23 For example, assume that an organization has a special event that is an ongoing and major activity with a ticket price of \$100. Assume that the activity does not meet the audience criterion in SOP 98-2, *Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising*, and, therefore, all costs of the activity, other than the direct donor benefits, should be reported as fund raising. The event includes a dinner that costs the organization \$25 and that has a fair value of \$30. (Chapter 5, "Contributions Received and Agency Transactions," of this Guide, discusses the appropriate reporting if the meal or other items of value are donated to the organization for resale.) In addition, the organization incurs other direct costs of the event in connection with promoting and conducting the event, including incremental direct costs incurred in transactions with independent third parties and the payroll and payroll-related costs for the activities of employees who are directly associated with, and devote time to, the event. Those other direct costs, which include (a) \$5 that otherwise might be considered management and general costs if they had been incurred in a different activity, and (b) fund-raising costs of \$10, are unrelated to the direct benefits to donors and, accordingly, should not be included as costs of benefits to donors. In addition, the organization has the following transactions, which are unrelated to the special event: unrestricted contributions of \$200, program expenses of \$60, management and general expenses of \$20, and fund-raising expenses of \$20.

13.24 Some ways in which the organization could display the results of the special event as part of its statement of activities are illustrated as follows:

Illustration 1

Changes in unrestricted net assets:		
Contributions		\$200
Special event revenue	100	
Less: Costs of direct benefits to donors	<u>(25)</u>	
Net revenues from special events		<u>75</u>
Contributions and net revenues from special events		275
Other expenses:		
Program		60
Management and general		20
Fund raising		<u>35</u>
Total other expenses		<u>115</u>
Increase in unrestricted net assets		<u>\$160</u>

Illustration 2

Changes in unrestricted net assets:		
Revenues:		
Contributions		\$200
Special event revenue		<u>100</u>
Total revenues		300
Expenses:		
Program		60
Costs of direct benefits to donors		25
Management and general		20
Fund raising		<u>35</u>
Total expenses		<u>140</u>
Increase in unrestricted net assets		<u>\$160</u>

Illustration 3

Changes in unrestricted net assets:		
Contributions		\$270
Dinner sales		30
Less: Costs of direct benefits to donors		<u>(25)</u>
Gross profit on special events		<u>5</u>
Contributions and net revenues from special events		275
Other expenses:		
Program		60
Management and general		20
Fund raising		<u>35</u>
Total other expenses		<u>115</u>
Increase in unrestricted net assets		<u>\$160</u>

fn 9 See footnote 1.

[Revised, June 2004, to reflect conforming changes necessary due to conforming changes made to the AICPA Audit and Accounting Guide *Not-for-Profit Organizations*.]

I.3. For governmental entities that have applied the accounting and financial reporting principles in SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations*, or the AICPA Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations* (modified by all applicable Financial Accounting Standards Board [FASB] pronouncements issued through November 30, 1989, and by most applicable Governmental Accounting Standards Board [GASB] pronouncements) in conformity with GASB Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*, this SOP amends the principles—based on SOP 78-10 and *Audits of Voluntary Health and Welfare Organizations*, as modified—that those entities apply. For governmental entities that have applied the accounting and financial reporting principles in the 1973 AICPA Industry Audit Guide *Audits of Colleges and Universities*, as amended by SOP 74-8, *Financial Accounting and Reporting by Colleges and Universities*, and as modified by applicable FASB pronouncements issued through November 30, 1989, and all applicable GASB pronouncements in conformity with GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*, this SOP amends the principles—based on *Audits of Colleges and Universities*, as amended and modified—that those entities apply. For other governmental organizations, this SOP amends the Audit and Accounting Guide *Audits of State and Local Governmental Units*.^{††}

^{††} See footnotes ‡ and || in paragraphs D.3 and D.4, respectively. Also, the AICPA Audit and Accounting Guide *State and Local Governments* supersedes the 1994 AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* and subsequent editions of that Guide with conforming changes made by the AICPA staff. The AICPA Audit and Accounting Guide *State and Local Governments*, provides guidance on the application of this SOP to state and local governments. [Footnote added, June 2004, to reflect conforming changes necessary due to the issuance of GASB Statements No. 34, No. 35, and the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units*.]

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Glossary

Activities. Activities are efforts to accomplish specific objectives. Some activities include producing and distributing materials. For example, if an entity undertakes a mass mailing that includes a letter and a pamphlet, producing and distributing the letter and pamphlet are part of the activity. Other activities may include no materials, such as an annual dinner or a radio commercial.

Compensation or fees. Reciprocal transfers of cash or other assets in exchange for services performed.

Contributions. Contributions are unconditional transfers of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner.

Costs of joint activities. Costs of joint activities are costs incurred for a joint activity. Costs of joint activities may include joint costs and costs other than joint costs. Costs other than joint costs are costs that are identifiable with a particular function, such as fund raising, program, management and general, and cost of sales. For example, some costs incurred for printing, paper, professional fees, and salaries to produce donor cards are not joint costs, although they may be incurred in connection with conducting joint activities.

Fund-raising activities. Fund-raising activities are activities undertaken to induce potential donors to contribute money, securities, services, materials, facilities, other assets, or time. They include publicizing and conducting fund-raising campaigns; maintaining donor mailing lists; conducting special fund-raising events; preparing and distributing fund-raising manuals, instructions, and other materials; and conducting other activities involved with soliciting contributions from individuals, foundations, governments, and others.

Help accomplish the entity's mission. Actions that help accomplish the entity's mission are actions that either benefit the recipient (such as by improving the recipient's physical, mental, emotional, or spiritual health and well-being) or benefit society (by addressing societal problems).

Joint activity. A joint activity is an activity that is part of the fund-raising function and has elements of one or more other functions, such as program, management and general, membership development, or any other functional category used by the entity.

Joint costs. Joint costs are the costs of conducting joint activities that are not identifiable with a particular component of the activity. For example, the cost of postage for a letter that includes both fund-raising and program components is a joint cost. Joint costs may include the costs of salaries, contract labor, consultants, professional fees, paper, printing, postage, event advertising, telephones, airtime, and facility rentals.

Management and general activities. Management and general activities are those that are not identifiable with a single program, fund-raising activity, or membership-development activity but that are indispensable to the conduct of those activities and to an organization's existence. They include oversight, business management, general recordkeeping, budgeting, financing, soliciting revenue from exchange transactions, such as

government contracts and related administrative activities, and all management and administration except for direct conduct of program services or fund-raising activities. Disseminating information to inform the public of the organization's "stewardship" of contributed funds, announcements concerning appointments, and the annual report, among other activities, are management and general activities, as are soliciting funds other than contributions, including exchange transactions (whether program-related or not).

Medium. A medium is a means of mass communication, such as direct mail, direct response advertising, or television.

Membership-development activities. Membership-development activities include soliciting for prospective members and membership dues, membership relations, and similar activities. If there are no significant benefits or duties connected with membership, however, the substance of membership-development activities may, in fact, be fund-raising.

Program activities. Program activities are the activities that result in goods or services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the organization exists. Those services are the major purpose for and the major output of the organization and often relate to several major programs. For example, a large university may have programs for student instruction, research, and patient care, among others. Similarly, a health and welfare organization may have programs for health and family services, research, disaster relief, and public education, among others.

<i>Location</i>	<i>GASB Codification Reference 2015-16</i>
Paragraph .07	Co5.801, Ho5.804
Paragraph .08	Co5.802, Ho5.805
Paragraph .09	Co5.803, Ho5.806
Paragraph .10	Co5.804, Ho5.807
Footnote 5	Co5 footnote 4, Ho5 footnote 8
Footnote 6	Co5 footnote 5, Ho5 footnote 9
Footnote 7	Co5 footnote 6, Ho5 footnote 10
Footnote 8	Co5 footnote 7, Ho5 footnote 11
Paragraph .11	Co5.805, Ho5.808
Paragraph .12	Co5.806, Ho5.809
Paragraph .13	Co5.807, Ho5.810
Paragraph .14	Co5.808, Ho5.811
Footnote 9	Co5 footnote 8, Ho5 footnote 12
Paragraph .15	Co5.809, Ho5.812
Paragraph .16	Co5.810, Ho5.813
Paragraph .17	Co5.811, Ho5.814
Paragraph .18	Co5.812, Ho5.815
Paragraph .19	Co5.813, Ho5.816
Paragraph .30	Co5.814-1-.814-12, Ho5.817-1-.817-12

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AR-C Cross-References to SSARSSs

Part I—Statements on Standards for Accounting and Review Services and Sources of Sections in Current Text

Statements on Standards for Accounting and Review Services*

No.	Date Issued	Title	AR-C Section
21	Oct. 2014	<i>Statements on Standards for Accounting and Review Services: Clarification and Recodification</i> ¹	
22	Sept. 2016	<i>Compilation of Pro Forma Financial Information</i>	120
23	Oct. 2016	<i>Omnibus Statement on Standards for Accounting and Review Services—2016</i> ²	
24	May 2018	<i>Omnibus Statement on Standards for Accounting and Review Services—2018</i> ³	
25	February 2020	<i>Materiality in a Review of Financial Statements and Adverse Conclusions</i> ⁴	
26	June 2022	<i>Quality Management for an Engagement Conducted in Accordance With Statements on Standards for Accounting and Review Services</i> ⁵	

* This table lists Statements on Standards for Accounting and Review Services (SSARSSs) issued subsequent to SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, which was issued in October 2014. Refer to part II, "List of Statements on Standards for Accounting and Review Services Nos. 1–20," of this section for SSARSSs issued prior to SSARS No. 21.

¹ SSARS No. 21 created various sections throughout *Accounting and Review Services (Clarified)*. See the following section, "Sources of Sections in Current Text," for a full list.

² SSARS No. 23 has been integrated within sections 60A.01, 60A.03–.04, 60A.07, 60A.17, 60.26, 60A.A4, 60A.12, 60A.21, 60A.26, 60A.33, 60A.38, 70A.01, 70A.10, 70A.14, 70A.19, 70A.A1–.A3, 70A.A9, 80A.01, 80A.10, 80A.24–.25, 80A.29–.30, 80A.A1–.A4, 80A.14, 90A.01, 90.05, 90.11–.12, 90.39g, 90.81–.83, 90A.A1, 90A.A11–.A12, 90A.20, and 90A.132–.A134.

³ SSARS No. 24 has been integrated within sections 60.07, 60A.51, 90.05, 90.34, 90.39, 90.65, 90.66–.69, 90.79, 90.80–.82, 90A.10, 90A.116–.A126, 90A.138–.A140, and 100.

⁴ SSARS No. 25 has been integrated within sections 60A.07, 60A.21, 60A.26, 60A.A13, 60A.A40, 60A.A47, 60A.A51–.A52, 60A.A59–.A62, 70A.07, 70A.14, 70A.17, 70A.20–.21, 70A.A15–.A16, 70A.A22–.A23, 80A.05, 80A.18–.21, 80A.26, 80A.A28–.A29, and 80A.A35–.A36, 90A.03–.05, 90A.07–.08, 90A.11, 90A.13, 90A.15–.16, 90A.19–.20, 90A.24–.25, 90A.29, 90A.32–.39, 90A.42, 90A.47–.57, 90A.60, 90A.64–.74, 90A.76, 90A.78–.81, 90A.88–.92, 90A.94–.97, 90A.109–.112, 90A.137–.139, 90A.A10, 90A.A17–.A21, 90A.A37–.A41, 90A.A47, 90A.A57, 90A.A60–.A69, 90A.A71–.A75, 90A.A78–.A86, 90A.A101–.A106, 90A.A119, 90A.A124–.A125, 90A.A130–.A132, 90A.A141–.A142, 90A.A145–.A146, 90A.A157–.A156, 90A.A175–.A176, 90A.A178–.A182, 90A.A216.

⁵ SSARS No. 26 has been integrated within sections 60.07, 60.20–.21, 60.23–.30, 60A.12–.A13, 60A.19, 60A.42–.A47, 60A.49, 60A.51–[A61], 70A.14, 80.17, 80A.25–.A26, 90.16, 90.76, 90.139, 90A.120–.A121, 90A.16

Sources of Sections in Current Text

<i>AR-C Section</i>	<i>Contents</i>	<i>Source</i>
60	<i>General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services</i>	SSARS No. 21
70	<i>Preparation of Financial Statements</i>	SSARS No. 21
80	<i>Compilation Engagements</i>	SSARS No. 21
90	<i>Review of Financial Statements</i>	SSARS No. 21
100	<i>Special Considerations—International Reporting Issues</i>	SSARS No. 24
120	<i>Compilation of Pro Forma Financial Information</i>	SSARS No. 22

Part II—List of Statements on Standards for Accounting and Review Services Nos. 1–20

Statements on Standards for Accounting and Review Services

No.	Date Issued	Title
1	Dec. 1978	<i>Compilation and Review of Financial Statements</i>
2	Oct. 1979	<i>Reporting on Comparative Financial Statements</i>
3	Dec. 1981	<i>Compilation Reports on Financial Statements Included in Certain Prescribed Forms</i>
4	Dec. 1981	<i>Communications Between Predecessor and Successor Accountants</i>
5	July 1982	<i>Reporting on Compiled Financial Statements</i>
6	Sept. 1986	<i>Reporting on Personal Financial Statements Included in Written Personal Financial Plans</i>
7	Nov. 1992	<i>Omnibus Statement on Standards for Accounting and Review Services—1992</i>
8	Oct. 2000	<i>Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements</i>
9	Nov. 2002	<i>Omnibus Statement on Standards for Accounting and Review Services—2002</i>
10	May 2004	<i>Performance of Review Engagements</i>
11	May 2004	<i>Standards for Accounting and Review Services</i>
12	July 2005	<i>Omnibus Statement on Standards for Accounting and Review Services—2005</i>
13	July 2005	<i>Compilation of Specified Elements, Accounts, or Items of a Financial Statement</i>
14	July 2005	<i>Compilation of Pro Forma Financial Information</i>
15	July 2007	<i>Elimination of Certain References to Statements on Auditing Standards and Incorporation of Appropriate Guidance Into Statements on Standards for Accounting and Review Services</i>
16	Dec. 2007	<i>Defining Professional Requirements in Statements on Standards for Accounting and Review Services</i>
17	Feb. 2008	<i>Omnibus Statement on Standards for Accounting and Review Services—2008</i>
18	Feb. 2009	<i>Applicability of Statements on Standards for Accounting and Review Services</i>
19	Dec. 2009	<i>Compilation and Review Engagements</i>
20	Feb. 2011	<i>Revised Applicability of Statements on Standards for Accounting and Review Services</i>

AR-C Introduction

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AR-C Introduction

Foreword

Clarified Statements on Standards for Accounting and Review Services

To address concerns over clarity, length, and complexity of its standards, the Accounting and Review Services Committee (ARSC) established clarity drafting conventions which are substantially the same as those adopted by the Auditing Standards Board in clarifying the auditing literature. The ARSC redrafted all of its Statements on Standards for Accounting and Review Services (SSARs) in accordance with those conventions, which include the following:

- Establish objectives for each clarified AR-C section
- Include a Definitions section, where relevant, in each clarified AR-C section
- Separate requirements from application and other explanatory material
- Number application and other explanatory material paragraphs using an A- prefix and present them in a separate section that follows the Requirements section
- Use formatting techniques, such as bullet lists, to enhance readability

This section contains "AR-C" section numbers instead of "AR" section numbers. As part of the clarification of the SSARs, the AR section numbers as designated by SSARs Nos. 1–20 were recodified and the "AR-C" was selected as an identifier in order to avoid confusion with references to superseded "AR" sections. Superseded "AR" sections were deleted from AICPA *Professional Standards* in May 2017, by which time substantially all engagement for which the "AR" sections were still effective were expected to be completed. The superseded "AR" sections can be accessed at www.aicpa.org/research/standards/compilationreview/pages/default.aspx.

Authority of SSARs

SSARs are standards issued by ARSC, the senior committee of the AICPA that is designated by Council to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires a member who performs compilation, review, or other professional services addressed by SSARs to comply with standards promulgated by ARSC.

An accountant must comply with an unconditional requirement in all cases in which such requirement is relevant. SSARs use the word "must" to indicate an unconditional requirement. An accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant. However, if, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must

document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Exhibits to and interpretations of SSARSs are *interpretative publications*, as defined in section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*. An accountant is required to consider applicable interpretive publications in the performance of an engagement in accordance with SSARSs. Interpretive publications are not SSARSs. Interpretive publications are recommendations on the application of SSARSs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with SSARSs. Compilation and review interpretations of SSARSs and exhibits to SSARSs are included in the AR-C sections.

ACCOUNTING AND REVIEW SERVICES COMMITTEE

Denny Ard, *Chair*

Michael P. Glynn, Senior Manager —
Audit & Attest Standards — Public Accounting
Jennifer Burns, Chief Auditor — AICPA

AR-C Glossary

Glossary of Terms

Analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Basic financial statements. Financial statements excluding supplementary information and required supplementary information.

Comparative financial statements. A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period.

Designated accounting standard-setter. A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Emphasis-of-matter paragraph. A paragraph included in the accountant's compilation or review report that is required by Statements on Standards for Accounting and Review Services (SSARs), or is included at the accountant's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.

Engagement partner. The partner or other individual appointed by the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon performed by the engagement quality reviewer and completed before the engagement report is released.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement.

Error. Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

Experienced accountant. An individual (whether internal or external to the firm) who has practical review experience and a reasonable understanding of

- a. review processes;
- b. SSARs and applicable legal and regulatory requirements;
- c. the business environment in which the entity operates; and
- d. review and financial reporting issues relevant to the entity's industry.

Fair presentation framework. See financial performing framework.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

The term *fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and does one of the following:

- a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.
- b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgment in (a) or (b) is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference.

The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

Fraud. An intentional act that results in a misstatement in financial statements.

Generally accepted accounting principles (GAAP). References to *generally accepted accounting principles* in SSARs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" and the "Accounting Principles Rule" of the AICPA Code of Professional Conduct.

General purpose financial statements. Financial statements prepared in accordance with a general purpose framework.

General purpose framework. A financial reporting framework designed to meet the common financial information needs of a wide range of users.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Inquiry. Inquiry consists of seeking information of knowledgeable persons within or outside the entity.

Inspection. Inspection is an evaluation of the adequacy of aspects of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.

Interpretive publications. Interpretations of SSARs; exhibits to SSARs; AICPA Guide *Preparation, Compilation, and Review Engagements*, guidance on preparation, compilation, and review engagements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

Limited assurance. A level of assurance that is less than the reasonable assurance obtained in an audit engagement but is at an acceptable level as the basis for the conclusion expressed in the accountant's review report.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Modified conclusion. A qualified conclusion or an adverse conclusion.

Network. As defined in "Definitions" (ET section 0.400) in the AICPA code, an association of entities that includes one or more firms.

Network firm. As defined in "Definitions" in the AICPA code, a firm or other entity that belongs to a network. References to a network firm are to be

read hereafter as "another firm or entity that belongs to the same network as the firm."

Noncompliance. Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Other-matter paragraph. A paragraph included in the accountant's compilation or review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to users' understanding of the compilation or review, the accountant's responsibilities, or the accountant's compilation or review report.

Other preparation, compilation and review publications. Publications other than interpretive publications.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

Personnel. Partners and staff in the firm.

Pervasive. A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements. Pervasive effects on the financial statements are those that, in the accountant's judgment

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent or could represent a substantial portion of the financial statements; or
- with regard to disclosures, are fundamental to users' understanding of the financial statements.

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by SSARs, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the preparation, compilation, or review engagement.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of review evidence.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" of the AICPA code, or by other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Pro forma financial information. A presentation that shows what the significant effects on historical financial information might have been had

a consummated or proposed transaction (or event) occurred at an earlier date.

Prospective financial information. Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and, if applicable, the engagement quality reviewer are subject, which consist of the AICPA code together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Report release date. The date the accountant grants the entity permission to use the accountant's review report in connection with the financial statements.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Review documentation. The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant reached (terms such as *working papers* or *workpapers* are also sometimes used).

Review evidence. Information used by the accountant to provide a reasonable basis for obtaining limited assurance. Review evidence includes both information contained in the accounting records underlying the financial statements and other information, which primarily consists of the results of analytical procedures and inquiries. Sufficiency of review evidence is the measure of the quantity of review evidence. Appropriateness of review evidence is the measure of the quality of review evidence, that is, its relevance and reliability in providing support for the conclusions on which the accountant's review report is based.

Special purpose financial statements. Financial statements prepared in accordance with a special purpose framework.

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.

- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance department).
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements, for example, the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

Specified parties. The intended users of the accountant's compilation or review report.

Subsequent events. Events occurring between the date of the financial statements and the date of the accountant's compilation or review report.

Subsequently discovered facts. Facts that become known to the accountant after the date of the accountant's review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant's compilation or review report.

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the reviewed financial statements or separate from the reviewed financial statements.

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Updated report. A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant's current engagement and that re-expresses the accountant's previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant's current report.

Written representation. A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

AR-C Section**STATEMENTS ON STANDARDS FOR
ACCOUNTING AND REVIEW SERVICES
(CLARIFIED)**

The following is a Codification of Statements on Standards for Accounting and Review Standards (SSARs) resulting from the Accounting and Review Services Committee's (ARSC's) project to clarify and revise the standards for reviews, compilations, and engagements to prepare financial statements. SSARs are issued by the ARSC, the senior committee of the AICPA designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. Council has designated ARSC as a body to establish technical standards under the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct.

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AR-C Section 60

General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services

Source: SSARS No. 21; SSARS No. 23; SSARS No. 24; SSARS No. 25; SSARS 26.

Effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section provides general principles for engagements performed in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the Accounting and Review Services Committee (ARSC) and codified into AR-C sections. This section also sets forth the meaning of certain terms used in SSARSs when describing the professional requirements imposed on accountants performing an engagement in accordance with SSARSs. [As amended, effective October 2016, by SSARS No. 23.]

.02 This section is intended to help accountants better understand their professional responsibilities when performing an engagement in accordance with SSARSs. Additional sections have been established to set forth specific performance and reporting requirements. Such additional requirements are based on the general principles provided by this section, and any requirements created by this section also have been incorporated into the additional sections.

.03 SSARSs do not address the responsibilities of the accountant that may exist in legislation, regulation, or otherwise. Such responsibilities may differ from those established in SSARSs. Accordingly, although the accountant may find aspects of SSARSs helpful in such circumstances, it is the responsibility of the accountant to ensure compliance with all relevant legal, regulatory, or professional obligations. [As amended, effective October 2016, by SSARS No. 23.]

.04 The financial statements subject to the engagement performed in accordance with SSARSs are those of the entity. SSARSs do not impose responsibilities on management and do not override laws and regulations that govern their responsibilities. (Ref: par. .A4–.A11) [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

Effective Date

.05 This section is effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015. Early

implementation is permitted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Objective

.06 The objective of the accountant is to obtain an understanding of the general principles for engagements performed in accordance with SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions

.07 For purposes of SSARSs, the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Designated accounting standard setter. A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Engagement partner.^[1] The partner or other individual appointed by the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body. (Ref: par. .A12)

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon performed by the engagement quality reviewer and completed before the engagement report is released.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement.

Fair presentation framework. See **financial reporting framework**.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

^[1] [Footnote deleted by the issuance of SSARS No. 26, June 2022.]

The term *fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and does one of the following:

- a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.
- b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgment in (a) or (b) is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference.

The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

General purpose financial statements. Financial statements prepared in accordance with a general purpose framework.

General purpose framework. A financial reporting framework designed to meet the common financial information needs of a wide range of users.

Inspection. Inspection is an evaluation of the adequacy of aspects of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.

Interpretive publications. Interpretations of SSARs; exhibits to SSARs; AICPA Guide *Preparation, Compilation, and Review Engagements*; [2] guidance on preparation, compilation, and review engagements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

[2] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Network. As defined in "Definitions" (ET section 0.400) in the AICPA code, an association of entities that includes one or more firms. (Ref: par. .A13)

Network firm. As defined in "Definitions" in the AICPA code, a firm or other entity that belongs to a network. References to a network firm are to be read hereafter as "another firm or entity that belongs to the same network as the firm."

Other preparation, compilation and review publications. Publications other than interpretive publications. (Ref: par. .A12)

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

Personnel. Partners and staff in the firm.

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by SSARs, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the preparation, compilation, or review engagement.

Professional standards. Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" of the AICPA code, or by other standard setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Prospective financial information. Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and, if applicable, the engagement quality reviewer are subject, which consist of the AICPA code together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Special purpose financial statements. Financial statements prepared in accordance with a special purpose framework.

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting: (Ref: par. .A13)

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial

reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance department).

- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements, for example, the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as other comprehensive bases of accounting.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after June 15, 2019, by SSARS No. 24. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Requirements

Ethical Requirements

.08 The accountant should comply with relevant ethical requirements. (Ref: par. .A16–.A19)

Professional Judgment

.09 The accountant should exercise professional judgment in the performance of an engagement in accordance with SSARSs. (Ref: par. .A20–.A24)

Conduct of the Engagement in Accordance With SSARSs

.10 The accountant must perform a review, compilation, or an engagement to prepare financial statements in accordance with SSARSs, except for certain reviews of interim financial information as discussed in section 90, *Review of Financial Statements*.³

Complying With AR-C Sections Relevant to the Engagement

.11 The accountant should comply with all AR-C sections relevant to the engagement. An AR-C section is relevant to the engagement when the AR-C section is in effect, and the circumstances addressed by the AR-C section exist. (Ref: par. .A24–.A29)

.12 The accountant should have an understanding of the entire text of an AR-C section, including its application and other explanatory material, to

³ Paragraph .02 of section 90, *Review of Financial Statements*.

understand its objectives and apply its requirements properly. (Ref: par. .A31–.A35)

.13 An accountant should not represent compliance with SSARs in the accountant's compilation or review report unless the accountant has complied with the requirements of this section and all other AR-C sections relevant to the engagement.

Complying With Relevant Requirements

.14 Subject to paragraph .16, the accountant should comply with each requirement of the relevant AR-C section unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist. (Ref: par. .A36)

Defining Professional Responsibilities in SSARs

.15 SSARs use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on accountants:

- *Unconditional requirements.* The accountant must comply with an unconditional requirement in all cases in which such requirement is relevant. SSARs use the word "must" to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .16. SSARs use the word "should" to indicate a presumptively mandatory requirement. (Ref: par. .A37)

.16 In rare circumstances, the accountant may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the accountant should perform alternative procedures to achieve the intent of the requirement. The need for an accountant to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the intent of the requirement.

.17 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph added, effective October 2016, by SSARS No. 23.]

Interpretive Publications

.18 The accountant should consider applicable interpretive publications in the performance of an engagement in accordance with SSARs. (Ref: par. .A38) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Other Preparation, Compilation and Review Publications

.19 In applying the guidance included in an other preparation, compilation and review publication, the accountant should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. (Ref: par. .A39–.A41) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Engagement Level Quality Management

.20 In an engagement performed in accordance with SSARSs, the engagement partner should determine that members of the engagement team have the appropriate competence and capabilities, including sufficient time, to perform the engagement. (Ref: par. .A42) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.21 In an engagement performed in accordance with SSARSs, the engagement partner should take responsibility for the following: (Ref: par. .A43–.A47)

- a.* The overall managing and achieving of quality on the engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner should be sufficiently and appropriately involved throughout the engagement such that the engagement partner has the basis for determining that the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the engagement.
- b.* Directing, supervising, planning, and performing the engagement in compliance with professional standards and applicable legal and regulatory requirements. If the engagement partner assigns the design or performance of procedures, tasks, or actions related to a requirement of this section to other members of the engagement team to assist the engagement partner in complying with the requirements of this section, the engagement partner should continue to take overall responsibility for managing and achieving quality on the engagement through direction and supervision of those members of the engagement team and review of their work.
- c.* The accountant's report being appropriate in the circumstances
- d.* The engagement being performed in accordance with the firm's policies or procedures, including the following:
 - i.* Being satisfied that the firm's policies or procedures for the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity (Ref: par. .A49–.A50)
 - ii.* Determining that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the engagement, the firm's policies or procedures, and any changes that may arise during the engagement
 - iii.* Taking responsibility for appropriate engagement documentation being maintained

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. As amended,

effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Relevant Considerations After Engagement Acceptance

.22 If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Compliance With Relevant Ethical Requirements

.23 The engagement partner should have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the engagement. (Ref: par. .A51–.A54) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.24 The engagement partner should take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the engagement, and the firm's related policies or procedures, including those that address the following: (Ref: par. .A43 and .A52–.A56)

- a. Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence, if applicable to the circumstances of the engagement
- b. Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, if applicable to the circumstances of the engagement, and the responsibilities of members of the engagement team when they become aware of breaches
- c. The responsibilities of members of the engagement team when they become aware of an instance of noncompliance with laws and regulations by the entity

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.25 If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner should evaluate the threats by complying with the firm's policies or procedures, using relevant information from the firm, the engagement team, or other sources; and take appropriate action. (Ref: par. .A55–.A56) [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.26 The engagement partner should remain alert throughout the engagement, through observation and making inquiries as necessary, for breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: par. .A57) [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.27 If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature and circumstances of the engagement have not been fulfilled, the engagement partner, in consultation

with others in the firm, should take appropriate action. (Ref: par. .A58) [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.28 In a compilation or review engagement, prior to dating the accountant's report, the engagement partner should take responsibility for determining whether relevant ethical requirements, including, in a review engagement, those related to independence, have been fulfilled. (Ref: par. .A59) [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Monitoring and Remediation

.29 The engagement partner should take responsibility for the following:

- a. Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm, including, as applicable, the information from the monitoring and remediation process of the network and across the network firms
- b. Determining the relevance and effect on the engagement of the information referred to in paragraph .29a and taking appropriate action
- c. Remaining alert throughout the engagement for information that may be relevant to the firm's monitoring and remediation process and communicating such information to those responsible for the process

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Acceptance and Continuance of Client Relationships and Engagements

.30 The accountant should not accept an engagement to be performed in accordance with SSARSs if (Ref: par. .A60)

- a. the accountant has reason to believe that relevant ethical requirements, including, if applicable, those related to independence, will not be satisfied;
- b. the accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is likely to be unavailable or unreliable; or (Ref: par. .A62)
- c. the accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.31 As a precondition for accepting an engagement to be performed in accordance with SSARSs, the accountant should

- a. determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable. (Ref: par. .A63–.A69)
- b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A70–.A74)
 - i. for the selection of the financial reporting framework to be applied in the preparation of financial statements.
 - ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, unless the accountant decides to accept responsibility for such internal control. (Ref: par. .A75)
 - iii. for preventing and detecting fraud.
 - iv. for ensuring that the entity complies with laws and regulations applicable to its activities.
 - v. for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements.
 - vi. to provide the accountant with (Ref: par. .A76)
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - (2) additional information that the accountant may request from management for the purpose of the engagement.
 - (3) unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after June 15, 2019, by SSARS No. 24. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Application and Other Explanatory Material

[.A1–.A3] [Paragraphs deleted by the issuance of SSARS No. 23, October 2016.]

Scope of This Section (Ref: par. .04)

.A4 If the accountant is engaged to perform a professional service in accordance with SSARSs on financial information other than financial statements (for example, the preparation or compilation of prospective financial information or the compilation of pro forma financial information), references in this section to *financial statements* are to be taken as references to such other financial information. [Paragraph added, effective October 2016, by SSARS No. 23.]

.A5 The preparation and fair presentation of the financial statements require

- the identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- the preparation and fair presentation of the financial statements in accordance with that framework.
- the inclusion of an adequate description of that framework in the financial statements.

The preparation and fair presentation of the financial statements require management to exercise judgment when making accounting estimates that are reasonable in the circumstances as well as when selecting and applying appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A6 The financial statements may be prepared in accordance with one of the following:

- A general purpose framework (a financial reporting framework designed to meet the common financial information needs of a wide range of users)
- A special purpose framework

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A7 The applicable financial reporting framework often encompasses financial accounting standards promulgated by an authorized or recognized standards-setting organization or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial accounting standards promulgated by an authorized or recognized standards-setting organization and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources or may even consist only of such sources. Such other sources may include the following:

- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations regarding accounting matters
- Published accounting interpretations of varying authority issued by standards-setting, professional, or regulatory organizations
- Published views of varying authority on emerging accounting issues issued by standards-setting, professional, or regulatory organizations
- General and industry practices widely recognized and prevalent
- Accounting literature

When conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained or among the sources that encompass the financial reporting framework, the source with the highest authority prevails. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events,

it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A9 The financial accounting standards promulgated by organizations that are authorized or recognized to promulgate standards to be used by entities for preparing financial statements in accordance with a general purpose framework include the FASB *Accounting Standards Codification*®; International Financial Reporting Standards, issued by the International Accounting Standards Board; Statements of Federal Financial Accounting Standards, issued by the Federal Accounting Standards Advisory Board for U.S. federal government entities; and Statements of the Governmental Accounting Standards Board, issued by the Governmental Accounting Standards Board for U.S. state and local governmental entities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A10 The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance, and cash flows of an entity. For example, a complete set of financial statements might include a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements. Examples of a single financial statement, each of which would include related notes, include the following:

- Balance sheet
- Statement of income or statement of operations
- Statement of retained earnings
- Statement of cash flows
- Statement of assets and liabilities
- Statement of changes in owners' equity
- Statement of revenue and expenses
- Statement of operations by product lines

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A11 An accountant may be engaged to prepare or perform a compilation or review engagement on a complete set of financial statements or an individual financial statement (for example, balance sheet only). The financial statements may be for an annual period or for a shorter or longer period, depending on management's needs. However, it is likely not appropriate for the entity to present financial statements for a period longer or shorter than an annual period in a comparative presentation with financial statements for an annual period. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .07)

"Engagement Partner" (Ref: par. 07)

.A12 Appendix B to the AICPA Code of Professional Conduct, "Council Resolution Concerning the Form of Organization and Name Rule," states that there must be a CPA who has ultimate responsibility for all engagements performed in accordance with SSARSs, and non-CPA owners could not assume ultimate

responsibility for any such engagements. Law or regulation may include additional requirements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

"Network" and "Network Firm" (Ref: par. 07)

.A13 The definitions of *network* or *network firm* in relevant ethical requirements may differ from those set out in this section. The AICPA code also provides guidance in relation to the terms *network* and *network firm*. Networks and other network firms may be structured in a variety of ways and are, in all cases, external to the firm. The provisions in this section in relation to networks also apply to any structures or organizations that do not form part of the firm but that exist within the network. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Other Preparation, Compilation, and Review Publications (Ref: par. 07)

.A14 Other preparation, compilation, and review publications include

- AICPA preparation, compilation, and review publications not defined as interpretive publications;
- AICPA's annual alert addressing engagements performed in accordance with SSARSs;
- articles addressing preparation, compilation, and review engagements in the *Journal of Accountancy* and other professional journals;
- continuing professional education programs and other instruction materials,
- textbooks, guide books, programs for preparation, compilation, and review engagements
- checklists; and
- other publications addressing preparation, compilation, and review engagements from state CPA societies, other organizations, and individuals.

[Paragraph added, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

Special Purpose Framework (Ref: par. 07)

.A15 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on a framework promulgated by an authorized or recognized standard-setting organization (for example, FASB or GASB) but does not include all the requirements of that framework. Such frameworks are regulatory bases of accounting, as described in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of SSARSs, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

Ethical Requirements (Ref: par. .08)

.A16 The accountant is subject to relevant ethical requirements relating to engagements performed in accordance with SSARSs. Ethical requirements consist of those contained in the AICPA Code of Professional Conduct, together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A17 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A18 Due care requires the accountant to discharge professional responsibilities with competence and have the appropriate capabilities to perform the engagement and enable an appropriate accountant's report to be issued, if applicable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A19 Statement on Quality Management Standards No. 1, *A Firm's System of Quality Management* (SQMS No. 1) (QM sec. 10), sets out the firm's responsibilities to design, implement, and operate a system of quality management for engagements performed in accordance with SSARSs. As part of its system of quality management, SQMS No. 1 requires the firm to establish quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence, if applicable.⁴ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Professional Judgment (Ref: par. .09)

.A20 Professional judgment is essential to the proper conduct of an engagement in accordance with SSARSs because interpretation of relevant ethical requirements and SSARSs and the informed decisions required throughout

⁴ Paragraph .30 of Statement on Quality Management Standards No. 1, *A Firm's System of Quality Management* (QM sec. 10). [As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

the engagement cannot be made without the application of relevant knowledge and experience to the facts and circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A21 The distinguishing feature of the professional judgment expected of the accountant is that it is exercised by an accountant whose training, knowledge, and experience have assisted in developing the necessary competencies to achieve reasonable judgments and make informed decisions about appropriate courses of action when undertaking an engagement in accordance with SSARSs. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, assists the accountant in making informed and reasonable judgments. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A22 The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known by the accountant throughout the engagement, including

- knowledge acquired from engagements carried out for the entity's financial statements in prior periods, where applicable.
- the accountant's understanding of the entity and its environment, including its accounting system, and the application of the applicable financial reporting framework in the entity's industry.
- the extent to which the preparation and presentation of the financial statements requires the exercise of judgment by management or the accountant, if applicable.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A23 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of SSARSs and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the accountant up to the date of the issuance of financial statements prepared by the accountant or the date of the accountant's compilation or review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A24 Professional judgment needs to be exercised throughout the engagement performed in accordance with SSARSs. It also needs to be appropriately documented in accordance with the requirements of the applicable AR-C section. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or, in a review engagement, the evidence obtained. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Conduct of an Engagement in Accordance With SSARs

Complying With AR-C Sections Relevant to the Engagement **(Ref: par. .11–.12)**

.A25 ARSC is designated to promulgate standards under the "General Standards Rule" (ET sec. 1.300.001) and the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct⁵ with respect to unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market. ARSC develops and issues standards in the form of SSARs through a process that includes deliberation in meetings open to the public, public exposure of proposed SSARs, and a formal vote. SSARs are codified in AR-C sections in AICPA *Professional Standards*. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A26 SSARs provide the standards used for fulfilling the overall objectives of the accountant's work. SSARs address the general responsibilities of the accountant as well as the accountant's further considerations relevant to the application of those responsibilities to specific topics. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A27 The scope, effective date, and any specific limitation of the applicability of a specific AR-C section are made clear in the AR-C section. Unless otherwise stated in the AR-C section, the accountant is permitted to apply an AR-C section before the effective date specified therein. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A28 In certain engagements, the accountant also may be required to comply with other requirements in addition to SSARs. SSARs do not override law or regulation that governs a review, compilation, or an engagement to prepare financial statements. In the event that such law or regulation differs from SSARs, an engagement conducted only in accordance with law or regulation will not necessarily comply with SSARs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A29 The accountant may also conduct the compilation or review of financial statements in accordance with both SSARs and

- International Standard on Related Services 4410 (Revised), *Compilation Engagements*,
- International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, or
- compilation or review standards of a specific jurisdiction or country.

⁵ AICPA's Professional Ethics Executive Committee has restructured the Code of Professional Conduct. References in this standard are to the revised code, which is effective December 15, 2014. It is available at <http://pub.aicpa.org/codeofconduct>.

In such cases, in addition to complying with each of the AR-C sections relevant to the engagement, it may be necessary for the accountant to perform additional compilation or review procedures in order to comply with the other compilation or review standards. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A30 SSARSs are relevant to engagements to prepare financial statements and compilations and reviews of financial statements of governmental entities. The accountant's responsibilities, however, may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an engagement in accordance with SSARSs. These additional responsibilities are not dealt with in SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A31 In addition to objectives and requirements, an AR-C section contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the AR-C section and definitions. The entire text of an AR-C section, therefore, is relevant to an understanding of the objectives stated in an AR-C section and the proper application of the requirements of an AR-C section. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A32 When necessary, the application and other explanatory material provides further explanation of the requirements of an AR-C section and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.
- include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements of an AR-C section. The accountant is required by paragraph .12 to understand the application and other explanatory material; how the accountant applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AR-C section. The words "may," "might," and "could" are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AR-C section. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A33 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AR-C section or within the title and introduction of the appendix itself. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A34 Introductory material may include, as needed, such matters as explanation of the following:

- The purpose and scope of the AR-C section, including how the AR-C section relates to other AR-C sections
- The subject matter of the AR-C section
- The respective responsibilities of the accountant and others in relation to the subject matter of the AR-C section
- The context in which the AR-C section is set

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A35 An AR-C section may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of SSARSs. These are provided to assist in the consistent application and interpretation of SSARSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Complying With Relevant Requirements (Ref: par. .14)

A36 In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the accountant may be required to withdraw from the engagement when withdrawal is possible under applicable law or regulation, or the accountant may be required to perform a certain action, unless prohibited by law or regulation. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Defining Professional Responsibilities in SSARSs (Ref: par. .15)

A37 If an AR-C section provides that a procedure or action is one that the accountant "should consider," consideration of the procedure or action is presumptively required. Whether the accountant performs the procedure or action is based upon the outcome of the accountant's consideration and the accountant's professional judgment. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Interpretive Publications (Ref: par. .18)

A38 Interpretive publications are not SSARSs. *Interpretive publications* are recommendations on the application of SSARSs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with SSARSs. Compilation and review interpretations of SSARSs and exhibits to SSARSs are included in the AR-C sections. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS

No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Other Preparation, Compilation and Review Publications (Ref: par. .19)

.A39 Other preparation, compilation and review publications have no authoritative status; however, they may help the accountant understand and apply SSARSs. The accountant is not expected to be aware of the full body of other preparation, compilation and review publications. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A40 Although the accountant determines the relevance of these publications in accordance with paragraph .19, the accountant may presume that other preparation, compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other preparation, compilation and review publications are listed in the exhibit, "Other Preparation, Compilation and Review Publications." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A41 When determining whether an other preparation, compilation and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the engagement, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying SSARSs and the degree to which the publisher or author is recognized as an authority in matters addressing preparation, compilation, and review engagements. An other preparation, compilation, and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff that contradicts an other preparation, compilation and review publication that has been reviewed by the AICPA Audit and Attest Standards staff is inappropriate. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

**Engagement Level Quality Management
(Ref: par. .20–.21 and .24)**

.A42 When determining that the members of the engagement team have the appropriate competence and capabilities to perform the engagement, the engagement partner may take into consideration such matters as the member's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant information technology and specialized areas of accounting or attest services.
- knowledge of relevant industries in which the entity operates.

- ability to exercise professional skepticism, if applicable, and professional judgment.
- understanding of the firm's quality management policies or procedures.

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A43 Within the context of the firm's system of quality management, engagement teams have a responsibility to implement the firm's policies or procedures that are applicable to the engagement and communicate to the firm information arising from the engagement that is required to be communicated by the firm's policies or procedures to support the firm's system of quality management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A44 The actions of the engagement partner and appropriate messages to the other members of the engagement team, in the context of the engagement partner taking overall responsibility for managing and achieving quality on each engagement, emphasize the fact that quality is essential when performing an engagement in accordance with SSARSs and the importance to the quality of the engagement of

- a. performing work that complies with professional standards and regulatory and legal requirements.
- b. complying with the firm's quality management policies or procedures, as applicable.
- c. issuing a report, if applicable, for the engagement that is appropriate in the circumstances.
- d. the engagement team's ability to raise concerns without fear of reprisals.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A45 Ordinarily, the engagement team may depend on the firm's policies or procedures unless

- the engagement team's understanding or practical experience indicates that the firm's policies or procedures will not effectively address the nature and circumstances of the engagement, or
- information provided by the firm or other parties about the effectiveness of such policies or procedures suggests they cannot be relied on (for example, information provided by the firm's monitoring activities, external inspections, or other relevant sources indicates that the firm's policies or procedures are not operating effectively).

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A46 For example, the engagement team may depend on the firm's policies and procedures in relation to

- competence and capabilities of personnel through their recruitment and formal training.
- independence through the accumulation and communication of relevant independence information.
- maintenance of client relationships through the firm's policies or procedures for acceptance and continuance of client relationships and specific engagements.
- adherence to regulatory and legal requirements through the firm's monitoring and remediation process.

When considering the deficiencies identified in the firm's system of quality management that may affect the engagement, the engagement partner may consider the remedial actions undertaken by the firm to address those deficiencies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A47 A deficiency in the firm's system of quality management does not necessarily indicate that an engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the accountant's report, if applicable, was not appropriate in the circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

[.A48] [Subsequently renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Acceptance and Continuance of Client Relationships and Engagements Performed in Accordance With SSARSs (Ref: par. .21di)

.A49 SQMS No. 1 requires the firm to establish quality objectives that address acceptance and continuance of client relationships and specific engagements. Information such as the following may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and engagements are appropriate:

- The integrity and ethical values of the principal owners, key management, and those charged with governance of the entity
- Whether sufficient and appropriate resources are available to perform the engagement
- Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement

- Whether the engagement team has the competence and capabilities, including sufficient time, to perform the engagement
- Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A50 If the engagement partner has cause to doubt management's integrity to a degree that is likely to affect proper performance of the engagement, it is not appropriate to accept the engagement, unless required by law or regulation, because doing so may lead to the accountant being associated with the entity's financial statements in an inappropriate manner. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Relevant Ethical Requirements (Ref: par. .23–.25)

.A51 Based on the nature and circumstances of the engagement, certain law, regulation, or aspects of relevant ethical requirements, such as those pertaining to noncompliance with laws or regulations, may be relevant to the engagement (for example, laws or regulations dealing with money laundering, corruption, or bribery). [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A52 The firm's information system and the resources provided by the firm may assist the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the engagement. For example, the firm may do the following:

- Communicate the independence requirements to engagement teams, if applicable in the circumstances of the engagement
- Provide training for engagement teams on relevant ethical requirements
- Establish manuals and guides (that is, intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the nature and circumstances of the firm and its engagements
- Assign personnel to manage and monitor compliance with relevant ethical requirements (for example, SQMS No. 1 requires that the firm obtains, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or provide consultation on matters related to relevant ethical requirements
- Establish policies or procedures for engagement team members to communicate relevant and reliable information to appropriate parties within the firm or to the engagement partner, such as policies or procedures for engagement teams to
 - communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during

the period of the engagement and during the period covered by the subject matter

- communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and, if it is not, address the threat by eliminating it or reducing it to an acceptable level
- promptly communicate any breaches of the relevant ethical requirements, including those related to independence

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A53 The engagement partner may take into account the information, communication, and resources described in paragraph .A49 when determining whether the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A54 Open and robust communication between the members of the engagement team about relevant ethical requirements may also assist in

- drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement, and
- keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Identifying and Evaluating Threats to Compliance With Relevant Ethical Requirements (Ref: par. .24–.25)

.A55 In accordance with SQMS No. 1, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to independence for engagement team members, include policies or procedures for identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A56 Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with. For example, the AICPA code (ET section 1.295.040) provides safeguards for reducing threats to independence to an acceptable level when performing nonattest services for an attest client. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Breaches of Relevant Ethical Requirements (Ref: par. .26)

.A57 In accordance with SQMS No. 1, the firm is required to establish policies or procedures for identifying, communicating, evaluating, and reporting any breaches of relevant ethical requirements and appropriately responding to

the causes and consequences of the breaches in a timely manner. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Taking Appropriate Action (Ref: par. .27)

.A58 Examples of appropriate actions may include the following:

- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate individuals so that appropriate action can be taken, including as applicable, disciplinary action.
- Communicating with those charged with governance.
- Communicating with regulatory authorities or professional bodies. In some circumstances, communication with regulatory authorities may be required by law or regulation.
- Seeking legal advice.
- Withdrawing from the engagement, when withdrawal is possible under applicable law or regulation.

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Prior to Dating the Accountant's Review Report (Ref: par. .28)

.A59 AR-C section 90, *Review of Financial Statements*, requires that the accountant's review report include a statement that the accountant is required to be independent of the entity and to meet the accountant's other ethical responsibilities in accordance with the relevant ethical requirements relating to the review.⁶ Performing the procedures required by paragraphs .23–.28 provide the basis for these statements in the accountant's review report. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

Acceptance and Continuance of Client Relationships and Engagements (Ref: par. .30–.31)

.A60 The accountant's consideration of acceptance and continuance of client relationships and relevant ethical requirements occurs throughout the engagement as conditions and changes in circumstances occur. Performing initial procedures on acceptance and continuance of client relationships and evaluation of relevant ethical requirements at the beginning of an engagement informs the accountant's decisions and actions prior to the performance of other significant activities for the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

[.A61] [Paragraph subsequently renumbered and deleted by the issuance of SSARS No. 26, June 2022.]

⁶ Paragraph .76eiii of section 90. [Footnote added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A62 This consideration is not directed at the need that sometimes arises in the course of an engagement to assist management by recommending adjusting entries required to finalize the financial statements prepared by management. An example of where the accountant may have cause to doubt whether the information needed to perform the review will be available or reliable is when the accounting records necessary for performing analytical procedures are suspected to be substantially inaccurate or incomplete. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

The Applicable Financial Reporting Framework

.A63 An applicable financial reporting framework provides the criteria for management to present the financial statements of an entity, including the fair presentation of those financial statements. The criteria used by the accountant to evaluate or measure the subject matter, including, when relevant, a basis for presentation and disclosure, are also provided by the financial reporting framework. These criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A64 Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements, and the accountant does not have suitable criteria for an engagement in accordance with SSARSs. In many cases, the accountant may presume that the applicable financial reporting framework is acceptable, as described in paragraphs .A69–.A71. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

Determining the Acceptability of the Financial Reporting Framework

.A65 Factors that are relevant to the accountant's determination of the acceptability of the financial reporting framework selected by management to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)
- Whether law or regulation prescribes the applicable financial reporting framework

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A66 Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. Although all the information needs of specific users cannot be met, financial information needs that are common to a wide range of users exist. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as *general purpose financial statements*. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A67 General purpose frameworks. The sources of established accounting principles that are generally accepted are accounting principles promulgated by a body designated by the Council of the AICPA to establish such principles, pursuant to the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct. Such financial reporting standards often are identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A68 Special purpose frameworks. In some cases, the financial statements will be prepared in accordance with a special purpose framework. For example, law or regulation may prescribe the financial reporting framework to be used in the preparation of financial statements for certain types of entities. Such financial statements are referred to as *special purpose financial statements*. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A69 After the engagement has been accepted, the accountant may encounter deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the previously agreed-upon terms will have changed. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A70 In accordance with this section, the accountant is required to obtain the agreement of management on management's responsibilities in relation to the financial statements as a condition precedent to accepting the engagement. In smaller entities, management may not be well-informed about what those responsibilities are, including those arising in applicable law or regulation. In order to obtain management's agreement on an informed basis, the accountant may find it necessary to discuss those responsibilities with management in advance of seeking management's agreement on its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A71 The financial statements are those of the entity. This section does not impose responsibilities on management and those charged with governance, nor does it override laws and regulations that govern their respective responsibilities. However, an engagement performed in accordance with SSARSs is conducted on the premise that management, and those charged with governance, as appropriate, have acknowledged certain responsibilities that are

fundamental to the conduct of the engagement. The accountant's engagement does not relieve management and those charged with governance of their responsibilities. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A72 As part of its responsibility for the preparation of the financial statements, management is required to exercise judgment in making accounting estimates that are reasonable in the circumstances and to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A73 Because of the significance of the preconditions for undertaking an engagement in accordance with SSARSs, the accountant is required, in accordance with this section, to obtain management's agreement that it understands its responsibilities before accepting a SSARSs engagement. The accountant may obtain management's agreement either orally or in writing. However, management's agreement is subsequently recorded within the written terms of the engagement. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A74 If management, and those charged with governance, where appropriate, do not or will not acknowledge their responsibilities in relation to the financial statements, it is not appropriate to accept the engagement. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A75 Although the accountant may accept responsibility for the design, implementation, and maintenance of internal control, accepting such responsibility would impair the accountant's independence.⁷ Therefore, if an accountant accepts such responsibility, the accountant would be precluded from performing a review of the financial statements. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A76 The accountant is entitled to rely on management to provide all relevant information for the engagement. The form of the information provided by management for the purpose of the engagement will vary in different engagement circumstances. In broad terms, it will comprise records, documents, explanations, and other information relevant to the preparation of the financial statements in accordance with the financial reporting framework adopted by management. The information provided may include, for example, information about management's assumptions, intentions, or plans underlying development of accounting estimates needed to prepare the financial statements in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

⁷ ET sec. 1.295.030.02*k*. [Footnote renumbered by the issuance of SSARS No. 26, June 2022.]

Exhibit — Other Preparation, Compilation and Review Publications

This listing identifies *other preparation, compilation and review publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate, as defined in section 60. Products may be obtained through <https://www.aicpa.org/cpe-learning>.

Current Alerts

Developments in Review, Compilation, and Financial Statement Preparation Engagements

Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities

Independence and Ethics Developments

Technical Questions and Answers Accounting and Compilation and Review Technical Questions and Answers (Q&A) Sections (available at <https://www.aicpa.org/resources/download/aicpa-technical-questions-and-answers-at-your-fingertips>)

Special Purpose Frameworks

- Q&A Section 1500.07, "Disclosure Concerning Subsequent Events in Special Purpose Financial Statements"
- Q&A Section 1800.06, "Applicability of Fair Value Disclosure Requirements in FASB ASC 820 to Financial Statements Prepared in Accordance With a Special Purpose Framework"

Compilation and Review Engagements

- Q&A Section 9150.04, "Financial Statements Marked As 'Unaudited'"
- Q&A Section 9150.08, "Supplementary Information"
- Q&A Section 9150.09, "Applicability of AR Section 300 to Certain Companies Required to File With Regulatory Bodies"
- Q&A Section 9150.10, "Review of Financial Statements Included in a Prescribed Form"
- Q&A Section 9150.16, "Reference to Accountant's Report in Notes to Financial Statements"
- Q&A Section 9150.18, "Bank Engaged an Accountant to Compile a Financial Statement of Another Entity"
- Q&A Section 9150.20, "Reissuance When Not Independent"
- Q&A Section 9150.24, "Issuing a Compilation Report on Financial Statements That Omit Substantially All Disclosures After Issuing a Report on the Same Financial Statements That Include Substantially All Disclosures"

- Q&A Section 9150.29, "Effects on Compilation and Review Engagements When Management Does Not Assess Whether the Reporting Entity Is the Primary Beneficiary of a Variable Interest Entity and Instructs the Accountant to Not Perform the Assessment"
- Q&A Section 9150.30, "Disclosure of Independence Impairment in the Accountant's Compilation Report on Comparative Financial Statements When the Accountant's Independence Is Impaired in Only One Period"
- Q&A Section 9150.31, "Break-Even Financial Statements"

Compilation of Financial Statements

- Q&A Section 1300.17, "Omission of Reconciliation of Net Income to Cash Flow From Operations"
- Q&A Section 8900.10, "Successor Accountant Becomes Aware of Information During the Performance of a Compilation or Review That Leads the Successor Accountant to Believe That Financial Statements Reported On by a Predecessor Accountant Who Has Ceased Operations May Require Revision"

Compilation Reports

- Q&A Section 1300.17, "Omission of Reconciliation of Net Income to Cash Flow From Operations"
- Q&A Section 9110.07, "Statement of Cash Receipts and Disbursements"

Review of Financial Statements

- Q&A Section 8900.10, "Successor Accountant Becomes Aware of Information During the Performance of a Compilation or Review That Leads the Successor Accountant to Believe That Financial Statements Reported On by a Predecessor Accountant Who Has Ceased Operations May Require Revision"

Review Reports

- Q&A Section 8800.30, "Making Reference to Review Report"
- Q&A Section 9110.07, "Statement of Cash Receipts and Disbursements"

Other Publications

Corporations: Checklists and Illustrative Financial Statements

The Engagement Letter: Best Practices and Examples

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

AR-C Section 60A

General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services

Source: SSARS No. 21; SSARS No. 23; SSARS No. 24; SSARS No. 25.

Effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section provides general principles for engagements performed in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the Accounting and Review Services Committee (ARSC) and codified into AR-C sections. This section also sets forth the meaning of certain terms used in SSARSs when describing the professional requirements imposed on accountants performing an engagement in accordance with SSARSs. [As amended, effective October 2016, by SSARS No. 23.]

.02 This section is intended to help accountants better understand their professional responsibilities when performing an engagement in accordance with SSARSs. Additional sections have been established to set forth specific performance and reporting requirements. Such additional requirements are based on the general principles provided by this section, and any requirements created by this section also have been incorporated into the additional sections.

.03 SSARSs do not address the responsibilities of the accountant that may exist in legislation, regulation, or otherwise. Such responsibilities may differ from those established in SSARSs. Accordingly, although the accountant may find aspects of SSARSs helpful in such circumstances, it is the responsibility of the accountant to ensure compliance with all relevant legal, regulatory, or professional obligations. [As amended, effective October 2016, by SSARS No. 23.]

.04 The financial statements subject to the engagement performed in accordance with SSARSs are those of the entity. SSARSs do not impose responsibilities on management and do not override laws and regulations that govern their responsibilities. (Ref: par. .A4–.A11) [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

Effective Date

.05 This section is effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015. Early implementation is permitted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Objective

.06 The objective of the accountant is to obtain an understanding of the general principles for engagements performed in accordance with SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions

.07 For purposes of SSARSs, the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Designated accounting standard setter. A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Engagement partner.¹ The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement.

Fair presentation framework. See **financial reporting framework**.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

The term *fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and does one of the following:

- a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.
- b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such

¹ This term is also defined in paragraph .13 of QM section 10A, *A Firm's System of Quality Control*, for purposes of the Statements on Quality Control Standards. Refer to QM section 10A for specific language.

departures are expected to be necessary only in rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgment in (a) or (b) is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including disclosures, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement. Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference.

The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

General purpose financial statements. Financial statements prepared in accordance with a general purpose framework.

General purpose framework. A financial reporting framework designed to meet the common financial information needs of a wide range of users.

Interpretive publications. Interpretations of SSARs; exhibits to SSARs; AICPA Guide *Preparation, Compilation, and Review Engagements*; ^[2] guidance on preparation, compilation, and review engagements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

Other preparation, compilation and review publications. Publications other than interpretive publications. (Ref: par. .A12)

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by SSARs, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the preparation, compilation, or review engagement.

Prospective financial information. Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Special purpose financial statements. Financial statements prepared in accordance with a special purpose framework.

^[2] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting: (Ref: par. .A13)

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance department).
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements, for example, the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as other comprehensive bases of accounting.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after June 15, 2019, by SSARS No. 24. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

Ethical Requirements

.08 The accountant should comply with relevant ethical requirements. (Ref: par. .A14–.A17)

Professional Judgment

.09 The accountant should exercise professional judgment in the performance of an engagement in accordance with SSARSs. (Ref: par. .A18–.A22)

Conduct of the Engagement in Accordance With SSARSs

.10 The accountant must perform a review, compilation, or an engagement to prepare financial statements in accordance with SSARSs, except for certain

reviews of interim financial information as discussed in section 90A, *Review of Financial Statements*.³

Complying With AR-C Sections Relevant to the Engagement

.11 The accountant should comply with all AR-C sections relevant to the engagement. An AR-C section is relevant to the engagement when the AR-C section is in effect, and the circumstances addressed by the AR-C section exist. (Ref: par. .A22–.A27)

.12 The accountant should have an understanding of the entire text of an AR-C section, including its application and other explanatory material, to understand its objectives and apply its requirements properly. (Ref: par. .A29–.A33)

.13 An accountant should not represent compliance with SSARs in the accountant's compilation or review report unless the accountant has complied with the requirements of this section and all other AR-C sections relevant to the engagement.

Complying With Relevant Requirements

.14 Subject to paragraph .16, the accountant should comply with each requirement of the relevant AR-C section unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist. (Ref: par. .A34)

Defining Professional Responsibilities in SSARs

.15 SSARs use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on accountants:

- *Unconditional requirements.* The accountant must comply with an unconditional requirement in all cases in which such requirement is relevant. SSARs use the word "must" to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .16. SSARs use the word "should" to indicate a presumptively mandatory requirement. (Ref: par. .A35)

.16 In rare circumstances, the accountant may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the accountant should perform alternative procedures to achieve the intent of the requirement. The need for an accountant to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the intent of the requirement.

.17 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph added, effective October 2016, by SSARS No. 23.]

³ Paragraph .02 of section 90A, *Review of Financial Statements*.

Interpretive Publications

.18 The accountant should consider applicable interpretive publications in the performance of an engagement in accordance with SSARSs. (Ref: par. .A36) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Other Preparation, Compilation and Review Publications

.19 In applying the guidance included in an other preparation, compilation and review publication, the accountant should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. (Ref: par. .A37–.A39) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Engagement Level Quality Control

.20 In an engagement performed in accordance with SSARSs, the engagement partner should possess the competence and capabilities to perform the engagement and competence in financial reporting, appropriate to the engagement circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.21 In an engagement performed in accordance with SSARSs, the engagement partner should take responsibility for the following: (Ref: par. .A40–.A43)

- a. The overall quality of each engagement to which that partner is assigned
- b. The direction, supervision, planning, and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements
- c. The accountant's report being appropriate in the circumstances
- d. The engagement being performed in accordance with the firm's quality control policies and procedures, including the following:
 - i. Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity (Ref: par. .A45–.A46)
 - ii. Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the engagement and expertise in financial reporting to (Ref: par. .A47)
 - (1) perform the engagement in accordance with professional standards and applicable legal and regulatory requirements and
 - (2) enable a report that is appropriate in the circumstances to be issued, if applicable
 - iii. Taking responsibility for appropriate engagement documentation being maintained

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Relevant Considerations After Engagement Acceptance

.22 If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Compliance With Relevant Ethical Requirements

.23 Throughout the engagement, the engagement partner should remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine the appropriate action. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Monitoring

.24 An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner should consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Acceptance and Continuance of Client Relationships and Engagements

.25 The accountant should not accept an engagement to be performed in accordance with SSARSs if (Ref: par. .A48)

- a. the accountant has reason to believe that relevant ethical requirements will not be satisfied; (Ref: par. .A49)
- b. the accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is likely to be unavailable or unreliable; or (Ref: par. .A50)
- c. the accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.26 As a precondition for accepting an engagement to be performed in accordance with SSARSs, the accountant should

- a. determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable. (Ref: par. .A51–.A57)
- b. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A58–.A62)
 - i. for the selection of the financial reporting framework to be applied in the preparation of financial statements.

- ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, unless the accountant decides to accept responsibility for such internal control. (Ref: par. .A63)
- iii. for preventing and detecting fraud.
- iv. for ensuring that the entity complies with laws and regulations applicable to its activities.
- v. for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements.
- vi. to provide the accountant with (Ref: par. .A64)
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - (2) additional information that the accountant may request from management for the purpose of the engagement.
 - (3) unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after June 15, 2019, by SSARS No. 24. As amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Application and Other Explanatory Material

[.A1–.A3] [Paragraphs deleted by the issuance of SSARS No. 23, October 2016.]

Scope of This Section (Ref: par. .04)

.A4 If the accountant is engaged to perform a professional service in accordance with SSARSs on financial information other than financial statements (for example, the preparation or compilation of prospective financial information or the compilation of pro forma financial information), references in this section to *financial statements* are to be taken as references to such other financial information. [Paragraph added, effective October 2016, by SSARS No. 23.]

.A5 The preparation and fair presentation of the financial statements require

- the identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- the preparation and fair presentation of the financial statements in accordance with that framework.
- the inclusion of an adequate description of that framework in the financial statements.

The preparation and fair presentation of the financial statements require management to exercise judgment when making accounting estimates that are reasonable in the circumstances as well as when selecting and applying appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A6 The financial statements may be prepared in accordance with one of the following:

- A general purpose framework (a financial reporting framework designed to meet the common financial information needs of a wide range of users)
- A special purpose framework

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A7 The applicable financial reporting framework often encompasses financial accounting standards promulgated by an authorized or recognized standards-setting organization or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial accounting standards promulgated by an authorized or recognized standards-setting organization and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources or may even consist only of such sources. Such other sources may include the following:

- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations regarding accounting matters
- Published accounting interpretations of varying authority issued by standards-setting, professional, or regulatory organizations
- Published views of varying authority on emerging accounting issues issued by standards-setting, professional, or regulatory organizations
- General and industry practices widely recognized and prevalent
- Accounting literature

When conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained or among the sources that encompass the financial reporting framework, the source with the highest authority prevails. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A9 The financial accounting standards promulgated by organizations that are authorized or recognized to promulgate standards to be used by entities for preparing financial statements in accordance with a general purpose framework include the FASB *Accounting Standards Codification*; International Financial Reporting Standards, issued by the International Accounting Standards Board; Statements of Federal Financial Accounting Standards,

issued by the Federal Accounting Standards Advisory Board for U.S. federal government entities; and Statements of the Governmental Accounting Standards Board, issued by the Governmental Accounting Standards Board for U.S. state and local governmental entities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A10 The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance, and cash flows of an entity. For example, a complete set of financial statements might include a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements. Examples of a single financial statement, each of which would include related notes, include the following:

- Balance sheet
- Statement of income or statement of operations
- Statement of retained earnings
- Statement of cash flows
- Statement of assets and liabilities
- Statement of changes in owners' equity
- Statement of revenue and expenses
- Statement of operations by product lines

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A11 An accountant may be engaged to prepare or perform a compilation or review engagement on a complete set of financial statements or an individual financial statement (for example, balance sheet only). The financial statements may be for an annual period or for a shorter or longer period, depending on management's needs. However, it is likely not appropriate for the entity to present financial statements for a period longer or shorter than an annual period in a comparative presentation with financial statements for an annual period. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .07)

.A12 Other preparation, compilation, and review publications include

- AICPA preparation, compilation, and review publications not defined as interpretive publications;
- AICPA's annual alert addressing engagements performed in accordance with SSARSs;
- articles addressing preparation, compilation, and review engagements in the *Journal of Accountancy* and other professional journals;
- continuing professional education programs and other instruction materials,
- textbooks, guide books, programs for preparation, compilation, and review engagements
- checklists; and

- other publications addressing preparation, compilation, and review engagements from state CPA societies, other organizations, and individuals.

[Paragraph added, effective October 2016, by SSARS No. 23.]

.A13 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on a framework promulgated by an authorized or recognized standard-setting organization (for example, FASB or GASB) but does not include all the requirements of that framework. Such frameworks are regulatory bases of accounting, as described in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of SSARSs, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Ethical Requirements (Ref: par. .08)

.A14 The accountant is subject to relevant ethical requirements relating to engagements performed in accordance with SSARSs. Ethical requirements consist of those contained in the AICPA Code of Professional Conduct, together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, by the issuance of SSARS No. 25, February 2020.]

.A15 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A16 Due care requires the accountant to discharge professional responsibilities with competence and have the appropriate capabilities to perform the engagement and enable an appropriate accountant's report to be issued, if applicable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A17 QM section 10A, *A Firm's System of Quality Control*, sets out the firm's responsibilities to establish and maintain its system of quality control for engagements performed in accordance with SSARSs and establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.⁴ [Paragraph renumbered by the issuance of SSARS

⁴ Paragraphs .21–.25 of QM section 10A.

No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Professional Judgment (Ref: par. .09)

.A18 Professional judgment is essential to the proper conduct of an engagement in accordance with SSARSs because interpretation of relevant ethical requirements and SSARSs and the informed decisions required throughout the engagement cannot be made without the application of relevant knowledge and experience to the facts and circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A19 The distinguishing feature of the professional judgment expected of the accountant is that it is exercised by an accountant whose training, knowledge, and experience have assisted in developing the necessary competencies to achieve reasonable judgments and make informed decisions about appropriate courses of action when undertaking an engagement in accordance with SSARSs. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, assists the accountant in making informed and reasonable judgments. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A20 The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known by the accountant throughout the engagement, including

- knowledge acquired from engagements carried out for the entity's financial statements in prior periods, where applicable.
- the accountant's understanding of the entity and its environment, including its accounting system, and the application of the applicable financial reporting framework in the entity's industry.
- the extent to which the preparation and presentation of the financial statements requires the exercise of judgment by management or the accountant, if applicable.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A21 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of SSARSs and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the accountant up to the date of the issuance of financial statements prepared by the accountant or the date of the accountant's compilation or review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A22 Professional judgment needs to be exercised throughout the engagement performed in accordance with SSARSs. It also needs to be appropriately documented in accordance with the requirements of the applicable AR-C section. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or, in a review engagement, the evidence obtained. [Paragraph

renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Conduct of an Engagement in Accordance With SSARSs

Complying With AR-C Sections Relevant to the Engagement ***(Ref: par. .11–.12)***

.A23 ARSC is designated to promulgate standards under the "General Standards Rule" (ET sec. 1.300.001) and the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct⁵ with respect to unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market. ARSC develops and issues standards in the form of SSARSs through a process that includes deliberation in meetings open to the public, public exposure of proposed SSARSs, and a formal vote. SSARSs are codified in AR-C sections in AICPA *Professional Standards*. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A24 SSARSs provide the standards used for fulfilling the overall objectives of the accountant's work. SSARSs address the general responsibilities of the accountant as well as the accountant's further considerations relevant to the application of those responsibilities to specific topics. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A25 The scope, effective date, and any specific limitation of the applicability of a specific AR-C section are made clear in the AR-C section. Unless otherwise stated in the AR-C section, the accountant is permitted to apply an AR-C section before the effective date specified therein. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A26 In certain engagements, the accountant also may be required to comply with other requirements in addition to SSARSs. SSARSs do not override law or regulation that governs a review, compilation, or an engagement to prepare financial statements. In the event that such law or regulation differs from SSARSs, an engagement conducted only in accordance with law or regulation will not necessarily comply with SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A27 The accountant may also conduct the compilation or review of financial statements in accordance with both SSARSs and

- International Standard on Related Services 4410 (Revised), *Compilation Engagements*,
- International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, or
- compilation or review standards of a specific jurisdiction or country.

⁵ AICPA's Professional Ethics Executive Committee has restructured the Code of Professional Conduct. References in this standard are to the revised code, which is effective December 15, 2014. It is available at <http://pub.aicpa.org/codeofconduct>.

In such cases, in addition to complying with each of the AR-C sections relevant to the engagement, it may be necessary for the accountant to perform additional compilation or review procedures in order to comply with the other compilation or review standards. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A28 SSARSs are relevant to engagements to prepare financial statements and compilations and reviews of financial statements of governmental entities. The accountant's responsibilities, however, may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an engagement in accordance with SSARSs. These additional responsibilities are not dealt with in SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A29 In addition to objectives and requirements, an AR-C section contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the AR-C section and definitions. The entire text of an AR-C section, therefore, is relevant to an understanding of the objectives stated in an AR-C section and the proper application of the requirements of an AR-C section. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A30 When necessary, the application and other explanatory material provides further explanation of the requirements of an AR-C section and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.
- include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements of an AR-C section. The accountant is required by paragraph .12 to understand the application and other explanatory material; how the accountant applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AR-C section. The words "may," "might," and "could" are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AR-C section. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A31 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AR-C section or within the title and introduction of the appendix itself. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A32 Introductory material may include, as needed, such matters as explanation of the following:

- The purpose and scope of the AR-C section, including how the AR-C section relates to other AR-C sections

- The subject matter of the AR-C section
- The respective responsibilities of the accountant and others in relation to the subject matter of the AR-C section
- The context in which the AR-C section is set

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A33 An AR-C section may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of SSARSs. These are provided to assist in the consistent application and interpretation of SSARSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Complying With Relevant Requirements (Ref: par. .14)

.A34 In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the accountant may be required to withdraw from the engagement when withdrawal is possible under applicable law or regulation, or the accountant may be required to perform a certain action, unless prohibited by law or regulation. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Defining Professional Responsibilities in SSARSs (Ref: par. .15)

.A35 If an AR-C section provides that a procedure or action is one that the accountant "should consider," consideration of the procedure or action is presumptively required. Whether the accountant performs the procedure or action is based upon the outcome of the accountant's consideration and the accountant's professional judgment. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Interpretive Publications (Ref: par. .18)

.A36 Interpretive publications are not SSARSs. *Interpretive publications* are recommendations on the application of SSARSs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with SSARSs. Compilation and review interpretations of SSARSs and exhibits to SSARSs are included in the AR-C sections. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Other Preparation, Compilation and Review Publications (Ref: par. .19)

.A37 Other preparation, compilation and review publications have no authoritative status; however, they may help the accountant understand and apply SSARSs. The accountant is not expected to be aware of the full body of other preparation, compilation and review publications. [Paragraph renumbered by

the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

A38 Although the accountant determines the relevance of these publications in accordance with paragraph .19, the accountant may presume that other preparation, compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other preparation, compilation and review publications are listed in the exhibit, "Other Preparation, Compilation and Review Publications." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

A39 When determining whether an other preparation, compilation and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the engagement, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying SSARSs and the degree to which the publisher or author is recognized as an authority in matters addressing preparation, compilation, and review engagements. An other preparation, compilation, and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff that contradicts an other preparation, compilation and review publication that has been reviewed by the AICPA Audit and Attest Standards staff is inappropriate. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Engagement Level Quality Control (Ref: par. .21)

A40 Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

A41 The actions of the engagement partner and appropriate messages to the other members of the engagement team, in the context of the engagement partner taking responsibility for the overall quality of each engagement, emphasize the fact that quality is essential when performing an engagement in accordance with SSARSs and the importance to the quality of the engagement of

- a. performing work that complies with professional standards and regulatory and legal requirements.
- b. complying with the firm's quality control policies and procedures, as applicable.
- c. issuing a report, if applicable, for the engagement that is appropriate in the circumstances.
- d. the engagement team's ability to raise concerns without fear of reprisals.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A42 Unless information provided by the firm or other parties suggests otherwise, the engagement team is entitled to rely on the firm's system of quality control. For example, the engagement team may rely on the firm's system of quality control in relation to

- competence of personnel through their recruitment and formal training.
- independence through the accumulation and communication of relevant independence information.
- maintenance of client relationships through acceptance and continuance systems.
- adherence to regulatory and legal requirements through the monitoring process.

When considering the deficiencies identified in the firm's system of quality control that may affect the engagement, the engagement partner may consider measures taken by the firm to rectify those deficiencies.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A43 A deficiency in the firm's system of quality control does not necessarily indicate that an engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the accountant's report, if applicable, was not appropriate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

[.A44] [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Subsequently renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Acceptance and Continuance of Client Relationships and Engagements Performed in Accordance With SSARSs (Ref: par. .21di)

.A45 QM section 10A requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and engagements in accordance with SSARSs are appropriate:

- The integrity of the principal owners, key management, and those charged with governance of the entity
- Whether the engagement team is competent to perform the engagement and has the necessary capabilities, including time and resources
- Whether the firm and the engagement team can comply with relevant ethical requirements
- Significant findings or issues that have arisen during the current or previous engagement and their implications for continuing the relationship

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A46 If the engagement partner has cause to doubt management's integrity to a degree that is likely to affect proper performance of the engagement, it is not appropriate to accept the engagement, unless required by law or regulation, because doing so may lead to the accountant being associated with the entity's financial statements in an inappropriate manner. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Assignment of Engagement Teams (Ref: par. .21 d*ii*)

.A47 When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant information technology and specialized areas of accounting or attest services.
- knowledge of relevant industries in which the client operates.
- ability to apply professional judgment.
- understanding of the firm's quality control policies and procedures.

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Acceptance and Continuance of Client Relationships and Engagements (Ref: par. .25–.26)

.A48 The accountant's consideration of engagement continuance and relevant ethical requirements occurs throughout the engagement as conditions and changes in circumstances occur. Performing initial procedures on engagement continuance and evaluation of relevant ethical requirements at the beginning of an engagement informs the accountant's decisions and actions prior to the performance of other significant activities for the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A49 Relevant ethical requirements with respect to a review engagement include independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A50 This consideration is not directed at the need that sometimes arises in the course of an engagement to assist management by recommending adjusting entries required to finalize the financial statements prepared by management. An example of where the accountant may have cause to doubt whether the information needed to perform the review will be available or reliable is when the accounting records necessary for performing analytical procedures are suspected to be substantially inaccurate or incomplete. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

The Applicable Financial Reporting Framework

.A51 An applicable financial reporting framework provides the criteria for management to present the financial statements of an entity, including the fair presentation of those financial statements. The criteria used by the accountant to evaluate or measure the subject matter, including, when relevant, a basis for presentation and disclosure, are also provided by the financial reporting framework. These criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. [Paragraph added, effective for engagements performed in accordance with SSARs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A52 Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements, and the accountant does not have suitable criteria for an engagement in accordance with SSARs. In many cases, the accountant may presume that the applicable financial reporting framework is acceptable, as described in paragraphs .A57–.A59. [Paragraph added, effective for engagements performed in accordance with SSARs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Determining the Acceptability of the Financial Reporting Framework

.A53 Factors that are relevant to the accountant's determination of the acceptability of the financial reporting framework selected by management to be applied in the preparation of the financial statements include the following:

- The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)
- Whether law or regulation prescribes the applicable financial reporting framework

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and amended, effective for engagements performed in accordance with SSARs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A54 Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. Although all the information needs of specific users cannot be met, financial information needs that are common to a wide range of users exist. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as *general purpose financial statements*. [Paragraph added, effective for engagements performed in accordance with SSARs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A55 General purpose frameworks. The sources of established accounting principles that are generally accepted are accounting principles promulgated by a body designated by the Council of the AICPA to establish such principles, pursuant to the "Accounting Principles Rule" (ET sec. 1.320.001) of the

AICPA Code of Professional Conduct. Such financial reporting standards often are identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A56 Special purpose frameworks. In some cases, the financial statements will be prepared in accordance with a special purpose framework. For example, law or regulation may prescribe the financial reporting framework to be used in the preparation of financial statements for certain types of entities. Such financial statements are referred to as *special purpose financial statements*. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A57 After the engagement has been accepted, the accountant may encounter deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the previously agreed-upon terms will have changed. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A58 In accordance with this section, the accountant is required to obtain the agreement of management on management's responsibilities in relation to the financial statements as a condition precedent to accepting the engagement. In smaller entities, management may not be well-informed about what those responsibilities are, including those arising in applicable law or regulation. In order to obtain management's agreement on an informed basis, the accountant may find it necessary to discuss those responsibilities with management in advance of seeking management's agreement on its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A59 The financial statements are those of the entity. This section does not impose responsibilities on management and those charged with governance, nor does it override laws and regulations that govern their respective responsibilities. However, an engagement performed in accordance with SSARSs is conducted on the premise that management, and those charged with governance, as appropriate, have acknowledged certain responsibilities that are fundamental to the conduct of the engagement. The accountant's engagement does not relieve management and those charged with governance of their responsibilities. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A60 As part of its responsibility for the preparation of the financial statements, management is required to exercise judgment in making accounting estimates that are reasonable in the circumstances and to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A61 Because of the significance of the preconditions for undertaking an engagement in accordance with SSARSs, the accountant is required, in accordance with this section, to obtain management's agreement that it understands its responsibilities before accepting a SSARSs engagement. The accountant may obtain management's agreement either orally or in writing. However, management's agreement is subsequently recorded within the written terms of the

engagement. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A62 If management, and those charged with governance, where appropriate, do not or will not acknowledge their responsibilities in relation to the financial statements, it is not appropriate to accept the engagement. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A63 Although the accountant may accept responsibility for the design, implementation, and maintenance of internal control, accepting such responsibility would impair the accountant's independence.⁶ Therefore, if an accountant accepts such responsibility, the accountant would be precluded from performing a review of the financial statements. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.A64 The accountant is entitled to rely on management to provide all relevant information for the engagement. The form of the information provided by management for the purpose of the engagement will vary in different engagement circumstances. In broad terms, it will comprise records, documents, explanations, and other information relevant to the preparation of the financial statements in accordance with the financial reporting framework adopted by management. The information provided may include, for example, information about management's assumptions, intentions, or plans underlying development of accounting estimates needed to prepare the financial statements in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

⁶ ET sec. 1.295.030.02*k*.

Exhibit — Other Preparation, Compilation and Review Publications

This listing identifies *other preparation, compilation and review publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate, as defined in section 60. Products may be obtained through <https://www.aicpa.org/cpe-learning>.

Current Alerts

Developments in Review, Compilation, and Financial Statement Preparation Engagements

Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities

Independence and Ethics Developments

Technical Questions and Answers Accounting and Compilation and Review Technical Questions and Answers (Q&A) Sections (available at <https://www.aicpa.org/resources/download/aicpa-technical-questions-and-answers-at-your-fingertips>)

Special Purpose Frameworks

- Q&A Section 1500.07, "Disclosure Concerning Subsequent Events in Special Purpose Financial Statements"
- Q&A Section 1800.06, "Applicability of Fair Value Disclosure Requirements in FASB ASC 820 to Financial Statements Prepared in Accordance With a Special Purpose Framework"

Compilation and Review Engagements

- Q&A Section 9150.04, "Financial Statements Marked As 'Unaudited'"
- Q&A Section 9150.08, "Supplementary Information"
- Q&A Section 9150.09, "Applicability of AR Section 300 to Certain Companies Required to File With Regulatory Bodies"
- Q&A Section 9150.10, "Review of Financial Statements Included in a Prescribed Form"
- Q&A Section 9150.16, "Reference to Accountant's Report in Notes to Financial Statements"
- Q&A Section 9150.18, "Bank Engaged an Accountant to Compile a Financial Statement of Another Entity"
- Q&A Section 9150.20, "Reissuance When Not Independent"
- Q&A Section 9150.24, "Issuing a Compilation Report on Financial Statements That Omit Substantially All Disclosures After Issuing a Report on the Same Financial Statements That Include Substantially All Disclosures"

- Q&A Section 9150.29, "Effects on Compilation and Review Engagements When Management Does Not Assess Whether the Reporting Entity Is the Primary Beneficiary of a Variable Interest Entity and Instructs the Accountant to Not Perform the Assessment"
- Q&A Section 9150.30, "Disclosure of Independence Impairment in the Accountant's Compilation Report on Comparative Financial Statements When the Accountant's Independence Is Impaired in Only One Period"
- Q&A Section 9150.31, "Break-Even Financial Statements"

Compilation of Financial Statements

- Q&A Section 1300.17, "Omission of Reconciliation of Net Income to Cash Flow From Operations"
- Q&A Section 8900.10, "Successor Accountant Becomes Aware of Information During the Performance of a Compilation or Review That Leads the Successor Accountant to Believe That Financial Statements Reported On by a Predecessor Accountant Who Has Ceased Operations May Require Revision"

Compilation Reports

- Q&A Section 1300.17, "Omission of Reconciliation of Net Income to Cash Flow From Operations"
- Q&A Section 9110.07, "Statement of Cash Receipts and Disbursements"

Review of Financial Statements

- Q&A Section 8900.10, "Successor Accountant Becomes Aware of Information During the Performance of a Compilation or Review That Leads the Successor Accountant to Believe That Financial Statements Reported On by a Predecessor Accountant Who Has Ceased Operations May Require Revision"

Review Reports

- Q&A Section 8800.30, "Making Reference to Review Report"
- Q&A Section 9110.07, "Statement of Cash Receipts and Disbursements"

Other Publications

Corporations: Checklists and Illustrative Financial Statements

The Engagement Letter: Best Practices and Examples

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

AR-C Section 60B***General Principles for Engagements
Performed in Accordance With Statements
on Standards for Accounting
and Review Services***

Source: SSARS No. 21; SSARS No. 23; SSARS No. 24.

Effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction**Scope of This Section**

.01 This section provides general principles for engagements performed in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the Accounting and Review Services Committee (ARSC) and codified into AR-C sections. This section also sets forth the meaning of certain terms used in SSARSs when describing the professional requirements imposed on accountants performing an engagement in accordance with SSARSs. [As amended, effective October 2016, by SSARS No. 23.]

.02 This section is intended to help accountants better understand their professional responsibilities when performing an engagement in accordance with SSARSs. Additional sections have been established to set forth specific performance and reporting requirements. Such additional requirements are based on the general principles provided by this section, and any requirements created by this section also have been incorporated into the additional sections.

.03 SSARSs do not address the responsibilities of the accountant that may exist in legislation, regulation, or otherwise. Such responsibilities may differ from those established in SSARSs. Accordingly, although the accountant may find aspects of SSARSs helpful in such circumstances, it is the responsibility of the accountant to ensure compliance with all relevant legal, regulatory, or professional obligations. [As amended, effective October 2016, by SSARS No. 23.]

.04 The financial statements subject to the engagement performed in accordance with SSARSs are those of the entity. SSARSs do not impose responsibilities on management and do not override laws and regulations that govern their responsibilities. (Ref: par. .A4–.A11) [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

Effective Date

.05 This section is effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015. Early implementation is permitted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Objective

.06 The objective of the accountant is to obtain an understanding of the general principles for engagements performed in accordance with SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions

.07 For purposes of SSARSs, the following terms have the meanings attributed as follows:

Engagement partner.¹ The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement.

Fair presentation framework. See financial reporting framework.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

The term *fair presentation framework* refers to a financial reporting framework that requires compliance with the requirements of the framework and does one of the following:

- a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.
- b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgment in (a) or (b) is not a fair presentation framework.

Financial statements. A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term *financial statements* ordinarily refers to a complete set of

¹ This term is also defined in paragraph .13 of QM section 10A, *A Firm's System of Quality Control*, for purposes of the Statements on Quality Control Standards. Refer to QM section 10A for specific language.

financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

Interpretive publications. Interpretations of SSARs; exhibits to SSARs; AICPA Guide *Preparation, Compilation, and Review Engagements*,^[2] guidance on preparation, compilation, and review engagements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

Other preparation, compilation and review publications. Publications other than interpretive publications. (Ref: par. .A12)

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by SSARs, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the preparation, compilation, or review engagement.

Prospective financial information Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. As amended, effective for engagements performed in accordance with SSARS for periods ending on or after June 15, 2019, by SSARS No. 24.]

Requirements

Ethical Requirements

.08 The accountant should comply with relevant ethical requirements. (Ref: par. .A13–.A16)

Professional Judgment

.09 The accountant should exercise professional judgment in the performance of an engagement in accordance with SSARs. (Ref: par. .A17–.A21)

Conduct of the Engagement in Accordance With SSARs

.10 The accountant must perform a review, compilation, or an engagement to prepare financial statements in accordance with SSARs, except for certain reviews of interim financial information as discussed in section 90B, *Review of Financial Statements*.³

Complying With AR-C Sections Relevant to the Engagement

.11 The accountant should comply with all AR-C sections relevant to the engagement. An AR-C section is relevant to the engagement when the AR-C

^[2] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

³ Paragraph .02 of section 90B, *Review of Financial Statements*.

section is in effect, and the circumstances addressed by the AR-C section exist. (Ref: par. .A22–.A27)

.12 The accountant should have an understanding of the entire text of an AR-C section, including its application and other explanatory material, to understand its objectives and apply its requirements properly. (Ref: par. .A28–.A32)

.13 An accountant should not represent compliance with SSARs in the accountant's compilation or review report unless the accountant has complied with the requirements of this section and all other AR-C sections relevant to the engagement.

Complying With Relevant Requirements

.14 Subject to paragraph .16, the accountant should comply with each requirement of the relevant AR-C section unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist. (Ref: par. .A33)

Defining Professional Responsibilities in SSARs

.15 SSARs use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on accountants:

- *Unconditional requirements.* The accountant must comply with an unconditional requirement in all cases in which such requirement is relevant. SSARs use the word "must" to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .16. SSARs use the word "should" to indicate a presumptively mandatory requirement. (Ref: par. .A34)

.16 In rare circumstances, the accountant may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the accountant should perform alternative procedures to achieve the intent of the requirement. The need for an accountant to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the intent of the requirement.

.17 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph added, effective October 2016, by SSARS No. 23.]

Interpretive Publications

.18 The accountant should consider applicable interpretive publications in the performance of an engagement in accordance with SSARs. (Ref: par. .A35) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Other Preparation, Compilation and Review Publications

.19 In applying the guidance included in an other preparation, compilation and review publication, the accountant should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. (Ref: par. .A36–.A38) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Engagement Level Quality Control

.20 In an engagement performed in accordance with SSARSs, the engagement partner should possess the competence and capabilities to perform the engagement and competence in financial reporting, appropriate to the engagement circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.21 In an engagement performed in accordance with SSARSs, the engagement partner should take responsibility for the following: (Ref: par. .A39–.A42)

- a. The overall quality of each engagement to which that partner is assigned
- b. The direction, supervision, planning, and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements (Ref: par. .A43)
- c. The accountant's report being appropriate in the circumstances
- d. The engagement being performed in accordance with the firm's quality control policies and procedures, including the following:
 - i. Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity (Ref: par. .A44–.A45)
 - ii. Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the engagement and expertise in financial reporting to
 - (1) perform the engagement in accordance with professional standards and applicable legal and regulatory requirements and
 - (2) enable a report that is appropriate in the circumstances to be issued, if applicable
 - iii. Taking responsibility for appropriate engagement documentation being maintained.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Relevant Considerations After Engagement Acceptance

.22 If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Compliance With Relevant Ethical Requirements

.23 Throughout the engagement, the engagement partner should remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine the appropriate action. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Monitoring

.24 An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner should consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Acceptance and Continuance of Client Relationships and Engagements

.25 The accountant should not accept an engagement to be performed in accordance with SSARSs if (Ref: par. .A46)

- a. the accountant has reason to believe that relevant ethical requirements will not be satisfied; (Ref: par. .A47)
- b. the accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is likely to be unavailable or unreliable; or (Ref: par. .A48)
- c. the accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.26 As a precondition for accepting an engagement to be performed in accordance with SSARSs, the accountant should

- a. determine whether preliminary knowledge of the engagement circumstances indicate that ethical requirements regarding professional competence will be satisfied.
- b. determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable. (Ref: par. .A49)
- c. obtain the agreement of management that it acknowledges and understands its responsibility (Ref: par. .A50)
 - i. for the selection of the financial reporting framework to be applied in the preparation of financial statements.
 - ii. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material

misstatement, whether due to fraud or error, unless the accountant decides to accept responsibility for such internal control. (Ref: par. .A51)

- iii. for preventing and detecting fraud.
- iv. for ensuring that the entity complies with laws and regulations applicable to its activities.
- v. for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements.
- vi. to provide the accountant with (Ref: par. .A52)
 - (1) access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.
 - (2) additional information that the accountant may request from management for the purpose of the engagement.
 - (3) unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. As amended, effective for engagements performed in accordance with SSARS for periods ending on or after June 15, 2019, by SSARS No. 24.]

Application and Other Explanatory Material

Financial Statements

[.A1–.A3] [Paragraphs deleted by the issuance of SSARS No. 23, October 2016.]

Scope of This Section (Ref: par. .04)

.A4 If the accountant is engaged to perform a professional service in accordance with SSARSs on financial information other than financial statements (for example, the preparation or compilation of prospective financial information or the compilation of pro forma financial information), references in this section to *financial statements* are to be taken as references to such other financial information. [Paragraph added, effective October 2016, by SSARS No. 23.]

.A5 The preparation and fair presentation of the financial statements require

- the identification of the applicable financial reporting framework, in the context of any relevant laws or regulations.
- the preparation and fair presentation of the financial statements in accordance with that framework.
- the inclusion of an adequate description of that framework in the financial statements.

The preparation and fair presentation of the financial statements require management to exercise judgment when making accounting estimates that are reasonable in the circumstances as well as when selecting and applying appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A6 The financial statements may be prepared in accordance with one of the following:

- A general purpose framework (a financial reporting framework designed to meet the common financial information needs of a wide range of users)
- A special purpose framework

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A7 The applicable financial reporting framework often encompasses financial accounting standards promulgated by an authorized or recognized standards-setting organization or legislative or regulatory requirements. In some cases, the financial reporting framework may encompass both financial accounting standards promulgated by an authorized or recognized standards-setting organization and legislative or regulatory requirements. Other sources may provide direction on the application of the applicable financial reporting framework. In some cases, the applicable financial reporting framework may encompass such other sources or may even consist only of such sources. Such other sources may include the following:

- The legal and ethical environment, including statutes, regulations, court decisions, and professional ethical obligations regarding accounting matters
- Published accounting interpretations of varying authority issued by standards-setting, professional, or regulatory organizations
- Published views of varying authority on emerging accounting issues issued by standards-setting, professional, or regulatory organizations
- General and industry practices widely recognized and prevalent
- Accounting literature

When conflicts exist between the financial reporting framework and the sources from which direction on its application may be obtained or among the sources that encompass the financial reporting framework, the source with the highest authority prevails. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A9 The financial accounting standards promulgated by organizations that are authorized or recognized to promulgate standards to be used by entities for preparing financial statements in accordance with a general purpose framework include the FASB *Accounting Standards Codification*¹; International Financial Reporting Standards, issued by the International Accounting Standards Board; Statements of Federal Financial Accounting Standards,

issued by the Federal Accounting Standards Advisory Board for U.S. federal government entities; and Statements of the Governmental Accounting Standards Board, issued by the Governmental Accounting Standards Board for U.S. state and local governmental entities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A10 The requirements of the applicable financial reporting framework also determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance, and cash flows of an entity. For example, a complete set of financial statements might include a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements. Examples of a single financial statement, each of which would include related notes, include the following:

- Balance sheet
- Statement of income or statement of operations
- Statement of retained earnings
- Statement of cash flows
- Statement of assets and liabilities
- Statement of changes in owners' equity
- Statement of revenue and expenses
- Statement of operations by product lines

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A11 An accountant may be engaged to prepare or perform a compilation or review engagement on a complete set of financial statements or an individual financial statement (for example, balance sheet only). The financial statements may be for an annual period or for a shorter or longer period, depending on management's needs. However, it is likely not appropriate for the entity to present financial statements for a period longer or shorter than an annual period in a comparative presentation with financial statements for an annual period. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .07)

.A12 Other preparation, compilation, and review publications include

- AICPA preparation, compilation, and review publications not defined as interpretive publications;
- AICPA's annual alert addressing engagements performed in accordance with SSARSs;
- articles addressing preparation, compilation, and review engagements in the *Journal of Accountancy* and other professional journals;
- continuing professional education programs and other instruction materials,
- textbooks, guide books, programs for preparation, compilation, and review engagements
- checklists; and

- other publications addressing preparation, compilation, and review engagements from state CPA societies, other organizations, and individuals.

[Paragraph added, effective October 2016, by SSARS No. 23.]

Ethical Requirements (Ref: par. .08)

.A13 The accountant is subject to relevant ethical requirements relating to engagements performed in accordance with SSARSs. Ethical requirements consist of those contained in the AICPA Code of Professional Conduct, together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A14 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A15 Due care requires the accountant to discharge professional responsibilities with competence and have the appropriate capabilities to perform the engagement and enable an appropriate accountant's report to be issued, if applicable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A16 QM section 10A, *A Firm's System of Quality Control*, sets out the firm's responsibilities to establish and maintain its system of quality control for engagements performed in accordance with SSARSs and establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.⁴ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Professional Judgment (Ref: par. .09)

.A17 Professional judgment is essential to the proper conduct of an engagement in accordance with SSARSs because interpretation of relevant ethical requirements and SSARSs and the informed decisions required throughout the engagement cannot be made without the application of relevant knowledge and experience to the facts and circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A18 The distinguishing feature of the professional judgment expected of the accountant is that it is exercised by an accountant whose training, knowledge, and experience have assisted in developing the necessary competencies to achieve reasonable judgments and make informed decisions about appropriate courses of action when undertaking an engagement in accordance with

⁴ Paragraphs .21–.25 of QM section 10A.

SSARs. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, assists the accountant in making informed and reasonable judgments. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A19 The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known by the accountant throughout the engagement, including

- knowledge acquired from engagements carried out for the entity's financial statements in prior periods, where applicable.
- the accountant's understanding of the entity and its environment, including its accounting system, and the application of the applicable financial reporting framework in the entity's industry.
- the extent to which the preparation and presentation of the financial statements requires the exercise of judgment by management or the accountant, if applicable.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A20 Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of SSARSs and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the accountant up to the date of the issuance of financial statements prepared by the accountant or the date of the accountant's compilation or review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A21 Professional judgment needs to be exercised throughout the engagement performed in accordance with SSARSs. It also needs to be appropriately documented in accordance with the requirements of the applicable AR-C section. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or, in a review engagement, the evidence obtained. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

Conduct of an Engagement in Accordance With SSARSs

Complying With AR-C Sections Relevant to the Engagement (Ref: par. .11–.12)

.A22 ARSC is designated to promulgate standards under the "General Standards Rule" (ET sec. 1.300.001) and the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct⁵ with respect to unaudited financial statements or other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market. ARSC develops and issues standards in the form of SSARSs through a process that includes deliberation in meetings open to the public, public exposure of proposed SSARSs, and a formal vote. SSARSs are codified in AR-C sections in *AICPA Professional Standards*. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

⁵ AICPA's Professional Ethics Executive Committee has restructured the Code of Professional Conduct. References in this standard are to the revised code, which is effective December 15, 2014. It is available at <http://pub.aicpa.org/codeofconduct>.

.A23 SSARs provide the standards used for fulfilling the overall objectives of the accountant's work. SSARs address the general responsibilities of the accountant as well as the accountant's further considerations relevant to the application of those responsibilities to specific topics. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A24 The scope, effective date, and any specific limitation of the applicability of a specific AR-C section are made clear in the AR-C section. Unless otherwise stated in the AR-C section, the accountant is permitted to apply an AR-C section before the effective date specified therein. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A25 In certain engagements, the accountant also may be required to comply with other requirements in addition to SSARs. SSARs do not override law or regulation that governs a review, compilation, or an engagement to prepare financial statements. In the event that such law or regulation differs from SSARs, an engagement conducted only in accordance with law or regulation will not necessarily comply with SSARs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A26 The accountant may also conduct the compilation or review of financial statements in accordance with both SSARs and

- International Standard on Related Services 4410 (Revised), *Compilation Engagements*,
- International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, or
- compilation or review standards of a specific jurisdiction or country.

In such cases, in addition to complying with each of the AR-C sections relevant to the engagement, it may be necessary for the accountant to perform additional compilation or review procedures in order to comply with the other compilation or review standards. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A27 SSARs are relevant to engagements to prepare financial statements and compilations and reviews of financial statements of governmental entities. The accountant's responsibilities, however, may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an engagement in accordance with SSARs. These additional responsibilities are not dealt with in SSARs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A28 In addition to objectives and requirements, an AR-C section contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the AR-C section and definitions. The entire text of an AR-C section, therefore, is relevant to an understanding of the objectives stated in an AR-C section and the proper application of the requirements of an AR-C section. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A29 When necessary, the application and other explanatory material provides further explanation of the requirements of an AR-C section and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.

- include examples of procedures that may be appropriate in the circumstances.

Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements of an AR-C section. The accountant is required by paragraph .12 to understand the application and other explanatory material; how the accountant applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AR-C section. The words "may," "might," and "could" are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AR-C section. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A30 Appendixes form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AR-C section or within the title and introduction of the appendix itself. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A31 Introductory material may include, as needed, such matters as explanation of the following:

- The purpose and scope of the AR-C section, including how the AR-C section relates to other AR-C sections
- The subject matter of the AR-C section
- The respective responsibilities of the accountant and others in relation to the subject matter of the AR-C section
- The context in which the AR-C section is set

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A32 An AR-C section may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of SSARSs. These are provided to assist in the consistent application and interpretation of SSARSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Complying With Relevant Requirements (Ref: par. .14)

.A33 In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the accountant may be required to withdraw from the engagement when withdrawal is possible under applicable law or regulation, or the accountant may be required to perform a certain action, unless prohibited by law or regulation. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

Defining Professional Responsibilities in SSARSs (Ref: par. .15)

.A34 If an AR-C section provides that a procedure or action is one that the accountant "should consider," consideration of the procedure or action is presumptively required. Whether the accountant performs the procedure or action is based upon the outcome of the accountant's consideration and the accountant's professional judgment. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Interpretive Publications (Ref: par. .18)

.A35 Interpretive publications are not SSARSs. *Interpretive publications* are recommendations on the application of SSARSs in specific circumstances, including engagements for entities in specialized industries. An interpretive publication is issued under the authority of ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with SSARSs. Compilation and review interpretations of SSARSs and exhibits to SSARSs are included in the AR-C sections. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Other Preparation, Compilation and Review Publications (Ref: par. .19)

.A36 Other preparation, compilation and review publications have no authoritative status; however, they may help the accountant understand and apply SSARSs. The accountant is not expected to be aware of the full body of other preparation, compilation and review publications. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A37 Although the accountant determines the relevance of these publications in accordance with paragraph .19, the accountant may presume that other preparation, compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are appropriate. These other preparation, compilation and review publications are listed in the exhibit, "Other Preparation, Compilation and Review Publications." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A38 When determining whether an other preparation, compilation and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff is appropriate to the circumstances of the engagement, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying SSARSs and the degree to which the publisher or author is recognized as an authority in matters addressing preparation, compilation, and review engagements. An other preparation, compilation, and review publication that has not been reviewed by the AICPA Audit and Attest Standards staff that contradicts an other preparation, compilation and review publication that has been reviewed by the AICPA Audit and Attest Standards staff is inappropriate. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Revised, February 2017, to better reflect the AICPA Council Resolution designating the PCAOB to promulgate technical standards.]

Engagement Level Quality Control (Ref: par. .21)

.A39 Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures applicable to the engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A40 The actions of the engagement partner and appropriate messages to the other members of the engagement team, in the context of the engagement partner taking responsibility for the overall quality of each engagement, emphasize the fact that quality is essential when performing an engagement in accordance with SSARSs and the importance to the quality of the engagement of

- a. performing work that complies with professional standards and regulatory and legal requirements.
- b. complying with the firm's quality control policies and procedures, as applicable.
- c. issuing a report, if applicable, for the engagement that is appropriate in the circumstances.
- d. the engagement team's ability to raise concerns without fear of reprisals.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A41 Unless information provided by the firm or other parties suggests otherwise, the engagement team is entitled to rely on the firm's system of quality control. For example, the engagement team may rely on the firm's system of quality control in relation to

- competence of personnel through their recruitment and formal training.
- independence through the accumulation and communication of relevant independence information.
- maintenance of client relationships through acceptance and continuance systems.
- adherence to regulatory and legal requirements through the monitoring process.

When considering the deficiencies identified in the firm's system of quality control that may affect the engagement, the engagement partner may consider measures taken by the firm to rectify those deficiencies.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A42 A deficiency in the firm's system of quality control does not necessarily indicate that an engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the accountant's report, if applicable, was not appropriate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Assignment of Engagement Teams (Ref: par. .21b)

.A43 When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- technical expertise, including expertise with relevant information technology and specialized areas of accounting or attest services.
- knowledge of relevant industries in which the client operates.
- ability to apply professional judgment.
- understanding of the firm's quality control policies and procedures.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Acceptance and Continuance of Client Relationships and Engagements Performed in Accordance With SSARSs (Ref: par. .21di)

.A44 QM section 10A requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and engagements in accordance with SSARSs are appropriate:

- The integrity of the principal owners, key management, and those charged with governance of the entity
- Whether the engagement team is competent to perform the engagement and has the necessary capabilities, including time and resources
- Whether the firm and the engagement team can comply with relevant ethical requirements
- Significant findings or issues that have arisen during the current or previous engagement and their implications for continuing the relationship

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A45 If the engagement partner has cause to doubt management's integrity to a degree that is likely to affect proper performance of the engagement, it is not appropriate to accept the engagement, unless required by law or regulation, because doing so may lead to the accountant being associated with the entity's financial statements in an inappropriate manner. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Acceptance and Continuance of Client Relationships and Engagements (Ref: par. .25–.26)

.A46 The accountant's consideration of engagement continuance and relevant ethical requirements occurs throughout the engagement as conditions and changes in circumstances occur. Performing initial procedures on engagement continuance and evaluation of relevant ethical requirements at the beginning of an engagement informs the accountant's decisions and actions prior to the performance of other significant activities for the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A47 Relevant ethical requirements with respect to a review engagement include independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A48 This consideration is not directed at the need that sometimes arises in the course of an engagement to assist management by recommending adjusting entries required to finalize the financial statements prepared by management. An example of where the accountant may have cause to doubt whether the information needed to perform the review will be available or reliable is when the accounting records necessary for performing analytical procedures are suspected to be substantially inaccurate or incomplete. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A49 Factors that are relevant to the accountant's determination of the acceptability of the financial reporting framework selected by management to be applied in the preparation of the financial statements include the following:

- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
- Whether law or regulation prescribes the applicable financial reporting framework

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A50 In accordance with this section, the accountant is required to obtain the agreement of management on management's responsibilities in relation to the financial statements as a condition precedent to accepting the engagement. In smaller entities, management may not be well-informed about what those responsibilities are, including those arising in applicable law or regulation. In order to obtain management's agreement on an informed basis, the accountant may find it necessary to discuss those responsibilities with management in advance of seeking management's agreement on its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A51 Although the accountant may accept responsibility for the design, implementation, and maintenance of internal control, accepting such responsibility would impair the accountant's independence.⁶ Therefore, if an accountant accepts such responsibility, the accountant would be precluded from performing a review of the financial statements. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A52 The accountant is entitled to rely on management to provide all relevant information for the engagement. The form of the information provided by management for the purpose of the engagement will vary in different engagement circumstances. In broad terms, it will comprise records, documents, explanations, and other information relevant to the preparation of the financial statements in accordance with the financial reporting framework adopted by management. The information provided may include, for example, information about management's assumptions, intentions, or plans underlying development of accounting estimates needed to prepare the financial statements in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

⁶ ET sec. 1.295.030.02*k*.

Exhibit — Other Preparation, Compilation and Review Publications

This listing identifies *other preparation, compilation and review publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate, as defined in section 60. Products may be obtained through www.aicpastore.com.

Current AICPA Alerts

Developments in Review, Compilation, and Financial Statement Preparation Engagements

Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities

Independence and Ethics Developments

AICPA Technical Questions and Answers Accounting and Compilation and Review Technical Questions and Answers (Q&A) Sections (available in hard copy)

Special Purpose Frameworks

- Q&A Section 1500.07, "Disclosure Concerning Subsequent Events in Special Purpose Financial Statements"
- Q&A Section 1800.06, "Applicability of Fair Value Disclosure Requirements in FASB ASC 820 to Financial Statements Prepared in Accordance With a Special Purpose Framework"

Compilation and Review Engagements

- Q&A Section 9150.04, "Financial Statements Marked As 'Unaudited'"
- Q&A Section 9150.08, "Supplementary Information"
- Q&A Section 9150.09, "Applicability of AR Section 300 to Certain Companies Required to File With Regulatory Bodies"
- Q&A Section 9150.10, "Review of Financial Statements Included in a Prescribed Form"
- Q&A Section 9150.16, "Reference to Accountant's Report in Notes to Financial Statements"
- Q&A Section 9150.18, "Bank Engaged an Accountant to Compile a Financial Statement of Another Entity"
- Q&A Section 9150.20, "Reissuance When Not Independent"
- Q&A Section 9150.24, "Issuing a Compilation Report on Financial Statements That Omit Substantially All Disclosures After Issuing a Report on the Same Financial Statements That Include Substantially All Disclosures"

- Q&A Section 9150.29, "Effects on Compilation and Review Engagements When Management Does Not Assess Whether the Reporting Entity Is the Primary Beneficiary of a Variable Interest Entity and Instructs the Accountant to Not Perform the Assessment"
- Q&A Section 9150.30, "Disclosure of Independence Impairment in the Accountant's Compilation Report on Comparative Financial Statements When the Accountant's Independence Is Impaired in Only One Period"
- Q&A Section 9150.31, "Break-Even Financial Statements"

Compilation of Financial Statements

- Q&A Section 1300.17, "Omission of Reconciliation of Net Income to Cash Flow From Operations"
- Q&A Section 8900.10, "Successor Accountant Becomes Aware of Information During the Performance of a Compilation or Review That Leads the Successor Accountant to Believe That Financial Statements Reported On by a Predecessor Accountant Who Has Ceased Operations May Require Revision"

Compilation Reports

- Q&A Section 1300.17, "Omission of Reconciliation of Net Income to Cash Flow From Operations"
- Q&A Section 9110.07, "Statement of Cash Receipts and Disbursements"

Review of Financial Statements

- Q&A Section 8900.10, "Successor Accountant Becomes Aware of Information During the Performance of a Compilation or Review That Leads the Successor Accountant to Believe That Financial Statements Reported On by a Predecessor Accountant Who Has Ceased Operations May Require Revision"

Review Reports

- Q&A Section 8800.30, "Making Reference to Review Report"
- Q&A Section 9110.07, "Statement of Cash Receipts and Disbursements"

Other Publications

Corporations: Checklists and Illustrative Financial Statements

The Engagement Letter: Best Practices and Examples

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

AR-C Section 70

Preparation of Financial Statements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 25; SSARS No. 26.

Effective for the preparation of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when an accountant in public practice is engaged to prepare financial statements or prospective financial information. (Ref: par. .A1–.A2).

This section may also be applied, adapted as appropriate in the circumstances, to the preparation of other historical financial information. (Ref: par. .A3)

This section does not apply when an accountant prepares financial statements or prospective financial information

- and is engaged to perform an audit, review, or compilation of those financial statements,
- solely for submission to taxing authorities,
- for inclusion in written personal financial plans prepared by the accountant,
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or
- in conjunction with business valuation services.^[1]

[As amended, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.02 The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. .A4)

The Preparation Engagement

.03 An engagement to prepare financial statements is a nonattest service and does not require a determination about whether the accountant is independent of the entity. (Ref: par. .A5)

.04 In addition, an engagement to prepare financial statements does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

^[1] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Effective Date

.05 This section is effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.06 The objective of the accountant is to prepare financial statements pursuant to a specified financial reporting framework.

Definitions

.07 For purposes of Statements on Standards for Accounting and Review Services (SSARSs), the following terms have the meanings attributed as follows:

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

[As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

General Principles for Performing Engagements to Prepare Financial Statements

.08 In addition to complying with this section, an accountant is required to comply with section 60, *General Principles For Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Acceptance and Continuance of Client Relationships and Engagements to Prepare Financial Statements

.09 If the accountant is not satisfied with any of the matters set out in paragraph .31 of section 60 as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter

or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A7–.A11)

- a. The objective of the engagement
- b. The responsibilities of management set forth in paragraph .31b of section 60
- c. The agreement of management that each page of the financial statements will include a statement indicating that no assurance is provided on the financial statements or the accountant will be required to issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A13)
- d. The responsibilities of the accountant
- e. The limitations of the engagement to prepare financial statements
- f. Identification of the applicable financial reporting framework for the preparation of financial statements
- g. Whether the financial statements are to contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure) or omit substantially all disclosures required by the applicable financial reporting framework

[As amended, effective October 2016, by SSARS No. 23.]

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A10)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A12)

Preparing the Financial Statements

.13 The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.

.14 The accountant should ensure that a statement is included on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements. If the accountant is unable to include a statement on each page of the financial statements, the accountant should do one of the following: (Ref: par. .A13)

- a. Issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A14)
- b. Perform a compilation engagement in accordance with section 80, *Compilation Engagements*.
- c. Withdraw from the engagement and inform management of the reasons for withdrawing. (Ref: par. .A15–.A16)

[As amended, effective October 2016, by SSARS No. 23. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.15 When preparing financial statements in accordance with a special purpose framework, the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. (Ref: par. .A17)

.16 If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in financial statements and accepts responsibility for those judgments. (Ref: par. .A18 and .A24)

.17 If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statements are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information. If management fails to provide such additional or corrected information, the accountant should disclose a material misstatement or misstatements in the financial statements in accordance with paragraph .18 or withdraw from the engagement and inform management of the reasons for withdrawing. (Ref: par. .A15–.A16) [As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.18 When, after discussions with management, the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement or misstatements in the financial statements. (Ref: par. .A19)

Preparing Prospective Financial Information

.19 The summary of significant assumptions is essential to the user's understanding of prospective financial information. Accordingly, the accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not prepare a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.20 When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission either in the financial statements or in an accompanying disclaimer. (Ref: par. .A20) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.21 The accountant should not prepare financial statements that omit substantially all disclosures required by the financial reporting framework if, in the

accountant's professional judgment, such financial statements would be misleading to users of the financial statements. (Ref: par. .A21–.A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Documentation in a Preparation Engagement

.22 The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following: (Ref: par. .A24)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11
- b. A copy of the financial statements that the accountant prepared

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.23 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 If the accountant is engaged to prepare prospective financial information, references in this section to *financial statements* are to be taken as a reference to prospective financial information. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.A2 AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines;" chapter 7, "Reasonably Objective Basis;" chapter 8, "Presentation Guidelines;" and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.A3 Other historical financial information to which this section may be applied includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information

- Required supplementary information
- Pro forma financial information

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A4 The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Preparation Engagement (Ref: par. .03)

.A5 The "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295) addresses the accountant's considerations with respect to independence when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The accountant needs to be aware that the performance of the preparation services may impair independence unless the safeguards described in this subtopic are met. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .07)

[.A6] [Paragraph deleted by the issuance of SSARS No. 25, February 2020.]

Agreement on Engagement Terms (Ref: par. .10–.11)

.A7 Both management and the accountant have an interest in documenting the agreed-upon terms of the engagement to prepare financial statements before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or may expect the accountant to protect management against certain risks or to perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A9 The understanding with management regarding the services to be performed for engagements to prepare financial statements is required by paragraph .10 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A10 The roles of management and those charged with governance in agreeing upon the terms of the engagement to prepare financial statements for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when

the agreement on the terms of engagement is only with those charged with governance in accordance with paragraph .31*b* of section 60, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A11 An illustrative example of an engagement letter for an engagement to prepare financial statements is presented in the exhibit, "Illustrative Engagement Letter." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A12 The requirement that the accountant obtain an understanding of the financial reporting framework adopted by management intended to be used in the preparation of the financial statements and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Preparing the Financial Statements (Ref: par. .10, .14–.16, and .18)

.A13 The statement on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements. The statement is made at management's discretion, and the accountant or the accountant's firm name is not required to be included. The accountant is concerned that the indication is not misleading. Examples of a statement on each page of the financial statements include the following:

- No assurance is provided on these financial statements.
- These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.

Other statements that convey that no assurance is provided on the financial statements would also be acceptable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A14 An example of a disclaimer that the accountant may issue is as follows:

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by us and we do not express an opinion, a conclusion, nor provide any assurance on them.

[Signature of the accountant's firm]

[Accountant's city and state]

[Date]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A15 In circumstances addressed by the requirements of this section in which withdrawal from the engagement is necessary, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant's ethical obligations. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A16 When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A17 A description of the special purpose framework is usually placed next to or under the title of the financial statements (for example "statement of assets and liabilities—modified cash basis"). However, the description may be placed elsewhere in the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A18 In the preparation of financial statements, the accountant may provide assistance to management with significant judgments (for example, the accountant may advise management on alternative accounting policies that are significant to the financial statements or help management with significant judgments regarding material accounting estimates). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A19 The disclosure of the material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .20–.21)

.A20 The disclosure of the omission of substantially all disclosures required by the applicable financial reporting framework may be made on the face of the financial statements or in a selected note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A21 The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by *[the applicable financial reporting framework]* Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A22 Financial statements may be misleading, for example, if the applicable financial reporting framework includes the premise that the financial

statements are prepared on the going concern basis and undisclosed uncertainties exist regarding the entity's ability to continue as a going concern. If the accountant becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity's ability to continue as a going concern in order to avoid the financial statements being misleading. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A23 Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Documentation in a Preparation Engagement **(Ref: par. .16 and .22)**

.A24 Documentation may include documentation regarding significant consultations or significant professional judgments made throughout the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A25

Appendix — Preparation of Financial Statements Versus Assistance in Preparing Financial Statements (Ref: par. .A4)

The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on the services the client requests the accountant to perform and requires the accountant to apply professional judgment. The following table provides examples of services that the accountant may be engaged to perform and whether section 70 would apply. The table is not intended to be all inclusive, and professional judgment would still need to be applied.

<i>Examples of Services for Which This Section Applies</i>	<i>Examples of Accountant Services for Which This Section Does Not Apply</i>
Preparation of financial statements prior to audit or review by another accountant	Preparation of financial statements when the accountant is engaged to perform an audit, review, or compilation of such financial statements
Preparation of financial statements for an entity to be presented alongside the entity's tax return	Preparation of financial statements with a tax return solely for submission to taxing authorities
Preparation of personal financial statements for presentation alongside a financial plan	Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
	Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
	Financial statements prepared in conjunction with business valuation services
	Maintaining depreciation schedules
	Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
Preparation of single financial statements, such as a balance sheet or income statement or financial statements with substantially all disclosures omitted	Drafting financial statement notes
Using the information in a general ledger to prepare financial statements outside of an accounting software system	Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A26

Exhibit — Illustrative Engagement Letter (Ref: par. .A11)

The following is an example of an engagement letter for an engagement to prepare financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This engagement letter is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the preparation of financial statements for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended and the related notes to the financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

Our Responsibilities

The objective of our engagement is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A10.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Management Responsibilities

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- f. To provide us with:
 - i. Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
 - ii. Additional information that may be requested for the purpose of the preparation of the financial statements, and
 - iii. Unrestricted access to persons within ABC Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

[If the accountant expects to issue a disclaimer, instead of the preceding paragraph, the following may be added:

As part of our engagement, we will issue a disclaimer that will state that the financial statements were not subjected to an audit, review, or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.]

Other Relevant Information

Our fees for these services . . .

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

AR-C Section 70A

Preparation of Financial Statements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 25.

Effective for the preparation of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when an accountant in public practice is engaged to prepare financial statements or prospective financial information. (Ref: par. .A1–.A2).

This section may also be applied, adapted as appropriate in the circumstances, to the preparation of other historical financial information. (Ref: par. .A3)

This section does not apply when an accountant prepares financial statements or prospective financial information

- and is engaged to perform an audit, review, or compilation of those financial statements,
- solely for submission to taxing authorities,
- for inclusion in written personal financial plans prepared by the accountant,
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or
- in conjunction with business valuation services.^[1]

[As amended, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.02 The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. .A4)

The Preparation Engagement

.03 An engagement to prepare financial statements is a nonattest service and does not require a determination about whether the accountant is independent of the entity. (Ref: par. .A5)

.04 In addition, an engagement to prepare financial statements does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

^[1] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Effective Date

.05 This section is effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.06 The objective of the accountant is to prepare financial statements pursuant to a specified financial reporting framework.

Definitions

.07 For purposes of Statements on Standards for Accounting and Review Services (SSARSs), the following terms have the meanings attributed as follows:

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

[As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

General Principles for Performing Engagements to Prepare Financial Statements

.08 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles For Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Acceptance and Continuance of Client Relationships and Engagements to Prepare Financial Statements

.09 If the accountant is not satisfied with any of the matters set out in paragraph .26 of section 60A as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The

agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A7–.A11)

- a. The objective of the engagement
- b. The responsibilities of management set forth in paragraph .26b of section 60A
- c. The agreement of management that each page of the financial statements will include a statement indicating that no assurance is provided on the financial statements or the accountant will be required to issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A13)
- d. The responsibilities of the accountant
- e. The limitations of the engagement to prepare financial statements
- f. Identification of the applicable financial reporting framework for the preparation of financial statements
- g. Whether the financial statements are to contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure) or omit substantially all disclosures required by the applicable financial reporting framework

[As amended, effective October 2016, by SSARS No. 23.]

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A10)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A12)

Preparing the Financial Statements

.13 The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.

.14 The accountant should ensure that a statement is included on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements. If the accountant is unable to include a statement on each page of the financial statements, the accountant should do one of the following: (Ref: par. .A13)

- a. Issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A14)
- b. Perform a compilation engagement in accordance with section 80, *Compilation Engagements*.
- c. Withdraw from the engagement and inform management of the reasons for withdrawing. (Ref: par. .A15–.A16)

[As amended, effective October 2016, by SSARS No. 23. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.15 When preparing financial statements in accordance with a special purpose framework, the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. (Ref: par. .A17)

.16 If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in financial statements and accepts responsibility for those judgments. (Ref: par. .A18 and .A24)

.17 If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statements are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information. If management fails to provide such additional or corrected information, the accountant should disclose a material misstatement or misstatements in the financial statements in accordance with paragraph .18 or withdraw from the engagement and inform management of the reasons for withdrawing. (Ref: par. .A15–.A16) [As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.18 When, after discussions with management, the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement or misstatements in the financial statements. (Ref: par. .A19)

Preparing Prospective Financial Information

.19 The summary of significant assumptions is essential to the user's understanding of prospective financial information. Accordingly, the accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not prepare a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.20 When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission either in the financial statements or in an accompanying disclaimer. (Ref: par. .A20) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.21 The accountant should not prepare financial statements that omit substantially all disclosures required by the financial reporting framework if, in the

accountant's professional judgment, such financial statements would be misleading to users of the financial statements. (Ref: par. .A21–.A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Documentation in a Preparation Engagement

.22 The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following: (Ref: par. .A24)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11
- b. A copy of the financial statements that the accountant prepared

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.23 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 If the accountant is engaged to prepare prospective financial information, references in this section to *financial statements* are to be taken as a reference to prospective financial information. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.A2 AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines;" chapter 7, "Reasonably Objective Basis;" chapter 8, "Presentation Guidelines;" and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.A3 Other historical financial information to which this section may be applied includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information

- Required supplementary information
- Pro forma financial information

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A4 The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Preparation Engagement (Ref: par. .03)

.A5 The "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295) addresses the accountant's considerations with respect to independence when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The accountant needs to be aware that the performance of the preparation services may impair independence unless the safeguards described in this subtopic are met. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .07)

[.A6] [Paragraph deleted by the issuance of SSARS No. 25, February 2020.]

Agreement on Engagement Terms (Ref: par. .10–.11)

.A7 Both management and the accountant have an interest in documenting the agreed-upon terms of the engagement to prepare financial statements before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or may expect the accountant to protect management against certain risks or to perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A9 The understanding with management regarding the services to be performed for engagements to prepare financial statements is required by paragraph .10 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A10 The roles of management and those charged with governance in agreeing upon the terms of the engagement to prepare financial statements for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when

the agreement on the terms of engagement is only with those charged with governance in accordance with paragraph .26b of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A11 An illustrative example of an engagement letter for an engagement to prepare financial statements is presented in the exhibit, "Illustrative Engagement Letter." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A12 The requirement that the accountant obtain an understanding of the financial reporting framework adopted by management intended to be used in the preparation of the financial statements and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Preparing the Financial Statements (Ref: par. .10, .14–.16, and .18)

.A13 The statement on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements. The statement is made at management's discretion, and the accountant or the accountant's firm name is not required to be included. The accountant is concerned that the indication is not misleading. Examples of a statement on each page of the financial statements include the following:

- No assurance is provided on these financial statements.
- These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.

Other statements that convey that no assurance is provided on the financial statements would also be acceptable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A14 An example of a disclaimer that the accountant may issue is as follows:

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by me (us) and I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A15 In circumstances addressed by the requirements of this section in which withdrawal from the engagement is necessary, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant's ethical obligations. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A16 When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A17 A description of the special purpose framework is usually placed next to or under the title of the financial statements (for example "statement of assets and liabilities—modified cash basis"). However, the description may be placed elsewhere in the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A18 In the preparation of financial statements, the accountant may provide assistance to management with significant judgments (for example, the accountant may advise management on alternative accounting policies that are significant to the financial statements or help management with significant judgments regarding material accounting estimates). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A19 The disclosure of the material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .20–.21)

.A20 The disclosure of the omission of substantially all disclosures required by the applicable financial reporting framework may be made on the face of the financial statements or in a selected note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A21 The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by *the applicable financial reporting framework* Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A22 Financial statements may be misleading, for example, if the applicable financial reporting framework includes the premise that the financial statements are prepared on the going concern basis and undisclosed uncertainties

exist regarding the entity's ability to continue as a going concern. If the accountant becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity's ability to continue as a going concern in order to avoid the financial statements being misleading. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A23 Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted. [Paragraph added, effective for the preparation of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Documentation in a Preparation Engagement **(Ref: par. .16 and .22)**

.A24 Documentation may include documentation regarding significant consultations or significant professional judgments made throughout the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A25

Appendix — Preparation of Financial Statements Versus Assistance in Preparing Financial Statements (Ref: par. .A4)

The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on the services the client requests the accountant to perform and requires the accountant to apply professional judgment. The following table provides examples of services that the accountant may be engaged to perform and whether section 70 would apply. The table is not intended to be all inclusive, and professional judgment would still need to be applied.

<i>Examples of Services for Which This Section Applies</i>	<i>Examples of Accountant Services for Which This Section Does Not Apply</i>
Preparation of financial statements prior to audit or review by another accountant	Preparation of financial statements when the accountant is engaged to perform an audit, review, or compilation of such financial statements
Preparation of financial statements for an entity to be presented alongside the entity's tax return	Preparation of financial statements with a tax return solely for submission to taxing authorities
Preparation of personal financial statements for presentation alongside a financial plan	Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
	Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
	Financial statements prepared in conjunction with business valuation services
	Maintaining depreciation schedules
	Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
Preparation of single financial statements, such as a balance sheet or income statement or financial statements with substantially all disclosures omitted	Drafting financial statement notes
Using the information in a general ledger to prepare financial statements outside of an accounting software system	Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A26

Exhibit — Illustrative Engagement Letter (Ref: par. .A11)

The following is an example of an engagement letter for an engagement to prepare financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This engagement letter is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the preparation of financial statements for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended and the related notes to the financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

Our Responsibilities

The objective of our engagement is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A10.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Management Responsibilities

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- f. To provide us with:
 - i. Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
 - ii. Additional information that may be requested for the purpose of the preparation of the financial statements, and
 - iii. Unrestricted access to persons within ABC Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

[If the accountant expects to issue a disclaimer, instead of the preceding paragraph, the following may be added:

As part of our engagement, we will issue a disclaimer that will state that the financial statements were not subjected to an audit, review, or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.]

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

AR-C Section 70B

Preparation of Financial Statements

Source: SSARS No. 21; SSARS No. 23.

Effective for the preparation of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when an accountant in public practice is engaged to prepare financial statements or prospective financial information. (Ref: par. .A1–.A2).

This section may also be applied, adapted as appropriate in the circumstances, to the preparation of other historical financial information. (Ref: par. .A3)

This section does not apply when an accountant prepares financial statements or prospective financial information

- and is engaged to perform an audit, review, or compilation of those financial statements,
- solely for submission to taxing authorities,
- for inclusion in written personal financial plans prepared by the accountant,
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or
- in conjunction with business valuation services.^[1]

[As amended, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.02 The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. .A4)

The Preparation Engagement

.03 An engagement to prepare financial statements is a nonattest service and does not require a determination about whether the accountant is independent of the entity. (Ref: par. .A5)

.04 In addition, an engagement to prepare financial statements does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

^[1] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Effective Date

.05 This section is effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.06 The objective of the accountant is to prepare financial statements pursuant to a specified financial reporting framework.

Definitions

.07 For purposes of Statements on Standards for Accounting and Review Services (SSARs), the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission). (Ref: par. .A6)
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting* (OCBOA).

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the

strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Requirements

General Principles for Performing Engagements to Prepare Financial Statements

.08 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles For Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Acceptance and Continuance of Client Relationships and Engagements to Prepare Financial Statements

.09 If the accountant is not satisfied with any of the matters set out in paragraph .26 of section 60A as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A7–.A11)

- a. The objective of the engagement
- b. The responsibilities of management set forth in paragraph .26c of section 60A
- c. The agreement of management that each page of the financial statements will include a statement indicating that no assurance is provided on the financial statements or the accountant will be required to issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A13)
- d. The responsibilities of the accountant
- e. The limitations of the engagement to prepare financial statements
- f. Identification of the applicable financial reporting framework for the preparation of financial statements
- g. Whether the financial statements are to contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure) or omit substantially all disclosures required by the applicable financial reporting framework

[As amended, effective October 2016, by SSARS No. 23.]

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate.
(Ref: par. .A10)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A12)

Preparing the Financial Statements

.13 The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.

.14 The accountant should ensure that a statement is included on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements. If the accountant is unable to include a statement on each page of the financial statements, the accountant should (Ref: par. .A13)

- a. issue either a disclaimer that makes clear that no assurance is provided on the financial statements; (Ref: par. .A14)
- b. perform a compilation engagement in accordance with section 80, *Compilation Engagements*; or
- c. withdraw from the engagement.

[As amended, effective October 2016, by SSARS No. 23.]

.15 When preparing financial statements in accordance with a special purpose framework, the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. (Ref: par. .A15)

.16 If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in financial statements and accepts responsibility for those judgments. (Ref: par. .A16 and .A20)

.17 If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statements are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information.

.18 When, after discussions with management, the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement or misstatements in the financial statements. (Ref: par. .A17)

Preparing Prospective Financial Information

.19 The summary of significant assumptions is essential to the user's understanding of prospective financial information. Accordingly, the accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not prepare a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.20 When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission in the financial statements. (Ref: par. .A18) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.21 The accountant should not prepare financial statements that omit substantially all disclosures required by the financial reporting framework if the accountant becomes aware that the omission of substantially all disclosures was undertaken with the intention of misleading users of such financial statements. (Ref: par. .A19) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Documentation in a Preparation Engagement

.22 The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following: (Ref: par. .A20)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11
- b. A copy of the financial statements that the accountant prepared

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.23 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 If the accountant is engaged to prepare prospective financial information, references in this section to *financial statements* are to be taken as a reference to prospective financial information. [Paragraph added, effective for

prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.A2 AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines;" chapter 7, "Reasonably Objective Basis;" chapter 8, "Presentation Guidelines;" and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for prospective financial information prepared on or after May 1, 2017, by SSARS No. 23.]

.A3 Other historical financial information to which this section may be applied includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Pro forma financial information

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A4 The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Preparation Engagement (Ref: par. .03)

.A5 The "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295) addresses the accountant's considerations with respect to independence when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The accountant needs to be aware that the performance of the preparation services may impair independence unless the safeguards described in this subtopic are met. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .07)

.A6 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all the requirements of GAAP. Such frameworks are regulatory bases of accounting, as defined in paragraph .07. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting

are not regulatory bases of accounting. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Agreement on Engagement Terms (Ref: par. .10–.11)

.A7 Both management and the accountant have an interest in documenting the agreed-upon terms of the engagement to prepare financial statements before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or may expect the accountant to protect management against certain risks or to perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A9 The understanding with management regarding the services to be performed for engagements to prepare financial statements is required by paragraph .10 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A10 The roles of management and those charged with governance in agreeing upon the terms of the engagement to prepare financial statements for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance in accordance with paragraph .26c of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A11 An illustrative example of an engagement letter for an engagement to prepare financial statements is presented in the exhibit, "Illustrative Engagement Letter." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A12 The requirement that the accountant obtain an understanding of the financial reporting framework adopted by management intended to be used in the preparation of the financial statements and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and

periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Preparing the Financial Statements (Ref: par. .10, .14–.16, and .18)

.A13 The statement on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements. The statement is made at management's discretion, and the accountant or the accountant's firm name is not required to be included. The accountant is concerned that the indication is not misleading. Examples of a statement on each page of the financial statements include the following:

- No assurance is provided on these financial statements.
- These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.

Other statements that convey that no assurance is provided on the financial statements would also be acceptable. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A14 An example of a disclaimer that the accountant may issue is as follows:

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by me (us) and I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A15 A description of the special purpose framework is usually placed next to or under the title of the financial statements (for example "statement of assets and liabilities—modified cash basis"). However, the description may be placed elsewhere in the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A16 In the preparation of financial statements, the accountant may provide assistance to management with significant judgments (for example, the accountant may advise management on alternative accounting policies that are significant to the financial statements or help management with significant judgments regarding material accounting estimates). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A17 The disclosure of the material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .20–.21)

.A18 The disclosure of the omission of substantially all disclosures required by the applicable financial reporting framework may be made on the face of the financial statements or in a selected note to the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A19 The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by [*the applicable financial reporting framework*] Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Documentation in a Preparation Engagement (Ref: par. .16 and .22)

.A20 Documentation may include documentation regarding significant consultations or significant professional judgments made throughout the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A21

Appendix — Preparation of Financial Statements Versus Assistance in Preparing Financial Statements (Ref: par. .A4)

The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on the services the client requests the accountant to perform and requires the accountant to apply professional judgment. The following table provides examples of services that the accountant may be engaged to perform and whether section 70 would apply. The table is not intended to be all inclusive, and professional judgment would still need to be applied.

<i>Examples of Services for Which This Section Applies</i>	<i>Examples of Accountant Services for Which This Section Does Not Apply</i>
Preparation of financial statements prior to audit or review by another accountant	Preparation of financial statements when the accountant is engaged to perform an audit, review, or compilation of such financial statements
Preparation of financial statements for an entity to be presented alongside the entity's tax return	Preparation of financial statements with a tax return solely for submission to taxing authorities
Preparation of personal financial statements for presentation alongside a financial plan	Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
	Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
	Financial statements prepared in conjunction with business valuation services
	Maintaining depreciation schedules
	Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
Preparation of single financial statements, such as a balance sheet or income statement or financial statements with substantially all disclosures omitted	Drafting financial statement notes
Using the information in a general ledger to prepare financial statements outside of an accounting software system	Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A22

Exhibit — Illustrative Engagement Letter (Ref: par. .A11)

The following is an example of an engagement letter for an engagement to prepare financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This engagement letter is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the preparation of financial statements for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended and the related notes to the financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

Our Responsibilities

The objective of our engagement is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A10.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Management Responsibilities

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- f. To provide us with:
 - i. Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
 - ii. Additional information that may be requested for the purpose of the preparation of the financial statements, and
 - iii. Unrestricted access to persons within ABC Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

[If the accountant expects to issue a disclaimer, instead of the preceding paragraph, the following may be added:

As part of our engagement, we will issue a disclaimer that will state that the financial statements were not subjected to an audit, review, or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.]

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

AR-C Section 80

Compilation Engagements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 25; SSARS No. 26.

Effective for compilations of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when the accountant is engaged to perform a compilation of financial statements, prospective financial information, pro forma financial information, or other historical financial information. (Ref: par. .A1–.A4).^[1] [As amended, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

The Compilation Engagement

.02 Because a compilation engagement is not an assurance engagement, a compilation engagement does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements.

Effective Date

.03 This section is effective for compilations of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.04 The objective of the accountant in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with this section without, undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Definitions

.05 For purposes of Statements on Standards for Accounting and Review Services (SSARs), the following terms have the meanings attributed as follows:

^[1] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Basic financial statements. Financial statements excluding supplementary information and required supplementary information.

Generally accepted accounting principles (GAAP). Reference to *generally accepted accounting principles* in SSARSs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the financial statements subjected to the compilation engagement or separate from the financial statements subjected to the compilation engagement. (Ref: par. .A6–.A7)

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

[Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

General Principles for Performing and Reporting on Compilation Engagements

.06 In addition to complying with this section, an accountant is required to comply with section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Independence

.07 The accountant must determine whether the accountant is independent of the entity. (Ref: par. .A8)

Acceptance and Continuance of Client Relationships and Compilation Engagements

.08 As a condition for accepting an engagement to perform a compilation with respect to an entity's financial statements, in addition to the requirements in paragraph .31 of section 60, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes (Ref: par. .A9)
 - i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, (Ref: par. .A31)
 - ii. a description of any significant interpretations of the contract on which the special purpose financial statements are prepared, in the case of financial statements prepared in accordance with a contractual basis of accounting, and
 - iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.
- b. to include the accountant's compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached. (Ref: par. .A10)

.09 If the accountant is not satisfied about any of the matters set out in paragraph .31 of section 60 or paragraph .08 of this section as preconditions for accepting a compilation engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made

to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A11–.A16)

- a. The objectives of the engagement
- b. The responsibilities of management set forth in paragraph .31b of section 60 and paragraph .08 of this section
- c. The responsibilities of the accountant
- d. The limitations of the compilation engagement
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. The expected form and content of the accountant's compilation report and a statement that there may be circumstances in which the report may differ from its expected form and content

[As amended, effective October 2016, by SSARS No. 23.]

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A12)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A17)

Compilation Procedures

.13 The accountant should read the financial statements in light of the accountant's understanding of the applicable financial reporting framework and the significant accounting policies adopted by management and consider whether such financial statements appear to be appropriate in form and free from obvious material misstatements.

.14 If, in the course of the engagement, the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, provided by management are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information. (Ref: par. .A18)

.15 If the accountant becomes aware during the course of the engagement that

- a. the financial statements do not adequately refer to or describe the applicable financial reporting framework (Ref: par. .A19);

- b. revisions to the financial statements are required for the financial statements to be in accordance with the applicable financial reporting framework; or
- c. the financial statements are otherwise misleading (Ref: par. .A20–.A21)

the accountant should propose the appropriate revisions to management.

.16 The accountant should withdraw from the engagement and inform management of the reasons for withdrawing if (Ref: par. .A22–.A23)

- a. the accountant is unable to complete the engagement because management has failed to provide records, documents, explanations, or other information, including significant judgments, as requested, or
- b. management does not make appropriate revisions that are proposed by the accountant or does not disclose such departures in the financial statements, and the accountant determines to not disclose such departures in the accountant's compilation report.

The Accountant's Compilation Report

.17 The accountant's compilation report should be in writing and (Ref: par. .A24 and .A29)

- a. include a statement that management (owners) is (are) responsible for the financial statements.
- b. identify the financial statements that have been subjected to the compilation engagement.
- c. identify the entity whose financial statements have been subjected to the compilation engagement.
- d. specify the date or period covered by the financial statements.
- e. include a statement that the accountant performed the compilation engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA.
- f. include a statement that the accountant did not audit or review the financial statements nor was the accountant required to perform any procedures to verify the accuracy or completeness of the information provided by management and does not express an opinion, a conclusion, nor provide any assurance on the financial statements.
- g. include the manual or printed signature of the accountant's firm.
- h. include the city and state where the accountant practices. (Ref: par. .A27)
- i. include the date of the report, which should be the date that the accountant has completed the procedures required by this section.

[Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. As amended, effective for compilations of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

The Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Special Purpose Framework

.18 Unless the entity elects to omit substantially all disclosures, the accountant should modify the compilation report when that accountant becomes aware that the financial statements do not include

- a. a description of the special purpose framework. (Ref: par. .A29–.A31)
- b. a summary of significant accounting policies. (Ref: par. .A32)
- c. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. (Ref: par. .A31)
- d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. (Ref: par. .A34)

.19 In the case of financial statements prepared in accordance with the provisions of a contract, the accountant should consider whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based and modify the compilation report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based. [As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.20 In the case of an accountant's compilation report on special purpose financial statements, if management has a choice of financial reporting frameworks in the preparation of the special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances. [As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.21 The accountant's compilation report on financial statements prepared in accordance with a special purpose framework should include a separate paragraph that (Ref: par. A36–.A37)

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes the framework, if applicable, and
- c. states that the special purpose framework is a basis of accounting other than GAAP.

For special purpose financial statements prepared in accordance with a contractual basis of accounting, the separate paragraph should also state that, as a result, the financial statements may not be suitable for another purpose. [As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting When the Accountant Is Not Independent

.22 When the accountant is not independent with respect to the entity, the accountant should indicate the accountant's lack of independence in a final paragraph of the accountant's compilation report. (Ref: par. .A38–.A40)

.23 If the accountant elects to disclose a description about the reasons the accountant's independence is impaired, the accountant should include all such reasons in the description.

Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.24 The summary of significant assumptions is essential to the user's understanding of prospective financial information. Accordingly, the accountant should not issue a compilation report on prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not issue a compilation report on a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.25 In addition to the reporting elements required by paragraph .17, an accountant's compilation report on prospective financial information should include statements that

- a. the forecasted or projected results may not be achieved and
- b. the accountant assumes no responsibility to update the report for events and circumstances occurring after the date of the report.

[Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.26 The accountant should not issue an accountant's compilation report on financial statements that omit substantially all disclosures required by the applicable financial reporting framework if, in the accountant's professional judgment, such financial statements would be misleading to users of the financial statements. (Ref: par. .A21) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.27 When reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should include a separate paragraph in the accountant's compilation report that includes the following elements: (Ref: par. .A41–.A42)

- a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable) required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with a special purpose framework)
- b. A statement that if the omitted disclosures (and the statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the entity's financial position, results of operations, and cash flows (or the equivalent for presentations other than GAAP)
- c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.28 The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation report like any other departure from the applicable financial reporting framework, and the nature of the departure and its effects, if known, should be disclosed in accordance with paragraphs .29–.33. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Reporting Known Departures From the Applicable Financial Reporting Framework

.29 When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements and the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure. (Ref: par. .A44) [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.30 If the accountant concludes that modification of the standard report is adequate, the departure should be disclosed in a separate paragraph of the report. The effects of the departure on the financial statements should be disclosed if such effects have been determined by management or are readily known to the accountant as the result of the accountant's procedures. [Paragraph renumbered and amended, by SSARS No. 23, October 2016.]

.31 If the effects of the departure have not been determined by management or are not readily known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.32 If the accountant believes that modification of the compilation report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the engagement and provide no further services with respect to those financial statements. (Ref: par. .A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.33 The accountant should not modify the compilation report to include a statement that the financial statements are not in conformity with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report Thereon

.34 When supplementary information accompanies financial statements and the accountant's compilation report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either

- a. a separate paragraph in the accountant's compilation report on the financial statements or
- b. a separate report on the supplementary information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.35 When the accountant has performed a compilation engagement with respect to both the financial statements and the supplementary information, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements or issue a separate report on the supplementary information that states (Ref: par. .A46 and .A48)

- a.* the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b.* the supplementary information is the responsibility of management;
- c.* the supplementary information was subject to the compilation engagement; and
- d.* the accountant has not audited or reviewed the supplementary information and does not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.36 When the accountant has performed a compilation engagement with respect to the financial statements but the supplementary information was not subject to the compilation engagement, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements or issue a separate report on the supplementary information that states (Ref: par. .A47–.A48)

- a.* the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b.* the supplementary information is the responsibility of management; and
- c.* the supplementary information was not subject to the compilation engagement and the accountant does not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Required Supplementary Information

.37 With regard to the requirement in paragraph .34, with respect to required supplementary information, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable: (Ref: par. .A49)

- a.* The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
- b.* The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
- c.* The required supplementary information is omitted.

- d. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines. (Ref: par. .A50)
- e. The accountant has identified departures from the prescribed guidelines.
- f. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.38 If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation engagement on the required supplementary information, the separate paragraph in the accountant's compilation report referred to in paragraph .34 should include the following elements: (Ref: par. .A51)

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* requires that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and does not express an opinion, a conclusion, nor provide any assurance on the information
- d. If some of the required supplementary information is omitted:
 - i. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
 - ii. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist *[describe the material departures from the applicable financial reporting framework]*
- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be

presented in accordance with guidelines established by [*identify designated accounting standards-setter*]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.39 If all the required supplementary information is omitted, the separate paragraph in the accountant's compilation report should include the following elements:

- a. A statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards-setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Documentation in a Compilation Engagement

.40 The accountant should prepare documentation in connection with each compilation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following:

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11 (Ref: par. .A14 and .A16)
- b. A copy of the financial statements
- c. A copy of the accountant's report

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 If the accountant is engaged to perform a compilation on prospective financial information or pro forma financial information, references in this section to *financial statements* are to be taken as a reference to such other financial information. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A2 AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines;" chapter 7, "Reasonably Objective Basis;" chapter 8, "Presentation Guidelines;" and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing

prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A3 Other historical financial information to which this section applies includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information

[Paragraph renumbered and amended, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A4 In addition to the requirements of this section, in a compilation of pro forma financial information, the accountant is also required to adhere to the requirements of section 120, *Compilation of Pro Forma Financial Information*. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

Definitions (Ref: par. .05)

[.A5] [Paragraph deleted by the issuance of SSARS No. 25, February 2020.]

.A6 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity. [Paragraph added to reflect conforming changes necessary due to the issuance of SSARS No. 23]

.A7 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements. [Paragraph added to reflect conforming changes necessary due to the issuance of SSARS No. 23]

Independence (Ref: par. .07)

.A8 The interpretations of the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct provide authoritative guidance with respect to independence. It is in the public interest and, therefore, required by this section, that the accountant modify the accountant's compilation report when the accountant is not independent of the entity whose financial statements are the subject of the compilation engagement. The AICPA Code of Professional Conduct also defines *independence* as consisting of two elements, independence of mind and independence in appearance. Independence enhances the accountant's ability to act with integrity and be objective. Independence implies an impartiality that recognizes an obligation to be fair not only to management but also to users of the financial statements, who may rely upon the accountant's compilation report. In the absence of an interpretation of the "Independence Rule" that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010). [Paragraph renumbered by the issuance of SSARS

No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Acceptance and Continuance of Client Relationships and Compilation Engagements (Ref: par. .08)

.A9 A compilation in accordance with SSARSs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .31b of section 60. The preparation of financial statements, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295). To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the compilation engagement as required by paragraphs .10–.11. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A10 Documents containing financial statements that may include an indication that such financial statements have been subjected to a compilation engagement by the entity's accountant includes documents submitted to bonding companies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Agreement on Engagement Terms (Ref: par. .10–.11 and .40)

.A11 Both management and the accountant have an interest in documenting the terms of the compilation engagement before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A12 The roles of management and those charged with governance in agreeing upon the terms of the compilation engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance, in accordance with paragraph .31b of section 60, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A13 When a third party has contracted for a compilation of the entity's financial statements, agreeing the terms of the compilation with management of the entity is necessary in order to establish that the preconditions for a compilation are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A14 The understanding with management regarding the services to be performed for compilation engagements is required by paragraph .10 to be in

a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for compilation engagements. [Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A15 Although the accountant may prepare the financial statements, in whole or in part, the financial statements are representations of management, and the fairness of their presentation in accordance with the applicable financial reporting framework is management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A16 Illustrative examples of engagement letters for a compilation engagement are presented in exhibit A, "Illustrative Engagement Letters." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A17 The requirement that the accountant obtain an understanding of the applicable financial reporting framework intended to be used in the preparation of the financial statements, and the significant accounting policies adopted by management, does not prevent the accountant from accepting a compilation engagement for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the framework or the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Compilation Procedures (Ref: par. .14–.16, .26, and .32)

.A18 The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have performed such inquiries or procedures and the results of those inquiries or procedures, knowledge gained from prior engagements, or the financial statements themselves may cause the accountant to become aware that information provided by management is incorrect, incomplete, or otherwise unsatisfactory. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A19 The financial statements may adequately refer to or describe the applicable financial reporting framework via

- the financial statement titles or
- the notes to the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A20 Financial statements may be misleading, for example, if the applicable financial reporting framework includes the premise that the financial statements are prepared on the going concern basis, and undisclosed uncertainties exist regarding the entity's ability to continue as a going concern. If the accountant becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity's ability to continue as a going concern in order to avoid the financial statements being misleading. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A21 Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A22 In circumstances addressed by the requirements of this section in which withdrawal from the engagement is necessary, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant's ethical obligations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A23 When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Accountant's Compilation Report (Ref: par. .17)

.A24 The accountant's written report may become unattached from the financial statements. To minimize the possibility that a user of the financial statements may infer an unintended level of reliance on the financial statements, the accountant may request that management include a reference on each page of the financial statements to the accountant's written report. An example of a reference to the accountant's written report included on each page of the financial statements is "See Accountant's Report" or "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A25 In some cases, law or regulation may allow for the use of electronic signatures in the accountant's compilation report. [Paragraph deleted by the issuance of SSARS No. 23, October 2016. Paragraph reinstated, effective for compilations of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A26 In certain situations, the accountant's compilation report may be required by law or regulation to include the personal name and signature of the accountant, in addition to the accountant's firm. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A27 The city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A28 Illustrative examples of accountant's compilation reports are presented in exhibit B, "Illustrative Examples of the Accountant's Compilation Reports on Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

The Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Special Purpose Framework (Ref: par. .08, .18, and .20)

.A29 Circumstances may exist in which a regulatory or contractual basis of accounting is based on a general purpose framework established by a designated accounting standard setter, such as GAAP, or by law or regulation, but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial statements are materially misstated due to a departure from that framework, paragraphs .29–.33 apply. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A30 When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply that the special purpose framework includes all the requirements of, or is the same as, the financial reporting framework on which the special purpose framework is based. In the example of the contract in paragraph .A29, the description of the applicable financial reporting framework would refer to the financial reporting provisions of the contract. The requirement in paragraph .21 is designed to avoid misunderstandings about compliance with the general purpose framework. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A31 The description of the special purpose framework may be included in the financial statement titles, in the notes to the financial statements, or otherwise on the face of the financial statements. Although terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows*, or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP, such titles, with appropriate modification, may be used in connection with financial statements prepared in accordance with a special purpose framework. Suitable financial statement titles for financial statements

prepared in accordance with a special purpose framework include, but are not limited to

- a modified cash basis financial statement that might be titled
 - "Income Statement — Modified Cash Basis," or
 - "Statement of Cash Receipts and Disbursements."
- financial statements prepared in accordance with the tax basis of accounting that might be titled
 - "Balance Sheet — Tax Basis,"
 - "Statement of Assets, Liabilities, and Equity — Tax Basis,"
 - "Statement of Operations — Tax Basis," or
 - "Statement of Revenue and Expenses — Tax Basis."
- a financial statement prepared in accordance with a regulatory basis of accounting that might be titled "Statement of Income — Regulatory Basis."

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A32 Financial statements prepared in accordance with a special purpose framework need not include a summary of significant accounting policies or a description about how the special purpose framework differs from GAAP if such financial statements omit substantially all disclosures, and the omission of substantially all disclosures is not, to the accountant's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A33 The description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described or quantified. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A34 Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by

the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

[**A35**] [Paragraph subsequently renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A36 Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .21 requires the accountant to include a separate paragraph in the accountant's compilation report that alerts users of the accountant's compilation report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

A37 Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of SSARSs. The requirement in paragraph .21 is designed to avoid misunderstandings about the framework used to prepare the financial statements. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

Reporting When the Accountant Is Not Independent (Ref: par. .22)

A38 An example of a disclosure that an accountant may make to indicate the accountant's lack of independence would be

I am (We are) not independent with respect to XYZ Company.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A39 The accountant is not precluded from disclosing a description about the reason(s) that the accountant's independence is impaired. The following are examples of descriptions the accountant may use:

- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.
- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.
- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we)

performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A40 Illustrative examples of accountant's compilation reports when the accountant's independence has been impaired are presented in exhibit B.² [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .27)

.A41 When management elects to include disclosures about only a few matters in the notes to the financial statements, such disclosures may be labeled "Selected Information — Substantially All Disclosures Required by *[the applicable financial reporting framework]* Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A42 An illustrative example of an accountant's compilation report on financial statements that omit substantially all disclosures required by the applicable financial reporting framework is presented in exhibit B.³ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

² Illustration 4, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment" and illustration 5, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reasons for the Independence Impairment," of exhibit B, "Illustrative Examples of the Accountant's Compilation Report on Financial Statements."

³ Illustration 3, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting," of exhibit B.

Reporting Known Departures From the Applicable Financial Reporting Framework (Ref: par. .30 and .33)

.A43 The accountant is precluded from including a statement that the financial statements are not in conformity with the applicable financial reporting framework because such a statement would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A44 An illustrative example of an accountant's compilation report on financial statements that contain known departures from the applicable financial reporting framework that are not disclosed in the notes to the financial statements is presented in exhibit B.⁴ [Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report Thereon (Ref: par. .34–.36)

[.A45] [Paragraph deleted to reflect conforming changes necessary due to the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A46 The following is an example of how an accountant may word a separate paragraph in the accountant's compilation report addressing supplementary information when the accountant has performed a compilation engagement on both the financial statements and the supplementary information:

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was subject to our compilation engagement. I (We) have not audited or reviewed the supplementary information and do not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A47 The following is an example of how an accountant may word a separate paragraph in the accountant's compilation report addressing

⁴ Illustration 6, "An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant is Aware of Departures From Accounting Principles Generally Accepted in the United States of America," of exhibit B.

supplementary information when the accountant has performed a compilation engagement on the financial statements but has not performed a compilation on the supplementary information:

The accompanying [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was not subject to our compilation engagement. I (We) do not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A48 Supplementary information may become unattached from the accountant's compilation report. To minimize the possibility that a user of the supplementary information may infer, through the accountant's association with such information, an unintended level of reliance on it, the accountant may request that management include a reference to the accountant's compilation report on each page of the supplementary information. An example of a reference to the accountant's compilation report included on each page of the supplementary information is "See Accountant's Report" or "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Required Supplementary Information (Ref: par. .37–.38)

A49 Examples of required supplementary information that may accompany financial statements and the accountant's compilation report thereon include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by *FASB Accounting Standards Codification 972-235-50-3*
- Management's discussion and analysis and budgetary comparison statements as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A50 *Prescribed guidelines* are the authoritative guidelines established by the designated accounting standards-setter for the methods of measurement and presentation of the required supplementary information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently

renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A51 Because the required supplementary information accompanies the basic financial statements, the accountant's compilation report on the financial statements includes a discussion of the responsibility taken by the accountant on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A52

Exhibit A — Illustrative Engagement Letters (Ref: par. .A16)

Illustration 1 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Except the Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP and in Which the Accountant's Independence Is Impaired

Illustration 3 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

The illustrative engagement letters in this exhibit are intended as illustrations that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances, and the illustrations are drafted to refer to a compilation engagement for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

Illustration 1 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the compilation engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America and will include all related notes required by accounting principles generally accepted in the United States of America
- The accountant expects that his or her independence will not be impaired

To the appropriate representative of management of ABC Company:¹

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and perform a compilation engagement with respect to those financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSS:

² Throughout this engagement letter, references to *you, we, us, management, and accountant* will be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes and perform a compilation engagement with respect to those financial statements, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity, and perform a compilation engagement with respect to those financial statements." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's

knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements.]

Illustration 2 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Except the Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP and in Which the Accountant's Independence Is Impaired

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements subject to the compilation engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America, except the statement of cash flows and substantially all disclosures required by accounting principles generally accepted in the United States of America will be omitted.
- The accountant's independence will be impaired as a result of the performance of the nonattest preparation service.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity for the year then ended, and perform a compilation engagement with respect to those financial statements.³ These financial statements will not include a statement of cash flows and related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping service.

Our Responsibilities

The objective of our engagement is to

- a.* prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b.* apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion, a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The compilation engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSS:

- a.* The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b.* The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America
- c.* The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d.* The prevention and detection of fraud
- e.* To ensure that the entity complies with the laws and regulations applicable to its activities

- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. We will disclose that we are not independent in our report. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our report will disclose that the Company's management has elected to omit the statement of cash flows and substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the statement of cash flows and omitted disclosures were to be included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, the financial statements will not be designed for those who are not informed about such matters.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation

engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

[*Signature of accountant or accountant's firm*]

Acknowledged and agreed on behalf of ABC Company by:

[*Signed*]

[*Name and Title*]

[*Date*]

[Revised, February 2015, to include additional required engagement letter elements.]

Illustration 3 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements subject to the compilation engagement.
- The financial statements will be prepared in accordance with the tax basis of accounting.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity — tax basis as of December 31, 20XX, and the related statements of operations and related earnings — tax basis, and cash flows — tax basis for the year then ended, and the related notes to the financial statements and perform a compilation engagement with respect to those financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with the tax basis of accounting based on information provided by you and

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you*, *we*, *us*, *management*, and *accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows — tax basis and the related notes and perform a compilation engagement with respect to those financial statements, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity — tax basis as of December 31, 20XX, and the related statement of operations and retained earnings — tax basis, and perform a compilation engagement with respect to those financial statements." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows — tax basis and related notes to the financial statements."

⁴ The accountant may include nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion, a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with the tax basis of accounting and assist you in the presentation of the financial statements in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of the tax basis of accounting as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of financial statements in accordance with the tax basis of accounting
- c. The inclusion of all informative disclosures that is appropriate for the tax basis of accounting. This includes
 - i. a description of the tax basis of accounting, including a summary of significant accounting policies, and how the tax basis of accounting differs from accounting principles generally accepted in the United States of America, the effects of which need not be quantified and
 - ii. informative disclosures similar to those required by accounting principles generally accepted in the United States of America.⁵
- d. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error

⁵ The responsibility described in c need not be included if the financial statements omit substantially all disclosures required by the financial reporting framework.

- e. The prevention and detection of fraud
- f. To ensure that the entity complies with the laws and regulations applicable to its activities
- g. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the compilation engagement
- h. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our report will disclose that the financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services . . .

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and perform a compilation

engagement with respect to those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Revised, February 2015, to include additional required engagement letter elements. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A53

Exhibit B — Illustrative Examples of the Accountant's Compilation Report on Financial Statements (Ref: par. .A28, .A40, .A42, and .A44)

Illustration 1 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities

Illustration 3 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 4 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment

Illustration 5 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reason for the Independence Impairment

Illustration 6 — An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of Departures From Accounting Principles Generally Accepted in the United States of America

Illustration 1 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not

express an opinion, a conclusion, nor provide any assurance on these financial statements.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 2 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1 and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 3 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Management is responsible for the accompanying financial statements of XYZ Partnership, which comprise the statements of assets, liabilities, and partners' capital — tax basis as of December 31, 20X2 and 20X1 and the related statements of revenue and expenses — tax basis, and changes in partners' capital — tax basis for the years then ended in accordance with the tax basis of accounting, and for determining that the tax basis of accounting is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

The financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

Management has elected to omit substantially all the disclosures ordinarily included in financial statements prepared in accordance with the tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, equity, revenue, and expenses. Accordingly, the financial statements are not designed for those who are not informed about such matters.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 4 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I am (we are) not independent with respect to XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 5 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reason for the Independence Impairment

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1, and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the

AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

I am (we are) not independent with respect to XYZ Company as during the year ended December 31, 20X2, I (a member of the engagement team) had a direct financial interest in XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 6 — An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of Departures From Accounting Principles Generally Accepted in the United States of America

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

Accounting principles generally accepted in the United States of America require that land be stated at cost. Management has informed me (us) that XYZ Company has stated its land at appraised value and that if accounting principles generally accepted in the United States of America had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

AR-C Section 80A

Compilation Engagements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 25.

Effective for compilations of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when the accountant is engaged to perform a compilation of financial statements, prospective financial information, pro forma financial information, or other historical financial information. (Ref: par. .A1–.A4).^[1] [As amended, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

The Compilation Engagement

.02 Because a compilation engagement is not an assurance engagement, a compilation engagement does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements.

Effective Date

.03 This section is effective for compilations of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.04 The objective of the accountant in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with this section without, undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Definitions

.05 For purposes of Statements on Standards for Accounting and Review Services (SSARSS), the following terms have the meanings attributed as follows:

^[1] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

Basic financial statements. Financial statements excluding supplementary information and required supplementary information.

Generally accepted accounting principles (GAAP). Reference to *generally accepted accounting principles* in SSARSs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the financial statements subjected to the compilation engagement or separate from the financial statements subjected to the compilation engagement. (Ref: par. .A6–.A7)

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

[Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

General Principles for Performing and Reporting on Compilation Engagements

.06 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Independence

.07 The accountant must determine whether the accountant is independent of the entity. (Ref: par. .A8)

Acceptance and Continuance of Client Relationships and Compilation Engagements

.08 As a condition for accepting an engagement to perform a compilation with respect to an entity's financial statements, in addition to the requirements in paragraph .26 of section 60A, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes (Ref: par. .A9)
 - i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, (Ref: par. .A30)
 - ii. a description of any significant interpretations of the contract on which the special purpose financial statements are prepared, in the case of financial statements prepared in accordance with a contractual basis of accounting, and
 - iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.
- b. to include the accountant's compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached. (Ref: par. .A10)

.09 If the accountant is not satisfied about any of the matters set out in paragraph .26 of section 60A or paragraph .08 of this section as preconditions for accepting a compilation engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot

be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A11–.A16)

- a. The objectives of the engagement
- b. The responsibilities of management set forth in paragraph .26*b* of section 60A and paragraph .08 of this section
- c. The responsibilities of the accountant
- d. The limitations of the compilation engagement
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. The expected form and content of the accountant's compilation report and a statement that there may be circumstances in which the report may differ from its expected form and content

[As amended, effective October 2016, by SSARS No. 23.]

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A12)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A17)

Compilation Procedures

.13 The accountant should read the financial statements in light of the accountant's understanding of the applicable financial reporting framework and the significant accounting policies adopted by management and consider whether such financial statements appear to be appropriate in form and free from obvious material misstatements.

.14 If, in the course of the engagement, the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, provided by management are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information. (Ref: par. .A18)

.15 If the accountant becomes aware during the course of the engagement that

- a. the financial statements do not adequately refer to or describe the applicable financial reporting framework (Ref: par. .A19);

- b. revisions to the financial statements are required for the financial statements to be in accordance with the applicable financial reporting framework; or
- c. the financial statements are otherwise misleading (Ref: par. .A20–.A21)

the accountant should propose the appropriate revisions to management.

.16 The accountant should withdraw from the engagement and inform management of the reasons for withdrawing if (Ref: par. .A22–.A23)

- a. the accountant is unable to complete the engagement because management has failed to provide records, documents, explanations, or other information, including significant judgments, as requested, or
- b. management does not make appropriate revisions that are proposed by the accountant or does not disclose such departures in the financial statements, and the accountant determines to not disclose such departures in the accountant's compilation report.

The Accountant's Compilation Report

.17 The accountant's compilation report should be in writing and (Ref: par. .A24 and .A27)

- a. include a statement that management (owners) is (are) responsible for the financial statements.
- b. identify the financial statements that have been subjected to the compilation engagement.
- c. identify the entity whose financial statements have been subjected to the compilation engagement.
- d. specify the date or period covered by the financial statements.
- e. include a statement that the accountant performed the compilation engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA.
- f. include a statement that the accountant did not audit or review the financial statements nor was the accountant required to perform any procedures to verify the accuracy or completeness of the information provided by management and does not express an opinion, a conclusion, nor provide any assurance on the financial statements.
- g. include the signature of the accountant or the accountant's firm.
- h. include the city and state where the accountant practices. (Ref: par. .A26)
- i. include the date of the report, which should be the date that the accountant has completed the procedures required by this section.

[Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Special Purpose Framework

.18 Unless the entity elects to omit substantially all disclosures, the accountant should modify the compilation report when that accountant becomes aware that the financial statements do not include

- a. a description of the special purpose framework. (Ref: par. .A28–.A30)
- b. a summary of significant accounting policies. (Ref: par. .A31)
- c. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. (Ref: par. .A30)
- d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. (Ref: par. .A33)

.19 In the case of financial statements prepared in accordance with the provisions of a contract, the accountant should consider whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based and modify the compilation report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based. [As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.20 In the case of an accountant's compilation report on special purpose financial statements, if management has a choice of financial reporting frameworks in the preparation of the special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances. [As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.21 The accountant's compilation report on financial statements prepared in accordance with a special purpose framework should include a separate paragraph that (Ref: par. .A35–.A36)

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes the framework, if applicable, and
- c. states that the special purpose framework is a basis of accounting other than GAAP.

For special purpose financial statements prepared in accordance with a contractual basis of accounting, the separate paragraph should also state that, as a result, the financial statements may not be suitable for another purpose. [As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting When the Accountant Is Not Independent

.22 When the accountant is not independent with respect to the entity, the accountant should indicate the accountant's lack of independence in a final paragraph of the accountant's compilation report. (Ref: par. .A37–.A39)

.23 If the accountant elects to disclose a description about the reasons the accountant's independence is impaired, the accountant should include all such reasons in the description.

Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.24 The summary of significant assumptions is essential to the user's understanding of prospective financial information. Accordingly, the accountant should not issue a compilation report on prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not issue a compilation report on a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.25 In addition to the reporting elements required by paragraph .17, an accountant's compilation report on prospective financial information should include statements that

- a. the forecasted or projected results may not be achieved and
- b. the accountant assumes no responsibility to update the report for events and circumstances occurring after the date of the report.

[Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.26 The accountant should not issue an accountant's compilation report on financial statements that omit substantially all disclosures required by the applicable financial reporting framework if, in the accountant's professional judgment, such financial statements would be misleading to users of the financial statements. (Ref: par. .A21) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. As amended, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.27 When reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should include a separate paragraph in the accountant's compilation report that includes the following elements: (Ref: par. .A40–.A41)

- a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable) required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with a special purpose framework)
- b. A statement that if the omitted disclosures (and the statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the entity's financial position, results of operations, and cash flows (or the equivalent for presentations other than GAAP)
- c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.28 The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation report like any other departure from the applicable financial reporting framework, and the nature of the departure and its effects, if known, should be disclosed in accordance with

paragraphs .29–.33. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Reporting Known Departures From the Applicable Financial Reporting Framework

.29 When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements and the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure. (Ref: par. .A43) [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.30 If the accountant concludes that modification of the standard report is adequate, the departure should be disclosed in a separate paragraph of the report. The effects of the departure on the financial statements should be disclosed if such effects have been determined by management or are readily known to the accountant as the result of the accountant's procedures. [Paragraph renumbered and amended, by SSARS No. 23, October 2016.]

.31 If the effects of the departure have not been determined by management or are not readily known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.32 If the accountant believes that modification of the compilation report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the engagement and provide no further services with respect to those financial statements. (Ref: par. .A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.33 The accountant should not modify the compilation report to include a statement that the financial statements are not in conformity with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report Thereon

.34 When supplementary information accompanies financial statements and the accountant's compilation report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either

- a. a separate paragraph in the accountant's compilation report on the financial statements or
- b. a separate report on the supplementary information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.35 When the accountant has performed a compilation engagement with respect to both the financial statements and the supplementary information, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements or issue a separate report on the supplementary information that states (Ref: par. .A45 and .A47)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management;
- c. the supplementary information was subject to the compilation engagement; and
- d. the accountant has not audited or reviewed the supplementary information and does not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.36 When the accountant has performed a compilation engagement with respect to the financial statements but the supplementary information was not subject to the compilation engagement, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements or issue a separate report on the supplementary information that states (Ref: par. .A46–.A47)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management; and
- c. the supplementary information was not subject to the compilation engagement and the accountant does not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Required Supplementary Information

.37 With regard to the requirement in paragraph .34, with respect to required supplementary information, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable: (Ref: par. .A48)

- a. The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
- b. The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
- c. The required supplementary information is omitted.
- d. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines. (Ref: par. .A49)
- e. The accountant has identified departures from the prescribed guidelines.

- f. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.38 If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation engagement on the required supplementary information, the separate paragraph in the accountant's compilation report referred to in paragraph .34 should include the following elements: (Ref: par. .A50)

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* requires that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and does not express an opinion, a conclusion, nor provide any assurance on the information
- d. If some of the required supplementary information is omitted:
 - i. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
 - ii. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist *[describe the material departures from the applicable financial reporting framework]*
- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standards-setter]*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.39 If all the required supplementary information is omitted, the separate paragraph in the accountant's compilation report should include the following elements:

- a. A statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards-setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Documentation in a Compilation Engagement

.40 The accountant should prepare documentation in connection with each compilation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following:

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11 (Ref. par. .A14 and .A16)
- b. A copy of the financial statements
- c. A copy of the accountant's report

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 If the accountant is engaged to perform a compilation on prospective financial information or pro forma financial information, references in this section to *financial statements* are to be taken as a reference to such other financial information. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A2 AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines;" chapter 7, "Reasonably Objective Basis;" chapter 8, "Presentation Guidelines;" and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A3 Other historical financial information to which this section applies includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information

[Paragraph renumbered and amended, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A4 In addition to the requirements of this section, in a compilation of pro forma financial information, the accountant is also required to adhere to the requirements of section 120, *Compilation of Pro Forma Financial Information*. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

Definitions (Ref: par. .05)

[.A5] [Paragraph deleted by the issuance of SSARS No. 25, February 2020.]

.A6 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity. [Paragraph added to reflect conforming changes necessary due to the issuance of SSARS No. 23]

.A7 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements. [Paragraph added to reflect conforming changes necessary due to the issuance of SSARS No. 23]

Independence (Ref: par. .07)

.A8 The interpretations of the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct provide authoritative guidance with respect to independence. It is in the public interest and, therefore, required by this section, that the accountant modify the accountant's compilation report when the accountant is not independent of the entity whose financial statements are the subject of the compilation engagement. The AICPA Code of Professional Conduct also defines *independence* as consisting of two elements, independence of mind and independence in appearance. Independence enhances the accountant's ability to act with integrity and be objective. Independence implies an impartiality that recognizes an obligation to be fair not only to management but also to users of the financial statements, who may rely upon the accountant's compilation report. In the absence of an interpretation of the "Independence Rule" that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Acceptance and Continuance of Client Relationships and Compilation Engagements (Ref: par. .08)

.A9 A compilation in accordance with SSARs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .26b of section 60A. The preparation of financial statements, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295). To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the compilation engagement as required by paragraphs .10–.11. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A10 Documents containing financial statements that may include an indication that such financial statements have been subjected to a compilation engagement by the entity's accountant includes documents submitted to bonding companies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Agreement on Engagement Terms (Ref: par. .10–.11 and .40)

.A11 Both management and the accountant have an interest in documenting the terms of the compilation engagement before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A12 The roles of management and those charged with governance in agreeing upon the terms of the compilation engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance, in accordance with paragraph .26b of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A13 When a third party has contracted for a compilation of the entity's financial statements, agreeing the terms of the compilation with management of the entity is necessary in order to establish that the preconditions for a compilation are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A14 The understanding with management regarding the services to be performed for compilation engagements is required by paragraph .10 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services

to be performed for compilation engagements. [Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A15 Although the accountant may prepare the financial statements, in whole or in part, the financial statements are representations of management, and the fairness of their presentation in accordance with the applicable financial reporting framework is management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A16 Illustrative examples of engagement letters for a compilation engagement are presented in exhibit A, "Illustrative Engagement Letters." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A17 The requirement that the accountant obtain an understanding of the applicable financial reporting framework intended to be used in the preparation of the financial statements, and the significant accounting policies adopted by management, does not prevent the accountant from accepting a compilation engagement for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the framework or the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Compilation Procedures (Ref: par. .14–.16, .26, and .32)

.A18 The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have performed such inquiries or procedures and the results of those inquiries or procedures, knowledge gained from prior engagements, or the financial statements themselves may cause the accountant to become aware that information provided by management is incorrect, incomplete, or otherwise unsatisfactory. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A19 The financial statements may adequately refer to or describe the applicable financial reporting framework via

- the financial statement titles or
- the notes to the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A20 Financial statements may be misleading, for example, if the applicable financial reporting framework includes the premise that the financial statements are prepared on the going concern basis, and undisclosed uncertainties exist regarding the entity's ability to continue as a going concern. If the accountant becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity's ability to continue as a going concern in order to avoid the financial statements being misleading. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A21 Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A22 In circumstances addressed by the requirements of this section in which withdrawal from the engagement is necessary, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant's ethical obligations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A23 When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Accountant's Compilation Report (Ref: par. .17)

.A24 The accountant's written report may become unattached from the financial statements. To minimize the possibility that a user of the financial statements may infer an unintended level of reliance on the financial statements, the accountant may request that management include a reference on each page of the financial statements to the accountant's written report. An example of a reference to the accountant's written report included on each page of the financial statements is "See Accountant's Report" or "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

[.A25] [Paragraph deleted by the issuance of SSARS No. 23, October 2016.]

.A26 The city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A27 Illustrative examples of accountant's compilation reports are presented in exhibit B, "Illustrative Examples of the Accountant's Compilation Reports on Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Special Purpose Framework (Ref: par. .08, .18, and .20)

.A28 Circumstances may exist in which a regulatory or contractual basis of accounting is based on a general purpose framework established by a designated accounting standard setter, such as GAAP, or by law or regulation, but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial statements are materially misstated due to a departure from that framework, paragraphs .29–.33 apply. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A29 When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply that the special purpose framework includes all the requirements of, or is the same as, the financial reporting framework on which the special purpose framework is based. In the example of the contract in paragraph .A28, the description of the applicable financial reporting framework would refer to the financial reporting provisions of the contract. The requirement in paragraph .21 is designed to avoid misunderstandings about compliance with the general purpose framework. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A30 The description of the special purpose framework may be included in the financial statement titles, in the notes to the financial statements, or otherwise on the face of the financial statements. Although terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows*, or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP, such titles, with appropriate modification, may be used in connection with financial statements prepared in accordance with a special purpose framework. Suitable financial statement titles for financial statements prepared in accordance with a special purpose framework include, but are not limited to

- a modified cash basis financial statement that might be titled
 - "Income Statement — Modified Cash Basis," or
 - "Statement of Cash Receipts and Disbursements."
- financial statements prepared in accordance with the tax basis of accounting that might be titled
 - "Balance Sheet — Tax Basis,"
 - "Statement of Assets, Liabilities, and Equity — Tax Basis,"
 - "Statement of Operations — Tax Basis," or
 - "Statement of Revenue and Expenses — Tax Basis."

- a financial statement prepared in accordance with a regulatory basis of accounting that might be titled "Statement of Income — Regulatory Basis."

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A31 Financial statements prepared in accordance with a special purpose framework need not include a summary of significant accounting policies or a description about how the special purpose framework differs from GAAP if such financial statements omit substantially all disclosures, and the omission of substantially all disclosures is not, to the accountant's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A32 The description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described or quantified. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A33 Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

[.A34] [Paragraph subsequently renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A35 Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .21 requires the accountant to include a separate paragraph in the accountant's compilation report that alerts users of the accountant's compilation report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A36 Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad

distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of SSARSs. The requirement in paragraph .21 is designed to avoid misunderstandings about the framework used to prepare the financial statements. [Paragraph added, effective for compilations of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting When the Accountant Is Not Independent (Ref: par. .22)

.A37 An example of a disclosure that an accountant may make to indicate the accountant's lack of independence would be

I am (We are) not independent with respect to XYZ Company.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A38 The accountant is not precluded from disclosing a description about the reason(s) that the accountant's independence is impaired. The following are examples of descriptions the accountant may use:

- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.
- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.
- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A39 Illustrative examples of accountant's compilation reports when the accountant's independence has been impaired are presented in exhibit B.² [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes

² Illustration 4, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment" and illustration 5, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reasons for the Independence Impairment," of exhibit B, "Illustrative Examples of the Accountant's Compilation Report on Financial Statements."

necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .27)

.A40 When management elects to include disclosures about only a few matters in the notes to the financial statements, such disclosures may be labeled "Selected Information — Substantially All Disclosures Required by *[the applicable financial reporting framework]* Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A41 An illustrative example of an accountant's compilation report on financial statements that omit substantially all disclosures required by the applicable financial reporting framework is presented in exhibit B.³ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Reporting Known Departures From the Applicable Financial Reporting Framework (Ref: par. .30 and .33)

.A42 The accountant is precluded from including a statement that the financial statements are not in conformity with the applicable financial reporting framework because such a statement would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A43 An illustrative example of an accountant's compilation report on financial statements that contain known departures from the applicable financial reporting framework that are not disclosed in the notes to the financial statements is presented in exhibit B.⁴ [Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

³ Illustration 3, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting," of exhibit B.

⁴ Illustration 6, "An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant is Aware of Departures From Accounting Principles Generally Accepted in the United States of America," of exhibit B.

Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report Thereon (Ref: par. .34–.36)

[.A44] [Paragraph deleted to reflect conforming changes necessary due to the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.A45 The following is an example of how an accountant may word a separate paragraph in the accountant's compilation report addressing supplementary information when the accountant has performed a compilation engagement on both the financial statements and the supplementary information:

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was subject to our compilation engagement. I (We) have not audited or reviewed the supplementary information and do not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A46 The following is an example of how an accountant may word a separate paragraph in the accountant's compilation report addressing supplementary information when the accountant has performed a compilation engagement on the financial statements but has not performed a compilation on the supplementary information:

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was not subject to our compilation engagement. I (We) do not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A47 Supplementary information may become unattached from the accountant's compilation report. To minimize the possibility that a user of the supplementary information may infer, through the accountant's association with such information, an unintended level of reliance on it, the accountant may request that management include a reference to the accountant's compilation report on each page of the supplementary information. An example of a reference to the accountant's compilation report included on each page of the supplementary information is "See Accountant's Report" or "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Required Supplementary Information (Ref: par. .37–.38)

.A48 Examples of required supplementary information that may accompany financial statements and the accountant's compilation report thereon include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by FASB *Accounting Standards Codification* 972-235-50-3
- Management's discussion and analysis and budgetary comparison statements as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A49 *Prescribed guidelines* are the authoritative guidelines established by the designated accounting standards-setter for the methods of measurement and presentation of the required supplementary information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A50 Because the required supplementary information accompanies the basic financial statements, the accountant's compilation report on the financial statements includes a discussion of the responsibility taken by the accountant on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Exhibit A — Illustrative Engagement Letters (Ref: par. .A16)

Illustration 1 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Except the Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP and in Which the Accountant's Independence Is Impaired

Illustration 3 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

The illustrative engagement letters in this exhibit are intended as illustrations that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances, and the illustrations are drafted to refer to a compilation engagement for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

Illustration 1 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the compilation engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America and will include all related notes required by accounting principles generally accepted in the United States of America
- The accountant expects that his or her independence will not be impaired

To the appropriate representative of management of ABC Company:¹

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and perform a compilation engagement with respect to those financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes and perform a compilation engagement with respect to those financial statements, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity, and perform a compilation engagement with respect to those financial statements." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing

misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements.]

Illustration 2 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Except the Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP and in Which the Accountant's Independence Is Impaired

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements subject to the compilation engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America, except the statement of cash flows and substantially all disclosures required by accounting principles generally accepted in the United States of America will be omitted.
- The accountant's independence will be impaired as a result of the performance of the nonattest preparation service.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you*, *we*, *us*, *management*, and *accountant* would be used or amended as appropriate in the circumstances.

statements of income and changes in stockholders' equity for the year then ended, and perform a compilation engagement with respect to those financial statements.³ These financial statements will not include a statement of cash flows and related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion, a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The compilation engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSS:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping service.

statements that are free from material misstatement, whether due to fraud or error

- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. We will disclose that we are not independent in our report. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our report will disclose that the Company's management has elected to omit the statement of cash flows and substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the statement of cash flows and omitted disclosures were to be included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, the financial statements will not be designed for those who are not informed about such matters.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements.]

Illustration 3 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements subject to the compilation engagement.
- The financial statements will be prepared in accordance with the tax basis of accounting.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity — tax basis as of December 31, 20XX, and the related statements of operations and related earnings — tax basis, and cash flows — tax basis for the year then ended, and the related notes to the financial statements and perform a compilation engagement with respect to those financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows — tax basis and the related notes and perform a compilation engagement with respect to those financial statements, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity — tax basis as of December 31, 20XX, and the related statement of operations and retained earnings — tax basis, and perform a compilation engagement with respect to those financial statements." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows — tax basis and related notes to the financial statements."

⁴ The accountant may include nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with the tax basis of accounting based on information provided by you and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the tax basis of accounting.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion, a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with the tax basis of accounting and assist you in the presentation of the financial statements in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSS:

- a. The selection of the tax basis of accounting as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of financial statements in accordance with the tax basis of accounting
- c. The inclusion of all informative disclosures that is appropriate for the tax basis of accounting. This includes
 - i. a description of the tax basis of accounting, including a summary of significant accounting policies, and how the tax basis of accounting differs from accounting principles generally accepted in the United States of America, the effects of which need not be quantified and
 - ii. informative disclosures similar to those required by accounting principles generally accepted in the United States of America.⁵
- d. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial

⁵ The responsibility described in *c* need not be included if the financial statements omit substantially all disclosures required by the financial reporting framework.

statements that are free from material misstatement, whether due to fraud or error

- e. The prevention and detection of fraud
- f. To ensure that the entity complies with the laws and regulations applicable to its activities
- g. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the compilation engagement
- h. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our report will disclose that the financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and perform a compilation

engagement with respect to those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Revised, February 2015, to include additional required engagement letter elements. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Exhibit B — Illustrative Examples of the Accountant's Compilation Report on Financial Statements (Ref: par. .A27, .A39, .A41, and .A43)

Illustration 1 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities

Illustration 3 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 4 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment

Illustration 5 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reason for the Independence Impairment

Illustration 6 — An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of Departures From Accounting Principles Generally Accepted in the United States of America

Illustration 1 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of

the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 2 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1 and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 3 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Management is responsible for the accompanying financial statements of XYZ Partnership, which comprise the statements of assets, liabilities, and partners' capital — tax basis as of December 31, 20X2 and 20X1 and the related statements of revenue and expenses — tax basis, and changes in partners' capital — tax basis for the years then ended in accordance with the tax basis of accounting, and for determining that the tax basis of accounting is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

The financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

Management has elected to omit substantially all the disclosures ordinarily included in financial statements prepared in accordance with the tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, equity, revenue, and expenses. Accordingly, the financial statements are not designed for those who are not informed about such matters.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 4 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I am (we are) not independent with respect to XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 5 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reason for the Independence Impairment

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1, and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the

AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

I am (we are) not independent with respect to XYZ Company as during the year ended December 31, 20X2, I (a member of the engagement team) had a direct financial interest in XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 6 — An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of Departures From Accounting Principles Generally Accepted in the United States of America

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

Accounting principles generally accepted in the United States of America require that land be stated at cost. Management has informed me (us) that XYZ Company has stated its land at appraised value and that if accounting principles generally accepted in the United States of America had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

AR-C Section 80B

Compilation Engagements

Source: SSARS No. 21; SSARS No. 23.

Effective for compilations of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope of This Section

.01 This section applies when the accountant is engaged to perform a compilation of financial statements, prospective financial information, pro forma financial information, or other historical financial information. (Ref: par. .A1–.A4).^[1] [As amended, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

The Compilation Engagement

.02 Because a compilation engagement is not an assurance engagement, a compilation engagement does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements.

Effective Date

.03 This section is effective for compilations of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.04 The objective of the accountant in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with this section without, undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Definitions

.05 For purposes of Statements on Standards for Accounting and Review Services (SSARSs), the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the

^[1] [Footnote deleted by the issuance of SSARS No. 23, October 2016.]

entity and the objective of the financial statements or that is required by law or regulation.

Basic financial statements. Financial statements excluding supplementary information and required supplementary information.

Generally accepted accounting principles (GAAP). Reference to *generally accepted accounting principles* in SSARs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission). (Ref: par. .A5)
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.

- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting* (OCBOA).

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the financial statements subjected to the compilation engagement or separate from the financial statements subjected to the compilation engagement. (Ref: par. .A6–.A7)

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

[Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Requirements

General Principles for Performing and Reporting on Compilation Engagements

.06 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Independence

.07 The accountant must determine whether the accountant is independent of the entity. (Ref: par. .A8)

Acceptance and Continuance of Client Relationships and Compilation Engagements

.08 As a condition for accepting an engagement to perform a compilation with respect to an entity's financial statements, in addition to the requirements in paragraph .26 of section 60A, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes (Ref: par. .A9)

- i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, (Ref: par. .A28)
 - ii. a description of any significant interpretations of the contract on which the special purpose financial statements are prepared, in the case of financial statements prepared in accordance with a contractual basis of accounting, and
 - iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.
- b. to include the accountant's compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached. (Ref: par. .A10)

.09 If the accountant is not satisfied about any of the matters set out in paragraph .26 of section 60A or paragraph .08 of this section as preconditions for accepting a compilation engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A11–.A16)

- a. The objectives of the engagement
- b. The responsibilities of management set forth in paragraph .26c of section 60A and paragraph .08 of this section
- c. The responsibilities of the accountant
- d. The limitations of the compilation engagement
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. The expected form and content of the accountant's compilation report and a statement that there may be circumstances in which the report may differ from its expected form and content

[As amended, effective October 2016, by SSARS No. 23.]

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A12)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A17)

Compilation Procedures

.13 The accountant should read the financial statements in light of the accountant's understanding of the applicable financial reporting framework and the significant accounting policies adopted by management and consider whether such financial statements appear to be appropriate in form and free from obvious material misstatements.

.14 If, in the course of the engagement, the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, provided by management are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information. (Ref: par. .A18)

.15 If the accountant becomes aware during the course of the engagement that

- a. the financial statements do not adequately refer to or describe the applicable financial reporting framework (Ref: par. .A19);
- b. revisions to the financial statements are required for the financial statements to be in accordance with the applicable financial reporting framework; or
- c. the financial statements are otherwise misleading (Ref: par. .A20–.A21)

the accountant should propose the appropriate revisions to management.

.16 The accountant should withdraw from the engagement and inform management of the reasons for withdrawing if (Ref: par. .A22–.A23)

- a. the accountant is unable to complete the engagement because management has failed to provide records, documents, explanations, or other information, including significant judgments, as requested, or
- b. management does not make appropriate revisions that are proposed by the accountant or does not disclose such departures in the financial statements, and the accountant determines to not disclose such departures in the accountant's compilation report.

The Accountant's Compilation Report

.17 The accountant's compilation report should be in writing and (Ref: par. .A24 and .A27)

- a. include a statement that management (owners) is (are) responsible for the financial statements.
- b. identify the financial statements that have been subjected to the compilation engagement.
- c. identify the entity whose financial statements have been subjected to the compilation engagement.
- d. specify the date or period covered by the financial statements.

- e. include a statement that the accountant performed the compilation engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA.
- f. include a statement that the accountant did not audit or review the financial statements nor was the accountant required to perform any procedures to verify the accuracy or completeness of the information provided by management and does not express an opinion, a conclusion, nor provide any assurance on the financial statements.
- g. include the signature of the accountant or the accountant's firm.
- h. include the city and state where the accountant practices. (Ref: par. A26)
- i. include the date of the report, which should be the date that the accountant has completed the procedures required by this section.

[Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Special Purpose Framework

.18 Unless the entity elects to omit substantially all disclosures, the accountant should modify the compilation report when that accountant becomes aware that the financial statements do not include

- a. a description of the special purpose framework. (Ref: par. A28)
- b. a summary of significant accounting policies. (Ref: par. A29)
- c. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. (Ref: par. A28)
- d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. (Ref: par. A31)

.19 In the case of financial statements prepared in accordance with a contractual basis of accounting, the accountant should modify the compilation report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based.

.20 The accountant's compilation report on financial statements prepared in accordance with a special purpose framework should

- a. make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of financial reporting frameworks in the preparation of such financial statements.
- b. describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information when the financial statements are prepared in accordance with a regulatory or contractual basis of accounting. (Ref: par. A32)

.21 The accountant's compilation report on financial statements prepared in accordance with a special purpose framework should include a separate paragraph that

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes the framework, if applicable, and
- c. states that the special purpose framework is a basis of accounting other than GAAP.

Reporting When the Accountant Is Not Independent

.22 When the accountant is not independent with respect to the entity, the accountant should indicate the accountant's lack of independence in a final paragraph of the accountant's compilation report. (Ref: par. .A33–.A35)

.23 If the accountant elects to disclose a description about the reasons the accountant's independence is impaired, the accountant should include all such reasons in the description.

Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.24 The summary of significant assumptions is essential to the user's understanding of prospective financial information. Accordingly, the accountant should not issue a compilation report on prospective financial information that excludes disclosure of the summary of significant assumptions. Also, the accountant should not issue a compilation report on a financial projection that excludes either (a) an identification of the hypothetical assumptions or (b) a description of the limitations on the usefulness of the presentation. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.25 In addition to the reporting elements required by paragraph .17, an accountant's compilation report on prospective financial information should include statements that

- a. the forecasted or projected results may not be achieved and
- b. the accountant assumes no responsibility to update the report for events and circumstances occurring after the date of the report.

[Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.26 The accountant should not issue an accountant's compilation report on financial statements that omit substantially all disclosures required by the applicable financial reporting framework unless the omission of substantially all disclosures is not, to the accountant's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. (Ref: par. .A21) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.27 When reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should include a separate paragraph in the accountant's compilation report that includes the following elements: (Ref: par. .A36–.A37)

- a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable)

required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with a special purpose framework)

- b. A statement that if the omitted disclosures (and the statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the entity's financial position, results of operations, and cash flows (or the equivalent for presentations other than GAAP)
- c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.28 The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation report like any other departure from the applicable financial reporting framework, and the nature of the departure and its effects, if known, should be disclosed in accordance with paragraphs .29–.33. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Reporting Known Departures From the Applicable Financial Reporting Framework

.29 When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements and the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure. (Ref: par. .A39) [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.30 If the accountant concludes that modification of the standard report is adequate, the departure should be disclosed in a separate paragraph of the report. The effects of the departure on the financial statements should be disclosed if such effects have been determined by management or are readily known to the accountant as the result of the accountant's procedures. [Paragraph renumbered and amended, by SSARS No. 23, October 2016.]

.31 If the effects of the departure have not been determined by management or are not readily known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.32 If the accountant believes that modification of the compilation report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the engagement and provide no further services with respect to those financial statements. (Ref: par. .A23) [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.33 The accountant should not modify the compilation report to include a statement that the financial statements are not in conformity with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report Thereon

.34 When supplementary information accompanies financial statements and the accountant's compilation report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either

- a. a separate paragraph in the accountant's compilation report on the financial statements or
- b. a separate report on the supplementary information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.35 When the accountant has performed a compilation engagement with respect to both the financial statements and the supplementary information, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements or issue a separate report on the supplementary information that states (Ref: par. .A41 and .A43)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management;
- c. the supplementary information was subject to the compilation engagement; and
- d. the accountant has not audited or reviewed the supplementary information and does not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.36 When the accountant has performed a compilation engagement with respect to the financial statements but the supplementary information was not subject to the compilation engagement, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements or issue a separate report on the supplementary information that states (Ref: par. .A42–.A43)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management; and
- c. the supplementary information was not subject to the compilation engagement and the accountant does not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Required Supplementary Information

.37 With regard to the requirement in paragraph .34, with respect to required supplementary information, the accountant should include a separate paragraph in the accountant's compilation report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable: (Ref: par. .A44)

- a. The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
- b. The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
- c. The required supplementary information is omitted.
- d. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines. (Ref: par. .A45)
- e. The accountant has identified departures from the prescribed guidelines.
- f. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.38 If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation engagement on the required supplementary information, the separate paragraph in the accountant's compilation report referred to in paragraph .34 should include the following elements: (Ref: par. .A46)

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* requires that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and does not express an opinion, a conclusion, nor provide any assurance on the information
- d. If some of the required supplementary information is omitted:
 - i. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements

- ii. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist *[describe the material departures from the applicable financial reporting framework]*
- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standards-setter]*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.39 If all the required supplementary information is omitted, the separate paragraph in the accountant's compilation report should include the following elements:

- a. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Documentation in a Compilation Engagement

.40 The accountant should prepare documentation in connection with each compilation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following:

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11 (Ref: par. .A14 and .A16)
- b. A copy of the financial statements
- c. A copy of the accountant's report

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 If the accountant is engaged to perform a compilation on prospective financial information or pro forma financial information, references in this section to *financial statements* are to be taken as a reference to such other financial information. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A2 AICPA Guide *Prospective Financial Information* (the guide) provides comprehensive guidance regarding prospective financial information. Chapter 6, "Preparation Guidelines;" chapter 7, "Reasonably Objective Basis;" chapter 8, "Presentation Guidelines;" and chapter 9, "Illustrative Prospective Financial Statements," of the guide establish the preparation and presentation guidelines for financial forecasts and financial projections. The guide also includes information about the types and uses of prospective financial information. The guide provides suitable criteria for the preparation and presentation of prospective financial information. The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A3 Other historical financial information to which this section applies includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information

[Paragraph renumbered and amended, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

.A4 In addition to the requirements of this section, in a compilation of pro forma financial information, the accountant is also required to adhere to the requirements of section 120, *Compilation of Pro Forma Financial Information*. [Paragraph added, effective for compilation reports on prospective financial information dated on or after May 1, 2017, by SSARS No. 23.]

Definitions (Ref: par. .05)

.A5 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all the requirements of GAAP. Such frameworks are regulatory bases of accounting, as defined in paragraph .05. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A6 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources

outside the accounting system or outside the entity. [Paragraph added to reflect conforming changes necessary due to the issuance of SSARS No. 23]

.A7 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements. [Paragraph added to reflect conforming changes necessary due to the issuance of SSARS No. 23]

Independence (Ref: par. .07)

.A8 The interpretations of the "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct provide authoritative guidance with respect to independence. It is in the public interest and, therefore, required by this section, that the accountant modify the accountant's compilation report when the accountant is not independent of the entity whose financial statements are the subject of the compilation engagement. The AICPA Code of Professional Conduct also defines *independence* as consisting of two elements, independence of mind and independence in appearance. Independence enhances the accountant's ability to act with integrity and be objective. Independence implies an impartiality that recognizes an obligation to be fair not only to management but also to users of the financial statements, who may rely upon the accountant's compilation report. In the absence of an interpretation of the "Independence Rule" that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Acceptance and Continuance of Client Relationships and Compilation Engagements (Ref: par. .08)

.A9 A compilation in accordance with SSARSs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .26c of section 60. The preparation of financial statements, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295). To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the compilation engagement as required by paragraphs .10–.11. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A10 Documents containing financial statements that may include an indication that such financial statements have been subjected to a compilation engagement by the entity's accountant includes documents submitted to bonding companies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Agreement on Engagement Terms (Ref: par. .10–.11 and .40)

.A11 Both management and the accountant have an interest in documenting the terms of the compilation engagement before the commencement of the engagement to help avoid misunderstandings with respect to the engagement.

For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A12 The roles of management and those charged with governance in agreeing upon the terms of the compilation engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance, in accordance with paragraph .26c of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A13 When a third party has contracted for a compilation of the entity's financial statements, agreeing the terms of the compilation with management of the entity is necessary in order to establish that the preconditions for a compilation are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A14 The understanding with management regarding the services to be performed for compilation engagements is required by paragraph .10 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for compilation engagements. [Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph renumbered and amended, effective October 2016, by SSARS No. 23.]

.A15 Although the accountant may prepare the financial statements, in whole or in part, the financial statements are representations of management, and the fairness of their presentation in accordance with the applicable financial reporting framework is management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A16 Illustrative examples of engagement letters for a compilation engagement are presented in exhibit A, "Illustrative Engagement Letters." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A17 The requirement that the accountant obtain an understanding of the applicable financial reporting framework intended to be used in the preparation of the financial statements, and the significant accounting policies adopted by management, does not prevent the accountant from accepting a compilation engagement for an entity in an industry in which the accountant has no

previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the framework or the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Compilation Procedures (Ref: par. .14–.16, .26, and .32)

.A18 The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have performed such inquiries or procedures and the results of those inquiries or procedures, knowledge gained from prior engagements, or the financial statements themselves may cause the accountant to become aware that information provided by management is incorrect, incomplete, or otherwise unsatisfactory. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A19 The financial statements may adequately refer to or describe the applicable financial reporting framework via

- the financial statement titles or
- the notes to the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A20 Financial statements may be misleading, for example, if the applicable financial reporting framework includes the premise that the financial statements are prepared on the going concern basis, and undisclosed uncertainties exist regarding the entity's ability to continue as a going concern. If the accountant becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity's ability to continue as a going concern in order to avoid the financial statements being misleading. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A21 Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A22 In circumstances addressed by the requirements of this section in which withdrawal from the engagement is necessary, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant's ethical obligations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A23 When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

The Accountant's Compilation Report (Ref: par. .17)

.A24 The accountant's written report may become unattached from the financial statements. To minimize the possibility that a user of the financial statements may infer an unintended level of reliance on the financial statements, the accountant may request that management include a reference on each page of the financial statements to the accountant's written report. An example of a reference to the accountant's written report included on each page of the financial statements is "See Accountant's Report" or "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

[**.A25**] [Paragraph deleted by the issuance of SSARS No. 23, October 2016.]

.A26 The city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A27 Illustrative examples of accountant's compilation reports are presented in exhibit B, "Illustrative Examples of the Accountant's Compilation Reports on Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

The Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Special Purpose Framework (Ref: par. .08, .18, and .20)

.A28 The description of the special purpose framework may be included in the financial statement titles, in the notes to the financial statements, or otherwise on the face of the financial statements. Although terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows*, or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP, such titles, with appropriate modification, may be used in connection with financial statements prepared in accordance with a special purpose framework. Suitable financial statement titles for financial statements prepared in accordance with a special purpose framework include, but are not limited to

- a modified cash basis financial statement that might be titled
 - "Income Statement—Modified Cash Basis," or
 - "Statement of Cash Receipts and Disbursements."
- financial statements prepared in accordance with the tax basis of accounting that might be titled
 - "Balance Sheet—Tax Basis,"
 - "Statement of Assets, Liabilities, and Equity—Tax Basis,"

- "Statement of Operations—Tax Basis," or
- "Statement of Revenue and Expenses—Tax Basis."
- a financial statement prepared in accordance with a regulatory basis of accounting that might be titled "Statement of Income—Regulatory Basis."

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A29 Financial statements prepared in accordance with a special purpose framework need not include a summary of significant accounting policies or a description about how the special purpose framework differs from GAAP if such financial statements omit substantially all disclosures, and the omission of substantially all disclosures is not, to the accountant's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A30 The description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described or quantified. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A31 Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A32 When the financial statements are prepared in accordance with a regulatory or contractual basis of accounting, the accountant is required by paragraph .20*b* to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the financial statements are used for purposes other than those for which they were intended. The note to the financial statements may also describe any significant interpretations of the contract on which the financial statements are based. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Reporting When the Accountant Is Not Independent (Ref: par. .22)

.A33 An example of a disclosure that an accountant may make to indicate the accountant's lack of independence would be

I am (We are) not independent with respect to XYZ Company.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A34 The accountant is not precluded from disclosing a description about the reason(s) that the accountant's independence is impaired. The following are examples of descriptions the accountant may use:

- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.
- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.
- I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A35 Illustrative examples of accountant's compilation reports when the accountant's independence has been impaired are presented in exhibit B.² [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .27)

.A36 When management elects to include disclosures about only a few matters in the notes to the financial statements, such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by *[the applicable financial reporting framework]* Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A37 An illustrative example of an accountant's compilation report on financial statements that omit substantially all disclosures required by the

² Illustration 4, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment" and illustration 5, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reasons for the Independence Impairment," of exhibit B, "Illustrative Examples of the Accountant's Compilation Report on Financial Statements."

applicable financial reporting framework is presented in exhibit B.³ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Reporting Known Departures From the Applicable Financial Reporting Framework (Ref: par. .30 and .33)

.A38 The accountant is precluded from including a statement that the financial statements are not in conformity with the applicable financial reporting framework because such a statement would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A39 An illustrative example of an accountant's compilation report on financial statements that contain known departures from the applicable financial reporting framework that are not disclosed in the notes to the financial statements is presented in exhibit B.⁴ [Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report Thereon (Ref: par. .34–.36)

[.A40] [Paragraph deleted to reflect conforming changes necessary due to the issuance of SSARS No. 23, October 2016.]

.A41 The following is an example of how an accountant may word a separate paragraph in the accountant's compilation report addressing supplementary information when the accountant has performed a compilation engagement on both the financial statements and the supplementary information:

The accompanying [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was subject to our compilation engagement. I (We) have not audited or reviewed the supplementary information and do not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

³ Illustration 3, "An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting," of exhibit B.

⁴ Illustration 6, "An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant is Aware of Departures From Accounting Principles Generally Accepted in the United States of America," of exhibit B.

.A42 The following is an example of how an accountant may word a separate paragraph in the accountant's compilation report addressing supplementary information when the accountant has performed a compilation engagement on the financial statements but has not performed a compilation on the supplementary information:

The accompanying [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was not subject to our compilation engagement. I (We) do not express an opinion, a conclusion, nor provide any assurance on such information.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A43 Supplementary information may become unattached from the accountant's compilation report. To minimize the possibility that a user of the supplementary information may infer, through the accountant's association with such information, an unintended level of reliance on it, the accountant may request that management include a reference to the accountant's compilation report on each page of the supplementary information. An example of a reference to the accountant's compilation report included on each page of the supplementary information is "See Accountant's Report" or "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

Required Supplementary Information (Ref: par. .37–.38)

.A44 Examples of required supplementary information that may accompany financial statements and the accountant's compilation report thereon include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by *FASB Accounting Standards Codification* 972-235-50-3
- Management's discussion and analysis and budgetary comparison statements as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A45 *Prescribed guidelines* are the authoritative guidelines established by the designated accounting standards-setter for the methods of measurement and presentation of the required supplementary information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A46 Because the required supplementary information accompanies the basic financial statements, the accountant's compilation report on the financial statements includes a discussion of the responsibility taken by the accountant

on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered and revised, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

.A47

Exhibit A — Illustrative Engagement Letters (Ref: par. .A16)

Illustration 1 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Except the Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP and in Which the Accountant's Independence Is Impaired

Illustration 3 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

The illustrative engagement letters in this exhibit are intended as illustrations that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances, and the illustrations are drafted to refer to a compilation engagement for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

Illustration 1 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the compilation engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America and will include all related notes required by accounting principles generally accepted in the United States of America
- The accountant expects that his or her independence will not be impaired

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you*, *we*, *us*, *management*, and *accountant* would be used or amended as appropriate in the circumstances.

statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and perform a compilation engagement with respect to those financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes and perform a compilation engagement with respect to those financial statements, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity, and perform a compilation engagement with respect to those financial statements." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- b. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by

third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements.]

Illustration 2 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Except the Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP and in Which the Accountant's Independence Is Impaired

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements subject to the compilation engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America, except the statement of cash flows and substantially all disclosures required by accounting principles generally accepted in the United States of America will be omitted.
- The accountant's independence will be impaired as a result of the performance of the nonattest preparation service.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity for the year then ended, and perform a compilation engagement with respect to those financial statements.³ These financial statements will not include a statement of cash

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping service.

flows and related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion, a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The compilation engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSS:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities

- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. We will disclose that we are not independent in our report. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our report will disclose that the Company's management has elected to omit the statement of cash flows and substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the statement of cash flows and omitted disclosures were to be included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, the financial statements will not be designed for those who are not informed about such matters.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation

engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements.]

Illustration 3 — An Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements subject to the compilation engagement.
- The financial statements will be prepared in accordance with the tax basis of accounting.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity—tax basis as of December 31, 20XX, and the related statements of operations and related earnings—tax basis, and cash flows—tax basis for the year then ended, and the related notes to the financial statements and perform a compilation engagement with respect to those financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A12.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows—tax basis and the related notes and perform a compilation engagement with respect to those financial statements, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity—tax basis as of December 31, 20XX, and the related statement of operations and retained earnings—tax basis, and perform a compilation engagement with respect to those financial statements." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows—tax basis and related notes to the financial statements."

⁴ The accountant may include nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Our Responsibilities

The objective of our engagement is to

- a.* prepare financial statements in accordance with the tax basis of accounting based on information provided by you and
- b.* apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the tax basis of accounting.

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion, a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with the tax basis of accounting and assist you in the presentation of the financial statements in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSs:

- a.* The selection of the tax basis of accounting as the financial reporting framework to be applied in the preparation of the financial statements
- b.* The preparation and fair presentation of financial statements in accordance with the tax basis of accounting
- c.* The inclusion of all informative disclosures that is appropriate for the tax basis of accounting. This includes
 - i.* a description of the tax basis of accounting, including a summary of significant accounting policies, and how the tax basis of accounting differs from accounting principles generally accepted in the United States of America, the effects of which need not be quantified and
 - ii.* informative disclosures similar to those required by accounting principles generally accepted in the United States of America.⁵

⁵ The responsibility described in *c* need not be included if the financial statements omit substantially all disclosures required by the financial reporting framework.

- d. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- e. The prevention and detection of fraud
- f. To ensure that the entity complies with the laws and regulations applicable to its activities
- g. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the compilation engagement
- h. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the compilation engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. Circumstances may arise in which it is necessary for us to modify our report or withdraw from the engagement.

Our report will disclose that the financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

You agree to include our accountant's compilation report in any document containing financial statements that indicates that we have performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and perform a compilation engagement with respect to those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23. Revised, February 2015, to include additional required engagement letter elements.]

Exhibit B — Illustrative Examples of the Accountant's Compilation Report on Financial Statements (Ref: par. .A27, .A35, .A37, and .A39)

Illustration 1 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities

Illustration 3 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 4 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment

Illustration 5 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reason for the Independence Impairment

Illustration 6 — An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of Departures From Accounting Principles Generally Accepted in the United States of America

Illustration 1 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of

the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 2 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1 and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 3 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting, and Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Management is responsible for the accompanying financial statements of XYZ Partnership, which comprise the statements of assets, liabilities, and partners' capital—tax basis as of December 31, 20X2 and 20X1 and the related statements of revenue and expenses—tax basis, and changes in partners' capital—tax basis for the years then ended in accordance with the tax basis of accounting, and for determining that the tax basis of accounting is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

The financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

Management has elected to omit substantially all the disclosures ordinarily included in financial statements prepared in accordance with the tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, equity, revenue, and expenses. Accordingly, the financial statements are not designed for those who are not informed about such matters.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 4 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Accountant's Independence Is Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I am (we are) not independent with respect to XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 5 — An Accountant's Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities When the Accountant's Independence Has Been Impaired Due to the Accountant Having a Financial Interest in the Entity, and the Accountant Decides to Disclose the Reason for the Independence Impairment

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1, and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the

AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

I am (we are) not independent with respect to XYZ Company as during the year ended December 31, 20X2, I (a member of the engagement team) had a direct financial interest in XYZ Company.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

Illustration 6 — An Accountant's Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of Departures From Accounting Principles Generally Accepted in the United States of America

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

Accounting principles generally accepted in the United States of America require that land be stated at cost. Management has informed me (us) that XYZ Company has stated its land at appraised value and that if accounting principles generally accepted in the United States of America had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered, October 2016, to reflect conforming changes necessary due to the issuance of SSARS No. 23.]

AR-C Section 90

Review of Financial Statements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 24; SSARS No. 25; SSARS No. 26.

Effective for reviews of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope and Applicability of This Section

.01 This section applies when the accountant is engaged to perform a review of financial statements. This section also applies when the accountant is engaged to review other historical financial information, excluding pro forma financial information. Reviews of pro forma financial information are to be performed in accordance with Statements on Standards for Attestation Engagements. (Ref: par. .A1–.A3) [As amended, effective October 2016, by SSARS No. 23.]

.02 This section does not apply when the accountant is engaged to review interim financial information when

- a. the entity's latest annual financial statements have been audited by the accountant or a predecessor;
- b. the accountant either
 - i. has been engaged to audit the entity's current year financial statements or
 - ii. audited the entity's latest annual financial statements and, in situations in which it is expected that the current year financial statements will be audited, the engagement of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review; and
- c. the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

AU-C section 930, *Interim Financial Information*, provides guidance for review engagements when the conditions in a–c are met.

The Engagement to Review Financial Statements

.03 In a review of financial statements, the accountant expresses a conclusion regarding the entity's financial statements in accordance with an applicable financial reporting framework. The accountant's conclusion is based on the accountant obtaining limited assurance. The accountant's report includes a description of the nature of a review engagement as context for the readers of the report to be able to understand the conclusion. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.04 The accountant performs primarily analytical procedures and inquiries to obtain sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, expressed in accordance with the requirements of this section. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.05 If the accountant becomes aware of a matter that causes the accountant to believe the financial statements may be materially misstated, the accountant designs and performs additional procedures, as the accountant considers necessary in the circumstances, to be able to conclude on the financial statements in accordance with this section. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Effective Date

.06 This section is effective for reviews of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Objectives

.07 In conducting a review of financial statements, the objectives of the accountant are to

- a. obtain limited assurance, primarily by performing analytical procedures and inquiries, as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework and (Ref: par. .A4)
- b. report on the financial statements as a whole and communicate, as required by this section.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Definitions

.08 For purposes of Statements on Standards for Accounting and Review Services (SSARSs), the following terms have the meanings attributed as follows:

Analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Comparative financial statements. A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period.

Emphasis-of-matter paragraph. A paragraph included in the accountant's review report that is required by SSARSs, or is included at the accountant's discretion, and that refers to a matter appropriately

presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.

Error. Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

Experienced accountant. An individual (whether internal or external to the firm) who has practical review experience and a reasonable understanding of

- a. review processes;
- b. SSARs and applicable legal and regulatory requirements;
- c. the business environment in which the entity operates; and
- d. review and financial reporting issues relevant to the entity's industry.

Fraud. An intentional act that results in a misstatement in financial statements.

Generally accepted accounting principles (GAAP). References to GAAP in SSARs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Inquiry. Inquiry consists of seeking information of knowledgeable persons within or outside the entity.

Limited assurance. A level of assurance that is less than the reasonable assurance obtained in an audit engagement but is at an acceptable level as the basis for the conclusion expressed in the accountant's review report. (Ref: par. .A10)

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board or an owner-manager.

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Modified conclusion. A qualified conclusion or an adverse conclusion.

Noncompliance. Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Other-matter paragraph. A paragraph included in the accountant's review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report.

Pervasive. A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements. Pervasive effects on the financial statements are those that, in the accountant's judgment

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent or could represent a substantial portion of the financial statements; or
- with regard to disclosures, are fundamental to users' understanding of the financial statements.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of review evidence.

Reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). (Ref: par. .A11)

Report release date. The date the accountant grants the entity permission to use the accountant's review report in connection with the financial statements.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Review documentation. The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant reached (terms such as *working papers* or *workpapers* are also sometimes used).

Review evidence. Information used by the accountant to provide a reasonable basis for obtaining limited assurance. Review evidence includes both information contained in the accounting records underlying the financial statements and other information, which primarily consists of the results of analytical procedures and inquiries. Sufficiency of review evidence is the measure of the quantity of review evidence. Appropriateness of review evidence is the measure of the quality of review evidence, that is, its relevance and reliability in providing support for the conclusions on which the accountant's review report is based.

Specified parties. The intended users of the accountant's review report.

Subsequent events. Events occurring between the date of the financial statements and the date of the accountant's review report.

Subsequently discovered facts. Facts that become known to the accountant after the date of the accountant's review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant's review report.

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the reviewed financial statements or separate from the reviewed financial statements. (Ref: par. .A13–.A14)

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Updated report. A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant's current engagement and that re-expresses the accountant's previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant's current report.

Written representation. A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

[As amended, effective October 2016, by SSARS No. 23. As amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

General Principles for Performing and Reporting on Review Engagements

.09 In addition to complying with this section, an accountant is required to comply with section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Independence

.10 The accountant must be independent of the entity when performing a review of financial statements in accordance with SSARSs. If, during the performance of the review engagement, the accountant determines that the accountant's independence is impaired, the accountant should withdraw from the review engagement. (Ref: par. .A15–.A16) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Professional Skepticism

.11 The accountant should plan and perform the review with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: par. .A17–.A21) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Acceptance and Continuance of Client Relationships and Review Engagements

.12 The accountant should not accept a review engagement if, in addition to the requirements in paragraph .31 of section 60, management or those charged with governance impose a limitation on the scope of the accountant's work in terms of a proposed review engagement such that the accountant believes the limitation will result in the accountant being unable to perform review procedures to provide an adequate basis for issuing a review report. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.13 As a condition for accepting an engagement to review an entity's financial statements, in addition to the requirements in paragraph .31 of section 60, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes (Ref: par. .A22)
 - i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP in the case of special purpose

financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP; (Ref: par. .A128)

- ii. a description of any significant interpretations of the contract on which the special purpose financial statements are based in the case of financial statements prepared in accordance with a contractual basis of accounting; and
 - iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.
- b. to provide the accountant, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
 - c. to include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by the entity's accountant unless a different understanding is reached. (Ref: par. .A23)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.14 If the accountant is not satisfied about any of the matters set out in paragraph .31 of section 60 or paragraph .13 of this section as preconditions for accepting a review engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.15 If it is discovered after the engagement has been accepted that the accountant is not satisfied regarding any of the preconditions in paragraph .31 of section 60 or paragraph .13 of this section, the accountant should discuss the matter with management or those charged with governance and should determine the following:

- a. Whether the matter can be resolved
- b. Whether it is appropriate to continue with the engagement
- c. Whether and how to communicate the matter in the accountant's report

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Agreement on Engagement Terms

.16 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A24–.A29)

- a. The objectives of the engagement
- b. The responsibilities of management set forth in paragraph .31b of section 60 and paragraph .13 of this section
- c. The responsibilities of the accountant
- d. The limitations of a review engagement, including a statement that a review is substantially less in scope than an audit and that

the accountant will not express an opinion on the financial statements

- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. The expected form and content of the accountant's review report and a statement that there may be circumstances in which the report may differ from its expected form and content

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. As amended, effective upon issuance for reviews of financial statements, by SSARS No. 26, June 2022.]

.17 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A25)

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Communication With Management and Those Charged With Governance

.18 The accountant should communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review engagement that, in the accountant's professional judgment, are of significant importance to merit the attention of management or those charged with governance, as appropriate. (Ref: par. .A30–.A36) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Performing the Engagement

Materiality in a Review of Financial Statements

.19 The accountant should determine materiality for the financial statements as a whole and apply this materiality in designing the procedures and evaluating the results obtained from those procedures. (Ref: par. .A37–.A40) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.20 The accountant should revise materiality for the financial statements as a whole if the accountant becomes aware of information during the review that would have caused the accountant to have determined a different amount initially. (Ref: par. .A41) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Understanding of the Industry

.21 To perform the review engagement, the accountant should possess or obtain an understanding of the industry in which the entity operates, including the accounting principles and practices generally used in the industry, sufficient to enable the accountant to review financial statements that are

appropriate for an entity operating in that industry. (Ref: par. .A42) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Knowledge of the Entity

.22 The accountant should obtain knowledge about the entity, including an understanding of

- a.* the entity's business and
- b.* the accounting principles and practices used by the entity

sufficient to identify areas in the financial statements in which there is a greater likelihood that material misstatements may arise and to be able to design procedures to address those areas. (Ref: par. .A43–.A44) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.23 In obtaining the understanding of the entity's accounting policies and practices, the accountant should be alert to accounting policies and procedures that, based on the accountant's knowledge of the industry, are unusual. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Designing and Performing Review Procedures

.24 The accountant should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to obtain sufficient appropriate review evidence as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework based on the accountant's (Ref: par. .A45)

- a.* understanding of the industry,
- b.* knowledge of the entity, and
- c.* awareness of the risk that the accountant may unknowingly issue an inappropriate accountant's review report. (Ref: par. .A46)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.25 In obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, the accountant should design and perform the analytical procedures and inquiries to address the following: (Ref: par. .A47)

- a.* All material items in the financial statements, including disclosures
- b.* Areas in the financial statements where the accountant believes there are increased risks of material misstatements

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Analytical Procedures

.26 The accountant should apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Such analytical procedures should include the following: (Ref: par. .A48–.A50)

- a. Comparing the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions
- b. Considering plausible relationships among both financial and, when relevant, nonfinancial information (Ref: par. .A51)
- c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist, based on the accountant's understanding of the entity and the industry in which the entity operates (Ref: par. .A52)
- d. Comparing disaggregated revenue data, as applicable (Ref: par. .A53)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.27 When designing and performing analytical procedures, the accountant should (Ref: par. .A54)

- a. determine the suitability of particular analytical procedures;
- b. consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available;
- c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph .28 and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Investigating Results of Analytical Procedures

.28 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the accountant should investigate such differences by

- a. inquiring of management and
- b. performing other review procedures if considered necessary in the circumstances. (Ref: par. .A55)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters

.29 The accountant should inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements, and others within the entity, as appropriate, about (Ref: par. .A56)

- a. whether the financial statements have been prepared and fairly presented in accordance with the applicable financial reporting

framework consistently applied, including how management determined that significant accounting estimates are reasonable in the circumstances.

- b.* the identification of related parties and related party transactions, including the purpose of those transactions
- c.* whether there are significant, unusual, or complex transactions, events, or matters that have affected or may affect the entity's financial statements, including the following: (Ref: par. .A57)
 - i.* Significant changes in the entity's business activities or operations
 - ii.* Significant changes to the terms of contracts that materially affect the entity's financial statements, including terms of finance and debt contracts or covenants
 - iii.* Significant journal entries or other adjustments to the financial statements
 - iv.* Significant transactions occurring or recognized during the period, particularly those in the last several days of the reporting period
 - v.* The status of any uncorrected misstatements identified during the previous review (that is, whether adjustments were recorded subsequent to the periods covered by the prior review and, if adjustments were recorded, the amounts recorded and period in which such adjustments were recorded)
 - vi.* Effects or possible implications for the entity of transactions or relationships with related parties
- d.* matters about which questions have arisen in the course of applying the review procedures.
- e.* the existence of any actual, suspected, or alleged
 - i.* fraud or noncompliance with laws and regulations affecting the entity and (Ref: par. .A58)
 - ii.* noncompliance with provisions of laws and regulations that are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations.
- f.* whether management has identified and addressed events subsequent to the date of the financial statements that require adjustment of, or disclosure in, the financial statements.
- g.* the basis for management's assessment of the entity's ability to continue as a going concern.
- h.* whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern.
- i.* material commitments, contractual obligations, or contingencies that have affected or may affect the entity's financial statements, including disclosures.
- j.* material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration.
- k.* communications from regulatory agencies, if applicable.

- l.* any litigation, claims, and assessments that existed at the date of the balance sheet being reported on and during the period from the balance sheet date to the date of management's response to the accountant's inquiry.
- m.* actions taken at meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements. (Ref: par. .A59)
- n.* any other matters that the accountant may consider necessary.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.30 The accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business. However, the accountant is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Reading the Financial Statements

.31 The accountant should read the financial statements and consider whether any information has come to the accountant's attention to indicate that such financial statements do not conform to the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Procedures to Address Specific Circumstances

Related Parties

.32 During the review, the accountant should remain alert for arrangements or information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the accountant. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.33 If the accountant identifies significant transactions outside the entity's normal course of business when performing the review procedure required by paragraph .32 or through other review procedures, the accountant should inquire of management about the following:

- a.* The nature of these transactions (Ref: par. .A60)
- b.* Whether related parties could be involved

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Fraud and Noncompliance With Laws or Regulations

.34 When there is an indication that fraud or noncompliance with laws or regulations has occurred, or is suspected to have occurred, the effects of which should be considered when preparing financial statements, the accountant should do the following:

- a.* Communicate identified or suspected fraud as soon as practical to the appropriate level of senior management (at a level above those involved with the suspected fraud, if possible) or those charged with governance, as appropriate.

- b. Communicate to management identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements, other than matters that are clearly inconsequential. (Ref: par. .A61)
- c. Request management's assessment of the effects, if any, on the financial statements.
- d. Consider the effect, if any, of management's assessment of the effects of fraud or noncompliance with laws or regulations communicated to the accountant on the accountant's conclusion on the financial statements and on the accountant's report.
- e. Determine whether there is a responsibility to report the occurrence or suspicion of fraud or noncompliance with laws and regulations to a party outside the entity. (Ref: par. .A62)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.35 If the fraud or noncompliance with laws or regulations involves senior management or results in a material misstatement of the financial statements, the accountant should communicate the matter directly to those charged with governance. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.36 The accountant should consider the need to obtain legal advice and take appropriate action, including potential withdrawal, if management or, as appropriate, those charged with governance do not provide sufficient information that supports either of the following: (Ref: par. .A63)

- a. The financial statements are not materially misstated due to fraud.
- b. The entity is in compliance with laws and regulations, and in the accountant's professional judgment, the effect of the suspected noncompliance may be material to the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Going Concern

.37 If the applicable financial reporting framework includes requirements for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements, the accountant should perform review procedures related to the following: (Ref: par. .A64–.A65)

- a. Whether the going concern basis of accounting is appropriate
- b. Management's evaluation of whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
- c. If there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, management's plans to mitigate those matters
- d. The adequacy of the related disclosures in the financial statements

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.38 If the applicable financial reporting framework does not include a requirement for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements, and conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time existed at the date of the prior period financial statements (regardless of whether the substantial doubt was alleviated by the accountant's consideration of management's plans) or, in the course of performing review procedures on the current period financial statements, the accountant becomes aware of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, the accountant should do the following: (Ref: par. .A66–.A67)

- a. Inquire of management whether the going concern basis of accounting is appropriate.
- b. Inquire of management about its plans for addressing the adverse effects of the conditions and events. (Ref: par. .A68)
- c. Consider the adequacy of the disclosure about such matters in the financial statements. (Ref: par. .A69)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Using the Work of Others

.39 In performing the review, it may be necessary for the accountant to use work performed by other accountants, or the work of an individual or organization possessing expertise in a field other than financial reporting. If the accountant uses work performed by another accountant or an expert in the course of performing the review, the accountant should take appropriate steps to be satisfied that the work performed is adequate for the accountant's purposes. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.40 If other accountants have issued a report on the financial statements of significant components, such as subsidiaries and investees, the accountant should obtain and read reports from such other accountants. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Reconciling the Financial Statements to the Underlying Accounting Records

.41 The accountant should obtain evidence that the financial statements agree or reconcile with the accounting records. (Ref: par. .A70) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Additional Procedures When the Accountant Becomes Aware That the Financial Statements May Be Materially Misstated

.42 If the accountant becomes aware of a matter or matters that cause the accountant to believe the financial statements may be materially misstated, the accountant should design and perform additional procedures sufficient to enable the accountant to (Ref: par. .A71–.A75)

- a. conclude that the matter or matters are not likely to cause the financial statements as a whole to be materially misstated or
- b. determine that the matter or matters cause the financial statements as a whole to be materially misstated.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Evaluating Review Evidence Obtained From the Procedures Performed

[.43–.44] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.45 If, during the performance of review procedures, the accountant becomes aware that information coming to the accountant's attention is incorrect, incomplete, or otherwise unsatisfactory, the accountant should

- a. request that management consider the effect of those matters on the financial statements and communicate the results of its consideration to the accountant and
- b. consider the results communicated to the accountant by management and whether such results indicate that the financial statements may be materially misstated.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

[.46] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.47 The accountant should evaluate whether sufficient appropriate review evidence has been obtained from the procedures performed and, if sufficient appropriate review evidence has not been obtained from the procedures performed, the accountant should perform other procedures that, in the accountant's professional judgment, are necessary in the circumstances to be able to form a conclusion on the financial statements. (Ref: par. .A78) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.48 If the accountant is not able to obtain sufficient appropriate review evidence to form a conclusion, the accountant should withdraw from the engagement. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequent Events and Subsequently Discovered Facts

Subsequent Events

.49 When evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements comes to the accountant's attention, the accountant should request that management consider whether each such event is appropriately reflected in the financial statements in accordance with the applicable financial reporting framework. (Ref: par. .A79) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.50 If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, the accountant should follow the guidance in paragraphs .69–.72. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequently Discovered Facts That Become Known to the Accountant Before the Report Release Date

.51 The accountant is not required to perform any review procedures regarding the financial statements after the date of the accountant's review report. However, if a subsequently discovered fact becomes known to the accountant before the report release date, the accountant should

- a. discuss the matter with management and, when appropriate, those charged with governance and
- b. determine whether the financial statements need revision and, if revision is needed, inquire how management intends to address the matter in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.52 If management revises the financial statements, the accountant should perform the review procedures necessary in the circumstances on the revision. The accountant should also do either of the following:

- a. Date the accountant's review report as of a later date.
- b. Include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, dual-date the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report are limited solely to the revision described in the relevant note to the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.53 If management does not revise the financial statements in circumstances in which the accountant believes they need to be revised, the accountant should modify the accountant's review report or withdraw, as appropriate. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequently Discovered Facts That Become Known to the Accountant After the Report Release Date

.54 If a subsequently discovered fact becomes known to the accountant after the report release date, the accountant should (Ref: par. .A80–.A81)

- a. discuss the matter with management and, when appropriate, those charged with governance and
- b. determine whether the financial statements need revision and, if revision is needed, inquire how management intends to address the matter in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.55 If management revises the financial statements, the accountant should do the following:

- a. Apply the requirements of paragraph .52.
- b. If the reviewed financial statements (before revision) have been made available to third parties, assess whether the steps taken

by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph .56. (Ref: par. .A82)

- c. If the accountant's conclusion on the revised financial statements differs from the accountant's conclusion on the original financial statements, disclose in an emphasis-of-matter paragraph, in accordance with paragraphs .89–.90,
 - i. the date of the accountant's previous report,
 - ii. a description of the revisions, and
 - iii. the substantive reasons for the revisions.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.56 If management does not revise the financial statements in circumstances in which the accountant believes they need to be revised, then the accountant should do the following:

- a. If the reviewed financial statements have not been made available to third parties, notify management and those charged with governance (unless all of those charged with governance are involved in managing the entity) not to make the reviewed financial statements available to third parties before the necessary revisions have been made and a new accountant's review report on the revised financial statements has been provided. If the reviewed financial statements are, nevertheless, subsequently made available to third parties without the necessary revisions, the accountant should apply the requirements of paragraph .56b.
- b. If the reviewed financial statements have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph .57. (Ref: par. .A81)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.57 If management does not take the necessary steps to ensure that anyone in receipt of the financial statements is informed of the situation, as provided by paragraph .55b or paragraph .56b, the accountant should notify management and those charged with governance (unless all of those charged with governance are involved in managing the entity) that the accountant will seek to prevent future use of the accountant's review report. If, despite such notification, management or those charged with governance do not take the necessary steps, the accountant should take appropriate action to seek to prevent use of the accountant's review report. (Ref: par. .A83–.A86) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Written Representations

Written Representations as Review Evidence

.58 *Written representations* are necessary information that the accountant requires in connection with a review of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are review evidence. (Ref: par. .A87) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Management From Whom Written Representations Are Requested

.59 The accountant should request written representations from members of management who have appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: par. .A88–.A90) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Specific Written Representations

.60 For all financial statements presented and all periods covered by the review, the accountant should request management to provide written representations that are dated as of the date of the accountant's review report and that indicate that it has fulfilled its responsibilities, as set out in the terms of the engagement, including the following: (Ref: par. .A91–.A97)

- a. Management has fulfilled its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
- b. Management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements, including its responsibility to prevent and detect fraud.
- c. All transactions have been recorded and are reflected in the financial statements.
- d. Management has provided the accountant with all relevant information and access to information, as agreed upon in the terms of the engagement.
- e. Management has responded fully and truthfully to all of the accountant's inquiries
- f. Management has disclosed to the accountant the identity of the entity's related parties and all the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.
- g. Management has disclosed to the accountant significant facts relating to any fraud or suspected fraud known to management that may have affected the entity involving
 - i. management,
 - ii. employees who have significant roles in internal control, or
 - iii. others, when the fraud could have a material effect on the financial statements.
- h. Management has disclosed to the accountant significant facts relating to any allegations of fraud or suspected fraud known to

management that may have affected the entity's financial statements communicated by employees, former employees, regulators, or others.

- i.* Management has disclosed to the accountant all known actual or possible instances of noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
- j.* Management has disclosed to the accountant all information relevant to the use of the going concern assumption in the financial statements.
- k.* Management has properly accounted for all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure, and it has made the necessary adjustments or disclosures.
- l.* Management has disclosed to the accountant whether it believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation.
- m.* Management has disclosed to the accountant all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.
- n.* Management has disclosed to the accountant whether it believes that significant assumptions it used in making accounting estimates are reasonable.

[As amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.61 If, in addition to the representations required by paragraph .60, the accountant determines that it is necessary to obtain one or more written representations to support other review evidence relevant to the financial statements, the accountant should request such other written representations. (Ref: par. .A98) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Form of Written Representations

.62 The written representations should be in the form of a representation letter addressed to the accountant. (Ref: par. .A99–.A100) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Concerns About the Reliability of Written Representations and Requested Written Representations Not Provided

.63 If, in relation to the written representations required by paragraphs .60–.61

- a.* management does not provide the written representations, or
- b.* the accountant concludes that there is cause to doubt management's integrity such that the written representations provided are not reliable

the accountant should discuss the matter with management and those charged with governance, as appropriate. If management does not provide the required representations or the accountant continues to doubt management's integrity such that the written representations provided may not be reliable, the accountant should withdraw from the engagement. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Forming the Accountant's Conclusion on the Financial Statements

Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements

.64 In forming the conclusion on the financial statements, the accountant should do the following:

- a. Evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A101–.A102)
- b. Consider whether, in the context of the requirements of the applicable financial reporting framework and the results of procedures performed,
 - i. the terminology used in the financial statements, including the title of each financial statement, is appropriate;
 - ii. the financial statements adequately disclose the significant accounting policies selected and applied;
 - iii. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
 - iv. accounting estimates made by management appear reasonable;
 - v. the information presented in the financial statements appears relevant, reliable, comparable, and understandable; and
 - vi. the financial statements provide adequate disclosures to enable the intended users to understand the effects of material transactions and events on the information conveyed in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.65 The accountant should consider the impact of the following:

- a. Uncorrected misstatements identified during the review, and in the previous year's review of the entity's financial statements, on the financial statements as a whole
- b. Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments (Ref: par. .A103–.A104)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.66 The accountant's consideration should also include the following:

- a. The overall presentation, structure, and content of the financial statements
- b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A105)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Form of the Conclusion

Unmodified Conclusion

.67 The accountant should express an unmodified conclusion in the accountant's review report on the financial statements as a whole when the accountant has obtained limited assurance to be able to conclude that nothing has come to the accountant's attention that causes the accountant to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.68 When the accountant expresses an unmodified conclusion, the accountant should, unless required by law or regulation, use the following language:

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements for them to be in accordance with *[the applicable financial reporting framework]*.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Modified Conclusion

.69 The accountant should express a modified conclusion in the accountant's review report on the financial statements as a whole when the accountant determines, based on the procedures performed and the review evidence obtained, that the financial statements are materially misstated. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.70 When the accountant modifies the conclusion expressed on the financial statements, the accountant should do the following:

- a. Use the heading "Qualified Conclusion" or "Adverse Conclusion," as appropriate, for the conclusion paragraph in the accountant's review report.
- b. Provide a description of the matter giving rise to the modification, under an appropriate heading (for example, "Basis for Qualified Conclusion," or "Basis for Adverse Conclusion," as appropriate), in a separate paragraph in the accountant's review report immediately before the conclusion paragraph (referred to as the *basis for conclusion paragraph*).

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Financial Statements Are Materially Misstated

.71 If the accountant, having obtained sufficient appropriate review evidence, determines, or is otherwise aware, that the financial statements are materially misstated, the accountant should express one of the following: (Ref: par. A106)

- a. A qualified conclusion, when the accountant concludes that the effects of the matter or matters giving rise to the modification are material but not pervasive to the financial statements
- b. An adverse conclusion, when the effects of the matter or matters giving rise to the modification are both material and pervasive to the financial statements

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.72 When the accountant expresses a qualified conclusion on the financial statements because of a material misstatement, the accountant should, unless otherwise required by law or regulation, use the following language:

Based on my (our) review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with *[the applicable financial reporting framework]*.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.73 When the accountant expresses an adverse conclusion on the financial statements, the accountant should, unless otherwise required by law or regulation, use the following language:

Based on my (our) review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements are not in accordance with *[the applicable financial reporting framework]*.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.74 In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the accountant should do the following:

- a. Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures) and the effects of the departure on the financial statements have been determined by management or are known to the accountant as a result of the accountant's procedures. If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of the departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management.
- b. Explain how disclosures are misstated if the material misstatement relates to narrative disclosures.
- c. Describe the nature of omitted information if the material misstatement relates to the nondisclosure of information required to

be disclosed. The accountant should include the omitted disclosures when practicable to do so.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting on the Financial Statements

.75 The accountant's review report should be in writing. (Ref: par. .A107–.A109) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Review Report

.76 The written review report should include the following: (Ref: par. .A126)

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant for a review engagement. (Ref: par. .A110)
- b. An addressee, based on the circumstances of the engagement. (Ref: par. .A111)
- c. An introductory paragraph that (Ref: par. .A112–.A114)
 - i. identifies the entity whose financial statements have been reviewed,
 - ii. states that the financial statements identified in the report were reviewed,
 - iii. identifies the financial statements,
 - iv. specifies the date or period covered by each financial statement,
 - v. includes a statement that a review includes primarily applying analytical procedures to management's (owner's) financial data and making inquiries of company management (owners), and
 - vi. includes a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.
- d. A section with the heading "Management's Responsibility for the Financial Statements" that includes an explanation that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error. (Ref: par. .A115)
- e. A section with the heading "Accountant's Responsibility" that includes the following statements:
 - i. The accountant's responsibility is to conduct the review engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA. The accountant's review report should also explain that those standards require that the accountant perform the

- procedures to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. (Ref: par. .A116–.A118)
- ii. The accountant believes that the results of the accountant's procedures provide a reasonable basis for the accountant's conclusion.
 - iii. The accountant is required to be independent of the entity and to meet the accountant's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the review.
- f. A concluding section with an appropriate heading that includes the accountant's conclusion on the financial statements in accordance with paragraphs .67–.74, as appropriate, and that identifies the country of origin of the financial reporting framework, if applicable
 - g. When the accountant's conclusion on the financial statements is modified,
 - i. a paragraph, under the appropriate heading, that contains the accountant's modified conclusion in accordance with paragraphs .69–.74, as appropriate, and
 - ii. a paragraph, under an appropriate heading, that provides a description of the matter or matters giving rise to the modification (Ref: par. .A119)
 - h. The manual or printed signature of the accountant's firm. (Ref: par. .A120–.A121)
 - i. The city and state where the accountant practices. (Ref: par. .A122)
 - j. The date of the review report, which should be dated no earlier than the date on which the accountant has obtained sufficient appropriate review evidence as the basis for the accountant's conclusion on the financial statements, including being satisfied that
 - i. all the statements that the financial statements comprise, including the related notes, have been prepared and
 - ii. management has asserted that it has taken responsibility for those financial statements. (Ref: par. .A123–.A124)

[As amended, effective October 2016, by SSARS No. 23. As amended, effective May 2018, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. As amended, effective for reviews of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

Accountant's Review Report on Financial Statements Prepared in Accordance With a Special Purpose Framework

.77 The accountant should modify the review report when the accountant becomes aware that the financial statements do not include

- a. a description of the special purpose framework. (Ref: par. .A128)
- b. a summary of significant accounting policies.

- c. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. (Ref: par. .A129)
- d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. (Ref: par. .A130)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.78 In the case of financial statements prepared in accordance with the provisions of a contract, the accountant should evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based and modify the review report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.79 In the case of an accountant's review report on special purpose financial statements, if management has a choice of financial reporting frameworks in the preparation of the special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.80 The accountant's review report on financial statements prepared in accordance with a special purpose framework should include an emphasis-of-matter paragraph, under an appropriate heading, that (Ref: par. .A132–.A133)

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes the framework, and
- c. states that the special purpose framework is a basis of accounting other than GAAP.

For special purpose financial statements prepared in accordance with a contractual basis of accounting, the emphasis-of-matter paragraph should also state that, as a result, the financial statements may not be suitable for another purpose. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.81 If the special purpose financial statements are prepared in accordance with the contractual basis of accounting, the accountant's review report should include, in accordance with paragraph .104, an other-matter paragraph, under an appropriate heading, that, in accordance with paragraphs .106–.109, restricts the use of the accountant's review report (Ref: par. .A134) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Comparative Financial Statements

.82 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the

accountant's report should refer to each period for which financial statements are presented. (Ref: par. .A135–.A136) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Updating the Report

.83 When reporting on all periods presented, a continuing accountant should update the report on one or more prior periods presented on a comparative basis with those of the current period. The accountant's report on comparative financial statements should not be dated earlier than the date that the accountant completed procedures sufficient to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework with respect to the current period. (Ref: par. .A137) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.84 When issuing an updated report, the continuing accountant should consider information that the accountant has become aware of during the review of the current period financial statements. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.85 If, during the current engagement, circumstances or events come to the accountant's attention that may affect the prior-period financial statements presented, the accountant should consider the effects on the review report. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Changed Reference to a Departure From the Applicable Financial Reporting Framework

.86 When the accountant's report on the financial statements of the prior period contains a changed reference to a departure from the applicable financial reporting framework, the accountant's review report should include an other-matter paragraph indicating (Ref: par. .A138)

- a. the date of the accountant's previous review report.
- b. the circumstances or events that caused the reference to be changed.
- c. when applicable, that the financial statements of the prior period have been changed.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Reporting When One Period Is Audited

.87 When the prior period financial statements were audited and the auditor's report on the prior period financial statements is not reissued, the review report on the current period financial statements should include an other-matter paragraph indicating

- a. that the financial statements of the prior period were previously audited;
- b. the date of the auditor's report on the prior period financial statements;
- c. the type of opinion issued on the prior period financial statements;
- d. if the opinion was modified, the substantive reasons for the modification; and

- e. that no auditing procedures were performed after the date of the previous report.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.88 [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report

Emphasis-of-Matter Paragraphs in the Accountant's Review Report

.89 If the accountant considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the accountant should include an emphasis-of-matter paragraph in the accountant's review report, provided that the accountant has obtained sufficient appropriate review evidence to conclude that the accountant is not aware of any material modifications that should be made to the financial statements with respect to such matter. Such a paragraph should refer only to information presented or disclosed in the financial statements. (Ref: par. .A143–.A145) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.90 When the accountant includes an emphasis-of-matter paragraph in the accountant's review report, the accountant should do the following:

- a. Include the paragraph within a separate section of the accountant's report with the heading "Emphasis of a Matter" or other appropriate heading. (Ref: par. .A146–.A147)
- b. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph should refer only to information presented or disclosed in the financial statements.
- c. Indicate that the accountant's conclusion is not modified with respect to the matter emphasized. (Ref: par. .A148)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Other-Matter Paragraphs in the Accountant's Review Report

.91 If the accountant considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to the users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the accountant should include an other-matter paragraph in the accountant's review report. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.92 When the accountant includes an other-matter paragraph in the accountant's review report, the accountant should include the paragraph within a separate section with the heading "Other Matter" or other appropriate heading. (Ref: par. .A143, .A146, and .A149–.A151) [Paragraph added, effective for

reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Communication With Management

.93 If the accountant expects to include an emphasis-of-matter or other-matter paragraph in the accountant's review report, the accountant should communicate with management regarding this expectation and the proposed wording of this paragraph. (Ref: par. .A152–.A153) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Correction of a Material Misstatement in Previously Issued Financial Statements

.94 The accountant should include an emphasis-of-matter paragraph in the accountant's review report when there are adjustments to correct a material misstatement in previously issued financial statements. The accountant should include this type of emphasis-of-matter paragraph in the accountant's review report when the related financial statements are restated to correct the prior material misstatement. The paragraph need not be repeated in subsequent periods. (Ref: par. .A154–.A156) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.95 The emphasis-of-matter paragraph should include

- a. a statement that the previously issued financial statements have been restated for the correction of a material misstatement in the respective period and
- b. a reference to the entity's disclosure of the correction of the material misstatement. (Ref: par. .A157)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.96 If the financial statement disclosures relating to the restatement to correct a material misstatement in previously issued financial statements are not adequate, the accountant should address the inadequacy of disclosure as described in paragraphs .69–.72. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Other Reporting Responsibilities

.97 An accountant may be requested to address other reporting responsibilities in the accountant's review report on the financial statements that are in addition to the accountant's responsibilities in accordance with this section to report on the financial statements. In such situations, those other reporting responsibilities should be addressed by the accountant in a separate section in the accountant's review report, under the heading "Report on Other Legal and Regulatory Requirements," or otherwise, as appropriate to the content of the section, following the section of the report titled "Report on the Financial Statements." (Ref: par. .A158) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.98–.102] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Alert That Restricts the Use of the Accountant's Review Report

.103 An accountant's review report should include an alert, in a separate paragraph, that restricts its use when the subject matter of the accountant's review report is based on (Ref: par. .A165–.A167)

- a. measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria or
- b. measurement or disclosure criteria that are available only to the specified parties.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.104 The alert that restricts the use of the accountant's review report required by paragraph .103 should

- a. state that the accountant's review report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the accountant's review report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A168)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Adding Other Specified Parties

.105 When, in accordance with paragraph .103, the accountant includes an alert that restricts the use of the accountant's review report to certain specified parties and the accountant is requested to add other parties as specified parties, the accountant should determine whether to agree to add the other parties as specified parties. (Ref: par. .A169) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.106 If the other parties are added after the release of the accountant's review report, the accountant should either:

- a. Amend the accountant's review report to add the other parties and, in such circumstances, not change the original date of the accountant's review report.
- b. Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties and state in the acknowledgment that no procedures were performed subsequent to the original date of the accountant's review report.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

The Accountant's Consideration of an Entity's Ability to Continue as a Going Concern

[.107–.108] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Implications for the Accountant's Review Report When Substantial Doubt Exists About the Entity's Ability to Continue as a Going Concern

.109 If, after considering conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the accountant should include a separate section in the accountant's review report with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that does the following: (Ref: par. .A177–.A184)

- a. Draws attention to the note in the financial statements that discloses
 - i. the conditions or events identified and management's plans that deal with these conditions or events and
 - ii. that these conditions or events indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
- b. States that the accountant's conclusion is not modified with respect to the matter

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.110 The description in the "Going Concern" section about the entity's ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The accountant should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A183) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.111 If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the accountant should do the following:

- a. Express a qualified or adverse conclusion, as appropriate, in accordance with paragraphs .71–.74
- b. In the "Basis for Qualified (Adverse) Conclusion" section of the accountant's review report, state that
 - i. substantial doubt exists about the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter or
 - ii. substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Management Unwilling to Perform or Extend Its Evaluation

.112 If management is unwilling to perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework when requested to do so by the accountant, the accountant should consider the implications for the accountant's review report. (Ref: par. .A125) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.113–.121] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Reference to the Work of Other Accountants in an Accountant's Review Report

.122 If other accountants audited or reviewed the financial statements of significant components, such as consolidated and unconsolidated subsidiaries and investees, and the accountant of the reporting entity decides not to assume responsibility for the audit or review performed by the other accountants, the accountant of the reporting entity should make reference to the review or audit of such other accountants in the accountant's review report. In that instance, the accountant should clearly indicate in the accountant's review report that the accountant used the work of other accountants and should include the magnitude of the portion of the financial statements audited or reviewed by the other accountants. (Ref: par. .A193–.A195) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.123 Reference to the audit or review of other accountants in the accountant's review report on the reporting entity should not be made if the other accountants issued an auditor's or an accountant's review report that includes an alert that restricts the use of such report. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Determining Whether the Other Accountants Are Familiar with SSARSs or Auditing Standards Generally Accepted in the United States of America, as Applicable

.124 Regardless of whether the accountant of the reporting entity decides to make reference to the review or audit of other accountants, the accountant of the reporting entity should communicate with the other accountants and determine the following:

- a. The other accountants are aware that the financial statements of the component that the other accountants have audited or reviewed are to be included in the financial statements on which the accountant of the reporting entity will report and that the other accountants' report thereon will be relied upon and, where applicable, referred to by the accountant of the reporting entity.
- b. The other accountants are familiar with the applicable financial reporting framework and with SSARSs or auditing standards generally accepted in the United States of America, as applicable, and will conduct the review or audit in accordance therewith. (Ref: par. .A196)

- c. The other accountants understand the ethical requirements that are relevant to the engagement and, in particular, are independent. (Ref: par. .A197)
- d. A review will be made of matters affecting elimination of inter-company transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same

.125 If the component's financial statements are prepared using a different financial reporting framework from that used for the financial statements of the reporting entity, reference to the review or audit of the other accountants in the review report of the accountant of the reporting entity should not be made unless the following apply:

- a. The accountant has determined that the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements in accordance with the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the reporting entity's financial statements in accordance with the financial reporting framework used by the reporting entity.
- b. The accountant of the reporting entity has obtained sufficient appropriate review evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the reporting entity without the need to assume responsibility for, and thus be involved in, the work of the other accountants. (Ref: par. .A198)

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Supplementary Information That Accompanies Reviewed Financial Statements and the Accountant's Review Report Thereon

.126 When supplementary information accompanies reviewed financial statements and the accountant's review report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either

- a. an other-matter paragraph in the accountant's review report on the financial statements or
- b. a separate report on the supplementary information

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.127 When the accountant has subjected the supplementary information to the review procedures applied in the accountant's review of the basic

financial statements, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that (Ref: par. .A200 and .A202)

- a.* the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b.* the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements;
- c.* the supplementary information has been subjected to the review procedures applied in the accountant's review of the basic financial statements and whether the accountant is aware of any material modifications that should be made to the supplementary information; and
- d.* the accountant has not audited the supplementary information and does not express an opinion on such information.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.128 When the accountant has not subjected the supplementary information to the review procedures applied in the accountant's review of the basic financial statements, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that (Ref: par. .A201–.A202)

- a.* the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b.* the supplementary information is the responsibility of management; and
- c.* the accountant has not audited or reviewed the supplementary information and, accordingly, does not express an opinion, a conclusion, nor provide any assurance on such information.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Required Supplementary Information

.129 Concerning the requirement in paragraph .126, with respect to required supplementary information, the accountant should include an other-matter paragraph in the accountant's review report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable: (Ref: par. .A203)

- a.* The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
- b.* The required supplementary information is included, and the accountant reviewed the required supplementary information.
- c.* The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.

- d. The required supplementary information is omitted.
- e. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines (Ref: par. A204)
- f. The accountant has identified departures from the prescribed guidelines.
- g. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.130 If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation or review on the required supplementary information, the other-matter paragraph referred to in paragraph .126 should include the following elements: (Ref: par. A205)

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and does not express an opinion or provide any assurance on the information
- d. If some of the required supplementary information is omitted
 - i. a statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
 - ii. a statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist *[describe the material departures from the applicable financial reporting framework]*
- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in

accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standards-setter]*

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.131 If all the required supplementary information is omitted, the other-matter paragraph should include the following elements:

- a. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Change in Engagement From Audit to Review

.132 If the accountant, who was engaged to perform an audit engagement in accordance with generally accepted auditing standards, has been requested to change the engagement to a review engagement, the accountant should consider the following before deciding whether to agree to the change: (Ref: par. .A206–.A207)

- a. The reason given for the request, particularly the implications of a restriction on the scope of the audit engagement, whether imposed by management or by circumstances (Ref: par. .A208)
- b. The additional audit effort required to complete the audit engagement
- c. The estimated additional cost to complete the audit engagement

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.133 In all circumstances, if the audit procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.134 If the accountant concludes, based upon the accountant's professional judgment, that reasonable justification exists to change the engagement, and if the accountant complies with the standards applicable to a review engagement, the accountant should issue an appropriate review report. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

- .135** The report should not include reference to
- the original engagement,
 - any audit procedures that may have been performed, or
 - scope limitations that resulted in the changed engagement.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.136 When the accountant has been engaged to audit an entity's financial statements and management refuses to allow the accountant to correspond with the entity's legal counsel, the accountant, except in rare circumstances, is precluded from accepting an engagement to review those financial statements. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Review Documentation

.137 The preparation of documentation for the review provides evidence that the review was performed in accordance with SSARSs and a sufficient and appropriate record of the basis for the accountant's report. The accountant should prepare review documentation in a timely manner that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand the following: (Ref: par. .A209–.A213)

- The nature, timing, and extent of the review procedures performed to comply with SSARSs
- The review evidence obtained from the review procedures performed and the accountant's conclusions formed on the basis of that review evidence
- Significant matters arising during the review, the accountant's conclusions reached thereon, and significant professional judgments made in reaching those conclusions

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.138 In addition to the requirements in paragraph .137, the review documentation should include the following:

- The engagement letter or other suitable form of written documentation with management, as described in paragraphs .16–.17 (Ref: par. .A25 and .A27)
- Communications with management regarding the accountant's expectation to include an emphasis-of-matter or other-matter paragraph in the accountant's review report as required by paragraph .93
- Communications with management, those charged with governance, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters
- Communications with other accountants that have audited or reviewed the financial statements of significant components as required by paragraph .122
- If, in the course of the engagement, the accountant identified information that is inconsistent with the accountant's findings

regarding significant matters affecting the financial statements, how the inconsistency was addressed

- f. The representation letter
- g. A copy of the reviewed financial statements and the accountant's review report thereon

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.139 In documenting the nature, timing, and extent of procedures performed as required in this section, the accountant should record the following:

- a. Who performed the work and the date such work was completed
- b. Who reviewed the work performed and the date and extent of the review
- c. If the review engagement is subject to an engagement quality review
 - i. the identity of the engagement quality reviewer for the engagement and the date and extent of such review and
 - ii. that the engagement quality review has been completed before the release of the accountant's review report

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. As amended, effective for reviews of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

Application and Other Explanatory Material

Introduction

.A1 If the accountant is engaged to perform a review of historical financial information other than financial statements, references in this section to *financial statements* are to be taken as a reference to such other historical financial information. [Paragraph added, effective October 2016, by SSARS No. 23.]

.A2 Examples of other historical financial information that an accountant may be engaged to review include, but are not limited to, the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Financial information contained in a tax return

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A3 The accountant may review a single financial statement, such as a balance sheet, and not other related financial statements, such as the statements of income, retained earnings, and cash flows, if the scope of the accountant's inquiry and analytical procedures have not been restricted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Objectives (Ref: par. .07)

.A4 A review differs significantly from an audit of financial statements in which the auditor obtains reasonable assurance, which is a high, but not absolute, level of assurance, that the financial statements are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit. Accordingly, in a review, the accountant does not obtain assurance that he or she will become aware of all significant matters that would be disclosed in an audit. Therefore, a review is designed to obtain only limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

[**.A5–.A9**] [Paragraphs deleted by the issuance of SSARS No. 25, February 2020.]

Definitions (Ref: par. .08)

.A10 Sufficient appropriate review evidence, consisting primarily of the results of the accountant's analytical procedures and inquiries, is required to obtain limited assurance to support the accountant's conclusion. Review evidence is cumulative in nature and primarily obtained from the procedures performed during the course of the review. The combination of the nature, timing, and extent of evidence-gathering procedures is limited compared to an audit engagement. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A11 Most financial reporting frameworks requiring an explicit management evaluation of the entity's ability to continue as a going concern specify the period of time to be evaluated. For example, the financial reporting frameworks of the following standard-setting bodies specify such period of time as follows:

- a. *FASB*. Within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).¹
- b. *GASB*. 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.²
- c. *International Accounting Standards Board*. At least, but not limited to, one year from the end of the reporting period.³

¹ "Pending Content" in *FASB Accounting Standards Codification (ASC) 205-40-50-1*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

² Paragraph 16 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

³ Paragraph 26 of International Accounting Standard 1, *Presentation of Financial Statements*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

[.A12] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A13 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity. [Paragraph added, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A14 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements. [Paragraph added, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Independence (Ref: par. .10)

.A15 The AICPA Code of Professional Conduct provides guidance with respect to independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A16 Nothing prohibits an accountant who is unable to complete a review engagement due to a determination that the accountant's independence is impaired from performing a compilation engagement on those financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Professional Skepticism (Ref: par. .11)

.A17 Professional skepticism includes being alert to the following, for example:

- Review evidence that contradicts other review evidence obtained
- Information that brings into question the reliability of responses to inquiries and other information or records to be used as review evidence
- Circumstances that suggest the need for review procedures in addition to those required by this section

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A18 Maintaining professional skepticism throughout the review is necessary if the accountant is, for example, to reduce the risks of

- overlooking unusual circumstances.

- overgeneralizing when drawing conclusions from review observations.
- using inappropriate assumptions in determining the nature, timing, and extent of the review procedures and evaluating the results thereof.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A19 Professional skepticism is necessary to the critical assessment of review evidence. This includes questioning contradictory review evidence and the reliability of responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of review evidence obtained in light of the circumstances. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A20 The accountant may accept records and documents as genuine unless the accountant has reason to believe the contrary. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A21 The accountant neither assumes that management is dishonest nor assumes unquestioned honesty. The accountant cannot be expected to disregard past experience of the honesty and integrity of management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the accountant of the need to maintain professional skepticism or allow the accountant to be satisfied with less than persuasive review evidence when obtaining limited assurance. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Acceptance and Continuance of Client Relationships and Review Engagements (Ref: par. .13)

.A22 A review in accordance with SSARSs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .31b of section 60. The preparation of financial statements, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" interpretation (ET sec. 1.295) of the "Independence Rule" of the AICPA Code of Professional Conduct. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the review engagement as required by paragraphs .16–.17. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A23 Documents containing financial statements that may include an indication that such financial statements have been reviewed by the entity's accountant includes documents submitted to bonding companies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Agreement on Engagement Terms (Ref: par. .16–.17 and .135)

.A24 Both management and the accountant have an interest in documenting the agreed-upon terms of the review engagement before the commencement of the review engagement to help avoid misunderstandings with respect to the review engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A25 The roles of management and those charged with governance in agreeing upon the terms of the review engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless, in accordance with paragraph .31b of section 60, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A26 When a third party has contracted for a review of the entity's financial statements, agreeing the terms of the review with management of the entity is necessary in order to establish that the preconditions for a review are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A27 The understanding with management regarding the services to be performed for review engagements is required by paragraph .16 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for review engagements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A28 Although the accountant may prepare the financial statements, in whole or in part, the financial statements are representations of management, and the fairness of their presentation in accordance with the applicable financial reporting framework is management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A29 Illustrations of engagement letters for a review of financial statements are presented in exhibit A, "Illustrative Engagement Letters." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Communication With Management and Those Charged With Governance (Ref: par. .18)

.A30 In a review engagement, the accountant's communications with management and those charged with governance take the form of

- a. inquiries the accountant makes in the course of performing the procedures for the review and
- b. other communications, in the context of having effective two-way communication to understand matters arising and to develop a constructive working relationship for the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A31 The appropriate timing for communications will vary with the circumstances of the engagement. Relevant factors include the significance and nature of the matter and any action expected to be taken by management or those charged with governance. For example, it may be appropriate to communicate a significant difficulty encountered during the review as soon as practicable if management or those charged with governance are able to assist the accountant to overcome the difficulty. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A32 Law or regulation may restrict the accountant's communication of certain matters with those charged with governance. For example, law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the accountant's obligations of confidentiality and obligations to communicate may be complex. In such cases, the accountant may consider obtaining legal advice. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Communicating Matters Concerning the Review

.A33 Matters to be communicated to management or those charged with governance, as appropriate, in accordance with this section may include the following:

- The accountant's responsibilities in the review engagement, as included in the engagement letter or other suitable form of written agreement.
- Significant findings from the review, for example
 - the accountant's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.
 - significant findings from the performance of procedures, including situations when the accountant considered performance of additional procedures necessary in accordance

with this section. The accountant may need to confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

- Matters arising that may lead to modification of the accountant's review report.
- Significant difficulties, if any, encountered during the review, for example, unavailability of expected information, unexpected inability to obtain evidence that the accountant considers necessary for the review, or restrictions imposed on the accountant by management. In some circumstances, such difficulties may lead to the accountant's withdrawal from the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A34 In some entities, different persons are responsible for the management and governance of an entity. In these circumstances, management may have the responsibility to communicate matters of governance interest to those charged with governance. Communication by management with those charged with governance of matters that the accountant is required to communicate does not relieve the accountant of the responsibility to also communicate with those charged with governance. However, communication of these matters by management may affect the form or timing of the accountant's communication with those charged with governance. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Communication With Third Parties

.A35 The accountant may be required by law or regulation to, for example

- notify a regulatory or enforcement body of certain matters communicated with those charged with governance.
- submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies or, in some cases, make such reports publicly available.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A36 Unless required by law or regulation to provide a third party with a copy of the accountant's written communications with those charged with governance, the accountant may need the prior consent of management or those charged with governance before doing so. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Performing the Engagement

Materiality in a Review of Financial Statements (Ref: par. .19)

.A37 The accountant's consideration of materiality is made in the context of the applicable financial reporting framework. Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.
- judgments about materiality are made in light of surrounding circumstances and affected by the size or nature of a misstatement or a combination of both.
- judgments about materiality involve both qualitative and quantitative considerations.
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A38 If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .A37 provide the accountant with such a frame of reference. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A39 The accountant's determination of materiality is a matter of professional judgment and is affected by the accountant's perception of the financial information needs of users of the financial statements. For purposes of determining materiality, the accountant may assume that reasonable users

- have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented, and reviewed to levels of materiality;
- recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- make reasonable judgments based on the information in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A40 The accountant's judgment about what is material in relation to the financial statements as a whole is the same regardless of the level of assurance obtained by the accountant as a basis for expressing a conclusion on the financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A41 The accountant's determination of materiality for the financial statements as a whole may need to be revised during the engagement as a result of the following:

- A change in the circumstances that occurred during the review (for example, a decision to dispose of a major part of the entity's business)
- New information, or a change in the accountant's understanding of the entity and its environment as a result of performing review procedures (for example, if during the review it appears that actual financial results are likely to be substantially different from anticipated period-end financial results that were used initially to consider materiality for the financial statements as a whole)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Understanding of the Industry (Ref: par. .21)

.A42 The requirement that the accountant possess a level of knowledge of the industry in which the entity operates does not prevent the accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Knowledge of the Entity (Ref: par. .22)

.A43 The accountant may obtain knowledge of the entity through inquiry of the entity's personnel, the review of documents prepared by the entity, or experience with the entity or the entity's industry. Such knowledge includes the following:

- An understanding of the entity's business
- An understanding of the accounting principles and practices used by the entity in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A44 The accountant's understanding of the entity's business encompasses a general understanding of the entity's organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Designing and Performing Review Procedures (Ref: par. .24–.25)

.A45 Review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the accountant with a reasonable basis for obtaining limited assurance. However, in addition to analytical procedures and inquiries, in certain circumstances and based on the accountant's professional judgment, the accountant may perform procedures ordinarily performed in an audit. In such instances, the engagement remains a review, and the accountant is not required to perform an audit of the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A46 The results of the accountant's analytical procedures and inquiries may modify the accountant's risk awareness. For example, the response to an inquiry that a related party transaction is not disclosed may revise the accountant's awareness of risk relative to related party transactions. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A47 Both quantitative and qualitative factors are considered when determining which items are material to the financial statements, including disclosures, and which areas include increased risk of material misstatement. For example, disclosure of the implementation status of a new accounting standard may not include quantitatively material disclosures but may be qualitatively material such that the accountant would perform inquiry procedures to validate the disclosures presented. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Analytical Procedures (Ref: par. .26–.27)

.A48 Examples of analytical procedures that an accountant may consider performing when conducting a review of financial statements are contained in appendix A, "Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A49 Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the accountant, such as an estimation of depreciation
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable and gross margin percentages with industry averages or other entities of comparable size in the same industry

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A50 Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information, such as gross margin percentages, that would be expected to conform to a predictable pattern based on recent history of the entity and industry
- Between financial information and relevant nonfinancial information, such as payroll costs to number of employees

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A51 When considering plausible relationships, the accountant may wish to consider information developed and used by the entity (for example, analyses prepared for management or those charged with governance). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A52 Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements may be less precise than those developed in an audit. Also, in a review, the accountant is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A53 To compare disaggregated revenue data, the accountant may compare, for example, revenue reported by month and product line or operating segment during the current period with that of comparable prior periods. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A54 Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses. Analytical procedures may be performed at the financial statement level or at the detailed account level. The nature, timing, and extent of analytical procedures are a matter of professional judgment. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Investigating Results of Analytical Procedures (Ref: par. .28b)

.A55 Although the accountant is not required to corroborate management's responses with other evidence, the need to perform other review procedures may arise when, for example, management is unable to provide an explanation, or the explanation is not considered adequate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters (Ref: par. .29)

.A56 In addition to members of management who have responsibility for financial and accounting matters, the accountant may determine to direct inquiries to others within the entity and those charged with governance, if appropriate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A57 Additional examples of unusual or complex transactions, events, or matters about which the accountant may inquire of management are as follows:

- Correction of an error
- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior periods
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Material off-balance-sheet transactions, variable interest entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A58 Management may obtain knowledge of fraud or suspected fraud affecting the entity involving management or others when the fraud could have a material effect on the financial statements through, among other things, communications received from employees, former employees, or others. [Paragraph

renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A59 The accountant may obtain and read minutes from meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements as an effective and efficient procedure to meet the requirement in paragraph .29m to inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements about actions taken at such meetings. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Procedures to Address Specific Circumstances

Related Parties

Understanding the Nature of Significant Transactions Outside the Normal Course of Business (Ref: par. .33a)

.A60 Inquiring into the nature of the significant transactions outside the entity's normal course of business involves obtaining an understanding of the business rationale of the transactions and the terms and conditions under which these have been entered into. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Fraud and Noncompliance With Laws or Regulations (Ref: par. .34)

.A61 The communication of matters involving identified or suspected noncompliance may describe the act of identified or suspected noncompliance, the circumstances of its occurrence, and the effect on the financial statements. The accountant may reach agreement in advance with management and those charged with governance, if applicable, on the nature and amount of matters that would be considered not material and, thus, need not be communicated. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A62 The accountant's professional duty to maintain the confidentiality of client information may preclude reporting identified or suspected noncompliance with laws and regulations to a party outside the entity. However, the accountant's legal responsibilities vary by jurisdiction, and in certain circumstances, the duty of confidentiality may be overridden by statute, the law, or courts of law. In the following circumstances, a duty to notify parties outside the entity may exist:

- In response to a court order
- In compliance with requirements for the reviews of entities that receive financial assistance from a government agency

Because potential conflicts with the accountant's ethical and legal obligations regarding confidentiality may be complex, the accountant may consult with legal counsel before discussing noncompliance with parties outside the entity. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A63 The accountant may consider whether withdrawal from the engagement is necessary when

- management or those charged with governance do not take the remedial action that the accountant considers necessary in the circumstances or
- matters regarding fraud or noncompliance with laws or regulations involve an owner of the business.

When deciding whether withdrawal from the engagement is necessary, the accountant may consider seeking legal advice. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Going Concern (Ref: par. .37–.38)

.A64 The nature and extent of the accountant's review procedures are matters of the accountant's professional judgment. For example, when a history of profitable operations and ready access to financing exists, inquiry alone might be sufficient to review the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A65 Certain financial reporting frameworks require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements. For example, FASB *Accounting Standards Codification*® (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern. Under FASB ASC, the evaluation period is within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A66 A review of financial statements is not designed to identify conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. However, conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time may have existed at the date of the prior period financial statements or may be identified as a result of inquiries of management or in the course of performing other review procedures. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A67 The following are examples of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time:

- *Negative trends.* For example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios
- *Other indications of possible financial difficulties.* For example, defaults on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets

- *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- *External matters.* For example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A68 The significance of such conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time can often be mitigated by other factors. The following list includes examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The examples are not all-inclusive. Following each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is probable⁴ that the plan will be effectively implemented within one year after the date that the financial statements are issued.⁵

- a. Plans to dispose of an asset or business
 - i. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loans or similar agreements, or encumbrances against the asset or business
 - ii. Marketability of the asset or business that management plans to sell
 - iii. Possible direct or indirect effects of disposal of the asset or business
- b. Plans to borrow money or restructure debt
 - i. Availability and terms of new debt financing or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback of assets
 - ii. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
 - iii. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures
 - i. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets

⁴ The FASB ASC Master Glossary defines *probable* as "the future event or events are likely to occur." [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

⁵ "Pending Content" in FASB ASC 205-40-55-3. [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

- ii. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures
- d. Plans to increase ownership equity
 - i. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
 - ii. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A69 In considering the adequacy of disclosure, some of the information that may be disclosed, depending on the requirements of the financial reporting framework, includes the following:

- Principal conditions and events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events in relation to the entity's ability to meet its obligations and any mitigating factors
- Possible discontinuance of operations
- Management's plans (including relevant prospective financial information) that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reconciling the Financial Statements to the Underlying Accounting Records (Ref: par. .41)

.A70 To obtain evidence that the financial statements agree or reconcile with the accounting records, the accountant may compare the financial statements to

- the accounting records, such as the general ledger;
- a consolidating schedule derived from the accounting records; or
- other supporting data in the entity's records.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Additional Procedures When the Accountant Becomes Aware That the Financial Statements May Be Materially Misstated (Ref: par. .42)

.A71 Additional procedures are required in accordance with this section if the accountant becomes aware of a matter that causes the accountant to believe the financial statements may be materially misstated. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A72 The accountant's response in undertaking additional procedures with respect to an item the accountant has cause to believe may be materially misstated in the financial statements will vary, depending on the circumstances, and is a matter for the accountant's professional judgment. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A73 The accountant's judgment about the nature, timing, and extent of additional procedures that are needed to obtain review evidence to either conclude that a material misstatement is not likely, or determine that a material misstatement exists, is guided by the following:

- Information obtained from the accountant's evaluation of the results of the procedures already performed
- The accountant's updated understanding of the entity and its environment obtained throughout the course of the engagement
- The accountant's view on the persuasiveness of review evidence needed to address the matter that causes the accountant to believe that the financial statements may be materially misstated

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A74 Additional procedures focus on obtaining sufficient appropriate review evidence to enable the accountant to form a conclusion on matters that the accountant believes may cause the financial statements to be materially misstated. Such procedures may consist of the following:

- Additional inquiry or analytical procedures, for example, being performed in greater detail or focused on the affected items (that is, amounts or disclosures concerning the affected accounts or transactions as reflected in the financial statements)
- Other types of procedures, for example, a substantive test of details or external confirmations

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A75 The following example illustrates the accountant's evaluation of the need to perform additional procedures and the accountant's response when the accountant believes additional procedures are necessary:

In the course of performing the inquiry and analytical procedures for the review, the accountant's analysis of accounts receivable shows a material amount of past due accounts receivable for which there is no allowance for bad or doubtful accounts. This causes the accountant to believe that the accounts receivable balance in the financial statements may be materially misstated. The accountant then inquires of management whether there are uncollectible accounts receivable that would need to be shown as being impaired. Depending on

management's response, the accountant's evaluation of the response may do the following:

- a. Enable the accountant to conclude that the accounts receivable balance is not likely to be materially misstated. In that case, no further procedures are required.
- b. Enable the accountant to determine that the matter causes the financial statements to be materially misstated. No further procedures are required, and the accountant would form the conclusion that the financial statements as a whole are materially misstated.
- c. Lead the accountant to continue to believe that the accounts receivable balance is likely to be materially misstated, while not providing sufficient appropriate review evidence for the accountant to determine that it is, in fact, misstated. In that case, the accountant is required to perform additional procedures, for example, requesting from management an analysis of amounts received for those accounts after the balance sheet date to identify uncollectible accounts receivable. The evaluation of the results of the additional procedures may enable the accountant to get to (a) or (b) preceding. If not, the accountant is required to do one of the following:
 - i. Continue performing additional procedures until the accountant reaches either (a) or (b) preceding
 - ii. If the accountant is not able to either conclude that the matter is not likely to cause the financial statements as a whole to be materially misstated or to determine that the matter does cause the financial statements as a whole to be materially misstated, then, in accordance with paragraph .48, withdraw from the engagement

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Evaluating Review Evidence Obtained From the Procedures Performed (Ref: par. .47)

[.A76–.A77] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A78 In some circumstances, the accountant may not have obtained the evidence that the accountant had expected to obtain through the design of primarily inquiry and analytical procedures and procedures addressing specific circumstances. In these circumstances, the accountant considers that the review evidence obtained from the procedures performed is not sufficient and appropriate to be able to form a conclusion on the financial statements. The accountant may

- extend the work performed or
- perform other procedures judged by the accountant to be necessary in the circumstances.

When neither of these is practicable in the circumstances, the accountant will not be able to obtain sufficient appropriate review evidence to be able to form a conclusion and is required by this section to determine the effect on the accountant's ability to complete the engagement. This situation may arise even though the accountant has not become aware of a matter or matters that cause

the accountant to believe the financial statements may be materially misstated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequent Events and Subsequently Discovered Facts

Subsequent Events (Ref: par. .49)

.A79 Evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements may come to the accountant's attention in the following ways:

- During the performance of review procedures
- Subsequent to the date of the accountant's review report but prior to the release of the report

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequently Discovered Facts That Become Known to the Accountant After the Report Release Date (Ref: par. .54–.57)

.A80 New information may come to the accountant's attention that, had such information been known to the accountant at the date of the accountant's review report, may have caused the accountant to revise the accountant's review report. When such information becomes known to the accountant after the report release date, the requirements in paragraphs .54–.57 apply, even if the accountant has withdrawn or been discharged. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A81 Because of the variety of conditions that might be encountered, the specific procedures or actions to be taken in a particular case may vary somewhat in light of the circumstances. For example, when determining whether the financial statements need revision, as required by paragraph .54b, the accountant may consider, in addition to the requirements of the applicable financial reporting framework, whether the accountant believes persons are currently using, or are likely to use, the financial statements and who would attach importance to the subsequently discovered facts. Consideration may be given, among other things, to the issuance of reviewed or audited financial statements for a subsequent period, the time elapsed since the financial statements were issued, the date of the accountant's review report released, and any legal implications. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A82 The steps taken by management to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used, depend on the circumstances. Management's steps may include the following:

- Notify anyone who is known to be using, or who is likely to use, the financial statements and the accountant's review report that they are not to be used and that revised financial statements, together with a new accountant's review report, will be issued. This may be

necessary when the issuance of revised financial statements and a new accountant's review report is not imminent.

- Issue, as soon as practicable, revised financial statements with appropriate disclosure of the matter.
- Issue the subsequent period's financial statements with appropriate disclosure of the matter. This may be appropriate when issuance of the subsequent period's reviewed or audited financial statements is imminent.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A83 If management made the reviewed financial statements available to third parties despite the accountant's notification not to do so, or if the accountant believes that management or those charged with governance have failed to take the necessary steps to prevent use of the accountant's review report on the previously issued reviewed financial statements despite the accountant's prior notification that the accountant will take action to seek to prevent such use, the accountant's course of action depends on the accountant's legal and ethical rights and obligations. Consequently, the accountant may consider it appropriate to seek legal advice. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A84 The actions that the accountant may take to seek to prevent use of the accountant's review report may depend on the degree of certainty of the accountant's knowledge that persons or entities exist who are currently using, or who will use, the reviewed financial statements, and who would attach importance to the information, and on the accountant's ability as a practical matter to communicate with them. In addition to seeking legal advice, the accountant may consider taking the following steps to the extent applicable:

- Notify management and those charged with governance that the accountant's review report is not to be used.
- Notify regulatory agencies having jurisdiction over the entity that the accountant's review report is not to be used, including a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.
- Notify anyone known to the accountant to be using the financial statements that the accountant's review report is not to be used. In some instances, it will not be practicable for the accountant to give appropriate individual notification to stockholders or investors at large whose identities are unknown to the accountant; notification to a regulatory agency having jurisdiction over the entity will usually be the only practical means for the accountant to provide appropriate disclosure, together with a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A85 Depending on the circumstances, if the accountant is able to determine that the financial statements need revision, the accountant's notification to anyone in receipt of the reviewed financial statements may, if permitted by law, regulation, and relevant ethical requirements,

- include a description of the nature of the matter and of its effect on the financial statements, avoiding comments concerning the conduct or motives of any person.
- describe the effect that the matter would have had on the accountant's review report if it had been known to the accountant at the date of the report and had not been reflected in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A86 If the accountant is not able to determine whether the financial statements need revision, the notification to anyone in receipt of the reviewed financial statements may indicate that information became known to the accountant and that, if the information is true, the accountant believes that the accountant's review report is not to be used. The specific matter may not be permitted by law, regulation, and ethical requirements to be detailed in the notification. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Written Representations

Written Representations as Review Evidence (Ref: par. .58)

.A87 Written representations are an important source of review evidence. If management modifies or does not provide the requested written representations, it may alert the accountant to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations, in many cases, may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Management From Whom Written Representations Are Requested (Ref: par. .59)

.A88 Written representations are requested from those with overall responsibility for financial and operating matters whom the accountant believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity; however, management (rather than those charged with governance) is often the responsible party. Written representations may, therefore, be requested from the entity's CEO and CFO or other equivalent persons in entities that do not use such titles. However, in some circumstances, other parties, such as those charged with governance, also are responsible for the preparation and fair presentation of the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A89 Due to its responsibility for the preparation and fair presentation of the financial statements and its responsibility for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements on which to base the written representations. [Paragraph renumbered by the issuance

of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A90 In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the accountant to accept such wording if, in the accountant's judgment, the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Specific Written Representations (Ref: par. .60–.61)

.A91 Review evidence obtained during the review that management has acknowledged the responsibilities referred to in paragraph .60a–b is not sufficient without obtaining representation from management that it believes that it has fulfilled those responsibilities. This is because the accountant is not able to judge solely on other review evidence whether management has prepared and fairly presented the financial statements and provided information to the accountant on the basis of the agreed acknowledgment and understanding of its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A92 The written representations relating to fraud required by paragraph .60g–h are important for the accountant to obtain, regardless of the size of the entity, because of the nature of fraud and the difficulties encountered by accountants in detecting material misstatements in the financial statements resulting from fraud. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A93 Because the preparation of financial statements requires management to adjust the financial statements to correct material misstatements, the accountant is required to request that management provide a written representation about uncorrected misstatements. In some circumstances, management may not believe that certain uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as "We do not agree that items ... and ... constitute misstatements because [*description of reasons*]." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A94 Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that
 - materially affect the financial statements or
 - involve management
- When they have made specific oral representations to the accountant on details of certain related party transactions

- When they have financial or other interests in the related parties or the related party transactions

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A95 Because written representations are necessary review evidence, the accountant has not obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework and the accountant's review report cannot be dated before the date of the written representations. Furthermore, because the accountant is concerned with events occurring up to the date of the accountant's review report that may require adjustment to, or disclosure in, the financial statements, the written representations are dated as of the date of the accountant's review report on the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A96 The written representations cover all periods referred to in the accountant's review report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The accountant and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A97 Situations may arise in which current management was not present during all periods referred to in the accountant's review report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the accountant to request from them written representations that cover the whole of the relevant period(s) still applies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A98 The accountant may request additional representations regarding matters specific to the entity's business or industry. In addition, the accountant is not precluded from obtaining representations regarding services performed in addition to the review engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Form of Written Representations (Ref: par. .62)

.A99 Occasionally, circumstances may prevent management from signing the representation letter and returning it to the accountant on the date of the accountant's review report. In those circumstances, the accountant may accept management's oral confirmation, on or before the date of the accountant's

review report, that management has reviewed the final representation letter and will sign the representation letter without exception as of the date of the accountant's review report. Possession of the signed management representation letter prior to releasing the accountant's review report is necessary because paragraph .62 requires that the representations be in the form of a written letter from management. Furthermore, when there are delays in releasing the report, a fact may become known to the accountant that, had it been known to the accountant at the date of the accountant's review report, might affect the accountant's review report and result in the need for updated representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A100 Exhibit B, "Illustrative Representation Letter," provides an illustrative example of a representation letter. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Forming the Accountant's Conclusion on the Financial Statements

Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements (Ref: par. .64--.66)

.A101 The description of the applicable financial reporting framework in the financial statements is important because it advises users of the financial statements of the framework on which the financial statements are based. If the financial statements are special purpose financial statements, they may be prepared under a special purpose financial reporting framework that is available only to the engaging party and the accountant. Description of the special purpose financial reporting framework used is important because the special purpose financial statements may not be appropriate for any use other than the intended use identified. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A102 A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (for example, "the financial statements are in substantial compliance with accounting principles generally accepted in the United States") is not an adequate description of that framework because it may mislead users of the financial statements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A103 In considering the qualitative aspects of the entity's accounting practices, the accountant may become aware of possible bias in management's judgments. The accountant may conclude that the cumulative effect of a lack of neutrality, together with the effect of apparent uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the accountant's evaluation of whether the financial statements as a whole may be materially misstated include the following:

- The selective correction of apparent misstatements brought to management's attention during the review (for example,

correcting misstatements with the effect of increasing reported earnings but not correcting misstatements that have the effect of decreasing reported earnings)

- Possible management bias in the making of accounting estimates

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A104 Indicators of possible management bias do not necessarily mean there are misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the accountant's consideration of whether the financial statements as a whole may be materially misstated. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Evaluation of Whether the Financial Statements Achieve Fair Presentation (Ref: par. .66b)

.A105 The accountant's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the accountant would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Financial Statements Are Materially Misstated (Ref: par. .71)

.A106 Unless prohibited by law or regulation, the accountant may determine it appropriate to withdraw from the engagement when the accountant has determined, based on the procedures performed and the review evidence obtained, that the financial statements are materially misstated. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting on the Financial Statements (Ref: par. .75)

.A107 A written report encompasses reports issued in hard copy format and those using an electronic medium. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A108 Financial statements that the accountant has reviewed may become unattached from the accountant's review report. To minimize the possibility that a user of the reviewed financial statements may infer, through the accountant's association with the reviewed financial statements, an unintended level of reliance on the reviewed financial statements, the accountant may consider including a reference on each page of the reviewed financial statements to the accountant's review report. An example of a reference to the accountant's review report included on each page of the reviewed financial statements is "See independent accountant's review report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A109 When the accountant is unable to perform the inquiry, analytical procedures, and other review procedures the accountant considers necessary

to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework, or management does not provide the accountant with a representation letter, the review will be incomplete. A review that is incomplete does not provide an adequate basis for issuing a review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Review Report (Ref: par. .76)

Title

.A110 An appropriate title would be "Independent Accountant's Review Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Addressee

.A111 The accountant's review report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being reviewed or to those charged with governance. A report on financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an accountant may be retained to review the financial statements of an entity that is not a client; in such a case, the report may be addressed to the entity and not to those charged with governance of the entity whose financial statements are being reviewed. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Introductory Paragraph

.A112 The introductory paragraph states, for example, that the accountant has "reviewed the accompanying financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the financial statements." If the financial statements include a separate statement of changes in stockholders' equity accounts or a separate statement of comprehensive income, paragraph .76ciii requires such statements to be identified in the introductory paragraph of the report as a statement to which the financial statements are comprised. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A113 When the accountant is aware that the reviewed financial statements will be included in a document that contains other information, such as an annual report, the accountant may consider, if the form of presentation allows, identifying the page numbers on which the reviewed financial statements are presented. This helps users identify the financial statements to which the accountant's review report relates. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the

issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A114 The identification of the title for each statement that the financial statements comprise may be achieved by referencing the table of contents. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Management's Responsibility

.A115 Management, and when appropriate, those charged with governance, accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the accountant's review report includes reference to both responsibilities because it helps explain to users the premise on which a review is conducted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Responsibility

.A116 The accountant's review report states that the accountant's responsibility is to conduct the review engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA in order to contrast it to management's responsibility for the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A117 The reference to the standards used conveys to users of the accountant's review report that the review engagement has been conducted in accordance with established standards. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A118 The accountant is not permitted to represent compliance with SSARSs in the accountant's review report unless the accountant has complied with the relevant requirements within the body of SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Basis for Modification Paragraph When the Conclusion Is Modified

.A119 An adverse conclusion relating to a specific matter described in the basis for modification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the accountant's conclusion. In instances in which other identified matters would have otherwise required a modification of the accountant's conclusion, the disclosure of such other matters of which the accountant is aware may be relevant to users of the financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Signature of the Auditor

.A120 In some cases, law or regulation may allow for the use of electronic signatures in the accountant's review report. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

.A121 In certain situations, the accountant's review report may be required by law or regulation to include the personal name and signature of the accountant, in addition to the accountant's firm. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2025, by SSARS No. 26.]

Accountant's Address

.A122 The city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Date of the Accountant's Review Report

.A123 The date of the accountant's review report informs users of the accountant's review report that the accountant has considered the effect of events and transactions of which the accountant became aware and that occurred up to that date. The accountant's responsibility for events and transactions after the date of the accountant's review report is addressed in paragraphs .49–.57. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A124 Because the accountant's conclusion is provided on the financial statements, and the financial statements are the responsibility of management, the accountant is not in a position to conclude that the accountant has obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework until evidence is obtained that all the statements that the financial statements comprise, including the related notes, have been prepared, and management has accepted responsibility for them. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A125 Exhibit C, "Illustrations of Accountant's Review Reports on Financial Statements," contains illustrations of accountant's review reports on financial statements incorporating the elements required by paragraph .76. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Accountant's Review Report on Financial Statements Prepared in Accordance With a Special Purpose Framework (Ref: par. .13, .77, and .80–.81)

.A126 There may be circumstances in which a regulatory or contractual basis of accounting is based on a general purpose framework established by a designated accounting standard setter, such as GAAP, or by law or regulation but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial statements are materially misstated due to a departure from that framework, paragraphs .71–.72 apply. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A127 When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply that the special purpose framework includes all the requirements of, or is the same as, the financial reporting framework on which the special purpose framework is based. In the example of the contract in paragraph .A126, the description of the applicable financial reporting framework may refer to the financial reporting provisions of the contract. The requirements in paragraphs .80–.81 are designed to avoid misunderstandings about compliance with the general purpose framework. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A128 The description of the special purpose framework may be included in the financial statement titles, in the notes to the financial statements, or otherwise on the face of the financial statements. Although terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows* or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP, such titles, with appropriate modification, may be used in connection with financial statements prepared in accordance with a special purpose framework. Suitable financial statement titles for financial statements prepared in accordance with a special purpose framework include, but are not limited to

- a modified cash basis financial statement that might be titled
 - "Income Statement—Modified Cash Basis," or
 - "Statement of Cash Receipts and Disbursements."
- financial statements prepared in accordance with the tax basis of accounting that might be titled
 - "Balance Sheet—Tax Basis,"
 - "Statement of Assets, Liabilities, and Equity—Tax Basis,"
 - "Statement of Operations—Tax Basis," or
 - "Statement of Revenue and Expenses—Tax Basis."

- a financial statement prepared in accordance with a regulatory basis of accounting that might be titled "Statement of Income—Regulatory Basis."

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A129 The description of how the special purpose framework differs from GAAP ordinarily includes only the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described. The differences need not be quantified. [Paragraph subsequently renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A130 Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

[.A131] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A132 Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .80 requires the accountant to include an emphasis-of-matter paragraph in the accountant's review report that alerts users of the accountant's review report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A133 Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of SSARSs. The requirement in paragraph .80 is designed to avoid misunderstandings about the framework used to prepare the financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A134 If the special purpose financial statements are prepared in accordance with a contractual basis of accounting, paragraph .81 requires the accountant to include an other-matter paragraph in the accountant's review report, under an appropriate heading, that restricts the use of the accountant's review report to specified parties pursuant to paragraphs .103–.104. In the case of special purpose financial statements prepared in accordance with a basis of accounting other than a contractual basis, the accountant may consider it necessary in the circumstances of the engagement to include an alert that restricts the use of the accountant's review report but is not required to do so. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Comparative Financial Statements (Ref: par. .82)

.A135 The level of information included for the prior periods in comparative financial statements is comparable with that of financial statements of the current period. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A136 If one firm of accountants merges with another firm, and the new firm becomes the accountant of a client of one of the two former firms, the new firm may accept responsibility and issue a review report on the financial statements for the prior period(s) as well as for those of the current period. The new firm may indicate in the accountant's review report or as part of the signature that a merger took place and may name the firm with whom it was merged. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Updating the Report (Ref: par. .83)

.A137 An updated report is issued in conjunction with the continuing accountant's report on the current period financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Changed Reference to a Departure From the Applicable Financial Reporting Framework (Ref: par. .86)

.A138 A changed reference includes the removal of a prior reference or the inclusion of a new reference. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

[**A139–A142**] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraphs subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report (Ref: par. .89 and .91)

.A143 The accountant is required to include an emphasis-of-matter or other-matter paragraph in the accountant's review report relating to the following matters:

- In accordance with paragraph .55c with respect to reporting when management revises financial statements for a subsequently discovered fact that became known to the accountant after the report release date and the accountant's review report on the revised financial statements differs from the accountant's review report on the original financial statements
- In accordance with paragraphs .80–.81 with respect to financial statements prepared in accordance with a special purpose framework
- In accordance with paragraph .86 with respect to a changed reference to a departure from the applicable financial reporting framework when reporting on comparative financial statements
- In accordance with paragraph .87 with respect to reporting on comparative financial statements when the prior period is audited
- In accordance with paragraph .109 when, after considering conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains
- In accordance with paragraph .123 with respect to supplementary information that accompanies reviewed financial statements and the accountant's review report thereon
- In accordance with paragraph .124 with respect to required supplementary information

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Emphasis-of-Matter Paragraphs in the Accountant's Review Report (Ref: par. .89–.90)

.A144 In addition to the required emphasis-of-matter paragraphs listed in paragraph .A143, the following are examples of circumstances when the accountant may consider it necessary to include an emphasis-of-matter paragraph:

- An uncertainty relating to the future outcome of unusually important litigation or regulatory action
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position

- Significant transactions with related parties
- Unusually important subsequent events

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A145 Paragraph .89 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A146 Another heading may be considered appropriate if it adequately describes the nature of the matter being disclosed or communicated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A147 The accountant may add further context to the heading "Emphasis of Matter" (for example, "Emphasis of Matter — Subsequent Event") to further describe the nature of the matter addressed by the emphasis-of-matter paragraph. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A148 The inclusion of an emphasis-of-matter paragraph in the accountant's review report does not affect the accountant's conclusion. An emphasis-of-matter paragraph is not a substitute for the following:

- A modified conclusion in accordance with paragraphs .69–.74 when required by the circumstances of a specific review engagement
- Disclosures in the financial statements that the applicable financial reporting framework requires management to make
- Reporting in accordance with paragraphs .109–.112 when, after considering identified conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, in which case the accountant is required to include a separate section in the accountant's report

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Other-Matter Paragraphs in the Accountant's Review Report (Ref: par. .91)

.A149 If not properly presented or disclosed in the financial statements, a matter cannot be included in an emphasis-of-matter paragraph. However, if the matter is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the matter can be disclosed in an other-matter paragraph. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A150 An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board) and may engage the accountant to review both sets of financial statements. If the accountant has determined that the frameworks are acceptable in the respective circumstances, the accountant may include an other-matter paragraph in the accountant's review report referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the accountant has issued a review report on those financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A151 The content of an other-matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the accountant is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to the confidentiality of information). An other-matter paragraph does not include information that is required to be provided by management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Communication With Management (Ref: par. .93)

.A152 The accountant's communication with management, as described in paragraph .93, enables management to be made aware of the nature of any specific matters that the accountant intends to highlight in the accountant's review report and provides them with an opportunity to obtain further clarification from the accountant, when necessary. When the inclusion of an other-matter paragraph on a particular matter in the accountant's review report recurs on each successive engagement, the accountant may determine that it is unnecessary to repeat the communication on each engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A153 In addition to management, the accountant may also consider it appropriate to communicate with those charged with governance regarding the expectation of including an other-matter paragraph in the accountant's review

report and the proposed wording of this paragraph. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Correction of a Material Misstatement in Previously Issued Financial Statements (Ref: par. .94–.95)

.A154 The requirement for the accountant to include an emphasis-of-matter paragraph in the accountant's review report when there are adjustments to correct a material misstatement in previously issued financial statements applies when comparative or single-year financial statements are presented. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A155 A change from an accounting principle that is not in accordance with the applicable financial reporting framework to one that is in accordance with the applicable financial reporting framework is a correction of a misstatement. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A156 Paragraphs .54–.55 address the accountant's responsibilities when adjustments have been made to correct a material misstatement in previously issued financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A157 The following is an example of an emphasis-of-matter paragraph when there has been a correction of a material misstatement in previously issued financial statements:

Emphasis of Matter

As discussed in Note X to the financial statements, the 20X2 financial statements have been restated to correct a misstatement. Our conclusion is not modified with respect to this matter.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

Other Reporting Responsibilities (Ref: par. .97)

.A158 These other reporting responsibilities are addressed in a separate section of the accountant's report, to clearly distinguish them from the accountant's responsibility in accordance with this section to report on the financial statements. Where relevant, this section may contain subheadings that describe the content of the other reporting responsibilities paragraph or paragraphs. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.A159–.A164]⁶ [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraphs subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

⁶ [Footnote renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Alert That Restricts the Use of the Accountant's Review Report (Ref: par. .103)

.A165 The need for an alert that restricts the use of the accountant's review report arises from the potential for the accountant's review report to be misunderstood if taken out of the context in which the accountant's review report is intended to be used. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A166 Accountant's review reports on financial statements prepared in accordance with a general purpose framework ordinarily do not include an alert that restricts their use. A general purpose framework is a financial reporting framework designed to meet the common financial information needs of a wide range of users. However, nothing in SSARSs precludes an accountant from including an alert in any accountant's review report. For example, financial statements prepared specifically for use in an acquisition may be prepared in accordance with a general purpose framework because the parties involved in the transaction have agreed that such general purpose financial statements are appropriate for their purposes. Nevertheless, when the terms of the engagement to review those financial statements require the accountant to supply the accountant's review report only to specified parties, the accountant may consider it necessary in the circumstances to include an other-matter paragraph in the accountant's review report that restricts the use of the accountant's review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Distribution of the Accountant's Review Report (Ref: par. .103)

.A167 An accountant is not responsible for controlling, and cannot control, distribution of the accountant's review report after its release. The alert that restricts the use of the accountant's review report is designed to avoid misunderstandings related to the use of the accountant's review report, particularly if the accountant's review report is taken out of the context in which the accountant's review report is intended to be used. An accountant may consider informing the entity or other specified parties that the accountant's review report is not intended for distribution to parties other than those specified in the accountant's review report. The accountant may, in connection with establishing the terms of the engagement, reach an understanding with the entity that the intended use of the accountant's review report will be restricted and may obtain the entity's agreement that the entity and specified parties will not distribute such accountant's review report to parties other than those identified therein. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Illustrative Alert Language (Ref: par. .104)

.A168 The alert that restricts the use of the accountant's review report may list the specified parties or refer to the specified parties listed elsewhere in

the accountant's review report. The following illustrates language that includes the elements required by paragraph .104:

This report is intended solely for the information and use of *[list or refer to the specified parties]* and is not intended to be, and should not be, used by anyone other than these specified parties.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Adding Other Specified Parties (Ref: par. .105)

.A169 When the accountant is requested to add other parties as specified parties, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties and the intended use of the accountant's review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

The Accountant's Consideration of an Entity's Ability to Continue as a Going Concern

[.A170–.A175]^{7–8} [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraphs subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Implications for the Accountant's Review Report When Substantial Doubt Exists About the Entity's Ability to Continue as a Going Concern (Ref: .109–.110 and .112)

[.A176] [Paragraph renumbered and deleted by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A177 The identification of substantial doubt is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as going concern alerts users to this circumstance. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A178 The following are illustrations of the statements that are required to be included in the accountant's review report on the financial statements. The following illustrations provide examples in which FASB ASC is the applicable financial reporting framework. If an applicable financial reporting framework other than FASB ASC is used, the wording in the illustrations may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

^{7–8} [Footnote renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Illustration 1 — An Accountant's Review Report Containing an Unmodified Conclusion and Including a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure in The Financial Statements Is Adequate

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our conclusion is not modified with respect to this matter.

Illustration 2 — An Accountant's Review Report Containing an Unmodified Opinion Conclusion and Including an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated

Emphasis of Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our conclusion is not modified with respect to this matter.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

[A179] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A180 When FASB ASC or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the accountant's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term or phrase may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A181 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the review evidence obtained, the accountant concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the accountant may include an emphasis-of-matter paragraph in

accordance with paragraphs .89–.90, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions or events. In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the accountant concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the accountant is required by paragraph .109 to include a separate "Going Concern" section in the accountant's review report.

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A182 As indicated in paragraph .71, in circumstances in which conditions and events have been identified and the accountant concludes that, based on the review evidence obtained, the disclosures are materially misstated, the accountant is required to modify the accountant's review report. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

.A183 Examples of conditional language that are inappropriate to use in the "Going Concern" section include the following:

- If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- The Company has been unable to renegotiate its expiring credit agreements. Unless the entity is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A184 In certain circumstances, the accountant may believe it necessary to request that management perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework. If management is unwilling to do so, a qualified or adverse conclusion in the accountant's review report may be appropriate. For example, management may be unwilling to extend its evaluation because it believes it has satisfied the requirements to conclude whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time when the applicable financial reporting framework requires management to make this evaluation. If, in the accountant's judgment, management's conclusion is not adequately supported, the accountant may conclude that a qualified or adverse conclusion for a departure from the applicable financial reporting framework is appropriate in the circumstances. Paragraphs .69–.74 provide guidance related to the modification of the accountant's conclusion. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by

SSARS No. 25. Paragraph renumbered by the issuance of SSARS No. 26, June 2022.]

[**A185–A192**] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Reference to the Work of Other Accountants in an Accountant's Review Report (Ref: par. .122)

.A193 The accountant of the reporting entity may make reference to any or all other accountants who audited or reviewed significant components. For example, if a significant component is audited or reviewed by an other accountant and a second significant component is audited or reviewed by a different other accountant, the accountant of the reporting entity may decide to make reference to one of the other accountants, both of the other accountants, or neither. The decision is solely at the discretion and judgment of the accountant of the reporting entity. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A194 The disclosure of the magnitude of the portion of the financial statements audited or reviewed by other accountants may be achieved by stating the dollar amounts or percentages of total assets, total revenues, other appropriate criteria, or a combination of these, whichever most clearly describes the portion of the financial statements audited or reviewed by other accountants. When two or more other accountants participate in the audit or review, the dollar amounts or the percentages covered by the other accountants may be stated in the aggregate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A195 Exhibit C contains an example of appropriate reporting in the accountant's review report when reference is made to the audit or review of significant components, such as consolidated and unconsolidated subsidiaries and investees, by other accountants.⁹ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Determining Whether the Other Accountants Are Familiar with SSARSs or Auditing Standards Generally Accepted in the United States of America, as Applicable (Ref: par. .124b)

.A196 An other accountant's review report stating that the review was conducted in accordance with SSARSs or an auditor's report stating that the audit was conducted in accordance with generally accepted auditing standards (GAAS) is sufficient to make the determination required by paragraph .124b.

⁹ Illustration 6, "An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component," of exhibit C. [Footnote renumbered by the issuance of SSARS No. 24, May 2018. Footnote subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

When the other accountant has performed a review of the component financial statements in accordance with standards other than SSARSs or an audit of the component financial statements in accordance with auditing standards other than GAAS, the accountant of the reporting entity may evaluate, exercising professional judgment, whether the engagement performed by the other accountant meets the relevant requirements of SSARSs or GAAS, as applicable. For the purposes of complying with paragraph .124*b*, relevant requirements of SSARSs or GAAS are those that pertain to planning and performing the engagement on the component financial statements and do not include those related to the form of the accountant's review or the auditor's report. Reviews performed in accordance with International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, and audits performed in accordance with International Standards on Auditing (ISAs), both of which are promulgated by the International Auditing and Assurance Standards Board (IAASB), are likely to meet the relevant requirements of SSARSs and GAAS, respectively. The other accountants may perform additional procedures in order to meet the relevant requirements of SSARSs or GAAS. The accountant of the reporting entity, having determined that all relevant requirements of SSARSs or GAAS have been met by the other accountant, may decide to make reference to the review or audit of that other accountant in the accountant's review report on the reporting entity's financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A197 When the other accountants are not subject to the AICPA Code of Professional Conduct, compliance by the other accountants with the ethics and independence requirements set forth in the International Ethics Standards Board's *Code of Ethics for Professional Accountants* is sufficient to fulfill the other accountants' ethical responsibilities. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same (Ref: par. .125*b*)

.A198 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of all material items in the component's financial statements in accordance with the financial reporting framework used by the component and the financial reporting framework used by the reporting entity, the less similar the financial reporting frameworks. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRS) and *International Financial Reporting Standard for Small- and Medium-Sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as similar to financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In most cases, special purpose frameworks are not similar to GAAP. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Supplementary Information That Accompanies Reviewed Financial Statements (Ref: par. .126-.128)

[A199] [Paragraph renumbered and deleted by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A200 The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the supplementary information has been subjected to the review procedures applied in the accountant's review of the basic financial statements:

Other Matter

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The supplementary information has been subjected to the review procedures applied in my (our) review of the basic financial statements. I am (We are) not aware of any material modifications that should be made to the supplementary information. I (We) have not audited the supplementary information and do not express an opinion on such information.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A201 The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the supplementary information has not been subjected to the review procedures applied in the review of the basic financial statements:

Other Matter

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. I (We) have not audited or reviewed such information and I (we) do not express an opinion, a conclusion, nor provide any assurance on it.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

A202 Supplementary information may become unattached from the accountant's review report. To minimize the possibility that a user of the supplementary information may infer, through the accountant's association with such information, an unintended level of reliance on it, the accountant may consider including a reference to the accountant's review report on each page of the supplementary information. An example of a reference to the accountant's review report included on each page of the supplementary information is "See independent accountant's review report." [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered

by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Required Supplementary Information (Ref: par. .129–.130)

.A203 Examples of required supplementary information that may accompany reviewed financial statements include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by FASB *Accounting Standards Codification* 972-235-50-3
- Management's discussion and analysis and budgetary comparison statements as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A204 *Prescribed guidelines* are the authoritative guidelines established by the designated accounting standard-setter for the methods of measurement and presentation of the required supplementary information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A205 Because the required supplementary information accompanies the basic financial statements, the accountant's review report on the financial statements includes a discussion of the responsibility taken by the accountant on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Change in Engagement From Audit to Review (Ref: par. .132)

.A206 A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit engagement; a misunderstanding regarding the nature of an audit or review engagement; or a restriction on the scope of the audit engagement, whether imposed by management or caused by circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A207 A change in circumstances that affects the entity's requirement for an audit engagement or a misunderstanding concerning the nature of an audit

or review engagement would ordinarily be considered a reasonable basis for requesting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A208 The implications of a restriction on the scope of the audit engagement include the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Review Documentation (Ref: par. .137)

.A209 Review documentation may be recorded on paper or on electronic or other media. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A210 The accountant need not include in review documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A211 The accountant is not precluded from supporting the review report by other means in addition to the review documentation. Such other means might include written documentation contained in other engagement files (for example, compilation or nonattest services) or quality control files (for example, consultation files) and, in limited situations, oral explanations. On their own, oral explanations by the accountant do not represent adequate support for the work the accountant performed or conclusions reached, but they may be used to explain or clarify information contained in the review documentation. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A212 In the case of a review in which the engagement partner performs all the review work, the engagement partner is still required to comply with the overriding requirement in paragraph .137 to prepare review documentation that can be understood by an experienced accountant because the review documentation may be subject to review by external parties. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A213 Findings or issues that, in the accountant's professional judgment, are significant may include the results of review procedures that indicate that

the financial statements could be materially misstated, including actions taken to address such findings and the basis for the final conclusions. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Appendix A — Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements (Ref: par. .A29)

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. Examples of analytical procedures that an accountant may consider performing in a review of financial statements include the following:

- Comparing current financial statements with the financial statements of the prior period.
- Comparing current financial statements with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial statements with corresponding information in [a] budgets, using expected rates, and [b] financial statements for prior periods). Caution is necessary when comparing and evaluating current financial statements with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results.
- Comparing current financial statements with relevant nonfinancial information.
- Comparing ratios and indicators for the current period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current financial statements and comparing the results with corresponding information for prior periods). Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial statements with corresponding relationships in the financial statements of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables).
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
 - By period (for example, financial statement items disaggregated into quarterly, monthly, or weekly amounts)
 - By product line or operating segment
 - By location (for example, subsidiary, division, or branch)

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

[.A215] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

Exhibit A — Illustrative Engagement Letters (Ref: par. .A29)

Illustration 1 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

The illustrative engagement letters in this exhibit are intended as illustrations that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances, and the illustrations are drafted to refer to a review engagement for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

Illustration 1 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the review engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements and perform a review engagement with respect to those financial statements.³ We are pleased to confirm our acceptance and understanding of this engagement by means of this letter.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A25.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America

- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the review engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services.

Our Report

[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows.]

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from accounting principles generally accepted in the United States of America, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

You agree to include our accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services. . .

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's

knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review of those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements; Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Illustration 2 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the review engagement.
- The financial statements will be prepared in accordance with the tax basis of accounting.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity—tax basis as of December 31, 20XX, and the related statements of operations and retained earnings—tax basis, and cash flows—tax basis for the year then ended, and the related notes to the financial statements and to perform a review engagement with respect to those financial statements.³ We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A25.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with the tax basis of accounting based on information provided by you and
- b. obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting.

We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with the tax basis of accounting and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of the tax basis of accounting as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of the financial statements in accordance with the tax basis of accounting and the inclusion of all informative disclosures that are appropriate for the tax basis of accounting. This includes
 - i. a description of the tax basis of accounting, including a summary of significant accounting policies, and how the tax basis of accounting differs from accounting principles

generally accepted in the United States of America, the effects of which need not be qualified

- ii. informative disclosures similar to those required by accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the review engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows.]

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary of us to report known departures from the tax basis of accounting, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our report will state that the financial statements are prepared in accordance with tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion will not be modified with respect to this matter.

You agree to include our accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services. . .

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review with respect to those same financial statements and our respective responsibilities. Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A217

Exhibit B — Illustrative Representation Letter (Ref: par. .A97)

The following illustrative letter is intended as an illustration that may be used to comply with the requirements of section 90. The representation letter will vary according to individual requirements and circumstances.

It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States of America, that no conditions or events exist that might be indicative of the entity's inability to continue as a going concern, and that no exceptions exist to the requested written representations. If circumstances differ from these assumptions, the representations would need to be modified to reflect the actual circumstances.

(Entity Letterhead)

(To Accountant)

(Date)

This representation letter is provided in connection with your review of the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements, for the purpose of obtaining limited assurance as a basis for reporting whether you are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We represent that *[to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves]* *[as of (date of accountant's review report)]*:

Financial Statements

- We acknowledge our responsibility and have fulfilled our responsibilities for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- We acknowledge our responsibility and have fulfilled our responsibilities for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Guarantees, whether written or oral, under which the company is contingently liable have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB *Accounting Standards Codification* (ASC) 275, *Risks and Uncertainties*, have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America. [Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]
- All events occurring subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America requires adjustment or disclosure have been properly accounted for.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole.
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.

[Any other matters that the accountant may consider appropriate.]

Information Provided

- We have responded fully and truthfully to all inquiries made to us by you during your review.
- We have provided you with
 - access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - minutes of meetings of stockholders, directors, and committees of directors or summaries of actions of recent meetings for which minutes have not yet been prepared;
 - additional information that you have requested from us for the purpose of the review; and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain review evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.

- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* fraud or suspected fraud that affects the entity and involves
 - management,
 - employees who have significant roles in internal control, or
 - others when the fraud could have a material effect on the financial statements.
- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* allegations of fraud, or suspected fraud, affecting the entity's financial statements as a whole communicated by employees, former employees, analysts, regulators, or others.
- We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
- We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws or regulations whose effects should be considered when preparing financial statements.
- We *[have disclosed to you all known actual or possible]* *[are not aware of any pending or threatened]* litigation and claims whose effects should be considered when preparing the financial statements *[and we have not consulted legal counsel concerning litigation or claims]*
- We have disclosed to you any other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies*.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- We have disclosed to you all information relevant to the use of the going concern assumption in the financial statements.
- No material losses exist (such as from obsolete inventory or purchase or sale commitments) that have not been properly accrued or disclosed in the financial statements.
- The company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
- We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- We are in agreement with the adjusting journal entries that you have recommended, and they have been posted to the company's accounts (if applicable).

[Any other matters that the accountant may consider necessary.]

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

Representation letters ordinarily are tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

.A218

Exhibit C — Illustrations of Accountant's Review Reports on Financial Statements (Ref: par. .A125 and .A193)

The illustrative accountant's review reports in this exhibit are intended as illustrations that may be used to comply with the requirements of section 90. The accountant's review report will vary according to individual requirements and circumstances.

Illustration 1 — An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Illustration 2 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 3 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 4 — An Accountant's Review Report on Interim Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 5 — An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America

Illustration 6 — An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component

Illustration 7 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America Containing an Adverse Conclusion Due to a Misstatement of the Financial Statements That Is Both Material and Pervasive to the Financial Statements

Illustration 1 — An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 2 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of financial statements (single year).
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 3 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- Review of a complete set of financial statements (single year).
- The financial statements are of a partnership and prepared in accordance with the basis of accounting the partnership uses for income tax purposes (that is, a special purpose framework).
- Management has a choice of financial reporting frameworks.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Partnership, which comprise the statement of assets, liabilities, and partners' capital—tax basis as of December 31, 20XX, and the related statements of revenue and expenses—tax basis, and partners' capital—tax basis for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (partners') financial data and making inquiries of partnership management (partners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Partners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting the partnership uses for income tax purposes; this includes determining that the basis of accounting the partnership uses for income tax purposes is an acceptable basis for the preparation of financial statements in the circumstances. Management (Partners) is (are) also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with the basis of accounting the partnership uses for income tax purposes. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Partnership and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the basis of accounting the partnership uses for income tax purposes.

Basis of Accounting

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the basis of accounting the partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion is not modified with respect to this matter.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 4 — An Accountant's Review Report on Interim Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of interim financial statements for the period ended September 30, 20XX, and for the three and nine months then ended.
- The interim financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.
- The accountant appropriately performs the engagement in accordance with SSARs (that is, AU-C section 930, *Interim Financial Information*, is not applicable).

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying interim financial statements of XYZ Company, which comprise the balance sheet as of September 30, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the three and nine months then ended, and the related notes to the interim financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the interim financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these interim financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the interim financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying interim financial statements in order

for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 5 — An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements contain a departure from accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Basis for Qualified Conclusion

As disclosed in Note X to these financial statements, accounting principles generally accepted in the United States of America require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that

the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from accounting principles generally accepted in the United States of America on financial position, results of operations, and cash flows have not been determined.

or

As disclosed in Note X to these financial statements, the company has adopted *[description of newly adopted method]*, whereas it previously used *[description of previous method]*. Although the *[description of newly adopted method]* is in accordance with accounting principles generally accepted in the United States of America, the company does not appear to have reasonable justification for making a change as required by FASB *Accounting Standards Codification 250, Accounting Changes and Error Corrections*.

Qualified Conclusion

Based on my (our) reviews, except for the effect of the matter described in the Basis for Qualified Conclusion paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 6 — An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component

Circumstances include the following:

- Review of a complete set of comparative consolidated financial statements.
- The financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X2 and 20X1, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended, were reviewed by other accountants, and the accountant has decided to make reference to the work of other accountants in the accountant's review report.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying consolidated financial statements of XYZ Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X2 and 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA. We have not reviewed the financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X2 and 20X1, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. These statements were reviewed by other accountants, whose report has been furnished to me (us), and our conclusion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other accountants.

SSARSs require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the consolidated financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Accountant's Conclusion

Based on my (our) reviews, and the report of other accountants, I am (we are) not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 7 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America Containing an Adverse Conclusion Due to a Misstatement of the Financial Statements That Is Both Material and Pervasive to the Financial Statements

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements contain a departure from accounting principles generally accepted in the United States of America that is both material and pervasive to the financial statements due to nonconsolidation of a subsidiary.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Basis for Adverse Conclusion

As disclosed in Note X to these financial statements, the Company has not consolidated the financial statements of subsidiary ABC Company it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Adverse Conclusion

Based on my (our) review, due to the significance of the matter described in the Basis for Adverse Conclusion paragraph, the financial statements are not in accordance with accounting principles generally accepted in the United States

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of America. [Had we been engaged to perform an audit, other matters might have come to our attention.]

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. Paragraph subsequently renumbered by the issuance of SSARS No. 26, June 2022.]

AR-C Section 90A

Review of Financial Statements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 24; SSARS No. 25.

Effective for reviews of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope and Applicability of This Section

.01 This section applies when the accountant is engaged to perform a review of financial statements. This section also applies when the accountant is engaged to review other historical financial information, excluding pro forma financial information. Reviews of pro forma financial information are to be performed in accordance with Statements on Standards for Attestation Engagements. (Ref: par. .A1–.A3) [As amended, effective October 2016, by SSARS No. 23.]

.02 This section does not apply when the accountant is engaged to review interim financial information when

- a. the entity's latest annual financial statements have been audited by the accountant or a predecessor;
- b. the accountant either
 - i. has been engaged to audit the entity's current year financial statements or
 - ii. audited the entity's latest annual financial statements and, in situations in which it is expected that the current year financial statements will be audited, the engagement of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review; and
- c. the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

AU-C section 930, *Interim Financial Information*, provides guidance for review engagements when the conditions in a–c are met.

The Engagement to Review Financial Statements

.03 In a review of financial statements, the accountant expresses a conclusion regarding the entity's financial statements in accordance with an applicable financial reporting framework. The accountant's conclusion is based on the accountant obtaining limited assurance. The accountant's report includes a description of the nature of a review engagement as context for the readers of the report to be able to understand the conclusion. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.04 The accountant performs primarily analytical procedures and inquiries to obtain sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, expressed in accordance with the requirements of this section. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.05 If the accountant becomes aware of a matter that causes the accountant to believe the financial statements may be materially misstated, the accountant designs and performs additional procedures, as the accountant considers necessary in the circumstances, to be able to conclude on the financial statements in accordance with this section. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Effective Date

.06 This section is effective for reviews of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Objectives

.07 In conducting a review of financial statements, the objectives of the accountant are to

- a. obtain limited assurance, primarily by performing analytical procedures and inquiries, as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework and (Ref: par. .A4)
- b. report on the financial statements as a whole and communicate, as required by this section.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Definitions

.08 For purposes of Statements on Standards for Accounting and Review Services (SSARSS), the following terms have the meanings attributed as follows:

Analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Comparative financial statements. A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period.

Emphasis-of-matter paragraph. A paragraph included in the accountant's review report that is required by SSARSS, or is included at the

accountant's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.

Error. Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

Experienced accountant. An individual (whether internal or external to the firm) who has practical review experience and a reasonable understanding of

- a. review processes;
- b. SSARs and applicable legal and regulatory requirements;
- c. the business environment in which the entity operates; and
- d. review and financial reporting issues relevant to the entity's industry.

Fraud. An intentional act that results in a misstatement in financial statements.

Generally accepted accounting principles (GAAP). References to GAAP in SSARs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Inquiry. Inquiry consists of seeking information of knowledgeable persons within or outside the entity.

Limited assurance. A level of assurance that is less than the reasonable assurance obtained in an audit engagement but is at an acceptable level as the basis for the conclusion expressed in the accountant's review report. (Ref: par. .A10)

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board or an owner-manager.

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Modified conclusion. A qualified conclusion or an adverse conclusion.

Noncompliance. Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Other-matter paragraph. A paragraph included in the accountant's review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report.

Pervasive. A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements. Pervasive effects on the financial statements are those that, in the accountant's judgment

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent or could represent a substantial portion of the financial statements; or
- with regard to disclosures, are fundamental to users' understanding of the financial statements.

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of review evidence.

Reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). (Ref: par. .A11)

Report release date. The date the accountant grants the entity permission to use the accountant's review report in connection with the financial statements.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Review documentation. The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant

reached (terms such as *working papers* or *workpapers* are also sometimes used).

Review evidence. Information used by the accountant to provide a reasonable basis for obtaining limited assurance. Review evidence includes both information contained in the accounting records underlying the financial statements and other information, which primarily consists of the results of analytical procedures and inquiries. Sufficiency of review evidence is the measure of the quantity of review evidence. Appropriateness of review evidence is the measure of the quality of review evidence, that is, its relevance and reliability in providing support for the conclusions on which the accountant's review report is based.

Specified parties. The intended users of the accountant's review report.

Subsequent events. Events occurring between the date of the financial statements and the date of the accountant's review report.

Subsequently discovered facts. Facts that become known to the accountant after the date of the accountant's review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant's review report.

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the reviewed financial statements or separate from the reviewed financial statements. (Ref: par. A13–A14)

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Updated report. A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant's current engagement and that re-expresses the accountant's previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant's current report.

Written representation. A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

[As amended, effective October 2016, by SSARS No. 23. As amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Requirements

General Principles for Performing and Reporting on Review Engagements

.09 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Independence

.10 The accountant must be independent of the entity when performing a review of financial statements in accordance with SSARSs. If, during the performance of the review engagement, the accountant determines that the accountant's independence is impaired, the accountant should withdraw from the review engagement. (Ref: par. .A15–.A16) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Professional Skepticism

.11 The accountant should plan and perform the review with professional skepticism, recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: par. .A17–.A21) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Acceptance and Continuance of Client Relationships and Review Engagements

.12 The accountant should not accept a review engagement if, in addition to the requirements in paragraph .25 of section 60A, management or those charged with governance impose a limitation on the scope of the accountant's work in terms of a proposed review engagement such that the accountant believes the limitation will result in the accountant being unable to perform review procedures to provide an adequate basis for issuing a review report. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.13 As a condition for accepting an engagement to review an entity's financial statements, in addition to the requirements in paragraph .26 of section 60A, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes (Ref: par. .A22)
 - i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those

required by GAAP in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP; (Ref: par. .A126)

- ii. a description of any significant interpretations of the contract on which the special purpose financial statements are based in the case of financial statements prepared in accordance with a contractual basis of accounting; and
 - iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.
- b. to provide the accountant, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
 - c. to include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by the entity's accountant unless a different understanding is reached. (Ref: par. .A23)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.14 If the accountant is not satisfied about any of the matters set out in paragraph .26 of section 60A or paragraph .13 of this section as preconditions for accepting a review engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.15 If it is discovered after the engagement has been accepted that the accountant is not satisfied regarding any of the preconditions in paragraph .26 of section 60A or paragraph .13 of this section, the accountant should discuss the matter with management or those charged with governance and should determine the following:

- a. Whether the matter can be resolved
- b. Whether it is appropriate to continue with the engagement
- c. Whether and how to communicate the matter in the accountant's report

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Agreement on Engagement Terms

.16 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A24–.A29)

- a. The objectives of the engagement
- b. The responsibilities of management set forth in paragraph .26b of section 60A and paragraph .13 of this section
- c. The responsibilities of the accountant

- d. The limitations of a review engagement, including a statement that a review is substantially less in scope than an audit and that the accountant will not express an opinion on the financial statements
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. The expected form and content of the accountant's review report and a statement that there may be circumstances in which the report may differ from its expected form and content

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25. As amended, effective upon issuance for reviews of financial statements, by SSARS No. 26, June 2022.]

.17 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate.
(Ref: par. .A25)

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Communication With Management and Those Charged With Governance

.18 The accountant should communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review engagement that, in the accountant's professional judgment, are of significant importance to merit the attention of management or those charged with governance, as appropriate. (Ref: par. .A30–.A36) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Performing the Engagement

Materiality in a Review of Financial Statements

.19 The accountant should determine materiality for the financial statements as a whole and apply this materiality in designing the procedures and evaluating the results obtained from those procedures. (Ref: par. .A37–.A40) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.20 The accountant should revise materiality for the financial statements as a whole if the accountant becomes aware of information during the review that would have caused the accountant to have determined a different amount initially. (Ref: par. .A41) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Understanding of the Industry

.21 To perform the review engagement, the accountant should possess or obtain an understanding of the industry in which the entity operates, including the accounting principles and practices generally used in the industry,

sufficient to enable the accountant to review financial statements that are appropriate for an entity operating in that industry. (Ref: par. .A42) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Knowledge of the Entity

.22 The accountant should obtain knowledge about the entity, including an understanding of

- a. the entity's business and
- b. the accounting principles and practices used by the entity

sufficient to identify areas in the financial statements in which there is a greater likelihood that material misstatements may arise and to be able to design procedures to address those areas. (Ref: par. .A43–.A44) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.23 In obtaining the understanding of the entity's accounting policies and practices, the accountant should be alert to accounting policies and procedures that, based on the accountant's knowledge of the industry, are unusual. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Designing and Performing Review Procedures

.24 The accountant should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to obtain sufficient appropriate review evidence as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework based on the accountant's (Ref: par. .A45)

- a. understanding of the industry,
- b. knowledge of the entity, and
- c. awareness of the risk that the accountant may unknowingly issue an inappropriate accountant's review report. (Ref: par. .A46)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.25 In obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, the accountant should design and perform the analytical procedures and inquiries to address the following: (Ref: par. .A47)

- a. All material items in the financial statements, including disclosures
- b. Areas in the financial statements where the accountant believes there are increased risks of material misstatements

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Analytical Procedures

.26 The accountant should apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Such analytical procedures should include the following: (Ref: par. .A48–.A50)

- a. Comparing the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions
- b. Considering plausible relationships among both financial and, when relevant, nonfinancial information (Ref: par. .A51)
- c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist, based on the accountant's understanding of the entity and the industry in which the entity operates (Ref: par. .A52)
- d. Comparing disaggregated revenue data, as applicable (Ref: par. .A53)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.27 When designing and performing analytical procedures, the accountant should (Ref: par. .A54)

- a. determine the suitability of particular analytical procedures;
- b. consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available;
- c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph .28 and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Investigating Results of Analytical Procedures

.28 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the accountant should investigate such differences by

- a. inquiring of management and
- b. performing other review procedures if considered necessary in the circumstances. (Ref: par. .A55)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters

.29 The accountant should inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements, and others within the entity, as appropriate, about (Ref: par. .A56)

- a. whether the financial statements have been prepared and fairly presented in accordance with the applicable financial reporting

framework consistently applied, including how management determined that significant accounting estimates are reasonable in the circumstances.

- b.* the identification of related parties and related party transactions, including the purpose of those transactions
- c.* whether there are significant, unusual, or complex transactions, events, or matters that have affected or may affect the entity's financial statements, including the following: (Ref: par. .A57)
 - i.* Significant changes in the entity's business activities or operations
 - ii.* Significant changes to the terms of contracts that materially affect the entity's financial statements, including terms of finance and debt contracts or covenants
 - iii.* Significant journal entries or other adjustments to the financial statements
 - iv.* Significant transactions occurring or recognized during the period, particularly those in the last several days of the reporting period
 - v.* The status of any uncorrected misstatements identified during the previous review (that is, whether adjustments were recorded subsequent to the periods covered by the prior review and, if adjustments were recorded, the amounts recorded and period in which such adjustments were recorded)
 - vi.* Effects or possible implications for the entity of transactions or relationships with related parties
- d.* matters about which questions have arisen in the course of applying the review procedures.
- e.* the existence of any actual, suspected, or alleged
 - i.* fraud or noncompliance with laws and regulations affecting the entity and (Ref: par. .A58)
 - ii.* noncompliance with provisions of laws and regulations that are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations.
- f.* whether management has identified and addressed events subsequent to the date of the financial statements that require adjustment of, or disclosure in, the financial statements.
- g.* the basis for management's assessment of the entity's ability to continue as a going concern.
- h.* whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern.
- i.* material commitments, contractual obligations, or contingencies that have affected or may affect the entity's financial statements, including disclosures.
- j.* material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration.
- k.* communications from regulatory agencies, if applicable.

- l.* any litigation, claims, and assessments that existed at the date of the balance sheet being reported on and during the period from the balance sheet date to the date of management's response to the accountant's inquiry.
- m.* actions taken at meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements. (Ref: par. .A59)
- n.* any other matters that the accountant may consider necessary.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.30 The accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business. However, the accountant is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Reading the Financial Statements

.31 The accountant should read the financial statements and consider whether any information has come to the accountant's attention to indicate that such financial statements do not conform to the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Procedures to Address Specific Circumstances

Related Parties

.32 During the review, the accountant should remain alert for arrangements or information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the accountant. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.33 If the accountant identifies significant transactions outside the entity's normal course of business when performing the review procedure required by paragraph .32 or through other review procedures, the accountant should inquire of management about the following:

- a.* The nature of these transactions (Ref: par. .A60)
- b.* Whether related parties could be involved

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Fraud and Noncompliance With Laws or Regulations

.34 When there is an indication that fraud or noncompliance with laws or regulations has occurred, or is suspected to have occurred, the effects of which should be considered when preparing financial statements, the accountant should do the following:

- a.* Communicate identified or suspected fraud as soon as practical to the appropriate level of senior management (at a level above those involved with the suspected fraud, if possible) or those charged with governance, as appropriate.

- b. Communicate to management identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements, other than matters that are clearly inconsequential. (Ref: par. .A61)
- c. Request management's assessment of the effects, if any, on the financial statements.
- d. Consider the effect, if any, of management's assessment of the effects of fraud or noncompliance with laws or regulations communicated to the accountant on the accountant's conclusion on the financial statements and on the accountant's report.
- e. Determine whether there is a responsibility to report the occurrence or suspicion of fraud or noncompliance with laws and regulations to a party outside the entity. (Ref: par. .A62)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.35 If the fraud or noncompliance with laws or regulations involves senior management or results in a material misstatement of the financial statements, the accountant should communicate the matter directly to those charged with governance. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.36 The accountant should consider the need to obtain legal advice and take appropriate action, including potential withdrawal, if management or, as appropriate, those charged with governance do not provide sufficient information that supports either of the following: (Ref: par. .A63)

- a. The financial statements are not materially misstated due to fraud.
- b. The entity is in compliance with laws and regulations, and in the accountant's professional judgment, the effect of the suspected noncompliance may be material to the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Going Concern

.37 If the applicable financial reporting framework includes requirements for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements, the accountant should perform review procedures related to the following: (Ref: par. .A64–.A65)

- a. Whether the going concern basis of accounting is appropriate
- b. Management's evaluation of whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
- c. If there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, management's plans to mitigate those matters
- d. The adequacy of the related disclosures in the financial statements

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.38 If the applicable financial reporting framework does not include a requirement for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements, and conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time existed at the date of the prior period financial statements (regardless of whether the substantial doubt was alleviated by the accountant's consideration of management's plans) or, in the course of performing review procedures on the current period financial statements, the accountant becomes aware of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, the accountant should do the following: (Ref: par. .A66–.A67)

- a. Inquire of management whether the going concern basis of accounting is appropriate.
- b. Inquire of management about its plans for addressing the adverse effects of the conditions and events. (Ref: par. .A68)
- c. Consider the adequacy of the disclosure about such matters in the financial statements. (Ref: par. .A69)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Using the Work of Others

.39 In performing the review, it may be necessary for the accountant to use work performed by other accountants, or the work of an individual or organization possessing expertise in a field other than financial reporting. If the accountant uses work performed by another accountant or an expert in the course of performing the review, the accountant should take appropriate steps to be satisfied that the work performed is adequate for the accountant's purposes. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.40 If other accountants have issued a report on the financial statements of significant components, such as subsidiaries and investees, the accountant should obtain and read reports from such other accountants. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Reconciling the Financial Statements to the Underlying Accounting Records

.41 The accountant should obtain evidence that the financial statements agree or reconcile with the accounting records. (Ref: par. .A70) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Additional Procedures When the Accountant Becomes Aware That the Financial Statements May Be Materially Misstated

.42 If the accountant becomes aware of a matter or matters that cause the accountant to believe the financial statements may be materially misstated, the accountant should design and perform additional procedures sufficient to enable the accountant to (Ref: par. .A71–.A75)

- a. conclude that the matter or matters are not likely to cause the financial statements as a whole to be materially misstated or
- b. determine that the matter or matters cause the financial statements as a whole to be materially misstated.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Evaluating Review Evidence Obtained From the Procedures Performed

[.43–.44] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.45 If, during the performance of review procedures, the accountant becomes aware that information coming to the accountant's attention is incorrect, incomplete, or otherwise unsatisfactory, the accountant should

- a.* request that management consider the effect of those matters on the financial statements and communicate the results of its consideration to the accountant and
- b.* consider the results communicated to the accountant by management and whether such results indicate that the financial statements may be materially misstated.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

[.46] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.47 The accountant should evaluate whether sufficient appropriate review evidence has been obtained from the procedures performed and, if sufficient appropriate review evidence has not been obtained from the procedures performed, the accountant should perform other procedures that, in the accountant's professional judgment, are necessary in the circumstances to be able to form a conclusion on the financial statements. (Ref: par. .A78) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.48 If the accountant is not able to obtain sufficient appropriate review evidence to form a conclusion, the accountant should withdraw from the engagement. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequent Events and Subsequently Discovered Facts

Subsequent Events

.49 When evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements comes to the accountant's attention, the accountant should request that management consider whether each such event is appropriately reflected in the financial statements in accordance with the applicable financial reporting framework. (Ref: par. .A79) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.50 If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, the accountant should follow the guidance in paragraphs .69–.72. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequently Discovered Facts That Become Known to the Accountant Before the Report Release Date

.51 The accountant is not required to perform any review procedures regarding the financial statements after the date of the accountant's review report. However, if a subsequently discovered fact becomes known to the accountant before the report release date, the accountant should

- a. discuss the matter with management and, when appropriate, those charged with governance and
- b. determine whether the financial statements need revision and, if revision is needed, inquire how management intends to address the matter in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.52 If management revises the financial statements, the accountant should perform the review procedures necessary in the circumstances on the revision. The accountant should also do either of the following:

- a. Date the accountant's review report as of a later date.
- b. Include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, dual-date the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report are limited solely to the revision described in the relevant note to the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.53 If management does not revise the financial statements in circumstances in which the accountant believes they need to be revised, the accountant should modify the accountant's review report or withdraw, as appropriate. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequently Discovered Facts That Become Known to the Accountant After the Report Release Date

.54 If a subsequently discovered fact becomes known to the accountant after the report release date, the accountant should (Ref: par. .A80–.A81)

- a. discuss the matter with management and, when appropriate, those charged with governance and
- b. determine whether the financial statements need revision and, if revision is needed, inquire how management intends to address the matter in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.55 If management revises the financial statements, the accountant should do the following:

- a. Apply the requirements of paragraph .52.
- b. If the reviewed financial statements (before revision) have been made available to third parties, assess whether the steps taken

by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph .56. (Ref: par. .A82)

- c. If the accountant's conclusion on the revised financial statements differs from the accountant's conclusion on the original financial statements, disclose in an emphasis-of-matter paragraph, in accordance with paragraphs .89–.90,
 - i. the date of the accountant's previous report,
 - ii. a description of the revisions, and
 - iii. the substantive reasons for the revisions.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.56 If management does not revise the financial statements in circumstances in which the accountant believes they need to be revised, then the accountant should do the following:

- a. If the reviewed financial statements have not been made available to third parties, notify management and those charged with governance (unless all of those charged with governance are involved in managing the entity) not to make the reviewed financial statements available to third parties before the necessary revisions have been made and a new accountant's review report on the revised financial statements has been provided. If the reviewed financial statements are, nevertheless, subsequently made available to third parties without the necessary revisions, the accountant should apply the requirements of paragraph .56*b*.
- b. If the reviewed financial statements have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph .57. (Ref: par. .A81)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.57 If management does not take the necessary steps to ensure that anyone in receipt of the financial statements is informed of the situation, as provided by paragraph .55*b* or paragraph .56*b*, the accountant should notify management and those charged with governance (unless all of those charged with governance are involved in managing the entity) that the accountant will seek to prevent future use of the accountant's review report. If, despite such notification, management or those charged with governance do not take the necessary steps, the accountant should take appropriate action to seek to prevent use of the accountant's review report. (Ref: par. .A83–.A86) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Written Representations

Written Representations as Review Evidence

.58 *Written representations* are necessary information that the accountant requires in connection with a review of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are review evidence. (Ref: par. .A87) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Management From Whom Written Representations Are Requested

.59 The accountant should request written representations from members of management who have appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: par. .A88–.A90) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Specific Written Representations

.60 For all financial statements presented and all periods covered by the review, the accountant should request management to provide written representations that are dated as of the date of the accountant's review report and that indicate that it has fulfilled its responsibilities, as set out in the terms of the engagement, including the following: (Ref: par. .A91–.A97)

- a. Management has fulfilled its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
- b. Management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements, including its responsibility to prevent and detect fraud.
- c. All transactions have been recorded and are reflected in the financial statements.
- d. Management has provided the accountant with all relevant information and access to information, as agreed upon in the terms of the engagement.
- e. Management has responded fully and truthfully to all of the accountant's inquiries
- f. Management has disclosed to the accountant the identity of the entity's related parties and all the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.
- g. Management has disclosed to the accountant significant facts relating to any fraud or suspected fraud known to management that may have affected the entity involving
 - i. management,
 - ii. employees who have significant roles in internal control, or
 - iii. others, when the fraud could have a material effect on the financial statements.
- h. Management has disclosed to the accountant significant facts relating to any allegations of fraud or suspected fraud known to

management that may have affected the entity's financial statements communicated by employees, former employees, regulators, or others.

- i.* Management has disclosed to the accountant all known actual or possible instances of noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
- j.* Management has disclosed to the accountant all information relevant to the use of the going concern assumption in the financial statements.
- k.* Management has properly accounted for all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure, and it has made the necessary adjustments or disclosures.
- l.* Management has disclosed to the accountant whether it believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation.
- m.* Management has disclosed to the accountant all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.
- n.* Management has disclosed to the accountant whether it believes that significant assumptions it used in making accounting estimates are reasonable.

[As amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.61 If, in addition to the representations required by paragraph .60, the accountant determines that it is necessary to obtain one or more written representations to support other review evidence relevant to the financial statements, the accountant should request such other written representations. (Ref: par. .A98) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Form of Written Representations

.62 The written representations should be in the form of a representation letter addressed to the accountant. (Ref: par. .A99–.A100) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Concerns About the Reliability of Written Representations and Requested Written Representations Not Provided

.63 If, in relation to the written representations required by paragraphs .60–.61

- a.* management does not provide the written representations, or
- b.* the accountant concludes that there is cause to doubt management's integrity such that the written representations provided are not reliable

the accountant should discuss the matter with management and those charged with governance, as appropriate. If management does not provide the required representations or the accountant continues to doubt management's integrity such that the written representations provided may not be reliable, the accountant should withdraw from the engagement. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Forming the Accountant's Conclusion on the Financial Statements

Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements

.64 In forming the conclusion on the financial statements, the accountant should do the following:

- a. Evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A101–.A102)
- b. Consider whether, in the context of the requirements of the applicable financial reporting framework and the results of procedures performed,
 - i. the terminology used in the financial statements, including the title of each financial statement, is appropriate;
 - ii. the financial statements adequately disclose the significant accounting policies selected and applied;
 - iii. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
 - iv. accounting estimates made by management appear reasonable;
 - v. the information presented in the financial statements appears relevant, reliable, comparable, and understandable; and
 - vi. the financial statements provide adequate disclosures to enable the intended users to understand the effects of material transactions and events on the information conveyed in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.65 The accountant should consider the impact of the following:

- a. Uncorrected misstatements identified during the review, and in the previous year's review of the entity's financial statements, on the financial statements as a whole
- b. Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments (Ref: par. .A103–.A104)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.66 The accountant's consideration should also include the following:

- a. The overall presentation, structure, and content of the financial statements

- b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A105)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Form of the Conclusion

Unmodified Conclusion

.67 The accountant should express an unmodified conclusion in the accountant's review report on the financial statements as a whole when the accountant has obtained limited assurance to be able to conclude that nothing has come to the accountant's attention that causes the accountant to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.68 When the accountant expresses an unmodified conclusion, the accountant should, unless required by law or regulation, use the following language:

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements for them to be in accordance with *[the applicable financial reporting framework]*.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Modified Conclusion

.69 The accountant should express a modified conclusion in the accountant's review report on the financial statements as a whole when the accountant determines, based on the procedures performed and the review evidence obtained, that the financial statements are materially misstated. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.70 When the accountant modifies the conclusion expressed on the financial statements, the accountant should do the following:

- a. Use the heading "Qualified Conclusion" or "Adverse Conclusion," as appropriate, for the conclusion paragraph in the accountant's review report.
- b. Provide a description of the matter giving rise to the modification, under an appropriate heading (for example, "Basis for Qualified Conclusion," or "Basis for Adverse Conclusion," as appropriate), in a separate paragraph in the accountant's review report immediately before the conclusion paragraph (referred to as the *basis for conclusion paragraph*).

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Financial Statements Are Materially Misstated

.71 If the accountant, having obtained sufficient appropriate review evidence, determines, or is otherwise aware, that the financial statements are materially misstated, the accountant should express one of the following: (Ref: par. .A106)

- a. A qualified conclusion, when the accountant concludes that the effects of the matter or matters giving rise to the modification are material but not pervasive to the financial statements
- b. An adverse conclusion, when the effects of the matter or matters giving rise to the modification are both material and pervasive to the financial statements

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.72 When the accountant expresses a qualified conclusion on the financial statements because of a material misstatement, the accountant should, unless otherwise required by law or regulation, use the following language:

Based on my (our) review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with *[the applicable financial reporting framework]*.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.73 When the accountant expresses an adverse conclusion on the financial statements, the accountant should, unless otherwise required by law or regulation, use the following language:

Based on my (our) review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements are not in accordance with *[the applicable financial reporting framework]*.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.74 In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the accountant should do the following:

- a. Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures) and the effects of the departure on the financial statements have been determined by management or are known to the accountant as a result of the accountant's procedures. If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of the departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management.
- b. Explain how disclosures are misstated if the material misstatement relates to narrative disclosures.
- c. Describe the nature of omitted information if the material misstatement relates to the nondisclosure of information required to be disclosed. The accountant should include the omitted disclosures when practicable to do so.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting on the Financial Statements

.75 The accountant's review report should be in writing. (Ref: par. .A107–.A109) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Review Report

.76 The written review report should include the following: (Ref: par. .A123)

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant for a review engagement. (Ref: par. .A110)
- b. An addressee, based on the circumstances of the engagement. (Ref: par. .A111)
- c. An introductory paragraph that (Ref: par. .A112–.A114)
 - i. identifies the entity whose financial statements have been reviewed,
 - ii. states that the financial statements identified in the report were reviewed,
 - iii. identifies the financial statements,
 - iv. specifies the date or period covered by each financial statement,
 - v. includes a statement that a review includes primarily applying analytical procedures to management's (owner's) financial data and making inquiries of company management (owners), and
 - vi. includes a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.
- d. A section with the heading "Management's Responsibility for the Financial Statements" that includes an explanation that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error. (Ref: par. .A115)
- e. A section with the heading "Accountant's Responsibility" that includes the following statements:
 - i. The accountant's responsibility is to conduct the review engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA. The accountant's review report should also explain that those standards require that the accountant perform the procedures to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. (Ref: par. .A116–.A118)

- ii. The accountant believes that the results of the accountant's procedures provide a reasonable basis for the accountant's conclusion.
 - iii. The accountant is required to be independent of the entity and to meet the accountant's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the review.
- f. A concluding section with an appropriate heading that includes the accountant's conclusion on the financial statements in accordance with paragraphs .67–.74, as appropriate, and that identifies the country of origin of the financial reporting framework, if applicable
- g. When the accountant's conclusion on the financial statements is modified,
 - i. a paragraph, under the appropriate heading, that contains the accountant's modified conclusion in accordance with paragraphs .69–.74, as appropriate, and
 - ii. a paragraph, under an appropriate heading, that provides a description of the matter or matters giving rise to the modification (Ref: par. .A119)
- h. The signature of the accountant or the accountant's firm.
- i. The city and state where the accountant practices. (Ref: par. .A120)
- j. The date of the review report, which should be dated no earlier than the date on which the accountant has obtained sufficient appropriate review evidence as the basis for the accountant's conclusion on the financial statements, including being satisfied that
 - i. all the statements that the financial statements comprise, including the related notes, have been prepared and
 - ii. management has asserted that it has taken responsibility for those financial statements. (Ref: par. .A121–A122)

[As amended, effective October 2016, by SSARS No. 23. As amended, effective May 2018, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Accountant's Review Report on Financial Statements Prepared in Accordance With a Special Purpose Framework

.77 The accountant should modify the review report when the accountant becomes aware that the financial statements do not include

- a. a description of the special purpose framework. (Ref: par. .A126)
- b. a summary of significant accounting policies.
- c. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. (Ref: par. .A127)
- d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or

similar to, those in financial statements prepared in accordance with GAAP. (Ref: par. .A128)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.78 In the case of financial statements prepared in accordance with the provisions of a contract, the accountant should evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based and modify the review report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.79 In the case of an accountant's review report on special purpose financial statements, if management has a choice of financial reporting frameworks in the preparation of the special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.80 The accountant's review report on financial statements prepared in accordance with a special purpose framework should include an emphasis-of-matter paragraph, under an appropriate heading, that (Ref: par. .A130–.A131)

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes the framework, and
- c. states that the special purpose framework is a basis of accounting other than GAAP.

For special purpose financial statements prepared in accordance with a contractual basis of accounting, the emphasis-of-matter paragraph should also state that, as a result, the financial statements may not be suitable for another purpose. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.81 If the special purpose financial statements are prepared in accordance with the contractual basis of accounting, the accountant's review report should include, in accordance with paragraph .104, an other-matter paragraph, under an appropriate heading, that, in accordance with paragraphs .106–.109, restricts the use of the accountant's review report (Ref: par. .A132) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Comparative Financial Statements

.82 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the accountant's report should refer to each period for which financial statements are presented. (Ref: par. .A133–.A134) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Updating the Report

.83 When reporting on all periods presented, a continuing accountant should update the report on one or more prior periods presented on a comparative basis with those of the current period. The accountant's report on comparative financial statements should not be dated earlier than the date that the accountant completed procedures sufficient to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework with respect to the current period. (Ref: par. .A135) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.84 When issuing an updated report, the continuing accountant should consider information that the accountant has become aware of during the review of the current period financial statements. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.85 If, during the current engagement, circumstances or events come to the accountant's attention that may affect the prior-period financial statements presented, the accountant should consider the effects on the review report. [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Changed Reference to a Departure From the Applicable Financial Reporting Framework

.86 When the accountant's report on the financial statements of the prior period contains a changed reference to a departure from the applicable financial reporting framework, the accountant's review report should include an other-matter paragraph indicating (Ref: par. .A136)

- a. the date of the accountant's previous review report.
- b. the circumstances or events that caused the reference to be changed.
- c. when applicable, that the financial statements of the prior period have been changed.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Reporting When One Period Is Audited

.87 When the prior period financial statements were audited and the auditor's report on the prior period financial statements is not reissued, the review report on the current period financial statements should include an other-matter paragraph indicating

- a. that the financial statements of the prior period were previously audited;
- b. the date of the auditor's report on the prior period financial statements;
- c. the type of opinion issued on the prior period financial statements;
- d. if the opinion was modified, the substantive reasons for the modification; and
- e. that no auditing procedures were performed after the date of the previous report.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

[.88] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report

Emphasis-of-Matter Paragraphs in the Accountant's Review Report

.89 If the accountant considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the accountant should include an emphasis-of-matter paragraph in the accountant's review report, provided that the accountant has obtained sufficient appropriate review evidence to conclude that the accountant is not aware of any material modifications that should be made to the financial statements with respect to such matter. Such a paragraph should refer only to information presented or disclosed in the financial statements. (Ref: par. .A141–.A143) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.90 When the accountant includes an emphasis-of-matter paragraph in the accountant's review report, the accountant should do the following:

- a. Include the paragraph within a separate section of the accountant's report with the heading "Emphasis of a Matter" or other appropriate heading. (Ref: par. .A144–.A145)
- b. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph should refer only to information presented or disclosed in the financial statements.
- c. Indicate that the accountant's conclusion is not modified with respect to the matter emphasized. (Ref: par. .A146)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Other-Matter Paragraphs in the Accountant's Review Report

.91 If the accountant considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to the users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the accountant should include an other-matter paragraph in the accountant's review report. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.92 When the accountant includes an other-matter paragraph in the accountant's review report, the accountant should include the paragraph within a separate section with the heading "Other Matter" or other appropriate heading. (Ref: par. .A141, .A144, and .A147–.A149) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Communication With Management

.93 If the accountant expects to include an emphasis-of-matter or other-matter paragraph in the accountant's review report, the accountant should communicate with management regarding this expectation and the proposed

wording of this paragraph. (Ref: par. .A150–.A151) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Correction of a Material Misstatement in Previously Issued Financial Statements

.94 The accountant should include an emphasis-of-matter paragraph in the accountant's review report when there are adjustments to correct a material misstatement in previously issued financial statements. The accountant should include this type of emphasis-of-matter paragraph in the accountant's review report when the related financial statements are restated to correct the prior material misstatement. The paragraph need not be repeated in subsequent periods. (Ref: par. .A152–.A154) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.95 The emphasis-of-matter paragraph should include

- a. a statement that the previously issued financial statements have been restated for the correction of a material misstatement in the respective period and
- b. a reference to the entity's disclosure of the correction of the material misstatement. (Ref: par. .A155)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.96 If the financial statement disclosures relating to the restatement to correct a material misstatement in previously issued financial statements are not adequate, the accountant should address the inadequacy of disclosure as described in paragraphs .69–.72. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Other Reporting Responsibilities

.97 An accountant may be requested to address other reporting responsibilities in the accountant's review report on the financial statements that are in addition to the accountant's responsibilities in accordance with this section to report on the financial statements. In such situations, those other reporting responsibilities should be addressed by the accountant in a separate section in the accountant's review report, under the heading "Report on Other Legal and Regulatory Requirements," or otherwise, as appropriate to the content of the section, following the section of the report titled "Report on the Financial Statements." (Ref: par. .A156) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.98–.102] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Alert That Restricts the Use of the Accountant's Review Report

.103 An accountant's review report should include an alert, in a separate paragraph, that restricts its use when the subject matter of the accountant's review report is based on (Ref: par. .A163–.A165)

- a. measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria or

- b. measurement or disclosure criteria that are available only to the specified parties.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.104 The alert that restricts the use of the accountant's review report required by paragraph .103 should

- a. state that the accountant's review report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the accountant's review report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A166)

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Adding Other Specified Parties

.105 When, in accordance with paragraph .103, the accountant includes an alert that restricts the use of the accountant's review report to certain specified parties and the accountant is requested to add other parties as specified parties, the accountant should determine whether to agree to add the other parties as specified parties. (Ref: par. .A167) [Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

.106 If the other parties are added after the release of the accountant's review report, the accountant should either:

- a. Amend the accountant's review report to add the other parties and, in such circumstances, not change the original date of the accountant's review report.
- b. Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties and state in the acknowledgment that no procedures were performed subsequent to the original date of the accountant's review report.

[Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

The Accountant's Consideration of an Entity's Ability to Continue as a Going Concern

[.107–.108] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Implications for the Accountant's Review Report When Substantial Doubt Exists About the Entity's Ability to Continue as a Going Concern

.109 If, after considering conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the accountant should include a separate section in the accountant's review report with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that does the following: (Ref: par. .A175–.A182)

- a. Draws attention to the note in the financial statements that discloses

- i. the conditions or events identified and management's plans that deal with these conditions or events and
 - ii. that these conditions or events indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
- b. States that the accountant's conclusion is not modified with respect to the matter

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.110 The description in the "Going Concern" section about the entity's ability to continue as a going concern for a reasonable period of time should use terms consistent with those included in the applicable financial reporting framework. The accountant should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A181) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.111 If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the accountant should do the following:

- a. Express a qualified or adverse conclusion, as appropriate, in accordance with paragraphs .71–.74
- b. In the "Basis for Qualified (Adverse) Conclusion" section of the accountant's review report, state that
 - i. substantial doubt exists about the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter or
 - ii. substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Management Unwilling to Perform or Extend Its Evaluation

.112 If management is unwilling to perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework when requested to do so by the accountant, the accountant should consider the implications for the accountant's review report. (Ref: par. .A123) [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.113–.121] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Reference to the Work of Other Accountants in an Accountant's Review Report

.122 If other accountants audited or reviewed the financial statements of significant components, such as consolidated and unconsolidated subsidiaries and investees, and the accountant of the reporting entity decides not to assume responsibility for the audit or review performed by the other accountants, the accountant of the reporting entity should make reference to the review or audit of such other accountants in the accountant's review report. In that instance, the accountant should clearly indicate in the accountant's review report that the accountant used the work of other accountants and should include the magnitude of the portion of the financial statements audited or reviewed by the other accountants. (Ref: par. .A191–.A193) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.123 Reference to the audit or review of other accountants in the accountant's review report on the reporting entity should not be made if the other accountants issued an auditor's or an accountant's review report that includes an alert that restricts the use of such report. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Determining Whether the Other Accountants Are Familiar with SSARSs or Auditing Standards Generally Accepted in the United States of America, as Applicable

.124 Regardless of whether the accountant of the reporting entity decides to make reference to the review or audit of other accountants, the accountant of the reporting entity should communicate with the other accountants and determine the following:

- a. The other accountants are aware that the financial statements of the component that the other accountants have audited or reviewed are to be included in the financial statements on which the accountant of the reporting entity will report and that the other accountants' report thereon will be relied upon and, where applicable, referred to by the accountant of the reporting entity.
- b. The other accountants are familiar with the applicable financial reporting framework and with SSARSs or auditing standards generally accepted in the United States of America, as applicable, and will conduct the review or audit in accordance therewith. (Ref: par. .A194)
- c. The other accountants understand the ethical requirements that are relevant to the engagement and, in particular, are independent. (Ref: par. .A195)
- d. A review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same

.125 If the component's financial statements are prepared using a different financial reporting framework from that used for the financial statements of the reporting entity, reference to the review or audit of the other accountants in the review report of the accountant of the reporting entity should not be made unless the following apply:

- a. The accountant has determined that the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements in accordance with the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the reporting entity's financial statements in accordance with the financial reporting framework used by the reporting entity.
- b. The accountant of the reporting entity has obtained sufficient appropriate review evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the reporting entity without the need to assume responsibility for, and thus be involved in, the work of the other accountants. (Ref: par. .A196)

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

Supplementary Information That Accompanies Reviewed Financial Statements and the Accountant's Review Report Thereon

.126 When supplementary information accompanies reviewed financial statements and the accountant's review report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either

- a. an other-matter paragraph in the accountant's review report on the financial statements or
- b. a separate report on the supplementary information

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.127 When the accountant has subjected the supplementary information to the review procedures applied in the accountant's review of the basic financial statements, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that (Ref: par. .A198 and .A200)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements;

- c. the supplementary information has been subjected to the review procedures applied in the accountant's review of the basic financial statements and whether the accountant is aware of any material modifications that should be made to the supplementary information; and
- d. the accountant has not audited the supplementary information and does not express an opinion on such information.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.128 When the accountant has not subjected the supplementary information to the review procedures applied in the accountant's review of the basic financial statements, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that (Ref: par. .A199–.A200)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management; and
- c. the accountant has not audited or reviewed the supplementary information and, accordingly, does not express an opinion, a conclusion, nor provide any assurance on such information.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Required Supplementary Information

.129 Concerning the requirement in paragraph .126, with respect to required supplementary information, the accountant should include an other-matter paragraph in the accountant's review report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable: (Ref: par. .A201)

- a. The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
- b. The required supplementary information is included, and the accountant reviewed the required supplementary information.
- c. The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
- d. The required supplementary information is omitted.
- e. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines (Ref: par. .A202)
- f. The accountant has identified departures from the prescribed guidelines.
- g. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.130 If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation or review on the required supplementary information, the other-matter paragraph referred to in paragraph .126 should include the following elements: (Ref: par. .A203)

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and does not express an opinion or provide any assurance on the information
- d. If some of the required supplementary information is omitted
 - i. a statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
 - ii. a statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist *[describe the material departures from the applicable financial reporting framework]*
- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standards-setter]*

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.131 If all the required supplementary information is omitted, the other-matter paragraph should include the following elements:

- a. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Change in Engagement From Audit to Review

.132 If the accountant, who was engaged to perform an audit engagement in accordance with generally accepted auditing standards, has been requested to change the engagement to a review engagement, the accountant should consider the following before deciding whether to agree to the change: (Ref: par. .A204–.A205)

- a. The reason given for the request, particularly the implications of a restriction on the scope of the audit engagement, whether imposed by management or by circumstances (Ref: par. .A206)
- b. The additional audit effort required to complete the audit engagement
- c. The estimated additional cost to complete the audit engagement

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.133 In all circumstances, if the audit procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.134 If the accountant concludes, based upon the accountant's professional judgment, that reasonable justification exists to change the engagement, and if the accountant complies with the standards applicable to a review engagement, the accountant should issue an appropriate review report. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.135 The report should not include reference to

- a. the original engagement,
- b. any audit procedures that may have been performed, or
- c. scope limitations that resulted in the changed engagement.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.136 When the accountant has been engaged to audit an entity's financial statements and management refuses to allow the accountant to correspond with the entity's legal counsel, the accountant, except in rare circumstances, is

precluded from accepting an engagement to review those financial statements. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Review Documentation

.137 The preparation of documentation for the review provides evidence that the review was performed in accordance with SSARSs and a sufficient and appropriate record of the basis for the accountant's report. The accountant should prepare review documentation in a timely manner that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand the following: (Ref: par. .A207–.A211)

- a. The nature, timing, and extent of the review procedures performed to comply with SSARSs
- b. The review evidence obtained from the review procedures performed and the accountant's conclusions formed on the basis of that review evidence
- c. Significant matters arising during the review, the accountant's conclusions reached thereon, and significant professional judgments made in reaching those conclusions

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.138 In addition to the requirements in paragraph .137, the review documentation should include the following:

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .16–.17 (Ref: par. .A25 and .A27)
- b. Communications with management regarding the accountant's expectation to include an emphasis-of-matter or other-matter paragraph in the accountant's review report as required by paragraph .93
- c. Communications with management, those charged with governance, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters
- d. Communications with other accountants that have audited or reviewed the financial statements of significant components as required by paragraph .122
- e. If, in the course of the engagement, the accountant identified information that is inconsistent with the accountant's findings regarding significant matters affecting the financial statements, how the inconsistency was addressed
- f. The representation letter
- g. A copy of the reviewed financial statements and the accountant's review report thereon

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.139 In documenting the nature, timing, and extent of procedures performed as required in this section, the accountant should record the following:

- a. Who performed the work and the date such work was completed
- b. Who reviewed the work performed for the purpose of quality control for the engagement and the date and extent of the review

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Application and Other Explanatory Material

Introduction

.A1 If the accountant is engaged to perform a review of historical financial information other than financial statements, references in this section to *financial statements* are to be taken as a reference to such other historical financial information. [Paragraph added, effective October 2016, by SSARS No. 23.]

.A2 Examples of other historical financial information that an accountant may be engaged to review include, but are not limited to, the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Financial information contained in a tax return

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A3 The accountant may review a single financial statement, such as a balance sheet, and not other related financial statements, such as the statements of income, retained earnings, and cash flows, if the scope of the accountant's inquiry and analytical procedures have not been restricted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Objectives (Ref: par. .07)

.A4 A review differs significantly from an audit of financial statements in which the auditor obtains reasonable assurance, which is a high, but not absolute, level of assurance, that the financial statements are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit. Accordingly, in a review, the accountant does not obtain assurance that he or she will become aware of all significant matters that would be disclosed in an audit. Therefore, a review is designed to obtain only limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

[.A5–.A9] [Paragraphs deleted by the issuance of SSARS No. 25, February 2020.]

Definitions (Ref: par. .08)

.A10 Sufficient appropriate review evidence, consisting primarily of the results of the accountant's analytical procedures and inquiries, is required to obtain limited assurance to support the accountant's conclusion. Review evidence is cumulative in nature and primarily obtained from the procedures performed during the course of the review. The combination of the nature, timing, and extent of evidence-gathering procedures is limited compared to an audit engagement. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A11 Most financial reporting frameworks requiring an explicit management evaluation of the entity's ability to continue as a going concern specify the period of time to be evaluated. For example, the financial reporting frameworks of the following standard-setting bodies specify such period of time as follows:

- a. *FASB*. Within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).¹
- b. *GASB*. 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.²
- c. *International Accounting Standards Board*. At least, but not limited to, one year from the end of the reporting period.³

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered by the issuance of SSARS No. 25, February 2020.]

[.A12] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A13 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity. [Paragraph added, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A14 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements. [Paragraph added, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

¹ "Pending Content" in *FASB Accounting Standards Codification (ASC) 205-40-50-1*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

² Paragraph 16 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

³ Paragraph 26 of International Accounting Standard 1, *Presentation of Financial Statements*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Independence (Ref: par. .10)

.A15 The AICPA Code of Professional Conduct provides guidance with respect to independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A16 Nothing prohibits an accountant who is unable to complete a review engagement due to a determination that the accountant's independence is impaired from performing a compilation engagement on those financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Professional Skepticism (Ref: par. .11)

.A17 Professional skepticism includes being alert to the following, for example:

- Review evidence that contradicts other review evidence obtained
- Information that brings into question the reliability of responses to inquiries and other information or records to be used as review evidence
- Circumstances that suggest the need for review procedures in addition to those required by this section

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A18 Maintaining professional skepticism throughout the review is necessary if the accountant is, for example, to reduce the risks of

- overlooking unusual circumstances.
- overgeneralizing when drawing conclusions from review observations.
- using inappropriate assumptions in determining the nature, timing, and extent of the review procedures and evaluating the results thereof.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A19 Professional skepticism is necessary to the critical assessment of review evidence. This includes questioning contradictory review evidence and the reliability of responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of review evidence obtained in light of the circumstances. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A20 The accountant may accept records and documents as genuine unless the accountant has reason to believe the contrary. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A21 The accountant neither assumes that management is dishonest nor assumes unquestioned honesty. The accountant cannot be expected to disregard past experience of the honesty and integrity of management and those charged

with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the accountant of the need to maintain professional skepticism or allow the accountant to be satisfied with less than persuasive review evidence when obtaining limited assurance. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Acceptance and Continuance of Client Relationships and Review Engagements (Ref: par. .13)

.A22 A review in accordance with SSARSs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .26b of section 60. The preparation of financial statements, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" interpretation (ET sec. 1.295) of the "Independence Rule" of the AICPA Code of Professional Conduct. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the review engagement as required by paragraphs .16–.17. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A23 Documents containing financial statements that may include an indication that such financial statements have been reviewed by the entity's accountant includes documents submitted to bonding companies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Agreement on Engagement Terms (Ref: par. .16–.17 and .135)

.A24 Both management and the accountant have an interest in documenting the agreed-upon terms of the review engagement before the commencement of the review engagement to help avoid misunderstandings with respect to the review engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A25 The roles of management and those charged with governance in agreeing upon the terms of the review engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless, in accordance with paragraph .26b of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A26 When a third party has contracted for a review of the entity's financial statements, agreeing the terms of the review with management of the entity is necessary in order to establish that the preconditions for a review are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A27 The understanding with management regarding the services to be performed for review engagements is required by paragraph .16 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for review engagements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A28 Although the accountant may prepare the financial statements, in whole or in part, the financial statements are representations of management, and the fairness of their presentation in accordance with the applicable financial reporting framework is management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A29 Illustrations of engagement letters for a review of financial statements are presented in exhibit A, "Illustrative Engagement Letters." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Communication With Management and Those Charged With Governance (Ref: par. .18)

.A30 In a review engagement, the accountant's communications with management and those charged with governance take the form of

- a. inquiries the accountant makes in the course of performing the procedures for the review and
- b. other communications, in the context of having effective two-way communication to understand matters arising and to develop a constructive working relationship for the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A31 The appropriate timing for communications will vary with the circumstances of the engagement. Relevant factors include the significance and nature of the matter and any action expected to be taken by management or those charged with governance. For example, it may be appropriate to communicate a significant difficulty encountered during the review as soon as practicable if management or those charged with governance are able to assist the accountant to overcome the difficulty. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the

issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A32 Law or regulation may restrict the accountant's communication of certain matters with those charged with governance. For example, law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the accountant's obligations of confidentiality and obligations to communicate may be complex. In such cases, the accountant may consider obtaining legal advice. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Communicating Matters Concerning the Review

.A33 Matters to be communicated to management or those charged with governance, as appropriate, in accordance with this section may include the following:

- The accountant's responsibilities in the review engagement, as included in the engagement letter or other suitable form of written agreement.
- Significant findings from the review, for example
 - the accountant's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.
 - significant findings from the performance of procedures, including situations when the accountant considered performance of additional procedures necessary in accordance with this section. The accountant may need to confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.
 - Matters arising that may lead to modification of the accountant's review report.
 - Significant difficulties, if any, encountered during the review, for example, unavailability of expected information, unexpected inability to obtain evidence that the accountant considers necessary for the review, or restrictions imposed on the accountant by management. In some circumstances, such difficulties may lead to the accountant's withdrawal from the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A34 In some entities, different persons are responsible for the management and governance of an entity. In these circumstances, management may have the responsibility to communicate matters of governance interest to those charged with governance. Communication by management with those charged with governance of matters that the accountant is required to communicate does not relieve the accountant of the responsibility to also communicate with

those charged with governance. However, communication of these matters by management may affect the form or timing of the accountant's communication with those charged with governance. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Communication With Third Parties

.A35 The accountant may be required by law or regulation to, for example

- notify a regulatory or enforcement body of certain matters communicated with those charged with governance.
- submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies or, in some cases, make such reports publicly available.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A36 Unless required by law or regulation to provide a third party with a copy of the accountant's written communications with those charged with governance, the accountant may need the prior consent of management or those charged with governance before doing so. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Performing the Engagement

Materiality in a Review of Financial Statements (Ref: par. .19)

.A37 The accountant's consideration of materiality is made in the context of the applicable financial reporting framework. Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.
- judgments about materiality are made in light of surrounding circumstances and affected by the size or nature of a misstatement or a combination of both.
- judgments about materiality involve both qualitative and quantitative considerations.
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A38 If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .A37 provide the accountant with such a frame of reference. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A39 The accountant's determination of materiality is a matter of professional judgment and is affected by the accountant's perception of the financial information needs of users of the financial statements. For purposes of determining materiality, the accountant may assume that reasonable users

- have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented, and reviewed to levels of materiality;
- recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- make reasonable judgments based on the information in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A40 The accountant's judgment about what is material in relation to the financial statements as a whole is the same regardless of the level of assurance obtained by the accountant as a basis for expressing a conclusion on the financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A41 The accountant's determination of materiality for the financial statements as a whole may need to be revised during the engagement as a result of the following:

- A change in the circumstances that occurred during the review (for example, a decision to dispose of a major part of the entity's business)
- New information, or a change in the accountant's understanding of the entity and its environment as a result of performing review procedures (for example, if during the review it appears that actual financial results are likely to be substantially different from anticipated period-end financial results that were used initially to consider materiality for the financial statements as a whole)

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Understanding of the Industry (Ref: par. .21)

.A42 The requirement that the accountant possess a level of knowledge of the industry in which the entity operates does not prevent the accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals

knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Knowledge of the Entity (Ref: par. .22)

.A43 The accountant may obtain knowledge of the entity through inquiry of the entity's personnel, the review of documents prepared by the entity, or experience with the entity or the entity's industry. Such knowledge includes the following:

- An understanding of the entity's business
- An understanding of the accounting principles and practices used by the entity in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A44 The accountant's understanding of the entity's business encompasses a general understanding of the entity's organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Designing and Performing Review Procedures (Ref: par. .24–.25)

.A45 Review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the accountant with a reasonable basis for obtaining limited assurance. However, in addition to analytical procedures and inquiries, in certain circumstances and based on the accountant's professional judgment, the accountant may perform procedures ordinarily performed in an audit. In such instances, the engagement remains a review, and the accountant is not required to perform an audit of the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A46 The results of the accountant's analytical procedures and inquiries may modify the accountant's risk awareness. For example, the response to an inquiry that a related party transaction is not disclosed may revise the accountant's awareness of risk relative to related party transactions. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A47 Both quantitative and qualitative factors are considered when determining which items are material to the financial statements, including disclosures, and which areas include increased risk of material misstatement. For example, disclosure of the implementation status of a new accounting standard may not include quantitatively material disclosures but may be qualitatively material such that the accountant would perform inquiry procedures to

validate the disclosures presented. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Analytical Procedures (Ref: par. .26–.27)

.A48 Examples of analytical procedures that an accountant may consider performing when conducting a review of financial statements are contained in appendix A, "Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A49 Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the accountant, such as an estimation of depreciation
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable and gross margin percentages with industry averages or other entities of comparable size in the same industry

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A50 Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information, such as gross margin percentages, that would be expected to conform to a predictable pattern based on recent history of the entity and industry
- Between financial information and relevant nonfinancial information, such as payroll costs to number of employees

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A51 When considering plausible relationships, the accountant may wish to consider information developed and used by the entity (for example, analyses prepared for management or those charged with governance). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A52 Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements may be less precise than those developed in an audit. Also, in a review, the accountant is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.

Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A53 To compare disaggregated revenue data, the accountant may compare, for example, revenue reported by month and product line or operating segment during the current period with that of comparable prior periods. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A54 Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses. Analytical procedures may be performed at the financial statement level or at the detailed account level. The nature, timing, and extent of analytical procedures are a matter of professional judgment. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Investigating Results of Analytical Procedures (Ref: par. .28b)

.A55 Although the accountant is not required to corroborate management's responses with other evidence, the need to perform other review procedures may arise when, for example, management is unable to provide an explanation, or the explanation is not considered adequate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters (Ref: par. .29)

.A56 In addition to members of management who have responsibility for financial and accounting matters, the accountant may determine to direct inquiries to others within the entity and those charged with governance, if appropriate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A57 Additional examples of unusual or complex transactions, events, or matters about which the accountant may inquire of management are as follows:

- Correction of an error
- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans

- Restructuring charges taken in the current and prior periods
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Material off-balance-sheet transactions, variable interest entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A58 Management may obtain knowledge of fraud or suspected fraud affecting the entity involving management or others when the fraud could have a material effect on the financial statements through, among other things, communications received from employees, former employees, or others. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A59 The accountant may obtain and read minutes from meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements as an effective and efficient procedure to meet the requirement in paragraph .29m to inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements about actions taken at such meetings. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Procedures to Address Specific Circumstances

Related Parties

Understanding the Nature of Significant Transactions Outside the Normal Course of Business (Ref: par. .33a)

.A60 Inquiring into the nature of the significant transactions outside the entity's normal course of business involves obtaining an understanding of the business rationale of the transactions and the terms and conditions under which these have been entered into. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Fraud and Noncompliance With Laws or Regulations (Ref: par. .34)

.A61 The communication of matters involving identified or suspected non-compliance may describe the act of identified or suspected noncompliance, the circumstances of its occurrence, and the effect on the financial statements. The accountant may reach agreement in advance with management and those charged with governance, if applicable, on the nature and amount of matters that would be considered not material and, thus, need not be communicated. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A62 The accountant's professional duty to maintain the confidentiality of client information may preclude reporting identified or suspected noncompliance with laws and regulations to a party outside the entity. However, the accountant's legal responsibilities vary by jurisdiction, and in certain circumstances, the duty of confidentiality may be overridden by statute, the law, or courts of law. In the following circumstances, a duty to notify parties outside the entity may exist:

- In response to a court order
- In compliance with requirements for the reviews of entities that receive financial assistance from a government agency

Because potential conflicts with the accountant's ethical and legal obligations regarding confidentiality may be complex, the accountant may consult with legal counsel before discussing noncompliance with parties outside the entity. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A63 The accountant may consider whether withdrawal from the engagement is necessary when

- management or those charged with governance do not take the remedial action that the accountant considers necessary in the circumstances or
- matters regarding fraud or noncompliance with laws or regulations involve an owner of the business.

When deciding whether withdrawal from the engagement is necessary, the accountant may consider seeking legal advice. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Going Concern (Ref: par. .37–.38)

.A64 The nature and extent of the accountant's review procedures are matters of the accountant's professional judgment. For example, when a history of profitable operations and ready access to financing exists, inquiry alone might be sufficient to review the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A65 Certain financial reporting frameworks require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements. For example, FASB *Accounting Standards Codification*® (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern. Under FASB ASC, the evaluation period is within one year after the date that the financial statements

are issued (or within one year after the date that the financial statements are available to be issued, when applicable). [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A66 A review of financial statements is not designed to identify conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. However, conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time may have existed at the date of the prior period financial statements or may be identified as a result of inquiries of management or in the course of performing other review procedures. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A67 The following are examples of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time:

- *Negative trends.* For example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios
- *Other indications of possible financial difficulties.* For example, defaults on loans or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, a need to restructure debt to avoid default, noncompliance with statutory capital requirements, and a need to seek new sources or methods of financing or to dispose of substantial assets
- *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- *External matters.* For example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe such as a hurricane, tornado, earthquake, or flood

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A68 The significance of such conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time can often be mitigated by other factors. The following list includes examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The examples are not all-inclusive. Following each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is probable⁴ that the

⁴ The FASB ASC Master Glossary defines *probable* as "the future event or events are likely to occur." [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

plan will be effectively implemented within one year after the date that the financial statements are issued.⁵

- a. Plans to dispose of an asset or business
 - i. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loans or similar agreements, or encumbrances against the asset or business
 - ii. Marketability of the asset or business that management plans to sell
 - iii. Possible direct or indirect effects of disposal of the asset or business
- b. Plans to borrow money or restructure debt
 - i. Availability and terms of new debt financing or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback of assets
 - ii. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
 - iii. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures
 - i. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
 - ii. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures
- d. Plans to increase ownership equity
 - i. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
 - ii. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A69 In considering the adequacy of disclosure, some of the information that may be disclosed, depending on the requirements of the financial reporting framework, includes the following:

- Principal conditions and events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events in relation to the entity's ability to meet its obligations and any mitigating factors

⁵ "Pending Content" in FASB ASC 205-40-55-3. [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

- Possible discontinuance of operations
- Management's plans (including relevant prospective financial information) that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reconciling the Financial Statements to the Underlying Accounting Records (Ref: par. .41)

.A70 To obtain evidence that the financial statements agree or reconcile with the accounting records, the accountant may compare the financial statements to

- the accounting records, such as the general ledger;
- a consolidating schedule derived from the accounting records; or
- other supporting data in the entity's records.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Additional Procedures When the Accountant Becomes Aware That the Financial Statements May Be Materially Misstated (Ref: par. .42)

.A71 Additional procedures are required in accordance with this section if the accountant becomes aware of a matter that causes the accountant to believe the financial statements may be materially misstated. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A72 The accountant's response in undertaking additional procedures with respect to an item the accountant has cause to believe may be materially misstated in the financial statements will vary, depending on the circumstances, and is a matter for the accountant's professional judgment. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A73 The accountant's judgment about the nature, timing, and extent of additional procedures that are needed to obtain review evidence to either conclude that a material misstatement is not likely, or determine that a material misstatement exists, is guided by the following:

- Information obtained from the accountant's evaluation of the results of the procedures already performed
- The accountant's updated understanding of the entity and its environment obtained throughout the course of the engagement
- The accountant's view on the persuasiveness of review evidence needed to address the matter that causes the accountant to believe that the financial statements may be materially misstated

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A74 Additional procedures focus on obtaining sufficient appropriate review evidence to enable the accountant to form a conclusion on matters that the accountant believes may cause the financial statements to be materially misstated. Such procedures may consist of the following:

- Additional inquiry or analytical procedures, for example, being performed in greater detail or focused on the affected items (that is, amounts or disclosures concerning the affected accounts or transactions as reflected in the financial statements)
- Other types of procedures, for example, a substantive test of details or external confirmations

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A75 The following example illustrates the accountant's evaluation of the need to perform additional procedures and the accountant's response when the accountant believes additional procedures are necessary:

In the course of performing the inquiry and analytical procedures for the review, the accountant's analysis of accounts receivable shows a material amount of past due accounts receivable for which there is no allowance for bad or doubtful accounts. This causes the accountant to believe that the accounts receivable balance in the financial statements may be materially misstated. The accountant then inquires of management whether there are uncollectible accounts receivable that would need to be shown as being impaired. Depending on management's response, the accountant's evaluation of the response may do the following:

- a. Enable the accountant to conclude that the accounts receivable balance is not likely to be materially misstated. In that case, no further procedures are required.
- b. Enable the accountant to determine that the matter causes the financial statements to be materially misstated. No further procedures are required, and the accountant would form the conclusion that the financial statements as a whole are materially misstated.
- c. Lead the accountant to continue to believe that the accounts receivable balance is likely to be materially misstated, while not providing sufficient appropriate review evidence for the accountant to determine that it is, in fact, misstated. In that case, the accountant is required to perform additional procedures, for example, requesting from management an analysis of amounts received for those accounts after the balance sheet date to identify uncollectible accounts receivable. The evaluation of the results of the additional procedures may enable the accountant to get to (a) or (b) preceding. If not, the accountant is required to do one of the following:
 - i. Continue performing additional procedures until the accountant reaches either (a) or (b) preceding
 - ii. If the accountant is not able to either conclude that the matter is not likely to cause the financial statements as a whole to be materially misstated or to determine that the matter does cause the financial statements as a whole to be materially misstated, then, in accordance with paragraph .48, withdraw from the engagement

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Evaluating Review Evidence Obtained From the Procedures Performed (Ref: par. .47)

[.A76–.A77] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A78 In some circumstances, the accountant may not have obtained the evidence that the accountant had expected to obtain through the design of primarily inquiry and analytical procedures and procedures addressing specific circumstances. In these circumstances, the accountant considers that the review evidence obtained from the procedures performed is not sufficient and appropriate to be able to form a conclusion on the financial statements. The accountant may

- extend the work performed or
- perform other procedures judged by the accountant to be necessary in the circumstances.

When neither of these is practicable in the circumstances, the accountant will not be able to obtain sufficient appropriate review evidence to be able to form a conclusion and is required by this section to determine the effect on the accountant's ability to complete the engagement. This situation may arise even though the accountant has not become aware of a matter or matters that cause the accountant to believe the financial statements may be materially misstated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequent Events and Subsequently Discovered Facts

Subsequent Events (Ref: par. .49)

.A79 Evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements may come to the accountant's attention in the following ways:

- During the performance of review procedures
- Subsequent to the date of the accountant's review report but prior to the release of the report

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Subsequently Discovered Facts That Become Known to the Accountant After the Report Release Date (Ref: par. .54–.57)

.A80 New information may come to the accountant's attention that, had such information been known to the accountant at the date of the accountant's review report, may have caused the accountant to revise the accountant's review report. When such information becomes known to the accountant after the report release date, the requirements in paragraphs .54–.57 apply, even if

the accountant has withdrawn or been discharged. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A81 Because of the variety of conditions that might be encountered, the specific procedures or actions to be taken in a particular case may vary somewhat in light of the circumstances. For example, when determining whether the financial statements need revision, as required by paragraph .54*b*, the accountant may consider, in addition to the requirements of the applicable financial reporting framework, whether the accountant believes persons are currently using, or are likely to use, the financial statements and who would attach importance to the subsequently discovered facts. Consideration may be given, among other things, to the issuance of reviewed or audited financial statements for a subsequent period, the time elapsed since the financial statements were issued, the date of the accountant's review report released, and any legal implications. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A82 The steps taken by management to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used, depend on the circumstances. Management's steps may include the following:

- Notify anyone who is known to be using, or who is likely to use, the financial statements and the accountant's review report that they are not to be used and that revised financial statements, together with a new accountant's review report, will be issued. This may be necessary when the issuance of revised financial statements and a new accountant's review report is not imminent.
- Issue, as soon as practicable, revised financial statements with appropriate disclosure of the matter.
- Issue the subsequent period's financial statements with appropriate disclosure of the matter. This may be appropriate when issuance of the subsequent period's reviewed or audited financial statements is imminent.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A83 If management made the reviewed financial statements available to third parties despite the accountant's notification not to do so, or if the accountant believes that management or those charged with governance have failed to take the necessary steps to prevent use of the accountant's review report on the previously issued reviewed financial statements despite the accountant's prior notification that the accountant will take action to seek to prevent such use, the accountant's course of action depends on the accountant's legal and ethical rights and obligations. Consequently, the accountant may consider it appropriate to seek legal advice. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A84 The actions that the accountant may take to seek to prevent use of the accountant's review report may depend on the degree of certainty of the accountant's knowledge that persons or entities exist who are currently using, or who will use, the reviewed financial statements, and who would attach importance to the information, and on the accountant's ability as a practical matter

to communicate with them. In addition to seeking legal advice, the accountant may consider taking the following steps to the extent applicable:

- Notify management and those charged with governance that the accountant's review report is not to be used.
- Notify regulatory agencies having jurisdiction over the entity that the accountant's review report is not to be used, including a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.
- Notify anyone known to the accountant to be using the financial statements that the accountant's review report is not to be used. In some instances, it will not be practicable for the accountant to give appropriate individual notification to stockholders or investors at large whose identities are unknown to the accountant; notification to a regulatory agency having jurisdiction over the entity will usually be the only practical means for the accountant to provide appropriate disclosure, together with a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A85 Depending on the circumstances, if the accountant is able to determine that the financial statements need revision, the accountant's notification to anyone in receipt of the reviewed financial statements may, if permitted by law, regulation, and relevant ethical requirements,

- include a description of the nature of the matter and of its effect on the financial statements, avoiding comments concerning the conduct or motives of any person.
- describe the effect that the matter would have had on the accountant's review report if it had been known to the accountant at the date of the report and had not been reflected in the financial statements.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A86 If the accountant is not able to determine whether the financial statements need revision, the notification to anyone in receipt of the reviewed financial statements may indicate that information became known to the accountant and that, if the information is true, the accountant believes that the accountant's review report is not to be used. The specific matter may not be permitted by law, regulation, and ethical requirements to be detailed in the notification. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Written Representations

Written Representations as Review Evidence (Ref: par. .58)

.A87 Written representations are an important source of review evidence. If management modifies or does not provide the requested written representations, it may alert the accountant to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations, in many cases, may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations. [Paragraph

renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Management From Whom Written Representations Are Requested
(Ref: par. .59)

.A88 Written representations are requested from those with overall responsibility for financial and operating matters whom the accountant believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity; however, management (rather than those charged with governance) is often the responsible party. Written representations may, therefore, be requested from the entity's CEO and CFO or other equivalent persons in entities that do not use such titles. However, in some circumstances, other parties, such as those charged with governance, also are responsible for the preparation and fair presentation of the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A89 Due to its responsibility for the preparation and fair presentation of the financial statements and its responsibility for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements on which to base the written representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A90 In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the accountant to accept such wording if, in the accountant's judgment, the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Specific Written Representations (Ref: par. .60–.61)

.A91 Review evidence obtained during the review that management has acknowledged the responsibilities referred to in paragraph .60a–b is not sufficient without obtaining representation from management that it believes that it has fulfilled those responsibilities. This is because the accountant is not able to judge solely on other review evidence whether management has prepared and fairly presented the financial statements and provided information to the accountant on the basis of the agreed acknowledgment and understanding of its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A92 The written representations relating to fraud required by paragraph .60g–h are important for the accountant to obtain, regardless of the size of the entity, because of the nature of fraud and the difficulties encountered by

accountants in detecting material misstatements in the financial statements resulting from fraud. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A93 Because the preparation of financial statements requires management to adjust the financial statements to correct material misstatements, the accountant is required to request that management provide a written representation about uncorrected misstatements. In some circumstances, management may not believe that certain uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as "We do not agree that items... and... constitute misstatements because *[description of reasons]*." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A94 Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that
 - materially affect the financial statements or
 - involve management
- When they have made specific oral representations to the accountant on details of certain related party transactions
- When they have financial or other interests in the related parties or the related party transactions

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A95 Because written representations are necessary review evidence, the accountant has not obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework and the accountant's review report cannot be dated before the date of the written representations. Furthermore, because the accountant is concerned with events occurring up to the date of the accountant's review report that may require adjustment to, or disclosure in, the financial statements, the written representations are dated as of the date of the accountant's review report on the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A96 The written representations cover all periods referred to in the accountant's review report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The accountant and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the

issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A97 Situations may arise in which current management was not present during all periods referred to in the accountant's review report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the accountant to request from them written representations that cover the whole of the relevant period(s) still applies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A98 The accountant may request additional representations regarding matters specific to the entity's business or industry. In addition, the accountant is not precluded from obtaining representations regarding services performed in addition to the review engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Form of Written Representations (Ref: par. .62)

.A99 Occasionally, circumstances may prevent management from signing the representation letter and returning it to the accountant on the date of the accountant's review report. In those circumstances, the accountant may accept management's oral confirmation, on or before the date of the accountant's review report, that management has reviewed the final representation letter and will sign the representation letter without exception as of the date of the accountant's review report. Possession of the signed management representation letter prior to releasing the accountant's review report is necessary because paragraph .62 requires that the representations be in the form of a written letter from management. Furthermore, when there are delays in releasing the report, a fact may become known to the accountant that, had it been known to the accountant at the date of the accountant's review report, might affect the accountant's review report and result in the need for updated representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A100 Exhibit B, "Illustrative Representation Letter," provides an illustrative example of a representation letter. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Forming the Accountant's Conclusion on the Financial Statements

Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements (Ref: par. .64–.66)

.A101 The description of the applicable financial reporting framework in the financial statements is important because it advises users of the financial

statements of the framework on which the financial statements are based. If the financial statements are special purpose financial statements, they may be prepared under a special purpose financial reporting framework that is available only to the engaging party and the accountant. Description of the special purpose financial reporting framework used is important because the special purpose financial statements may not be appropriate for any use other than the intended use identified. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A102 A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (for example, "the financial statements are in substantial compliance with accounting principles generally accepted in the United States") is not an adequate description of that framework because it may mislead users of the financial statements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A103 In considering the qualitative aspects of the entity's accounting practices, the accountant may become aware of possible bias in management's judgments. The accountant may conclude that the cumulative effect of a lack of neutrality, together with the effect of apparent uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the accountant's evaluation of whether the financial statements as a whole may be materially misstated include the following:

- The selective correction of apparent misstatements brought to management's attention during the review (for example, correcting misstatements with the effect of increasing reported earnings but not correcting misstatements that have the effect of decreasing reported earnings)
- Possible management bias in the making of accounting estimates

[Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A104 Indicators of possible management bias do not necessarily mean there are misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the accountant's consideration of whether the financial statements as a whole may be materially misstated. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Evaluation of Whether the Financial Statements Achieve Fair Presentation (Ref: par. .66b)

.A105 The accountant's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the accountant would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Financial Statements Are Materially Misstated (Ref: par. .71)

.A106 Unless prohibited by law or regulation, the accountant may determine it appropriate to withdraw from the engagement when the accountant

has determined, based on the procedures performed and the review evidence obtained, that the financial statements are materially misstated. [Paragraph added, effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2021, by SSARS No. 25.]

Reporting on the Financial Statements (Ref: par. .75)

.A107 A written report encompasses reports issued in hard copy format and those using an electronic medium. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A108 Financial statements that the accountant has reviewed may become unattached from the accountant's review report. To minimize the possibility that a user of the reviewed financial statements may infer, through the accountant's association with the reviewed financial statements, an unintended level of reliance on the reviewed financial statements, the accountant may consider including a reference on each page of the reviewed financial statements to the accountant's review report. An example of a reference to the accountant's review report included on each page of the reviewed financial statements is "See independent accountant's review report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A109 When the accountant is unable to perform the inquiry, analytical procedures, and other review procedures the accountant considers necessary to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework, or management does not provide the accountant with a representation letter, the review will be incomplete. A review that is incomplete does not provide an adequate basis for issuing a review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Review Report (Ref: par. .76)

Title

.A110 An appropriate title would be "Independent Accountant's Review Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Addressee

.A111 The accountant's review report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being reviewed or to those charged with governance. A report on financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an accountant may be retained to review the financial statements of an entity that is not a client; in such a case, the report may be addressed to the entity and not to those charged with governance of the entity

whose financial statements are being reviewed. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Introductory Paragraph

.A112 The introductory paragraph states, for example, that the accountant has "reviewed the accompanying financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the financial statements." If the financial statements include a separate statement of changes in stockholders' equity accounts or a separate statement of comprehensive income, paragraph .76c(iii) requires such statements to be identified in the introductory paragraph of the report as a statement to which the financial statements are comprised. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A113 When the accountant is aware that the reviewed financial statements will be included in a document that contains other information, such as an annual report, the accountant may consider, if the form of presentation allows, identifying the page numbers on which the reviewed financial statements are presented. This helps users identify the financial statements to which the accountant's review report relates. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A114 The identification of the title for each statement that the financial statements comprise may be achieved by referencing the table of contents. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Management's Responsibility

.A115 Management, and when appropriate, those charged with governance, accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the accountant's review report includes reference to both responsibilities because it helps explain to users the premise on which a review is conducted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Responsibility

.A116 The accountant's review report states that the accountant's responsibility is to conduct the review engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA in order to contrast it to management's responsibility for the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.

Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A117 The reference to the standards used conveys to users of the accountant's review report that the review engagement has been conducted in accordance with established standards. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A118 The accountant is not permitted to represent compliance with SSARSs in the accountant's review report unless the accountant has complied with the relevant requirements within the body of SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Basis for Modification Paragraph When the Conclusion Is Modified

.A119 An adverse conclusion relating to a specific matter described in the basis for modification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the accountant's conclusion. In instances in which other identified matters would have otherwise required a modification of the accountant's conclusion, the disclosure of such other matters of which the accountant is aware may be relevant to users of the financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Accountant's Address

.A120 The city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Date of the Accountant's Review Report

.A121 The date of the accountant's review report informs users of the accountant's review report that the accountant has considered the effect of events and transactions of which the accountant became aware and that occurred up to that date. The accountant's responsibility for events and transactions after the date of the accountant's review report is addressed in paragraphs .49–.57. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A122 Because the accountant's conclusion is provided on the financial statements, and the financial statements are the responsibility of management, the accountant is not in a position to conclude that the accountant has obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework until evidence is obtained that all the statements that the financial statements comprise, including the related notes, have been prepared, and management has accepted responsibility for them. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A123 Exhibit C, "Illustrations of Accountant's Review Reports on Financial Statements," contains illustrations of accountant's review reports on financial statements incorporating the elements required by paragraph .76. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Accountant's Review Report on Financial Statements Prepared in Accordance With a Special Purpose Framework (Ref: par. .13, .77, and .80–.81)

.A124 There may be circumstances in which a regulatory or contractual basis of accounting is based on a general purpose framework established by a designated accounting standard setter, such as GAAP, or by law or regulation but does not comply with all the requirements of that framework. An example is a contract that requires financial statements to be prepared in accordance with most, but not all, of GAAP. If the financial statements purport to be prepared in accordance with a general purpose framework and such financial statements are materially misstated due to a departure from that framework, paragraphs .71–.72 apply. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A125 When it is acceptable in the circumstances of the engagement to report, in accordance with this section, on special purpose financial statements that purport to be prepared in accordance with a regulatory or contractual basis of accounting that is based on a general purpose framework, it is inappropriate for the description of the applicable financial reporting framework in the special purpose financial statements to imply that the special purpose framework includes all the requirements of, or is the same as, the financial reporting framework on which the special purpose framework is based. In the example of the contract in paragraph .A124, the description of the applicable financial reporting framework may refer to the financial reporting provisions of the contract. The requirements in paragraphs .80–.81 are designed to avoid misunderstandings about compliance with the general purpose framework. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A126 The description of the special purpose framework may be included in the financial statement titles, in the notes to the financial statements, or otherwise on the face of the financial statements. Although terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows* or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP, such titles, with appropriate modification, may be used in connection with financial statements prepared in accordance with a special purpose framework. Suitable financial statement titles for financial statements prepared in accordance with a special purpose framework include, but are not limited to

- a modified cash basis financial statement that might be titled
 - "Income Statement—Modified Cash Basis," or
 - "Statement of Cash Receipts and Disbursements."

- financial statements prepared in accordance with the tax basis of accounting that might be titled
 - "Balance Sheet—Tax Basis,"
 - "Statement of Assets, Liabilities, and Equity—Tax Basis,"
 - "Statement of Operations—Tax Basis," or
 - "Statement of Revenue and Expenses—Tax Basis."
- a financial statement prepared in accordance with a regulatory basis of accounting that might be titled "Statement of Income—Regulatory Basis."

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A127 The description of how the special purpose framework differs from GAAP ordinarily includes only the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described. The differences need not be quantified. [Paragraph subsequently renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A128 Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

[.A129] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A130 Special purpose financial statements may be used for purposes other than those for which they were intended. To avoid misunderstandings, paragraph .80 requires the accountant to include an emphasis-of-matter paragraph in the accountant's review report that alerts users of the accountant's review report that the financial statements are prepared in accordance with a special purpose framework and that the basis of accounting is a basis of accounting other than GAAP. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A131 Financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. Such special purpose financial statements may be used by users other than those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements, the financial statements are still considered to be special purpose financial statements for purposes of SSARSs. The requirement in paragraph .80 is designed to avoid misunderstandings about the

framework used to prepare the financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A132 If the special purpose financial statements are prepared in accordance with a contractual basis of accounting, paragraph .81 requires the accountant to include an other-matter paragraph in the accountant's review report, under an appropriate heading, that restricts the use of the accountant's review report to specified parties pursuant to paragraphs .103–.104. In the case of special purpose financial statements prepared in accordance with a basis of accounting other than a contractual basis, the accountant may consider it necessary in the circumstances of the engagement to include an alert that restricts the use of the accountant's review report but is not required to do so. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Comparative Financial Statements (Ref: par. .82)

.A133 The level of information included for the prior periods in comparative financial statements is comparable with that of financial statements of the current period. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A134 If one firm of accountants merges with another firm, and the new firm becomes the accountant of a client of one of the two former firms, the new firm may accept responsibility and issue a review report on the financial statements for the prior period(s) as well as for those of the current period. The new firm may indicate in the accountant's review report or as part of the signature that a merger took place and may name the firm with whom it was merged. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Updating the Report (Ref: par. .83)

.A135 An updated report is issued in conjunction with the continuing accountant's report on the current period financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Changed Reference to a Departure From the Applicable Financial Reporting Framework (Ref: par. .86)

.A136 A changed reference includes the removal of a prior reference or the inclusion of a new reference. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

[.A137–.A140] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report (Ref: par. .89 and .91)

.A141 The accountant is required to include an emphasis-of-matter or other-matter paragraph in the accountant's review report relating to the following matters:

- In accordance with paragraph .55c with respect to reporting when management revises financial statements for a subsequently discovered fact that became known to the accountant after the report release date and the accountant's review report on the revised financial statements differs from the accountant's review report on the original financial statements
- In accordance with paragraphs .80–.81 with respect to financial statements prepared in accordance with a special purpose framework
- In accordance with paragraph .86 with respect to a changed reference to a departure from the applicable financial reporting framework when reporting on comparative financial statements
- In accordance with paragraph .87 with respect to reporting on comparative financial statements when the prior period is audited
- In accordance with paragraph .109 when, after considering conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains
- In accordance with paragraph .123 with respect to supplementary information that accompanies reviewed financial statements and the accountant's review report thereon
- In accordance with paragraph .124 with respect to required supplementary information

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Emphasis-of-Matter Paragraphs in the Accountant's Review Report (Ref: par. .89–.90)

.A142 In addition to the required emphasis-of-matter paragraphs listed in paragraph .A141, the following are examples of circumstances when the accountant may consider it necessary to include an emphasis-of-matter paragraph:

- An uncertainty relating to the future outcome of unusually important litigation or regulatory action
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position
- Significant transactions with related parties
- Unusually important subsequent events

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of

financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A143 Paragraph .89 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A144 Another heading may be considered appropriate if it adequately describes the nature of the matter being disclosed or communicated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A145 The accountant may add further context to the heading "Emphasis of Matter" (for example, "Emphasis of Matter — Subsequent Event") to further describe the nature of the matter addressed by the emphasis-of-matter paragraph. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A146 The inclusion of an emphasis-of-matter paragraph in the accountant's review report does not affect the accountant's conclusion. An emphasis-of-matter paragraph is not a substitute for the following:

- A modified conclusion in accordance with paragraphs .69–.74 when required by the circumstances of a specific review engagement
- Disclosures in the financial statements that the applicable financial reporting framework requires management to make
- Reporting in accordance with paragraphs .109–.112 when, after considering identified conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, in which case the accountant is required to include a separate section in the accountant's report

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Other-Matter Paragraphs in the Accountant's Review Report (Ref: par. .91)

.A147 If not properly presented or disclosed in the financial statements, a matter cannot be included in an emphasis-of-matter paragraph. However, if the matter is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the matter can be disclosed in an other-matter paragraph. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A148 An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles

generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board) and may engage the accountant to review both sets of financial statements. If the accountant has determined that the frameworks are acceptable in the respective circumstances, the accountant may include an other-matter paragraph in the accountant's review report referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the accountant has issued a review report on those financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A149 The content of an other-matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the accountant is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to the confidentiality of information). An other-matter paragraph does not include information that is required to be provided by management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Communication With Management (Ref: par. .93)

.A150 The accountant's communication with management, as described in paragraph .93, enables management to be made aware of the nature of any specific matters that the accountant intends to highlight in the accountant's review report and provides them with an opportunity to obtain further clarification from the accountant, when necessary. When the inclusion of an other-matter paragraph on a particular matter in the accountant's review report recurs on each successive engagement, the accountant may determine that it is unnecessary to repeat the communication on each engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A151 In addition to management, the accountant may also consider it appropriate to communicate with those charged with governance regarding the expectation of including an other-matter paragraph in the accountant's review report and the proposed wording of this paragraph. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Correction of a Material Misstatement in Previously Issued Financial Statements (Ref: par. .94–.95)

.A152 The requirement for the accountant to include an emphasis-of-matter paragraph in the accountant's review report when there are adjustments to correct a material misstatement in previously issued financial statements applies when comparative or single-year financial statements are presented. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A153 A change from an accounting principle that is not in accordance with the applicable financial reporting framework to one that is in accordance with the applicable financial reporting framework is a correction of a misstatement. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A154 Paragraphs .54–.55 address the accountant's responsibilities when adjustments have been made to correct a material misstatement in previously issued financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A155 The following is an example of an emphasis-of-matter paragraph when there has been a correction of a material misstatement in previously issued financial statements:

Emphasis of Matter

As discussed in Note X to the financial statements, the 20X2 financial statements have been restated to correct a misstatement. Our conclusion is not modified with respect to this matter.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

Other Reporting Responsibilities (Ref: par. .97)

.A156 These other reporting responsibilities are addressed in a separate section of the accountant's report, to clearly distinguish them from the accountant's responsibility in accordance with this section to report on the financial statements. Where relevant, this section may contain subheadings that describe the content of the other reporting responsibilities paragraph or paragraphs. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.A157–.A162]^[6] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Alert That Restricts the Use of the Accountant's Review Report (Ref: par. .103)

.A163 The need for an alert that restricts the use of the accountant's review report arises from the potential for the accountant's review report to be misunderstood if taken out of the context in which the accountant's review report is intended to be used. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A164 Accountant's review reports on financial statements prepared in accordance with a general purpose framework ordinarily do not include an alert that restricts their use. A general purpose framework is a financial reporting framework designed to meet the common financial information needs of a wide range of users. However, nothing in SSARSs precludes an accountant from including an alert in any accountant's review report. For example, financial statements prepared specifically for use in an acquisition may be prepared in accordance with a general purpose framework because the parties involved in the

^[6] [Footnote renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

transaction have agreed that such general purpose financial statements are appropriate for their purposes. Nevertheless, when the terms of the engagement to review those financial statements require the accountant to supply the accountant's review report only to specified parties, the accountant may consider it necessary in the circumstances to include an other-matter paragraph in the accountant's review report that restricts the use of the accountant's review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Distribution of the Accountant's Review Report (Ref: par. .103)

.A165 An accountant is not responsible for controlling, and cannot control, distribution of the accountant's review report after its release. The alert that restricts the use of the accountant's review report is designed to avoid misunderstandings related to the use of the accountant's review report, particularly if the accountant's review report is taken out of the context in which the accountant's review report is intended to be used. An accountant may consider informing the entity or other specified parties that the accountant's review report is not intended for distribution to parties other than those specified in the accountant's review report. The accountant may, in connection with establishing the terms of the engagement, reach an understanding with the entity that the intended use of the accountant's review report will be restricted and may obtain the entity's agreement that the entity and specified parties will not distribute such accountant's review report to parties other than those identified therein. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Illustrative Alert Language (Ref: par. .104)

.A166 The alert that restricts the use of the accountant's review report may list the specified parties or refer to the specified parties listed elsewhere in the accountant's review report. The following illustrates language that includes the elements required by paragraph .104:

This report is intended solely for the information and use of *[list or refer to the specified parties]* and is not intended to be, and should not be, used by anyone other than these specified parties.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Adding Other Specified Parties (Ref: par. .105)

.A167 When the accountant is requested to add other parties as specified parties, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties and the intended use of the accountant's review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

The Accountant's Consideration of an Entity's Ability to Continue as a Going Concern

[~~A.168–A.173~~]^{7–8} [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Implications for the Accountant's Review Report When Substantial Doubt Exists About the Entity's Ability to Continue as a Going Concern ***(Ref: .109–.110 and .112)***

[~~A.174~~] [Paragraph renumbered and deleted by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A175 The identification of substantial doubt is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as going concern alerts users to this circumstance. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A176 The following are illustrations of the statements that are required to be included in the accountant's review report on the financial statements. The following illustrations provide examples in which FASB ASC is the applicable financial reporting framework. If an applicable financial reporting framework other than FASB ASC is used, the wording in the illustrations may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

Illustration 1 — An Accountant's Review Report Containing an Unmodified Conclusion and Including a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure in The Financial Statements Is Adequate

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our conclusion is not modified with respect to this matter.

Illustration 2 — An Accountant's Review Report Containing an Unmodified Opinion Conclusion and Including an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated

Emphasis of Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our conclusion is not modified with respect to this matter.

^{7–8} [Footnote renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.A177] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A178 When FASB ASC or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the accountant's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term or phrase may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A179 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the review evidence obtained, the accountant concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the accountant may include an emphasis-of-matter paragraph in accordance with paragraphs .89–.90, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions or events. In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the accountant concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the accountant is required by paragraph .109 to include a separate "Going Concern" section in the accountant's review report.

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A180 As indicated in paragraph .71, in circumstances in which conditions and events have been identified and the accountant concludes that, based on the review evidence obtained, the disclosures are materially misstated, the accountant is required to modify the accountant's review report. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A181 Examples of conditional language that are inappropriate to use in the "Going Concern" section include the following:

- If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- The Company has been unable to renegotiate its expiring credit agreements. Unless the entity is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

.A182 In certain circumstances, the accountant may believe it necessary to request that management perform or extend its evaluation to meet the period of time required by the applicable financial reporting framework. If management is unwilling to do so, a qualified or adverse conclusion in the accountant's review report may be appropriate. For example, management may be unwilling to extend its evaluation because it believes it has satisfied the requirements to conclude whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time when the applicable financial reporting framework requires management to make this evaluation. If, in the accountant's judgment, management's conclusion is not adequately supported, the accountant may conclude that a qualified or adverse conclusion for a departure from the applicable financial reporting framework is appropriate in the circumstances. Paragraphs .69–.74 provide guidance related to the modification of the accountant's conclusion. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

[.A183–.A190] [Paragraphs renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

Reference to the Work of Other Accountants in an Accountant's Review Report (Ref: par. .122)

.A191 The accountant of the reporting entity may make reference to any or all other accountants who audited or reviewed significant components. For example, if a significant component is audited or reviewed by an other accountant and a second significant component is audited or reviewed by a different other accountant, the accountant of the reporting entity may decide to make reference to one of the other accountants, both of the other accountants, or neither. The decision is solely at the discretion and judgment of the accountant of the reporting entity. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A192 The disclosure of the magnitude of the portion of the financial statements audited or reviewed by other accountants may be achieved by stating the dollar amounts or percentages of total assets, total revenues, other appropriate criteria, or a combination of these, whichever most clearly describes the portion of the financial statements audited or reviewed by other accountants. When two or more other accountants participate in the audit or review, the dollar amounts or the percentages covered by the other accountants may be stated in the aggregate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A193 Exhibit C contains an example of appropriate reporting in the accountant's review report when reference is made to the audit or review of significant components, such as consolidated and unconsolidated subsidiaries and

investees, by other accountants.⁹ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Determining Whether the Other Accountants Are Familiar with SSARSs or Auditing Standards Generally Accepted in the United States of America, as Applicable (Ref: par. .124b)

.A194 An other accountant's review report stating that the review was conducted in accordance with SSARSs or an auditor's report stating that the audit was conducted in accordance with generally accepted auditing standards (GAAS) is sufficient to make the determination required by paragraph .124b. When the other accountant has performed a review of the component financial statements in accordance with standards other than SSARSs or an audit of the component financial statements in accordance with auditing standards other than GAAS, the accountant of the reporting entity may evaluate, exercising professional judgment, whether the engagement performed by the other accountant meets the relevant requirements of SSARSs or GAAS, as applicable. For the purposes of complying with paragraph .124b, relevant requirements of SSARSs or GAAS are those that pertain to planning and performing the engagement on the component financial statements and do not include those related to the form of the accountant's review or the auditor's report. Reviews performed in accordance with International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, and audits performed in accordance with International Standards on Auditing (ISAs), both of which are promulgated by the International Auditing and Assurance Standards Board (IAASB), are likely to meet the relevant requirements of SSARSs and GAAS, respectively. The other accountants may perform additional procedures in order to meet the relevant requirements of SSARSs or GAAS. The accountant of the reporting entity, having determined that all relevant requirements of SSARSs or GAAS have been met by the other accountant, may decide to make reference to the review or audit of that other accountant in the accountant's review report on the reporting entity's financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A195 When the other accountants are not subject to the AICPA Code of Professional Conduct, compliance by the other accountants with the ethics and independence requirements set forth in the International Ethics Standards Board's *Code of Ethics for Professional Accountants* is sufficient to fulfill the other accountants' ethical responsibilities. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same (Ref: par. .125b)

.A196 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement,

⁹ Illustration 6, "An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component," of exhibit C. [Footnote renumbered by the issuance of SSARS No. 24, May 2018. Footnote subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

recognition, presentation, and disclosure of all material items in the component's financial statements in accordance with the financial reporting framework used by the component and the financial reporting framework used by the reporting entity, the less similar the financial reporting frameworks. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRS) and *International Financial Reporting Standard for Small- and Medium-Sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as similar to financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In most cases, special purpose frameworks are not similar to GAAP. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Supplementary Information That Accompanies Reviewed Financial Statements (Ref: par. .126–.128)

[A197] [Paragraph renumbered and deleted by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

A198 The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the supplementary information has been subjected to the review procedures applied in the accountant's review of the basic financial statements:

Other Matter

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The supplementary information has been subjected to the review procedures applied in my (our) review of the basic financial statements. I am (We are) not aware of any material modifications that should be made to the supplementary information. I (We) have not audited the supplementary information and do not express an opinion on such information.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

A199 The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the supplementary information has not been subjected to the review procedures applied in the review of the basic financial statements:

Other Matter

The accompanying *[identify the supplementary information]* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. I (We) have not audited or reviewed such information and I (we) do not express an opinion, a conclusion, nor provide any assurance on it.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A200 Supplementary information may become unattached from the accountant's review report. To minimize the possibility that a user of the supplementary information may infer, through the accountant's association with such information, an unintended level of reliance on it, the accountant may consider including a reference to the accountant's review report on each page of the supplementary information. An example of a reference to the accountant's review report included on each page of the supplementary information is "See independent accountant's review report." [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Required Supplementary Information (Ref: par. .129–.130)

.A201 Examples of required supplementary information that may accompany reviewed financial statements include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by *FASB Accounting Standards Codification 972-235-50-3*
- Management's discussion and analysis and budgetary comparison statements as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A202 *Prescribed guidelines* are the authoritative guidelines established by the designated accounting standard-setter for the methods of measurement and presentation of the required supplementary information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A203 Because the required supplementary information accompanies the basic financial statements, the accountant's review report on the financial statements includes a discussion of the responsibility taken by the accountant on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Change in Engagement From Audit to Review (Ref: par. .132)

.A204 A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit engagement; a misunderstanding regarding the nature of an audit or review engagement; or

a restriction on the scope of the audit engagement, whether imposed by management or caused by circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A205 A change in circumstances that affects the entity's requirement for an audit engagement or a misunderstanding concerning the nature of an audit or review engagement would ordinarily be considered a reasonable basis for requesting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A206 The implications of a restriction on the scope of the audit engagement include the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Review Documentation (Ref: par. .137)

.A207 Review documentation may be recorded on paper or on electronic or other media. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A208 The accountant need not include in review documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A209 The accountant is not precluded from supporting the review report by other means in addition to the review documentation. Such other means might include written documentation contained in other engagement files (for example, compilation or nonattest services) or quality control files (for example, consultation files) and, in limited situations, oral explanations. On their own, oral explanations by the accountant do not represent adequate support for the work the accountant performed or conclusions reached, but they may be used to explain or clarify information contained in the review documentation. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A210 In the case of a review in which the engagement partner performs all the review work, the engagement partner is still required to comply with the overriding requirement in paragraph .137 to prepare review documentation that can be understood by an experienced accountant because the review documentation may be subject to review by external parties. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A211 Findings or issues that, in the accountant's professional judgment, are significant may include the results of review procedures that indicate that the financial statements could be materially misstated, including actions taken to address such findings and the basis for the final conclusions. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

Appendix A — Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements (Ref: par. .A29)

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. Examples of analytical procedures that an accountant may consider performing in a review of financial statements include the following:

- Comparing current financial statements with the financial statements of the prior period.
- Comparing current financial statements with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial statements with corresponding information in [a] budgets, using expected rates, and [b] financial statements for prior periods). Caution is necessary when comparing and evaluating current financial statements with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results.
- Comparing current financial statements with relevant nonfinancial information.
- Comparing ratios and indicators for the current period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current financial statements and comparing the results with corresponding information for prior periods). Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial statements with corresponding relationships in the financial statements of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables).
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
 - By period (for example, financial statement items disaggregated into quarterly, monthly, or weekly amounts)
 - By product line or operating segment
 - By location (for example, subsidiary, division, or branch)

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

[.A213] [Paragraph renumbered and deleted by the issuance of SSARS No. 25, February 2020.]

.A214

Exhibit A — Illustrative Engagement Letters (Ref: par. .A29)

Illustration 1 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

The illustrative engagement letters in this exhibit are intended as illustrations that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances, and the illustrations are drafted to refer to a review engagement for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

Illustration 1 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the review engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements and perform a review engagement with respect to those financial statements.³ We are pleased to confirm our acceptance and understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A25.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial

- statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
 - e. To ensure that the entity complies with the laws and regulations applicable to its activities
 - f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
 - g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the review engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries
 - h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services.

Our Report

[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows.]

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from accounting principles generally accepted in the United States of America, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

You agree to include our accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services. . .

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by

third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review of those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements; Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Illustration 2 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the review engagement.
- The financial statements will be prepared in accordance with the tax basis of accounting.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity—tax basis as of December 31, 20XX, and the related statements of operations and retained earnings—tax basis, and cash flows—tax basis for the year then ended, and the related notes to the financial statements and to perform a review engagement with respect to those financial statements.³ We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a.* prepare financial statements in accordance with the tax basis of accounting based on information provided by you and

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A25.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with the tax basis of accounting and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

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- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the review engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows.]

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary of us to report known departures from the tax basis of accounting, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our report will state that the financial statements are prepared in accordance with tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion will not be modified with respect to this matter.

You agree to include our accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services. . .

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing

misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review with respect to those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A215

Exhibit B — Illustrative Representation Letter (Ref: par. .A97)

The following illustrative letter is intended as an illustration that may be used to comply with the requirements of section 90. The representation letter will vary according to individual requirements and circumstances.

It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States of America, that no conditions or events exist that might be indicative of the entity's inability to continue as a going concern, and that no exceptions exist to the requested written representations. If circumstances differ from these assumptions, the representations would need to be modified to reflect the actual circumstances.

(Entity Letterhead)

(To Accountant)

(Date)

This representation letter is provided in connection with your review of the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements, for the purpose of obtaining limited assurance as a basis for reporting whether you are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We represent that *[to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves]* *[as of (date of accountant's review report)]*:

Financial Statements

- We acknowledge our responsibility and have fulfilled our responsibilities for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- We acknowledge our responsibility and have fulfilled our responsibilities for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Guarantees, whether written or oral, under which the company is contingently liable have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB *Accounting Standards Codification* (ASC) 275, *Risks and Uncertainties*, have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America. [Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]
- All events occurring subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America requires adjustment or disclosure have been properly accounted for.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole.
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.

[Any other matters that the accountant may consider appropriate.]

Information Provided

- We have responded fully and truthfully to all inquiries made to us by you during your review.
- We have provided you with
 - access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - minutes of meetings of stockholders, directors, and committees of directors or summaries of actions of recent meetings for which minutes have not yet been prepared;
 - additional information that you have requested from us for the purpose of the review; and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain review evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.

- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* fraud or suspected fraud that affects the entity and involves
 - management,
 - employees who have significant roles in internal control, or
 - others when the fraud could have a material effect on the financial statements.
- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* allegations of fraud, or suspected fraud, affecting the entity's financial statements as a whole communicated by employees, former employees, analysts, regulators, or others.
- We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
- We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws or regulations whose effects should be considered when preparing financial statements.
- We *[have disclosed to you all known actual or possible]* *[are not aware of any pending or threatened]* litigation and claims whose effects should be considered when preparing the financial statements *[and we have not consulted legal counsel concerning litigation or claims]*
- We have disclosed to you any other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies*.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- We have disclosed to you all information relevant to the use of the going concern assumption in the financial statements.
- No material losses exist (such as from obsolete inventory or purchase or sale commitments) that have not been properly accrued or disclosed in the financial statements.
- The company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
- We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- We are in agreement with the adjusting journal entries that you have recommended, and they have been posted to the company's accounts (if applicable).

[Any other matters that the accountant may consider necessary.]

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

Representation letters ordinarily are tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered by the issuance of SSARS No. 25, February 2020.]

.A216

Exhibit C — Illustrations of Accountant's Review Reports on Financial Statements (Ref: par. .A123 and .A191)

The illustrative accountant's review reports in this exhibit are intended as illustrations that may be used to comply with the requirements of section 90. The accountant's review report will vary according to individual requirements and circumstances.

Illustration 1 — An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Illustration 2 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 3 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 4 — An Accountant's Review Report on Interim Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 5 — An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America

Illustration 6 — An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component

Illustration 7 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America Containing an Adverse Conclusion Due to a Misstatement of the Financial Statements That Is Both Material and Pervasive to the Financial Statements

Illustration 1 — An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the

related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 2 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of financial statements (single year).
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. A review

includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 3 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- Review of a complete set of financial statements (single year).
- The financial statements are of a partnership and prepared in accordance with the basis of accounting the partnership uses for income tax purposes (that is, a special purpose framework).
- Management has a choice of financial reporting frameworks.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Partnership, which comprise the statement of assets, liabilities, and partners' capital—tax basis as of December 31, 20XX, and the related statements of revenue and expenses—tax basis, and partners' capital—tax basis for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (partners') financial data and

making inquiries of partnership management (partners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Partners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting the partnership uses for income tax purposes; this includes determining that the basis of accounting the partnership uses for income tax purposes is an acceptable basis for the preparation of financial statements in the circumstances. Management (Partners) is (are) also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with the basis of accounting the partnership uses for income tax purposes. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Partnership and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the basis of accounting the partnership uses for income tax purposes.

Basis of Accounting

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the basis of accounting the partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion is not modified with respect to this matter.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 4 — An Accountant's Review Report on Interim Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of interim financial statements for the period ended September 30, 20XX, and for the three and nine months then ended.

- The interim financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.
- The accountant appropriately performs the engagement in accordance with SSARs (that is, AU-C section 930, *Interim Financial Information*, is not applicable).

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying interim financial statements of XYZ Company, which comprise the balance sheet as of September 30, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the three and nine months then ended, and the related notes to the interim financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the interim financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these interim financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the interim financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our review.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying interim financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 5 — An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements contain a departure from accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Basis for Qualified Conclusion

As disclosed in Note X to these financial statements, accounting principles generally accepted in the United States of America require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from accounting principles generally accepted in the United States of America on financial position, results of operations, and cash flows have not been determined.

or

As disclosed in Note X to these financial statements, the company has adopted *[description of newly adopted method]*, whereas it previously used *[description*

of previous method]. Although the [*description of newly adopted method*] is in accordance with accounting principles generally accepted in the United States of America, the company does not appear to have reasonable justification for making a change as required by FASB *Accounting Standards Codification* 250, *Accounting Changes and Error Corrections*.

Qualified Conclusion

Based on my (our) reviews, except for the effect of the matter described in the Basis for Qualified Conclusion paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Accountant's city and state*]

[*Date of the accountant's review report*]

Illustration 6 — An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component

Circumstances include the following:

- Review of a complete set of comparative consolidated financial statements.
- The financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X2 and 20X1, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended, were reviewed by other accountants, and the accountant has decided to make reference to the work of other accountants in the accountant's review report.

Independent Accountant's Review Report

[*Appropriate Addressee*]

I (We) have reviewed the accompanying consolidated financial statements of XYZ Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X2 and 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services (SSARSS) promulgated by the Accounting and Review Services Committee of the AICPA. We have not reviewed the financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X2 and 20X1, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. These statements were reviewed by other accountants, whose report has been furnished to me (us), and our conclusion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other accountants.

SSARSS require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the consolidated financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Accountant's Conclusion

Based on my (our) reviews, and the report of other accountants, I am (we are) not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 7 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America Containing an Adverse Conclusion Due to a Misstatement of the Financial Statements That Is Both Material and Pervasive to the Financial Statements

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements contain a departure from accounting principles generally accepted in the United States of America that is both material and pervasive to the financial statements due to nonconsolidation of a subsidiary.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

We are required to be independent of XYZ Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements related to our reviews.

Basis for Adverse Conclusion

As disclosed in Note X to these financial statements, the Company has not consolidated the financial statements of subsidiary ABC Company it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Adverse Conclusion

Based on my (our) review, due to the significance of the matter described in the Basis for Adverse Conclusion paragraph, the financial statements are not in accordance with accounting principles generally accepted in the United States of America. [Had we been engaged to perform an audit, other matters might have come to our attention.]

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2021, by SSARS No. 25.]

AR-C Section 90B

Review of Financial Statements

Source: SSARS No. 21; SSARS No. 23; SSARS No. 24.

Effective for reviews of financial statements for periods ending on or after December 15, 2015, unless otherwise indicated.

Introduction

Scope and Applicability of This Section

.01 This section applies when the accountant is engaged to perform a review of financial statements. This section also applies when the accountant is engaged to review other historical financial information, excluding pro forma financial information. Reviews of pro forma financial information are to be performed in accordance with Statements on Standards for Attestation Engagements. (Ref: par. .A1–.A3) [As amended, effective October 2016, by SSARS No. 23.]

.02 This section does not apply when the accountant is engaged to review interim financial information when

- a. the entity's latest annual financial statements have been audited by the accountant or a predecessor;
- b. the accountant either
 - i. has been engaged to audit the entity's current year financial statements or
 - ii. audited the entity's latest annual financial statements and, in situations in which it is expected that the current year financial statements will be audited, the engagement of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review; and
- c. the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

AU-C section 930, *Interim Financial Information*, provides guidance for review engagements when the conditions in a–c are met.

Effective Date

.03 This section is effective for reviews of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.04 The objective of the accountant when performing a review of financial statements is to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the

financial statements for them to be in accordance with the applicable financial reporting framework, primarily through the performance of inquiry and analytical procedures. (Ref: par. .A4–.A9)

Definitions

.05 For purposes of Statements on Standards for Accounting and Review Services (SSARs), the following terms have the meanings attributed as follows:

Analytical procedures. Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

Comparative financial statements. A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period.

Designated accounting standard-setter. A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Emphasis-of-matter paragraph. A paragraph included in the accountant's review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.

Error. Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

Experienced accountant. An individual (whether internal or external to the firm) who has practical review experience and a reasonable understanding of

- a. review processes;
- b. SSARs and applicable legal and regulatory requirements;
- c. the business environment in which the entity operates; and
- d. review and financial reporting issues relevant to the entity's industry.

Fraud. An intentional act that results in a misstatement in financial statements.

Generally accepted accounting principles (GAAP). References to GAAP in SSARs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001) of the AICPA Code of Professional Conduct.

Historical financial information. Information expressed in financial terms regarding a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board or an owner-manager.

Misstatement. A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant's professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

Noncompliance. Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Other-matter paragraph. A paragraph included in the accountant's review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report.

Reasonable period of time. The period of time required by the applicable financial reporting framework or, if no such requirement exists, within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). (Ref: par. A10)

Report release date. The date the accountant grants the entity permission to use the accountant's review report in connection with the financial statements.

Required supplementary information. Information that a designated accounting standards-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting

standards-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established.

Review documentation. The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant reached (terms such as *working papers* or *workpapers* are also sometimes used).

Review evidence. Information used by the accountant to provide a reasonable basis for obtaining limited assurance.

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission). (Ref: par. .A11)
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

Specified parties. The intended users of the accountant's review report.

Subsequent events. Events occurring between the date of the financial statements and the date of the accountant's review report.

Subsequently discovered facts. Facts that become known to the accountant after the date of the accountant's review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant's review report.

Supplementary information. Information presented outside the basic financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the reviewed financial statements or separate from the reviewed financial statements. (Ref: par. .A12–.A13)

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Updated report. A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant's current engagement and that re-expresses the accountant's previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant's current report.

Written representation. A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

[As amended, effective October 2016, by SSARS No. 23. As amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Requirements

General Principles for Performing and Reporting on Review Engagements

.06 In addition to complying with this section, an accountant is required to comply with section 60A, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Independence

.07 The accountant must be independent of the entity when performing a review of financial statements in accordance with SSARSs. If, during the performance of the review engagement, the accountant determines that the accountant's independence is impaired, the accountant should withdraw from the review engagement. (Ref: par. .A14–.A15)

Acceptance and Continuance of Client Relationships and Review Engagements

.08 The accountant should not accept a review engagement if, in addition to the requirements in paragraph .25 of section 60A, management or those charged with governance impose a limitation on the scope of the accountant's work in terms of a proposed review engagement such that the accountant believes the limitation will result in the accountant being unable to perform review procedures to provide an adequate basis for issuing a review report.

.09 As a condition for accepting an engagement to review an entity's financial statements, in addition to the requirements in paragraph .26 of

section 60A, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility

- a. for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes (Ref: par. .A16)
 - i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, (Ref: par. .A82)
 - ii. a description of any significant interpretations of the contract on which the special purpose financial statements are prepared in the case of financial statements prepared in accordance with a contractual basis of accounting, and
 - iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.
- b. to provide the accountant, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
- c. to include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by the entity's accountant unless a different understanding is reached. (Ref: par. .A17)

.10 If the accountant is not satisfied about any of the matters set out in paragraph .26 of section 60A or paragraph .09 of this section as preconditions for accepting a review engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.11 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A18–.A23)

- a. The objectives of the engagement
- b. The responsibilities of management set forth in paragraph .26c of section 60A and paragraph .09 of this section
- c. The responsibilities of the accountant
- d. The limitations of a review engagement
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements

- f.* The expected form and content of the accountant's review report and a statement that there may be circumstances in which the report may differ from its expected form and content

[As amended, effective October 2016, by SSARS No. 23.]

.12 The engagement letter or other suitable form of written agreement should be signed by

- a.* the accountant or the accountant's firm and
- b.* management or those charged with governance, as appropriate. (Ref: par. .A19)

[As amended, effective October 2016, by SSARS No. 23.]

Communication With Management and Those Charged With Governance

.13 The accountant should communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review engagement that, in the accountant's professional judgment, are of significant importance to merit the attention of management or those charged with governance, as appropriate. (Ref: par. .A24–.A30)

Understanding of the Industry

.14 To perform the review engagement, the accountant should possess or obtain an understanding of the industry in which the entity operates, including the accounting principles and practices generally used in the industry, sufficient to enable the accountant to review financial statements that are appropriate for an entity operating in that industry. (Ref: par. .A31)

Knowledge of the Entity

.15 The accountant should obtain knowledge about the entity, including an understanding of

- a.* the entity's business and
- b.* the accounting principles and practices used by the entity

sufficient to identify areas in the financial statements in which there is a greater likelihood that material misstatements may arise and to be able to design procedures to address those areas. (Ref: par. .A32–.A33)

.16 In obtaining the understanding of the entity's accounting policies and practices, the accountant should be alert to accounting policies and procedures that, based on the accountant's knowledge of the industry, are unusual.

Designing and Performing Review Procedures

.17 The accountant should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework based on the accountant's (Ref: par. .A34)

- a.* understanding of the industry,
- b.* knowledge of the entity, and

- c. awareness of the risk that the accountant may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated. (Ref: par. .A35)

.18 The accountant should focus the analytical procedures and inquiries in those areas where the accountant believes there are increased risks of material misstatements.

Analytical Procedures

.19 The accountant should apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Such analytical procedures should include the following: (Ref: par. .A36–.A38)

- a. Comparing the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions
- b. Considering plausible relationships among both financial and, when relevant, nonfinancial information (Ref: par. .A39)
- c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist, based on the accountant's understanding of the entity and the industry in which the entity operates (Ref: par. .A40)
- d. Comparing disaggregated revenue data, as applicable (Ref: par. .A41)

.20 When designing and performing analytical procedures, the accountant should (Ref: par. .A42)

- a. determine the suitability of particular analytical procedures;
- b. consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available;
- c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph .21 and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations.

Investigating Results of Analytical Procedures

.21 If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the accountant should investigate such differences by

- a. inquiring of management and
- b. performing other review procedures if considered necessary in the circumstances. (Ref: par. .A43)

Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters

.22 The accountant should inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements about (Ref: par. .A44)

- a.* whether the financial statements have been prepared and fairly presented in accordance with the applicable financial reporting framework consistently applied.
- b.* unusual or complex situations that may have an effect on the financial statements. (Ref: par. .A45)
- c.* significant transactions occurring or recognized during the period, particularly those in the last several days of the period.
- d.* the status of uncorrected misstatements identified during the previous review (that is, whether adjustments had been recorded subsequent to the periods covered by the prior review and, if so, the amounts recorded and period in which such adjustments were recorded).
- e.* matters about which questions have arisen in the course of applying the review procedures.
- f.* events subsequent to the date of the financial statements that could have a material effect on the fair presentation of such financial statements.
- g.* its knowledge of any fraud or suspected fraud affecting the entity involving
 - i.* management,
 - ii.* employees who have significant roles in internal control, or
 - iii.* others, when the fraud could have a material effect on the financial statements. (Ref: par. .A46)
- h.* whether management is aware of allegations of fraud or suspected fraud affecting the entity communicated by employees, former employees, regulators, or others.
- i.* whether management has disclosed to the accountant all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
- j.* significant journal entries and other adjustments.
- k.* communications from regulatory agencies, if applicable.
- l.* related parties and significant new related party transactions.
- m.* any litigation, claims, and assessments that existed at the date of the balance sheet being reported on and during the period from the balance sheet date to the date of management's response to the accountant's inquiry.
- n.* whether management believes that significant assumptions used by it in making accounting estimates are reasonable.
- o.* actions taken at meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements. (Ref: par. .A47)
- p.* any other matters that the accountant may consider necessary.

.23 The accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business. However, the accountant is not required to corroborate management's responses with other evidence.

Reading the Financial Statements

.24 The accountant should read the financial statements and consider whether any information has come to the accountant's attention to indicate that such financial statements do not conform to the applicable financial reporting framework.

Using the Work of Other Accountants

.25 If other accountants have issued a report on the financial statements of significant components, such as subsidiaries and investees, the accountant should obtain and read reports from such other accountants.

Reconciling the Financial Statements to the Underlying Accounting Records

.26 The accountant should obtain evidence that the financial statements agree or reconcile with the accounting records. (Ref: par. .A48)

Evaluating Evidence Obtained From the Procedures Performed

.27 The accountant should accumulate uncorrected misstatements, including inadequate disclosure, identified by the accountant in performing the review procedures or brought to the accountant's attention during the performance of the review.

.28 The accountant should evaluate whether the uncorrected misstatements accumulated in accordance with paragraph .27 are, individually and in the aggregate, material to the financial statements in order to determine whether any modifications should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. (Ref: par. .A6 and .A49–.A50)

.29 If, during the performance of review procedures, the accountant becomes aware that information coming to the accountant's attention is incorrect, incomplete, or otherwise unsatisfactory, the accountant should

- a. request that management consider the effect of those matters on the financial statements and communicate the results of its consideration to the accountant and
- b. consider the results communicated to the accountant by management and whether such results indicate that the financial statements may be materially misstated.

.30 If the accountant believes that the financial statements may be materially misstated, the accountant should perform additional procedures deemed necessary to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework.

.31 The accountant should evaluate whether sufficient appropriate review evidence has been obtained from the procedures performed and, if not, the accountant should perform other procedures judged by the accountant to be

necessary in the circumstances to be able to form a conclusion on the financial statements. (Ref: par. .A51)

Written Representations

Written Representations as Review Evidence

.32 *Written representations* are necessary information that the accountant requires in connection with a review of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are review evidence. (Ref: par. .A52)

Management From Whom Written Representations Are Requested

.33 The accountant should request written representations from members of management who have appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: par. .A53–.A55)

Specific Written Representations

.34 For all financial statements presented and all periods covered by the review, the accountant should request management to provide written representations that are dated as of the date of the accountant's review report stating the following: (Ref: par. .A56–.A62)

- a. Management has fulfilled its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, as set out in the terms of the engagement.
- b. Management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements, including its responsibility to prevent and detect fraud.
- c. Management has provided the accountant with all relevant information and access, as agreed upon in the terms of the engagement.
- d. Management has responded fully and truthfully to all of the accountant's inquiries
- e. All transactions have been recorded and are reflected in the financial statements.
- f. Management has disclosed to the accountant its knowledge of fraud or suspected fraud affecting the entity involving
 - i. management,
 - ii. employees who have significant roles in internal control, or
 - iii. others, when the fraud could have a material effect on the financial statements.
- g. Management has disclosed to the accountant its knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
- h. Management has disclosed to the accountant all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.

- i. Management has disclosed to the accountant whether it believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation.
- j. Management has disclosed to the accountant all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.
- k. Management has disclosed to the accountant whether it believes that significant assumptions it used in making accounting estimates are reasonable.
- l. Management has disclosed to the accountant the identity of the entity's related parties and all of the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.
- m. Management has disclosed to the accountant all information relevant to use of the going concern assumption in the financial statements.
- n. Management has properly accounted for all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure.

[As amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.35 If, in addition to the representations required by paragraph .34, the accountant determines that it is necessary to obtain one or more written representations to support other review evidence relevant to the financial statements, the accountant should request such other written representations. (Ref: par. .A63)

Form of Written Representations

.36 The written representations should be in the form of a representation letter addressed to the accountant. (Ref: par. .A64–.A65)

Concerns About the Reliability of Written Representations and Requested Written Representations Not Provided

.37 If, in relation to the written representations required by paragraphs .34–.35

- a. management does not provide the written representations, or
- b. the accountant concludes that there is cause to doubt management's integrity such that the written representations provided are not reliable

the accountant should discuss the matter with management and those charged with governance, as appropriate. If management does not provide the required representations or the accountant continues to doubt management's integrity such that the written representations provided may not be reliable, the accountant should withdraw from the engagement.

Reporting on the Financial Statements

.38 The accountant's review report should be in writing. (Ref: par. .A66–.A68)

Accountant's Review Report

.39 The written review report should include the following: (Ref: par. .A81)

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent accountant. (Ref: par. .A69)
- b. An addressee, as appropriate for the circumstances of the engagement. (Ref: par. .A70)
- c. An introductory paragraph that (Ref: par. .A71–.A73)
 - i. identifies the entity whose financial statements have been reviewed,
 - ii. states that the financial statements identified in the report were reviewed,
 - iii. identifies the financial statements,
 - iv. specifies the date or period covered by each financial statement,
 - v. includes a statement that a review includes primarily applying analytical procedures to management's (owner's) financial data and making inquiries of company management (owners), and
 - vi. includes a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.
- d. A section with the heading "Management's Responsibility for the Financial Statements" that includes an explanation that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error. (Ref: par. .A74)
- e. A section with the heading "Accountant's Responsibility" that includes the following statements:
 - i. The accountant's responsibility is to conduct the review engagement in accordance with SSARs promulgated by the Accounting and Review Services Committee of the AICPA. The accountant's review report should also explain that those standards require that the accountant perform the procedures to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. (Ref: par. .A75–.A77)
 - ii. The accountant believes that the results of the accountant's procedures provide a reasonable basis for the accountant's conclusion.

- f.* A concluding section with an appropriate heading that includes a statement about whether the accountant is aware of any material modifications that should be made to the accompanying financial statements for them to be in accordance with the applicable financial reporting framework and that identifies the country of origin of those accounting principles, if applicable. (Ref: par. .A50)
- g.* The signature of the accountant or the accountant's firm.
- h.* The city and state where the accountant practices. (Ref: par. .A78)
- i.* The date of the review report, which should be dated no earlier than the date on which the accountant completed procedures sufficient to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework, including evidence that
 - i.* all the statements that the financial statements comprise, including the related notes, have been prepared and
 - ii.* management has asserted that they have taken responsibility for those financial statements. (Ref: par. .A79–.A80)

[As amended, effective October 2016, by SSARS No. 23. As amended, effective May 2018, by SSARS No. 24.]

Accountant's Review Report on Financial Statements Prepared in Accordance With a Special Purpose Framework

.40 The accountant should modify the review report when the accountant becomes aware that the financial statements do not include

- a.* a description of the special purpose framework. (Ref: par. .A82)
- b.* a summary of significant accounting policies.
- c.* an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified. (Ref: par. .A83)
- d.* informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. (Ref: par. .A84)

.41 In the case of financial statements prepared in accordance with a contractual basis of accounting, the accountant should modify the review report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based.

.42 The accountant's review report on financial statements prepared in accordance with a special purpose framework should

- a.* make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of financial reporting frameworks in the preparation of such financial statements.
- b.* describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information when the financial statements are prepared in

accordance with a regulatory or contractual basis of accounting.
(Ref: par. .A85)

.43 The accountant's review report on financial statements prepared in accordance with a special purpose framework should include an emphasis-of-matter paragraph, under an appropriate heading, that

- a. indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- b. refers to the note to the financial statements that describes the framework, and
- c. states that the special purpose framework is a basis of accounting other than GAAP.

.44 The accountant's review report on special purpose financial statements should include, in accordance with paragraph .54, an other-matter paragraph, under an appropriate heading, that, in accordance with paragraphs .61–.62, restricts the use of the accountant's review report when the special purpose financial statements are prepared in accordance with (Ref: par. .A86)

- a. a contractual basis of accounting,
- b. a regulatory basis of accounting, or
- c. an other basis of accounting when required pursuant to paragraph .61a–b.

Comparative Financial Statements

.45 Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the accountant's report should refer to each period for which financial statements are presented. (Ref: par. .A87–.A88)

Updating the Report

.46 When reporting on all periods presented, a continuing accountant should update the report on one or more prior periods presented on a comparative basis with those of the current period. The accountant's report on comparative financial statements should not be dated earlier than the date that the accountant completed procedures sufficient to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework with respect to the current period. (Ref: par. .A89)

.47 When issuing an updated report, the continuing accountant should consider information that the accountant has become aware of during the review of the current period financial statements.

.48 If, during the current engagement, circumstances or events come to the accountant's attention that may affect the prior-period financial statements presented, the accountant should consider the effects on the review report.

Changed Reference to a Departure From the Applicable Financial Reporting Framework

.49 When the accountant's report on the financial statements of the prior period contains a changed reference to a departure from the applicable financial reporting framework, the accountant's review report should include an other-matter paragraph indicating (Ref: par. .A90)

- a. the date of the accountant's previous review report.
- b. the circumstances or events that caused the reference to be changed.
- c. when applicable, that the financial statements of the prior period have been changed.

Reporting When One Period Is Audited

.50 When the prior period financial statements were audited and the auditor's report on the prior period financial statements is not reissued, the review report on the current period financial statements should include an other-matter paragraph indicating

- a. that the financial statements of the prior period were previously audited;
- b. the date of the auditor's report on the prior period financial statements;
- c. the type of opinion issued on the prior period financial statements;
- d. if the opinion was modified, the substantive reasons for the modification; and
- e. that no auditing procedures were performed after the date of the previous report.

Communicating to Management and Others Regarding Fraud or Noncompliance With Laws and Regulations

.51 If the accountant becomes aware that fraud (including misappropriation of assets) may have occurred, the accountant should communicate the matter as soon as practicable to the appropriate level of management (at a level above those involved with the suspected fraud, if possible). If the accountant becomes aware of matters involving identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements, the accountant should communicate the matters to management, other than when matters are clearly inconsequential. If the fraud or noncompliance with laws or regulations involves senior management or results in a material misstatement of the financial statements, the accountant should communicate the matter directly to those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that (Ref: par. .A91–.A93)

- a. the financial statements are not materially misstated due to fraud or
- b. the entity is in compliance with laws and regulations, and in the accountant's professional judgment, the effect of the suspected noncompliance may be material to the financial statements

the accountant should consider the need to obtain legal advice and take appropriate action, including potential withdrawal. (Ref: par. .A94)

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report

Emphasis-of-Matter Paragraphs in the Accountant's Review Report

.52 If the accountant considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that,

in the accountant's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the accountant should include an emphasis-of-matter paragraph in the accountant's review report, provided that the accountant does not believe that the financial statements may be materially misstated. Such a paragraph should refer only to information presented or disclosed in the financial statements. (Ref: par. .A95–.A97)

.53 When the accountant includes an emphasis-of-matter paragraph in the accountant's review report, the accountant should

- a. include it immediately after the accountant's conclusion paragraph in the accountant's review report,
- b. use the heading "Emphasis of a Matter" or other appropriate heading, (Ref: par. .A98)
- c. include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements, and
- d. indicate that the accountant's conclusion is not modified with respect to the matter emphasized. (Ref: par. .A99)

Other-Matter Paragraphs in the Accountant's Review Report

.54 If the accountant considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the accountant's professional judgment, is relevant to the users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the accountant should do so in a paragraph in the accountant's review report with the heading "Other Matter" or other appropriate heading. The accountant should include this paragraph immediately after the accountant's conclusion paragraph and any emphasis-of-matter paragraph. (Ref: .A95, .A98, and .A100–.A102)

Communication With Management

.55 If the accountant expects to include an emphasis-of-matter or other-matter paragraph in the accountant's review report, the accountant should communicate with management regarding this expectation and the proposed wording of this paragraph. (Ref: par. .A103–.A104)

Known Departures From the Applicable Financial Reporting Framework

.56 When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements and if the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure.

.57 If the accountant concludes that modification of the standard report is adequate, the departure should be disclosed in a separate paragraph of the report under the heading "Known Departures From the [*identify the applicable financial reporting framework*]," including disclosure of the effects of the departure on the financial statements if such effects have been determined by

management or are known to the accountant as the result of the accountant's procedures. (Ref: par. .A105 and .A110)

.58 If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances, the accountant should state in the report that such determination has not been made.

.59 If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the review engagement. (Ref: par. .A106)

.60 The accountant should not modify the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework. (Ref: par. .A107–.A109)

Alert That Restricts the Use of the Accountant's Review Report

.61 An accountant's review report should include an alert, in a separate paragraph, that restricts its use when the subject matter of the accountant's review report is based on (Ref: par. .A111–.A113)

- a. measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria or
- b. measurement or disclosure criteria that are available only to the specified parties.

.62 The alert that restricts the use of the accountant's review report required by paragraph .61 should

- a. state that the accountant's review report is intended solely for the information and use of the specified parties.
- b. identify the specified parties for whom use is intended.
- c. state that the accountant's review report is not intended to be, and should not be, used by anyone other than the specified parties. (Ref: par. .A114)

Adding Other Specified Parties

.63 When, in accordance with paragraph .61, the accountant includes an alert that restricts the use of the accountant's review report to certain specified parties and the accountant is requested to add other parties as specified parties, the accountant should determine whether to agree to add the other parties as specified parties. (Ref: par. .A115)

.64 If the other parties are added after the release of the accountant's review report, the accountant should either:

- a. Amend the accountant's review report to add the other parties and, in such circumstances, not change the original date of the accountant's review report.
- b. Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties and state in the acknowledgment that no procedures were performed subsequent to the original date of the accountant's review report.

The Accountant's Consideration of an Entity's Ability to Continue as a Going Concern

Inquiry Concerning an Entity's Ability to Continue as a Going Concern

.65 If the applicable financial reporting framework includes requirements for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements, the accountant should perform review procedures related to the following: (Ref: par. .A116–.A117)

- a. Whether the going concern basis of accounting is appropriate
- b. Management's evaluation of whether there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern
- c. If there are conditions or events that raised substantial doubt about the entity's ability to continue as a going concern, management's plans to mitigate those matters
- d. The adequacy of the related disclosures in the financial statements

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.66 If the applicable financial reporting framework does not include a requirement for management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements and conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time existed at the date of the prior period financial statements (regardless of whether the substantial doubt was alleviated by the accountant's consideration of management's plans) or, in the course of performing review procedures on the current period financial statements, the accountant becomes aware of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern, the accountant should do the following: (Ref: par. .A118–.A119)

- a. Inquire of management whether the going concern basis of accounting is appropriate.
- b. Inquire of management about its plans for dealing with the adverse effects of the conditions and events. (Ref: par. .A120)
- c. Consider the adequacy of the disclosure about such matters in the financial statements. (Ref: par. .A121)

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Consideration of the Effects on the Accountant's Review Report

.67 If, after considering conditions or events and management's plans, the accountant concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the accountant should include an emphasis-of-matter paragraph in the accountant's review report. (Ref: par. .A123–.A125) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.68 The emphasis-of-matter paragraph about the entity's ability to continue as a going concern for a reasonable period of time should be expressed through the use of terms consistent with those included in the applicable financial reporting framework. In a going concern emphasis-of-matter paragraph, the accountant should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. (Ref: par. .A126) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.69 If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the accountant should apply paragraphs .56–.60 regarding known departures from the applicable financial reporting framework. [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Subsequent Events and Subsequently Discovered Facts

Subsequent Events

.70 When evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements comes to the accountant's attention, the accountant should request that management consider whether each such event is appropriately reflected in the financial statements in accordance with the applicable financial reporting framework. (Ref: par. .A127) [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.71 If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, the accountant should follow the guidance in paragraphs .56–.60. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Subsequently Discovered Facts That Become Known to the Accountant Before the Report Release Date

.72 The accountant is not required to perform any review procedures regarding the financial statements after the date of the accountant's review report. However, if a subsequently discovered fact becomes known to the accountant before the report release date, the accountant should

- a. discuss the matter with management and, when appropriate, those charged with governance and
- b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.73 If management revises the financial statements, the accountant should perform the review procedures necessary in the circumstances on the revision. The accountant also should either

- a. date the accountant's review report as of a later date or
- b. include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, dual-date the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report

are limited solely to the revision of the financial statements described in the relevant note to the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.74 If management does not revise the financial statements in circumstances when the accountant believes they need to be revised, the accountant should modify the accountant's review report, as appropriate. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Subsequently Discovered Facts That Become Known to the Accountant After the Report Release Date

.75 If a subsequently discovered fact becomes known to the accountant after the report release date, the accountant should (Ref: par. .A128–.A129)

- a. discuss the matter with management and, when appropriate, those charged with governance and
- b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.76 If management revises the financial statements, the accountant should

- a. apply the requirements of paragraph .73.
- b. if the reviewed financial statements (before revision) have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph .77. (Ref: par. .A130)
- c. if the accountant's conclusion on the revised financial statements differs from the accountant's conclusion on the original financial statements, disclose in an emphasis-of-matter paragraph, in accordance with paragraphs .52–.53
 - i. the date of the accountant's previous report,
 - ii. a description of the revisions, and
 - iii. the substantive reasons for the revisions.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.77 If management does not revise the financial statements in circumstances when the accountant believes they need to be revised, then

- a. if the reviewed financial statements have not been made available to third parties, the accountant should notify management and those charged with governance, unless all of those charged with governance are involved in managing the entity, not to make the reviewed financial statements available to third parties before the necessary revisions have been made and a new accountant's review report on the revised financial statements has been provided. If the reviewed financial statements are, nevertheless, subsequently made available to third parties without the necessary revisions, the accountant should apply the requirements of paragraph .76b.

- b. if the reviewed financial statements have been made available to third parties, the accountant should assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph .78. (Ref: par. .A128)

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.78 If management does not take the necessary steps to ensure that anyone in receipt of the financial statements is informed of the situation, as provided by paragraph .76*b* or paragraph .77*b*, the accountant should notify management and those charged with governance, unless all of those charged with governance are involved in managing the entity, that the accountant will seek to prevent future use of the accountant's review report. If, despite such notification, management or those charged with governance do not take the necessary steps, the accountant should take appropriate action to seek to prevent use of the accountant's review report. (Ref: par. .A131–.A134) [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Reference to the Work of Other Accountants in an Accountant's Review Report

.79 If other accountants audited or reviewed the financial statements of significant components, such as consolidated and unconsolidated subsidiaries and investees, and the accountant of the reporting entity decides not to assume responsibility for the audit or review performed by the other accountants, the accountant of the reporting entity should make reference to the review or audit of such other accountants in the accountant's review report. In that instance, the accountant should clearly indicate in the accountant's review report that the accountant used the work of other accountants and should include the magnitude of the portion of the financial statements audited or reviewed by the other accountants. (Ref: par. .A135–.A137) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.80 Reference to the audit or review of other accountants in the accountant's review report on the reporting entity should not be made if the other accountants issued an auditor's or an accountant's review report that includes an alert that restricts the use of such report. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Determining Whether the Other Accountants Are Familiar with SSARs or Auditing Standards Generally Accepted in the United States of America, as Applicable

.81 Regardless of whether the accountant of the reporting entity decides to make reference to the review or audit of other accountants, the accountant of the reporting entity should communicate with the other accountants and determine the following:

- a. The other accountants are aware that the financial statements of the component that the other accountants have audited or reviewed are to be included in the financial statements on which the accountant of the reporting entity will report and that the

other accountants' report thereon will be relied upon and, where applicable, referred to by the accountant of the reporting entity.

- b. The other accountants are familiar with the applicable financial reporting framework and with SSARs or auditing standards generally accepted in the United States of America, as applicable, and will conduct the review or audit in accordance therewith. (Ref: par. .A138)
- c. The other accountants understand the ethical requirements that are relevant to the engagement and, in particular, are independent. (Ref: par. .A139)
- d. A review will be made of matters affecting elimination of inter-company transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same

.82 If the component's financial statements are prepared using a different financial reporting framework from that used for the financial statements of the reporting entity, reference to the review or audit of the other accountants in the review report of the accountant of the reporting entity should not be made unless the following apply:

- a. The accountant has determined that the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements in accordance with the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the reporting entity's financial statements in accordance with the financial reporting framework used by the reporting entity.
- b. The accountant of the reporting entity has obtained sufficient appropriate review evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the reporting entity without the need to assume responsibility for, and thus be involved in, the work of the other accountants. (Ref: par. .A140)

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Supplementary Information That Accompanies Reviewed Financial Statements and the Accountant's Review Report Thereon

.83 When supplementary information accompanies reviewed financial statements and the accountant's review report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either

- a. an other-matter paragraph in the accountant's review report on the financial statements or
- b. a separate report on the supplementary information

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.84 When the accountant has subjected the supplementary information to the review procedures applied in the accountant's review of the basic financial statements, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that (Ref: par. .A142 and .A144)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements;
- c. the supplementary information has been subjected to the review procedures applied in the accountant's review of the basic financial statements and whether the accountant is aware of any material modifications that should be made to the supplementary information; and
- d. the accountant has not audited the supplementary information and does not express an opinion on such information.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.85 When the accountant has not subjected the supplementary information to the review procedures applied in the accountant's review of the basic financial statements, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that (Ref: par. .A143–.A144)

- a. the supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements;
- b. the supplementary information is the responsibility of management; and
- c. the accountant has not audited or reviewed the supplementary information and, accordingly, does not express an opinion, a conclusion, nor provide any assurance on such information.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Required Supplementary Information

.86 Concerning the requirement in paragraph .83, with respect to required supplementary information, the accountant should include an other-matter paragraph in the accountant's review report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable: (Ref: par. .A145)

- a. The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.

- b. The required supplementary information is included, and the accountant reviewed the required supplementary information.
- c. The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
- d. The required supplementary information is omitted.
- e. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines (Ref: par. .A146)
- f. The accountant has identified departures from the prescribed guidelines.
- g. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.87 If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation or review on the required supplementary information, the other-matter paragraph referred to in paragraph .83 should include the following elements: (Ref: par. .A147)

- a. A statement that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require that the *[identify the required supplementary information]* be presented to supplement the basic financial statements
- b. A statement that such information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and does not express an opinion or provide any assurance on the information
- d. If some of the required supplementary information is omitted
 - i. a statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
 - ii. a statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed

guidelines exist *[describe the material departures from the applicable financial reporting framework]*

- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standards-setter]*

[As amended, effective October 2016, by SSARS No. 23. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.88 If all the required supplementary information is omitted, the other-matter paragraph should include the following elements:

- a. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* require to be presented to supplement the basic financial statements
- b. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standards-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Change in Engagement From Audit to Review

.89 If the accountant, who was engaged to perform an audit engagement in accordance with generally accepted auditing standards, has been requested to change the engagement to a review engagement, the accountant should consider the following before deciding whether to agree to the change: (Ref: par. .A148–.A149)

- a. The reason given for the request, particularly the implications of a restriction on the scope of the audit engagement, whether imposed by management or by circumstances (Ref: par. .A150)
- b. The additional audit effort required to complete the audit engagement
- c. The estimated additional cost to complete the audit engagement

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.90 In all circumstances, if the audit procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.91 If the accountant concludes, based upon the accountant's professional judgment, that reasonable justification exists to change the engagement, and if the accountant complies with the standards applicable to a review engagement, the accountant should issue an appropriate review report. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.92 The report should not include reference to

- a.* the original engagement,
- b.* any audit procedures that may have been performed, or
- c.* scope limitations that resulted in the changed engagement.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.93 When the accountant has been engaged to audit an entity's financial statements and management refuses to allow the accountant to correspond with the entity's legal counsel, the accountant, except in rare circumstances, is precluded from accepting an engagement to review those financial statements. [Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Review Documentation

.94 The accountant should prepare review documentation that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand (Ref: par. .A151–.A155)

- a.* the nature, timing, and extent of the review procedures performed to comply with SSARSs;
- b.* the results of the review procedures performed and the review evidence obtained; and
- c.* significant findings or issues arising during the review, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.95 In addition to the requirements in paragraph .94, the review documentation should include the following:

- a.* The engagement letter or other suitable form of written documentation with management, as described in paragraphs .11–.12 (Ref: par. .A21 and .A23)
- b.* Communications to management and others regarding fraud or noncompliance with laws and regulations as required by paragraph .51
- c.* Communications with management regarding the accountant's expectation to include an emphasis-of-matter or other-matter paragraph in the accountant's review report as required by paragraph .55
- d.* Communications with other accountants that have audited or reviewed the financial statements of significant components as required by paragraph .81
- e.* The representation letter
- f.* A copy of the reviewed financial statements and the accountant's review report thereon

[Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Application and Other Explanatory Material

Scope and Applicability of This Section (Ref: par. .01)

.A1 If the accountant is engaged to perform a review of historical financial information other than financial statements, references in this section to *financial statements* are to be taken as a reference to such other historical financial information. [Paragraph added, effective October 2016, by SSARS No. 23.]

.A2 Examples of other historical financial information that an accountant may be engaged to review include, but are not limited to, the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Financial information contained in a tax return

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A3 The accountant may review a single financial statement, such as a balance sheet, and not other related financial statements, such as the statements of income, retained earnings, and cash flows, if the scope of the accountant's inquiry and analytical procedures have not been restricted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Objective (Ref: par. .04 and .28)

.A4 A review differs significantly from an audit of financial statements in which the auditor obtains reasonable assurance, which is a high, but not absolute, level of assurance, that the financial statements are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit. Accordingly, in a review, the accountant does not obtain assurance that he or she will become aware of all significant matters that would be disclosed in an audit. Therefore, a review is designed to obtain only limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Materiality

.A5 The accountant's consideration of materiality is made in the context of the applicable financial reporting framework. Some financial reporting frameworks discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;

- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement or a combination of both; and
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A6 If present in the applicable financial reporting framework, a discussion of the concept of materiality provides a frame of reference to the accountant in determining, as required by paragraph .28, whether there are any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph .A5 provide the accountant with such a frame of reference. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A7 The accountant's determination of materiality is a matter of professional judgment and is affected by the accountant's perception of the needs of the intended users of the financial statements. In this context, it is reasonable for the accountant to assume that users

- have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented, and reviewed to levels of materiality;
- recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- make reasonable economic decisions on the basis of the information in the financial statements.

Further, unless the review engagement is undertaken for financial statements that are intended to meet the particular needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

.A8 The accountant's judgment about what is material in relation to the financial statements as a whole is the same regardless of the level of assurance obtained by the accountant as a basis for expressing a conclusion on the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Revising Materiality

.A9 The accountant's determination of materiality for the financial statements as a whole may need to be revised during the engagement as a result of

- a change in the circumstances that occurred during the review (for example, a decision to dispose of a major part of the entity's business).

- new information, or a change in the accountant's understanding of the entity and its environment as a result of performing review procedures (for example, if during the review it appears actual financial results are likely to be substantially different from anticipated period-end financial results that were used initially to consider materiality for the financial statements as a whole).

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016.]

Definitions (Ref: par. .05)

.A10 Most financial reporting frameworks requiring an explicit management evaluation of the entity's ability to continue as a going concern specify the period of time to be evaluated. For example, the financial reporting frameworks of the following standard-setting bodies specify such period of time as follows:

- FASB*. Within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable).¹
- GASB*. 12 months beyond the date of the financial statements. GASB further requires that, if a governmental entity currently knows information that may raise substantial doubt shortly thereafter (for example, within an additional three months), such information should also be considered.²
- International Accounting Standards Board*. At least, but not limited to, one year from the end of the reporting period.³

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A11 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all of the requirements of GAAP. Such frameworks are regulatory bases of accounting, as defined in paragraph .05. In some circumstances, however, the cash or tax basis of accounting may be permitted by a regulator. For purposes of this section, the cash and tax bases of accounting are not regulatory bases of accounting. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A12 Supplementary information includes additional details or explanations of items in or related to the basic financial statements, consolidating information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or outside the entity. [Paragraph added, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

¹ "Pending Content" in *FASB Accounting Standards Codification (ASC) 205-40-50-1*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

² Paragraph 16 of GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

³ Paragraph 26 of International Accounting Standard 1, *Presentation of Financial Statements*. [Footnote added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A13 Supplementary information may be prepared in accordance with an applicable financial reporting framework, by regulatory or contractual requirements, in accordance with management's criteria, or in accordance with other requirements. [Paragraph added, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Independence (Ref: par. .07)

.A14 The AICPA Code of Professional Conduct provides guidance with respect to independence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A15 Nothing prohibits an accountant who is unable to complete a review engagement due to a determination that the accountant's independence is impaired from performing a compilation engagement on those financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Acceptance and Continuance of Client Relationships and Review Engagements (Ref: par. .09)

.A16 A review in accordance with SSARSs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .26c of section 60. The preparation of financial statements, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" interpretation (ET sec. 1.295) of the "Independence Rule" of the AICPA Code of Professional Conduct. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the review engagement as required by paragraphs .11–.12. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A17 Documents containing financial statements that may include an indication that such financial statements have been reviewed by the entity's accountant includes documents submitted to bonding companies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Agreement on Engagement Terms (Ref: par. .11–.12 and .92)

.A18 Both management and the accountant have an interest in documenting the agreed-upon terms of the review engagement before the commencement of the review engagement to help avoid misunderstandings with respect to the review engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A19 The roles of management and those charged with governance in agreeing upon the terms of the review engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending

on the entity's structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, nonetheless, in accordance with paragraph .26c of section 60A, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A20 When a third party has contracted for a review of the entity's financial statements, agreeing the terms of the review with management of the entity is necessary in order to establish that the preconditions for a review are present. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A21 The understanding with management regarding the services to be performed for review engagements is required by paragraph .11 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for review engagements. [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A22 Although the accountant may prepare the financial statements, in whole or in part, the financial statements are representations of management, and the fairness of their presentation in accordance with the applicable financial reporting framework is management's responsibility. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A23 Illustrations of engagement letters for a review of financial statements are presented in exhibit A, "Illustrative Engagement Letters." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Communication With Management and Those Charged With Governance (Ref: par. .13)

.A24 In a review engagement, the accountant's communications with management and those charged with governance take the form of

- a. inquiries the accountant makes in the course of performing the procedures for the review and
- b. other communications, in the context of having effective two-way communication to understand matters arising and to develop a constructive working relationship for the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A25 The appropriate timing for communications will vary with the circumstances of the engagement. Relevant factors include the significance and nature of the matter and any action expected to be taken by management or those charged with governance. For example, it may be appropriate to communicate a significant difficulty encountered during the review as soon as practicable if management or those charged with governance are able to assist the accountant to overcome the difficulty. [Paragraph renumbered by the issuance

of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A26 Law or regulation may restrict the accountant's communication of certain matters with those charged with governance. For example, law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the accountant's obligations of confidentiality and obligations to communicate may be complex. In such cases, the accountant may consider obtaining legal advice. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Communicating Matters Concerning the Review

.A27 Matters to be communicated to management or those charged with governance, as appropriate, in accordance with this section may include the following:

- The accountant's responsibilities in the review engagement, as included in the engagement letter or other suitable form of written agreement.
- Significant findings from the review, for example
 - the accountant's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.
 - significant findings from the performance of procedures, including situations when the accountant considered performance of additional procedures necessary in accordance with this section. The accountant may need to confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.
 - Matters arising that may lead to modification of the accountant's review report.
 - Significant difficulties, if any, encountered during the review, for example, unavailability of expected information, unexpected inability to obtain evidence that the accountant considers necessary for the review, or restrictions imposed on the accountant by management. In some circumstances, such difficulties may lead to the accountant's withdrawal from the engagement.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A28 In some entities, different persons are responsible for the management and governance of an entity. In these circumstances, management may have the responsibility to communicate matters of governance interest to those charged with governance. Communication by management with those charged with governance of matters that the accountant is required to communicate does not relieve the accountant of the responsibility to also communicate with those charged with governance. However, communication of these matters by management may affect the form or timing of the accountant's communication with those charged with governance. [Paragraph renumbered by the issuance

of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Communication With Third Parties

.A29 The accountant may be required by law or regulation to, for example

- notify a regulatory or enforcement body of certain matters communicated with those charged with governance.
- submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies or, in some cases, make such reports publicly available.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A30 Unless required by law or regulation to provide a third party with a copy of the accountant's written communications with those charged with governance, the accountant may need the prior consent of management or those charged with governance before doing so. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Understanding of the Industry (Ref: par. .14)

.A31 The requirement that the accountant possess a level of knowledge of the industry in which the entity operates does not prevent the accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Knowledge of the Entity (Ref: par. .15)

.A32 The accountant may obtain knowledge of the entity through inquiry of the entity's personnel, the review of documents prepared by the entity, or experience with the entity or the entity's industry. Such knowledge includes the following:

- An understanding of the entity's business
- An understanding of the accounting principles and practices used by the entity in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A33 The accountant's understanding of the entity's business encompasses a general understanding of the entity's organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Designing and Performing Review Procedures (Ref: par. .17)

.A34 Review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the accountant with a reasonable basis for obtaining limited assurance. However, in addition to analytical procedures and inquiries, in certain circumstances and based on the accountant's professional judgment, the accountant may perform procedures ordinarily performed in an audit. In such instances, the engagement remains a review, and the accountant is not required to perform an audit of the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A35 The results of the accountant's analytical procedures and inquiries may modify the accountant's risk awareness. For example, the response to an inquiry that a related party transaction is not disclosed may revise the accountant's awareness of risk relative to related party transactions. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Analytical Procedures (Ref: par. .19–.20)

.A36 Examples of analytical procedures that an accountant may consider performing when conducting a review of financial statements are contained in appendix A, "Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A37 Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the accountant, such as an estimation of depreciation
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable and gross margin percentages with industry averages or other entities of comparable size in the same industry

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A38 Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information, such as gross margin percentages, that would be expected to conform to a predictable pattern based on recent history of the entity and industry
- Between financial information and relevant nonfinancial information, such as payroll costs to number of employees

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A39 When considering plausible relationships, the accountant may wish to consider information developed and used by the entity (for example, analyses prepared for management or those charged with governance). [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A40 Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements may be less precise than those developed in an audit. Also, in a review, the accountant is not required to corroborate management's responses with other evidence. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A41 To compare disaggregated revenue data, the accountant may compare, for example, revenue reported by month and product line or operating segment during the current period with that of comparable prior periods. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A42 Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses. Analytical procedures may be performed at the financial statement level or at the detailed account level. The nature, timing, and extent of analytical procedures are a matter of professional judgment. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Investigating Results of Analytical Procedures (Ref: par. .21b)

.A43 Although the accountant is not required to corroborate management's responses with other evidence, the need to perform other review procedures may arise when, for example, management is unable to provide an explanation, or the explanation is not considered adequate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters (Ref: par. .22)

.A44 In addition to members of management who have responsibility for financial and accounting matters, the accountant may determine to direct inquiries to others within the entity and those charged with governance, if appropriate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A45 Examples of unusual or complex situations about which the accountant may inquire of management are contained in appendix B, "Unusual or Complex Situations to Be Considered by the Accountant When Performing Inquiry Procedures in a Review of Financial Statements." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A46 Management may obtain knowledge of fraud or suspected fraud affecting the entity involving management or others when the fraud could have a material effect on the financial statements through, among other things, communications received from employees, former employees, or others. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A47 The accountant may obtain and read minutes from meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements as an effective and efficient procedure to meet the requirement in paragraph .22o to inquire of members of management who have responsibility for financial and accounting

matters concerning the financial statements about actions taken at such meetings. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Reconciling the Financial Statements to the Underlying Accounting Records (Ref: par. .26)

.A48 To obtain evidence that the financial statements agree or reconcile with the accounting records, the accountant may compare the financial statements to

- the accounting records, such as the general ledger;
- a consolidating schedule derived from the accounting records; or
- other supporting data in the entity's records.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Evaluating Evidence Obtained From the Procedures Performed (Ref: par. .28, .31, and .39A)

.A49 Considerations that may affect the evaluation of whether uncorrected misstatements, individually or in the aggregate, are material include the following:

- The nature, cause (if known), and amount of the misstatements
- Whether the misstatements originated in the preceding year
- The potential effect of the misstatements on future periods
- The appropriateness of offsetting a misstatement of an estimated amount with a misstatement of an item capable of precise measurement
- Recognition that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatements in future periods

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A50 The accountant's reporting responsibilities when the accountant concludes that the financial statements are materially misstated are addressed in paragraphs .56–.60 with respect to known departures from the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A51 In some circumstances, the accountant may not have obtained the evidence that the accountant had expected to obtain through the design of primarily inquiry and analytical procedures and procedures addressing specific circumstances. In these circumstances, the accountant considers that the evidence obtained from the procedures performed is not sufficient and appropriate to be able to form a conclusion on the financial statements. The accountant may

- extend the work performed or
- perform other procedures judged by the practitioner to be necessary in the circumstances.

When neither of these is practicable in the circumstances, the accountant will not be able to obtain sufficient appropriate evidence to be able to form a conclusion and is required by this section to determine the effect on the accountant's ability to complete the engagement. This situation may arise even though the accountant has not become aware of a matter(s) that causes the accountant to believe the financial statements may be materially misstated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Written Representations

Written Representations as Review Evidence (Ref: par. .32)

.A52 Written representations are an important source of review evidence. If management modifies or does not provide the requested written representations, it may alert the accountant to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations, in many cases, may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Management From Whom Written Representations Are Requested (Ref: par. .33)

.A53 Written representations are requested from those with overall responsibility for financial and operating matters whom the accountant believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity; however, management (rather than those charged with governance) is often the responsible party. Written representations may, therefore, be requested from the entity's CEO and CFO or other equivalent persons in entities that do not use such titles. However, in some circumstances, other parties, such as those charged with governance, also are responsible for the preparation and fair presentation of the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A54 Due to its responsibility for the preparation and fair presentation of the financial statements and its responsibility for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements on which to base the written representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A55 In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the accountant to accept such wording if, in the accountant's judgment, the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Specific Written Representations (Ref: par. .34-.35)

.A56 Review evidence obtained during the review that management has acknowledged the responsibilities referred to in paragraph .34a-b is not sufficient without obtaining representation from management that it believes that it has fulfilled those responsibilities. This is because the accountant is not able to judge solely on other review evidence whether management has prepared and fairly presented the financial statements and provided information to the accountant on the basis of the agreed acknowledgment and understanding of its responsibilities. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A57 The written representations relating to fraud required by paragraph .34f-g are important for the accountant to obtain, regardless of the size of the entity, because of the nature of fraud and the difficulties encountered by accountants in detecting material misstatements in the financial statements resulting from fraud. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A58 Because the preparation of financial statements requires management to adjust the financial statements to correct material misstatements, the accountant is required to request that management provide a written representation about uncorrected misstatements. In some circumstances, management may not believe that certain uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as "We do not agree that items... and... constitute misstatements because [description of reasons]." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A59 Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that
 - materially affect the financial statements or
 - involve management
- When they have made specific oral representations to the accountant on details of certain related party transactions
- When they have financial or other interests in the related parties or the related party transactions

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A60 Because written representations are necessary review evidence, the accountant has not obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework and the accountant's review report cannot be dated before the date of the written representations. Furthermore, because the accountant is concerned with events occurring up to the date of the accountant's review report that may require adjustment to, or disclosure in, the financial statements, the written representations are dated as of the date of the accountant's review report on the financial statements. [Paragraph

renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A61 The written representations cover all periods referred to in the accountant's review report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The accountant and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A62 Situations may arise in which current management was not present during all periods referred to in the accountant's review report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the accountant to request from them written representations that cover the whole of the relevant period(s) still applies. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A63 The accountant may request additional representations regarding matters specific to the entity's business or industry. In addition, the accountant is not precluded from obtaining representations regarding services performed in addition to the review engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Form of Written Representations (Ref: par. .36)

.A64 Occasionally, circumstances may prevent management from signing the representation letter and returning it to the accountant on the date of the accountant's review report. In those circumstances, the accountant may accept management's oral confirmation, on or before the date of the accountant's review report, that management has reviewed the final representation letter and will sign the representation letter without exception as of the date of the accountant's review report. Possession of the signed management representation letter prior to releasing the accountant's review report is necessary because paragraph .36 requires that the representations be in the form of a written letter from management. Furthermore, when there are delays in releasing the report, a fact may become known to the accountant that, had it been known to the accountant at the date of the accountant's review report, might affect the accountant's review report and result in the need for updated representations. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A65 Exhibit B, "Illustrative Representation Letter," provides an illustrative example of a representation letter. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Reporting on the Financial Statements (Ref: par. .38)

.A66 A written report encompasses reports issued in hard copy format and those using an electronic medium. [Paragraph renumbered by the issuance of

SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A67 Financial statements that the accountant has reviewed may become unattached from the accountant's review report. To minimize the possibility that a user of the reviewed financial statements may infer, through the accountant's association with the reviewed financial statements, an unintended level of reliance on the reviewed financial statements, the accountant may consider including a reference on each page of the reviewed financial statements to the accountant's review report. An example of a reference to the accountant's review report included on each page of the reviewed financial statements is "See independent accountant's review report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A68 When the accountant is unable to perform the inquiry, analytical procedures, and other review procedures the accountant considers necessary to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework, or management does not provide the accountant with a representation letter, the review will be incomplete. A review that is incomplete does not provide an adequate basis for issuing a review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Accountant's Review Report (Ref: par. .39)

Title

.A69 An appropriate title would be "Independent Accountant's Review Report." [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Addressee

.A70 The accountant's review report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being reviewed or to those charged with governance. A report on financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an accountant may be retained to review the financial statements of an entity that is not a client; in such a case, the report may be addressed to the entity and not to those charged with governance of the entity whose financial statements are being reviewed. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Introductory Paragraph

.A71 The introductory paragraph states, for example, that the accountant has "reviewed the accompanying financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity and cash flows for the year then ended, and the related notes to the financial statements." If the financial statements include a separate statement of changes in stockholders' equity accounts or a separate statement of comprehensive income, paragraph .39c(iii) requires such statements to be identified in the introductory paragraph of the report as a statement to which the financial statements are comprised.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A72 When the accountant is aware that the reviewed financial statements will be included in a document that contains other information, such as an annual report, the accountant may consider, if the form of presentation allows, identifying the page numbers on which the reviewed financial statements are presented. This helps users identify the financial statements to which the accountant's review report relates. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A73 The identification of the title for each statement that the financial statements comprise may be achieved by referencing the table of contents. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

Management's Responsibility

.A74 Management, and when appropriate, those charged with governance, accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the accountant's review report includes reference to both responsibilities because it helps explain to users the premise on which a review is conducted. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Accountant's Responsibility

.A75 The accountant's review report states that the accountant's responsibility is to conduct the review engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA in order to contrast it to management's responsibility for the financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A76 The reference to the standards used conveys to users of the accountant's review report that the review engagement has been conducted in accordance with established standards. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A77 The accountant is not permitted to represent compliance with SSARSs in the accountant's review report unless the accountant has complied with the relevant requirements within the body of SSARSs. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Accountant's Address

.A78 The city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Date of the Accountant's Review Report

.A79 The date of the accountant's review report informs users of the accountant's review report that the accountant has considered the effect of events and transactions of which the accountant became aware and that occurred up to that date. The accountant's responsibility for events and transactions after the date of the accountant's review report is addressed in paragraphs .72–.78. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A80 Because the accountant's conclusion is provided on the financial statements, and the financial statements are the responsibility of management, the accountant is not in a position to conclude that the accountant has obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework until evidence is obtained that all the statements that the financial statements comprise, including the related notes, have been prepared, and management has accepted responsibility for them. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A81 Exhibit C, "Illustrations of Accountant's Review Reports on Financial Statements," contains illustrations of accountant's review reports on financial statements incorporating the elements required by paragraph .39. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Accountant's Review Report on Financial Statements Prepared in Accordance With a Special Purpose Framework (Ref: par. .09, .40, .42, and .44)

.A82 The description of the special purpose framework may be included in the financial statement titles, in the notes to the financial statements, or otherwise on the face of the financial statements. Although terms such as *balance sheet*, *statement of financial position*, *statement of income*, *statement of operations*, and *statement of cash flows* or similar unmodified titles, are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in accordance with GAAP, such titles, with appropriate modification, may be used in connection with financial statements prepared in accordance with a special purpose framework. Suitable financial statement titles for financial statements prepared in accordance with a special purpose framework include, but are not limited to

- a modified cash basis financial statement that might be titled
 - "Income Statement—Modified Cash Basis," or
 - "Statement of Cash Receipts and Disbursements."
- financial statements prepared in accordance with the tax basis of accounting that might be titled
 - "Balance Sheet—Tax Basis,"
 - "Statement of Assets, Liabilities, and Equity—Tax Basis,"
 - "Statement of Operations—Tax Basis," or
 - "Statement of Revenue and Expenses—Tax Basis."

- a financial statement prepared in accordance with a regulatory basis of accounting that might be titled "Statement of Income—Regulatory Basis."

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A83 The description of how the special purpose framework differs from GAAP ordinarily includes only the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described. The differences need not be quantified. [Paragraph subsequently renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered by the issuance of SSARS No. 24, May 2018.]

.A84 Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A85 When the financial statements are prepared in accordance with a regulatory or contractual basis of accounting or an other basis of accounting that requires an alert that restricts the use of the accountant's review report pursuant to paragraph .61a–b, the accountant is required by paragraph .42 to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the financial statements are used for purposes other than those for which they were intended. The note to the financial statements may also describe any significant interpretations of the contract on which the financial statements are based. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A86 When use of the accountant's review report is restricted, the intended users are the specified parties. The restriction on use of the accountant's review report is necessary due to the nature of the report and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used. For example, special purpose financial statements prepared in accordance with a contractual basis of accounting are developed for and directed only to the parties to the contract or agreement. Paragraphs .63–.64 address the addition of other parties as specified parties. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Comparative Financial Statements (Ref: par. .45)

.A87 The level of information included for the prior periods in comparative financial statements is comparable with that of financial statements of the current period. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A88 If one firm of accountants merges with another firm, and the new firm becomes the accountant of a client of one of the two former firms, the new firm may accept responsibility and issue a review report on the financial statements for the prior period(s) as well as for those of the current period. The new firm may indicate in the accountant's review report or as part of the signature that a merger took place and may name the firm with whom it was merged. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Updating the Report (Ref: par. .46)

.A89 An updated report is issued in conjunction with the continuing accountant's report on the current period financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Changed Reference to a Departure From the Applicable Financial Reporting Framework (Ref: par. .49)

.A90 A changed reference includes the removal of a prior reference or the inclusion of a new reference. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Communicating to Management and Others Regarding Fraud or Noncompliance With Laws and Regulations (Ref: par. .51)

.A91 The communication of matters involving identified or suspected non-compliance may describe the act of identified or suspected noncompliance, the circumstances of its occurrence, and the effect on the financial statements. The accountant may reach agreement in advance with management and those charged with governance, if applicable, on the nature and amount of matters that would be considered not material and, thus, need not be communicated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A92 The disclosure of any evidence or information that comes to the accountant's attention during the performance of review procedures that fraud or noncompliance with laws or regulations may have occurred to parties other than the entity's senior management (or those charged with governance, if applicable) ordinarily is not part of the accountant's responsibility and, ordinarily, would be precluded by the accountant's ethical or legal obligations of confidentiality. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A93 A duty to disclose to parties outside of the entity may exist in the following circumstances:

- To comply with certain legal and regulatory requirements
- To a successor accountant when management has given permission for communication between the predecessor accountant and the successor accountant
- In response to a subpoena

In such circumstances, the accountant may consider it appropriate to consult with legal counsel. [Paragraph renumbered by the issuance of SSARS No. 23,

October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A94 The accountant may consider whether withdrawal from the engagement is necessary when

- management or those charged with governance do not take the remedial action that the accountant considers necessary in the circumstances, or
- matters regarding fraud or noncompliance with laws or regulations involve an owner of the business.

When deciding whether withdrawal from the engagement is necessary, the accountant may consider seeking legal advice. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report (Ref: par. .52 and .54)

.A95 The accountant is required to include an emphasis-of-matter or other-matter paragraph in the accountant's review report relating to the following matters:

- In accordance with paragraphs .43–.44 with respect to financial statements prepared in accordance with a special purpose framework
- In accordance with paragraph .49 with respect to a changed reference to a departure from the applicable financial reporting framework when reporting on comparative financial statements
- In accordance with paragraph .50 with respect to reporting on comparative financial statements when the prior period is audited
- In accordance with paragraph .57 with respect to reporting a known departure from the applicable financial reporting framework that is material to the financial statements
- In accordance with paragraph .76c with respect to reporting when management revises financial statements for a subsequently discovered fact that became known to the accountant after the report release date and the accountant's review report on the revised financial statements differs from the accountant's review report on the original financial statements
- In accordance with paragraph .83 with respect to supplementary information that accompanies reviewed financial statements and the accountant's review report thereon
- In accordance with paragraph .86 with respect to required supplementary information

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Emphasis-of-Matter Paragraphs in the Accountant's Review Report (Ref: par. .52–.54)

.A96 In addition to the required emphasis-of-matter paragraphs listed in paragraph .A92, the following are examples of circumstances when the accountant may consider it necessary to include an emphasis-of-matter paragraph:

- An uncertainty regarding the entity's ability to continue as a going concern for a reasonable period of time
- An uncertainty relating to the future outcome of unusually important litigation or regulatory action
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position
- Significant transactions with related parties
- Unusually important subsequent events

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A97 Paragraph .52 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A98 Another heading may be considered appropriate if it adequately describes the nature of the matter being disclosed or communicated. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A99 The inclusion of an emphasis-of-matter paragraph in the accountant's review report does not affect the accountant's conclusion. An emphasis-of-matter paragraph is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Other-Matter Paragraphs in the Accountant's Review Report (Ref: par. .54)

.A100 If not properly presented or disclosed in the financial statements, a matter cannot be included in an emphasis-of-matter paragraph. However, if the matter is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report, the matter can be disclosed in an other-matter paragraph. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A101 An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board) and may engage the accountant to review both sets of financial statements. If the accountant has determined that the frameworks are acceptable in the respective circumstances, the accountant may include an other-matter paragraph in the accountant's review report referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the accountant has issued a review report on those financial statements. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A102 The content of an other-matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the accountant is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to the confidentiality of information). An other-matter paragraph does not include information that is required to be provided by management. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Communication With Management (Ref: par. .55)

.A103 The accountant's communication with management, as described in paragraph .55, enables management to be made aware of the nature of any specific matters that the accountant intends to highlight in the accountant's review report and provides them with an opportunity to obtain further clarification from the accountant, when necessary. When the inclusion of an other-matter paragraph on a particular matter in the accountant's review report recurs on each successive engagement, the accountant may determine that it is unnecessary to repeat the communication on each engagement. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A104 In addition to management, the accountant may also consider it appropriate to communicate with those charged with governance regarding the expectation of including an other-matter paragraph in the accountant's review report and the proposed wording of this paragraph. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Known Departures From the Applicable Financial Reporting Framework (Ref: par. .57 and .59–.60)

.A105 Examples of headings that an accountant may use to disclose departures from an applicable financial reporting framework in the accountant's review report include the following:

- Known Departures From Accounting Principles Generally Accepted in the United States of America
- Known Departures From International Financial Reporting Standards as Promulgated by the International Accounting Standards Board
- Known Departures From the Cash Basis of Accounting
- Known Departures From the Tax Basis of Accounting

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A106 Prior to withdrawing from a review engagement in those circumstances when the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant may wish to consult with legal counsel. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A107 Including a statement that the financial statements are not in accordance with the applicable financial reporting framework would be tantamount to expressing an adverse opinion on the financial statements. Such an opinion can be expressed only in the context of an audit engagement. Furthermore, such a statement in an accountant's review report may confuse users because it would contradict the statement required in paragraph .39f about whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A108 Depending on the accountant's assessment of the possible dollar magnitude of the effect of the departures, the significance of the affected items to the entity, the pervasiveness and overall impact of the misstatements, and whether disclosure has been made of the effect of the departures, the accountant may, in accordance with paragraphs .52–.55, include a separate paragraph in the accountant's review report stating the limitations of the financial statements. The following is an illustration of such a separate paragraph with respect to an accountant's review report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America:

Limitations of the financial statements

Because of the significance and pervasiveness of the matters described in the Known Departures From Accounting Principles Generally Accepted in the United States of America paragraphs, we cannot assess their impact on the financial statements. Users of the accompanying financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in accordance with accounting principles generally accepted in the United States of America.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A109 Inclusion of a separate paragraph, such as that illustrated in paragraph .A105 in the accountant's review report is not a substitute for disclosure of the specific departures or the effects of such departures if such effects have been determined by management or are known as a result of the accountant's procedures. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A110 Exhibit C, "Illustrations of Accountant's Review Reports on Financial Statements," contains an illustrative example of an accountant's review report that discloses a departure from the applicable financial reporting framework.⁴ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

⁴ Illustration 5, "An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America," of exhibit C, "Illustrations of Accountant's Review Reports on Financial Statements." [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

Alert That Restricts the Use of the Accountant's Review Report (Ref: par. .61)

.A111 The need for an alert that restricts the use of the accountant's review report arises from the potential for the accountant's review report to be misunderstood if taken out of the context in which the accountant's review report is intended to be used. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A112 Accountant's review reports on financial statements prepared in accordance with a general purpose framework ordinarily do not include an alert that restricts their use. A general purpose framework is a financial reporting framework designed to meet the common financial information needs of a wide range of users. However, nothing in SSARSs precludes an accountant from including an alert in any accountant's review report. For example, financial statements prepared specifically for use in an acquisition may be prepared in accordance with a general purpose framework because the parties involved in the transaction have agreed that such general purpose financial statements are appropriate for their purposes. Nevertheless, when the terms of the engagement to review those financial statements require the accountant to supply the accountant's review report only to specified parties, the accountant may consider it necessary in the circumstances to include an other-matter paragraph in the accountant's review report that restricts the use of the accountant's review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Distribution of the Accountant's Review Report (Ref: par. .61)

.A113 An accountant is not responsible for controlling, and cannot control, distribution of the accountant's review report after its release. The alert that restricts the use of the accountant's review report is designed to avoid misunderstandings related to the use of the accountant's review report, particularly if the accountant's review report is taken out of the context in which the accountant's review report is intended to be used. An accountant may consider informing the entity or other specified parties that the accountant's review report is not intended for distribution to parties other than those specified in the accountant's review report. The accountant may, in connection with establishing the terms of the engagement, reach an understanding with the entity that the intended use of the accountant's review report will be restricted and may obtain the entity's agreement that the entity and specified parties will not distribute such accountant's review report to parties other than those identified therein. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Illustrative Alert Language (Ref: par. .62)

.A114 The alert that restricts the use of the accountant's review report may list the specified parties or refer to the specified parties listed elsewhere in the accountant's review report. The following illustrates language that includes the elements required by paragraph .62:

This report is intended solely for the information and use of [list or refer to the specified parties] and is not intended to be, and should not be, used by anyone other than these specified parties.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Adding Other Specified Parties (Ref: par. .63)

.A115 When the accountant is requested to add other parties as specified parties, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties and the intended use of the accountant's review report. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

The Accountant's Consideration of an Entity's Ability to Continue as a Going Concern

Inquiry Concerning an Entity's Ability to Continue as a Going Concern (Ref: par. .65–.66)

.A116 The nature and extent of the accountant's review procedures are matters of the accountant's professional judgment. For example, when a history of profitable operations and ready access to financing exists, inquiry alone might be sufficient to review the entity's ability to continue as a going concern for a reasonable period of time. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A117 Certain financial reporting frameworks require management to evaluate the entity's ability to continue as a going concern for a reasonable period of time in preparing financial statements. For example, FASB *Accounting Standards Codification*¹ (ASC) requires management to evaluate whether there are conditions and events, considered in the aggregate, that raise substantial doubt about an entity's ability to continue as a going concern. Under FASB ASC, the evaluation period is within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued, when applicable). [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A118 A review of financial statements is not designed to identify conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. However, conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time may have existed at the date of the prior period financial statements or may be identified as a result of inquiries of management or in the course of performing other review procedures. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A119 The following are examples of conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time:

- **Negative trends.** For example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, and other adverse key financial ratios

- *Other indications of possible financial difficulties.* For example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, noncompliance with statutory capital requirements, a need to restructure debt to avoid default, and a need to seek new sources or methods of financing or to dispose of substantial assets
- *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, and a need to significantly revise operations
- *External matters.* For example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; and an uninsured or underinsured catastrophe, such as a hurricane, tornado, earthquake, or flood

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

A120 The significance of such conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time can often be mitigated by other factors. The following list includes examples of plans that management may implement to mitigate conditions or events that raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. The examples are not all-inclusive. Following each example is a list of the types of information that management should consider at the date that the financial statements are issued in evaluating the feasibility of the plans to determine whether it is probable⁵ that the plan will be effectively implemented within one year after the date that the financial statements are issued.⁶

- a. Plans to dispose of an asset or business
 - i. Restrictions on disposal of an asset or business, such as covenants that limit those transactions in loan or similar agreements, or encumbrances against the asset or business
 - ii. Marketability of the asset or business that management plans to sell
 - iii. Possible direct or indirect effects of disposal of the asset or business
- b. Plans to borrow money or restructure debt
 - i. Availability and terms of new debt financing or availability and terms of existing debt refinancing, such as term debt, lines of credit, or arrangements for factoring receivables or sale-leaseback of assets
 - ii. Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity

⁵ The FASB ASC Master Glossary defines probable as "the future event or events are likely to occur." [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

⁶ "Pending Content" in FASB ASC 205-40-55-3. [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

- iii. Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- c. Plans to reduce or delay expenditures
 - i. Feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
 - ii. Possible direct or indirect effects on the entity and its cash flows of reduced or delayed expenditures
- d. Plans to increase ownership equity
 - i. Feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
 - ii. Existing or committed arrangements to reduce current dividend requirements or to accelerate cash infusions from affiliates or other investors

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A121 In considering the adequacy of disclosure, some of the information that may be disclosed, depending on the requirements of the financial reporting framework, includes the following:

- Principal conditions and events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events in relation to the entity's ability to meet its obligations and any mitigating factors
- Possible discontinuance of operations
- Management's plans (including relevant prospective financial information) that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Consideration of the Effects on the Accountant's Review Report ***(Ref: par. .67)***

[.A122] [Paragraph renumbered and deleted by the issuance of SSARS No. 24, May 2018.]

.A123 The following is an illustration of a going concern emphasis-of-matter paragraph when (a) the accountant concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, (b) management's plans do not alleviate the substantial doubt, and (c) the entity is required under the applicable financial reporting framework to include a statement in the notes to the financial statements:

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our conclusion is not modified with respect to this matter.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A124 The following is an illustration of a going concern emphasis-of-matter paragraph when (a) the accountant concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, (b) management's plans do not alleviate the substantial doubt, and (c) the entity is not required under the applicable financial reporting framework to include a statement in the notes to the financial statements that substantial doubt exists.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency, which raises substantial doubt about its ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our conclusion is not modified with respect to this matter.

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A125 If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the review evidence obtained, the accountant concludes that substantial doubt has been alleviated by management's plans, the accountant may include an emphasis-of-matter paragraph making reference to management's disclosures related to the conditions and events and management's plans related to those conditions or events. The following is an illustration of an emphasis-of-matter paragraph when management has disclosed (a) conditions or events, considered in the aggregate, that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time; (b) its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity's ability to meet its obligations; and (c) that the substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans.

Emphasis of Matter Regarding Going Concern

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate

these matters are also described in Note X. Our conclusion is not modified with respect to this matter.

[Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A126 Examples of inappropriate use of conditional language in an emphasis-of-matter paragraph when the accountant concludes that management has adequately disclosed that conditions or events have been identified and substantial doubt exists include the following:

- If the entity continues to experience recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- The entity has been unable to renegotiate its expiring credit agreements. Unless the entity is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Subsequent Events and Subsequently Discovered Facts

Subsequent Events (Ref: par. .70)

.A127 Evidence or information that subsequent events that require adjustment of, or disclosure in, the financial statements may come to the accountant's attention in the following ways:

- During the performance of review procedures
- Subsequent to the date of the accountant's review report but prior to the release of the report

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Subsequently Discovered Facts That Became Known to the Accountant After the Report Release Date (Ref: par. .75–.78)

.A128 New information may come to the accountant's attention that, had such information been known to the accountant at the date of the accountant's review report, may have caused the accountant to revise the accountant's review report. When such information becomes known to the accountant after the report release date, the requirements in paragraphs .75–.78 apply, even if the accountant has withdrawn or been discharged. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A129 Because of the variety of conditions that might be encountered, the specific procedures or actions to be taken in a particular case may vary somewhat in light of the circumstances. For example, when determining whether the financial statements need revision, as required by paragraph .75b, the accountant may consider, in addition to the requirements of the applicable financial reporting framework, whether the accountant believes persons are currently using, or are likely to use, the financial statements and who would attach importance to the subsequently discovered facts. Consideration may be given, among other things, to the issuance of reviewed or audited financial statements for a subsequent period, the time elapsed since the financial statements were issued

and the date of the accountant's review report released, and any legal implications. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A130 The steps taken by management to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used, depend on the circumstances. Management's steps may include the following:

- Notify anyone who is known to be using, or who is likely to use, the financial statements and the accountant's review report that they are not to be used and that revised financial statements, together with a new accountant's review report, will be issued. This may be necessary when the issuance of revised financial statements and a new accountant's review report is not imminent.
- Issue, as soon as practicable, revised financial statements with appropriate disclosure of the matter.
- Issue the subsequent period's financial statements with appropriate disclosure of the matter. This may be appropriate when issuance of the subsequent period's reviewed or audited financial statements is imminent.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A131 If management made the reviewed financial statements available to third parties despite the accountant's notification not to do so, or if the accountant believes that management or those charged with governance have failed to take the necessary steps to prevent use of the accountant's review report on the previously issued reviewed financial statements despite the accountant's prior notification that the accountant will take action to seek to prevent such use, the accountant's course of action depends upon the accountant's legal and ethical rights and obligations. Consequently, the accountant may consider it appropriate to seek legal advice. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A132 The actions that the accountant may take to seek to prevent use of the accountant's review report may depend upon the degree of certainty of the accountant's knowledge that persons or entities exist who are currently using, or who will use, the reviewed financial statements, and who would attach importance to the information, and the accountant's ability as a practical matter to communicate with them. In addition to seeking legal advice, the accountant may consider taking the following steps to the extent applicable:

- Notify management and those charged with governance that the accountant's review report is not to be used.
- Notify regulatory agencies having jurisdiction over the entity that the accountant's review report is not to be used, including a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.
- Notify anyone known to the accountant to be using the financial statements that the accountant's review report is not to be used. In some instances, it will not be practicable for the accountant to give appropriate individual notification to stockholders or investors at large whose identities are unknown to the accountant; notification to a regulatory agency having jurisdiction over the entity will

usually be the only practical means for the accountant to provide appropriate disclosure, together with a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A133 Depending on the circumstances, if the accountant is able to determine that the financial statements need revision, the accountant's notification to anyone in receipt of the reviewed financial statements may, if permitted by law, regulation, and relevant ethical requirements

- include a description of the nature of the matter and of its effect on the financial statements, avoiding comments concerning the conduct or motives of any person.
- describe the effect that the matter would have had on the accountant's review report if it had been known to the accountant at the date of the report and had not been reflected in the financial statements.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A134 If the accountant was not able to determine whether the financial statements need revision, the notification to anyone in receipt of the reviewed financial statements may indicate that information became known to the accountant and that, if the information is true, the accountant believes that the accountant's review report is not to be used. The specific matter may not be permitted by law, regulation, and ethical requirement to be detailed in the notification. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Reference to the Work of Other Accountants in an Accountant's Review Report (Ref: par. .79)

.A135 The accountant of the reporting entity may make reference to any or all other accountants who audited or reviewed significant components. For example, if a significant component is audited or reviewed by an other accountant and a second significant component is audited or reviewed by a different other accountant, the accountant of the reporting entity may decide to make reference to one of the other accountants, both of the other accountants, or neither. The decision is solely at the discretion and judgment of the accountant of the reporting entity. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A136 The disclosure of the magnitude of the portion of the financial statements audited or reviewed by other accountants may be achieved by stating the dollar amounts or percentages of total assets, total revenues, other appropriate criteria, or a combination of these, whichever most clearly describes the portion of the financial statements audited or reviewed by other accountants. When two or more other accountants participate in the audit or review, the dollar amounts or the percentages covered by the other accountants may be stated in the aggregate. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A137 Exhibit C contains an example of appropriate reporting in the accountant's review report when reference is made to the audit or review of significant components, such as consolidated and unconsolidated subsidiaries and investees, by other accountants.⁷ [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Determining Whether the Other Accountants Are Familiar with SSARSs or Auditing Standards Generally Accepted in the United States of America, as Applicable (Ref: par. .81b)

.A138 An other accountant's review report stating that the review was conducted in accordance with SSARSs or an auditor's report stating that the audit was conducted in accordance with generally accepted auditing standards (GAAS) is sufficient to make the determination required by paragraph .81b. When the other accountant has performed a review of the component financial statements in accordance with standards other than SSARSs or an audit of the component financial statements in accordance with auditing standards other than GAAS, the accountant of the reporting entity may evaluate, exercising professional judgment, whether the engagement performed by the other accountant meets the relevant requirements of SSARSs or GAAS, as applicable. For the purposes of complying with paragraph .81b, relevant requirements of SSARSs or GAAS are those that pertain to planning and performing the engagement on the component financial statements and do not include those related to the form of the accountant's review or the auditor's report. Reviews performed in accordance with International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, and audits performed in accordance with International Standards on Auditing (ISAs), both of which are promulgated by the International Auditing and Assurance Standards Board (IAASB), are likely to meet the relevant requirements of SSARSs and GAAS, respectively. The other accountants may perform additional procedures in order to meet the relevant requirements of SSARSs or GAAS. The accountant of the reporting entity, having determined that all relevant requirements of SSARSs or GAAS have been met by the other accountant, may decide to make reference to the review or audit of that other accountant in the accountant's review report on the reporting entity's financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

.A139 When the other accountants are not subject to the AICPA Code of Professional Conduct, compliance by the other accountants with the ethics and independence requirements set forth in the International Ethics Standards Board's *Code of Ethics for Professional Accountants* is sufficient to fulfill the other accountants' ethical responsibilities. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same (Ref: par. .82b)

.A140 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition,

⁷ Illustration 6, "An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component," of exhibit C. [Footnote renumbered by the issuance of SSARS No. 24, May 2018.]

presentation, and disclosure of all material items in the component's financial statements in accordance with the financial reporting framework used by the component and the financial reporting framework used by the reporting entity, the less similar the financial reporting frameworks. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRS) and *International Financial Reporting Standard for Small- and Medium-Sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as similar to financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). In most cases, special purpose frameworks are not similar to GAAP. [Paragraph added, effective for reviews of financial statements for periods ending on or after June 15, 2019, by SSARS No. 24.]

Supplementary Information That Accompanies Reviewed Financial Statements (Ref: par. .83–.85)

[A141] [Paragraph renumbered and deleted by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A142 The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the supplementary information has been subjected to the review procedures applied in the accountant's review of the basic financial statements:

Other Matter

The accompanying [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The supplementary information has been subjected to the review procedures applied in my (our) review of the basic financial statements. I am (We are) not aware of any material modifications that should be made to the supplementary information. I (We) have not audited the supplementary information and do not express an opinion on such information.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A143 The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the supplementary information has not been subjected to the review procedures applied in the review of the basic financial statements:

Other Matter

The accompanying [*identify the supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. I (We) have not audited or reviewed such information and I (we) do not express an opinion, a conclusion, nor provide any assurance on it.

[Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A144 Supplementary information may become unattached from the accountant's review report. To minimize the possibility that a user of the supplementary information may infer, through the accountant's association with such information, an unintended level of reliance on it, the accountant may consider including a reference to the accountant's review report on each page of the supplementary information. An example of a reference to the accountant's review report included on each page of the supplementary information is "See independent accountant's review report." [Paragraph renumbered and amended, effective October 2016, by SSARS No. 23. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Required Supplementary Information (Ref: par. .86–.87)

.A145 Examples of required supplementary information that may accompany reviewed financial statements include the following:

- With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by *FASB Accounting Standards Codification* 972-235-50-3
- Management's discussion and analysis and budgetary comparison statements as required by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A146 *Prescribed guidelines* are the authoritative guidelines established by the designated accounting standard-setter for the methods of measurement and presentation of the required supplementary information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A147 Because the required supplementary information accompanies the basic financial statements, the accountant's review report on the financial statements includes a discussion of the responsibility taken by the accountant on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Change in Engagement From Audit to Review (Ref: par. .89)

.A148 A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit engagement; a misunderstanding regarding the nature of an audit or review engagement; or a restriction on the scope of the audit engagement, whether imposed by management or caused by circumstances. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A149 A change in circumstances that affects the entity's requirement for an audit engagement or a misunderstanding concerning the nature of an audit or review engagement would ordinarily be considered a reasonable basis for requesting a change in the engagement. [Paragraph renumbered by the issuance

of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A150 The implications of a restriction on the scope of the audit engagement include the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Review Documentation (Ref: par. .94)

.A151 Review documentation may be recorded on paper or on electronic or other media. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A152 The accountant need not include in review documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A153 The accountant is not precluded from supporting the review report by other means in addition to the review documentation. Such other means might include written documentation contained in other engagement files (for example, compilation or nonattest services) or quality control files (for example, consultation files) and, in limited situations, oral explanations. On their own, oral explanations by the accountant do not represent adequate support for the work the accountant performed or conclusions reached, but they may be used to explain or clarify information contained in the review documentation. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A154 In the case of a review in which the engagement partner performs all the review work, the engagement partner is still required to comply with the overriding requirement in paragraph .94 to prepare review documentation that can be understood by an experienced accountant because the review documentation may be subject to review by external parties. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A155 Findings or issues that, in the accountant's professional judgment, are significant may include the results of review procedures that indicate that the financial statements could be materially misstated, including actions taken to address such findings and the basis for the final conclusions. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Appendix A — Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements (Ref: par. .A33)

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. Examples of analytical procedures that an accountant may consider performing in a review of financial statements include the following:

- Comparing current financial statements with the financial statements of the prior period.
- Comparing current financial statements with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial statements with corresponding information in [a] budgets, using expected rates, and [b] financial statements for prior periods). Caution is necessary when comparing and evaluating current financial statements with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results.
- Comparing current financial statements with relevant nonfinancial information.
- Comparing ratios and indicators for the current period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current financial statements and comparing the results with corresponding information for prior periods). Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial statements with corresponding relationships in the financial statements of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables).
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
 - By period (for example, financial statement items disaggregated into quarterly, monthly, or weekly amounts)
 - By product line or operating segment
 - By location (for example, subsidiary, division, or branch)

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques. [Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Appendix B — Unusual or Complex Situations to Be Considered by the Accountant When Performing Inquiry Procedures in a Review of Financial Statements (Ref: par. .A42)

The following are examples of situations about which the accountant may inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior periods
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related party transactions
- Material off-balance sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A158

Exhibit A — Illustrative Engagement Letters (Ref: par. .A20)

Illustration 1 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

The illustrative engagement letters in this exhibit are intended as illustrations that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances, and the illustrations are drafted to refer to a review engagement for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

Illustration 1 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the review engagement.
- The financial statements will be prepared in accordance with accounting principles generally accepted in the United States of America.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements and perform a review engagement with respect to those financial statements.³ We are pleased to confirm our acceptance and understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A19.

² Throughout this engagement letter, references to *you*, *we*, *us*, *management*, and *accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you and
- b. obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial

statements that are free from material misstatement, whether due to fraud or error

- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the review engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services.

Our Report

[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows.]

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from accounting principles generally accepted in the United States of America, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

You agree to include our accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services. . .

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by

third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review of those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements; Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

Illustration 2 — An Engagement Letter for a Review Engagement With Respect to Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the financial statements, including related notes, subject to the review engagement.
- The financial statements will be prepared in accordance with the tax basis of accounting.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the statement of assets, liabilities, and equity—tax basis as of December 31, 20XX, and the related statements of operations and retained earnings—tax basis, and cash flows—tax basis for the year then ended, and the related notes to the financial statements and to perform a review engagement with respect to those financial statements.³ We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Our Responsibilities

The objective of our engagement is to

- a. prepare financial statements in accordance with the tax basis of accounting based on information provided by you and

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A19.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

- b. obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting.

We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and any evidence or information that comes to our attention during the performance of our review procedures that indicates fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to prepare financial statements in accordance with the tax basis of accounting and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of the tax basis of accounting as the financial reporting framework to be applied in the preparation of the financial statements
- b. The preparation and fair presentation of the financial statements in accordance with the tax basis of accounting and the inclusion of all informative disclosures that are appropriate for the tax basis of accounting. This includes
 - i. a description of the tax basis of accounting, including a summary of significant accounting policies, and how the tax basis of accounting differs from accounting principles generally accepted in the United States of America, the effects of which need not be qualified
 - ii. informative disclosures similar to those required by accounting principles generally accepted in the United States of America

- c. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the entity complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- g. To provide us with
 - i. access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
 - ii. additional information that we may request from you for the purpose of the review engagement
 - iii. unrestricted access to persons within the entity of whom we determine it necessary to make inquiries
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows.]

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary of us to report known departures from the tax basis of accounting, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our report will state that the financial statements are prepared in accordance with tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion will not be modified with respect to this matter.

You agree to include our accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us and, prior to inclusion of the report, to ask our permission to do so.

Other Relevant Information

Our fees for these services. . .

[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing

misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review with respect to those same financial statements and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements. Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A159

Exhibit B — Illustrative Representation Letter (Ref: par. .A62)

The following illustrative letter is intended as an illustration that may be used to comply with the requirements of section 90. The representation letter will vary according to individual requirements and circumstances.

It is assumed in this illustration that the applicable financial reporting framework is accounting principles generally accepted in the United States of America, that no conditions or events exist that might be indicative of the entity's inability to continue as a going concern, and that no exceptions exist to the requested written representations. If circumstances differ from these assumptions, the representations would need to be modified to reflect the actual circumstances.

(Entity Letterhead)

(To Accountant)

(Date)

This representation letter is provided in connection with your review of the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements, for the purpose of obtaining limited assurance as a basis for reporting whether you are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We represent that *[to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves] [as of (date of accountant's review report)]*:

Financial Statements

- We acknowledge our responsibility and have fulfilled our responsibilities for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- We acknowledge our responsibility and have fulfilled our responsibilities for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Guarantees, whether written or oral, under which the company is contingently liable have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB *Accounting Standards Codification* (ASC) 275, *Risks and Uncertainties*, have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America. [Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]
- All events occurring subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America requires adjustment or disclosure have been properly accounted for.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole.
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.

[Any other matters that the accountant may consider appropriate.]

Information Provided

- We have responded fully and truthfully to all inquiries made to us by you during your review.
- We have provided you with
 - access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters;
 - minutes of meetings of stockholders, directors, and committees of directors or summaries of actions of recent meetings for which minutes have not yet been prepared;
 - additional information that you have requested from us for the purpose of the review; and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain review evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.

- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* fraud or suspected fraud that affects the entity and involves
 - management,
 - employees who have significant roles in internal control, or
 - others when the fraud could have a material effect on the financial statements.
- We have *[no knowledge of any]* *[disclosed to you all information that we are aware of regarding]* allegations of fraud, or suspected fraud, affecting the entity's financial statements as a whole communicated by employees, former employees, analysts, regulators, or others.
- We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
- We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws or regulations whose effects should be considered when preparing financial statements.
- We *[have disclosed to you all known actual or possible]* *[are not aware of any pending or threatened]* litigation and claims whose effects should be considered when preparing the financial statements *[and we have not consulted legal counsel concerning litigation or claims]*
- We have disclosed to you any other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, *Contingencies*.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- We have disclosed to you all information relevant to the use of the going concern assumption in the financial statements.
- No material losses exist (such as from obsolete inventory or purchase or sale commitments) that have not been properly accrued or disclosed in the financial statements.
- The company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
- We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- We are in agreement with the adjusting journal entries that you have recommended, and they have been posted to the company's accounts (if applicable).

[Any other matters that the accountant may consider necessary.]

[Name of Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title]

Representation letters ordinarily are tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

.A160

Exhibit C — Illustrations of Accountant's Review Reports on Financial Statements (Ref: par. .A78, .A107, and .A134)

The illustrative accountant's review reports in this exhibit are intended as illustrations that may be used to comply with the requirements of section 90. The accountant's review report will vary according to individual requirements and circumstances.

Illustration 1 — An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Illustration 2 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 3 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Illustration 4 — An Accountant's Review Report on Interim Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 5 — An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America

Illustration 6 — An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component

Illustration 1 — An Accountant's Review Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When a Review Has Been Performed for Both Periods

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's

(owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 2 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of financial statements (single year).
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 3 — An Accountant's Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting

Circumstances include the following:

- Review of a complete set of financial statements (single year).
- The financial statements are of a partnership and prepared in accordance with the basis of accounting the partnership uses for income tax purposes (that is, a special purpose framework).
- Management has a choice of financial reporting frameworks.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Partnership, which comprise the statement of assets, liabilities, and partners' capital—tax basis as of December 31, 20XX, and the related statements of revenue and expenses—tax basis, and partners' capital—tax basis for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (partners') financial data and making inquiries of partnership management (partners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Partners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting the partnership uses for income tax purposes; this includes determining that

the basis of accounting the partnership uses for income tax purposes is an acceptable basis for the preparation of financial statements in the circumstances. Management (Partners) is (are) also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with the basis of accounting the partnership uses for income tax purposes. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the basis of accounting the partnership uses for income tax purposes.

Basis of Accounting

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the basis of accounting the partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion is not modified with respect to this matter.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 4 — An Accountant's Review Report on Interim Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of interim financial statements for the period ended September 30, 20XX, and for the three and nine months then ended.
- The interim financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.
- The accountant appropriately performs the engagement in accordance with SSARs (that is, AU-C section 930, *Interim Financial Information* [AICPA, *Professional Standards*], is not applicable).

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying interim financial statements of XYZ Company, which comprise the balance sheet as of September 30, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows

for the three and nine months then ended, and the related notes to the interim financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the interim financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these interim financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the interim financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying interim financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 5 — An Accountant's Review Report on Comparative Financial Statements Disclosing a Departure From Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Review of a complete set of comparative financial statements.
- The financial statements contain a departure from accounting principles generally accepted in the United States of America.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which

is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) reviews, except for the issue noted in the Known Departure From Accounting Principles Generally Accepted in the United States of America paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

Known Departure From Accounting Principles Generally Accepted in the United States of America

As disclosed in Note X to these financial statements, accounting principles generally accepted in the United States of America require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from accounting principles generally accepted in the United States of America on financial position, results of operations, and cash flows have not been determined.

or

As disclosed in Note X to these financial statements, the company has adopted [description of newly adopted method], whereas it previously used [description of previous method]. Although the [description of newly adopted method] is in accordance with accounting principles generally accepted in the United States of America, the company does not appear to have reasonable justification for making a change as required by FASB *Accounting Standards Codification* 250, *Accounting Changes and Error Corrections*.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 6 — An Accountant's Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component

Circumstances include the following:

- Review of a complete set of comparative consolidated financial statements.
- The financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X2 and 20X1, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended, were reviewed by other accountants, and the accountant has decided to make reference to the work of other accountants in the accountant's review report.

Independent Accountant's Review Report

[Appropriate Addressee]

I (We) have reviewed the accompanying consolidated financial statements of XYZ Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X2 and 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA. We have not reviewed the financial statements of B Company, a wholly-owned subsidiary, whose financial statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X2 and 20X1, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. These statements were reviewed by other accountants, whose report has been furnished to me (us), and our conclusion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other accountants.

SSARs require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the consolidated financial statements for them to be in accordance with accounting principles generally accepted in the United States

of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) reviews, and the report of other accountants, I am (we are) not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

[Paragraph renumbered by the issuance of SSARS No. 23, October 2016. Paragraph subsequently renumbered by the issuance of SSARS No. 24, May 2018.]

AR-C Section 100

Special Considerations—International Reporting Issues

Source: SSARS No. 24.

Effective for compilations and reviews of financial statements for periods ending on or after June 15, 2019.

Introduction

Scope of This Section

.01 This section addresses situations in which an accountant is engaged to perform a compilation or review of financial statements in accordance with Statements on Standards for Accounting and Review Services (SSARSs) in either of the following circumstances:

- a. The financial statements have been prepared in accordance with a financial reporting framework generally accepted in another country not adopted by a body designated by the Council of the AICPA (Council) to establish generally accepted accounting principles (GAAP) (hereinafter referred to as a financial reporting framework generally accepted in another country).
- b. The compilation or review engagement is to be performed in accordance with both SSARSs and another set of compilation or review standards, such as International Standard on Related Services (ISRS) 4410 (Revised), *Compilation Engagements*, or International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*.

.02 Pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001), the Council of the AICPA designates the bodies to establish GAAP. This section does not apply to financial statements prepared in accordance with financial reporting frameworks established by the bodies designated by the Council. (Ref. par. .A2–.A3)

Effective Date

.03 This section is effective for compilations and reviews of financial statements for periods ending on or after June 15, 2019.

Objective

.04 The objective of the accountant, when performing a compilation or review of financial statements prepared in accordance with a financial reporting framework generally accepted in another country or in accordance with both

SSARs and another set of compilation or review standards, is to address appropriately the special considerations that are relevant to

- a. the acceptance of the engagement,
- b. the planning and performance of the engagement, and
- c. reporting on the financial statements.

Requirements

Considerations When Accepting the Engagement

.05 In a compilation or review of financial statements prepared in accordance with a financial reporting framework generally accepted in another country, in complying with paragraph .26b of section 60B, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*, which requires the accountant, as a condition for accepting an engagement to be performed in accordance with SSARs, to determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable, the accountant should obtain an understanding of the following: (Ref: par. .A4)

- a. The purpose for which the financial statements are prepared and whether the financial reporting framework applied in the preparation of the financial statements is a fair presentation framework
- b. The intended users of the financial statements
- c. The steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances

.06 The accountant should obtain an understanding of the applicable legal responsibilities involved when the compilation or review engagement is to be performed in accordance with both SSARs and another set of compilation or review standards and both of the following are true: (Ref: par. .A5)

- a. The financial statements are intended for use only outside of the United States.
- b. The accountant plans to use the form and content of the accountant's compilation or review report of the other set of compilation or review standards.

Compilation or Review of Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

.07 When performing a compilation or review on financial statements prepared in accordance with a financial reporting framework generally accepted in another country, the accountant should obtain an understanding of such framework. (Ref: par. .A6–.A7)

.08 The accountant should comply with section 80B, *Compilation Engagements*, and section 90B, *Review of Financial Statements*, with respect to compilations or reviews, respectively, of financial statements prepared in accordance with a financial reporting framework generally accepted in another country. When the financial statements are intended for use only outside of the United States, the accountant may use the report form and content of the other country in accordance with paragraph .10b.

Application of Another Set of Compilation or Review Standards

.09 If the accountant is engaged to perform a compilation or review of financial statements and the agreed-upon terms of the engagement require the accountant to apply another set of compilation or review standards in addition to SSARs, the accountant should obtain an understanding of and apply those relevant standards, as well as SSARs, except for requirements related to the form and content of the report in the situation described in paragraph .10a. (Ref: par. .A8–.A10)

Reporting

Reporting—Intended for Use Only Outside the United States

.10 If the accountant is issuing an accountant's compilation or review report on financial statements and such financial statements are intended for use only outside the United States, the accountant should use either of the following:

- a. A report in accordance with SSARs, the content of which includes the following: (Ref: par. .A11)
 - i. The elements required by section 80B or section 90B, as applicable, excluding the requirement from paragraph .21 of section 80B or paragraph .43 of section 90B to include a paragraph regarding financial statements prepared in accordance with a special purpose framework
 - ii. A statement that refers to the note to the financial statements, if applicable, that describes the basis of presentation of the financial statements on which the accountant is reporting, including identification of the country of origin of the accounting principles if the financial statements are prepared in accordance with a financial reporting framework generally accepted in another country
- b. The report form and content in accordance with another set of compilation or review standards (for example, as set forth in ISRS 4410 (Revised) or ISRE 2400 (Revised)), provided that the following are true:
 - i. Such a report would be issued by accountants in the other country in similar circumstances.
 - ii. If a review engagement is performed, the accountant has obtained sufficient appropriate review evidence to support the conclusion expressed in the review report.
 - iii. The accountant has complied with the reporting standards of the other set of compilation or review standards and identifies such standards in the report. (Ref: par. .A5)

Reporting—Use in the United States

.11 If the financial statements will be used in the United States, the accountant should report in accordance with SSARs, including the requirements related to financial statements prepared in accordance with a special purpose framework from paragraph .21 of section 80B and paragraph .43 of section 90B for compilations and reviews, respectively. (Ref: par. .A12–.A13)

Accountant's Report for Compilations or Reviews Conducted in Accordance With Both SSARs and Another Set of Compilation or Review Standards

.12 The accountant should not refer to having conducted a compilation or review in accordance with another set of compilation or review standards in addition to SSARs unless the compilation or review was conducted in accordance with both sets of standards in their entirety.

.13 When the accountant's compilation or review report refers to both SSARs and another set of compilation or review standards, the accountant's compilation or review report should identify the other set of compilation or review standards, as well as its origin.

Application and Other Explanatory Material**Scope of This Section (Ref: par. .01–.02)**

.A1 Pursuant to paragraph .10 of section 60B, the accountant must perform a review or compilation in accordance with SSARs, except for certain reviews of interim financial information as discussed in section 90B.

.A2 Sections 80B and 90B apply to compilations and reviews, respectively, of financial statements prepared in accordance with financial reporting frameworks established by the bodies designated by the Council, including financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

.A3 This section applies to compilations and reviews of financial statements prepared in accordance with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement in an appropriate note to the financial statements that such financial statements are in compliance with IFRS as promulgated by the IASB.

**Considerations When Accepting the Engagement
(Ref: par. .05b, .06, and .10biii)**

.A4 In obtaining an understanding of the purpose for which the financial statements are prepared and of the intended users, the accountant may consider whether the intended users are likely to be familiar with the applicable financial reporting framework. For example, if the financial statements are to be used in the United States in addition to the other country or countries for which they are intended, the accountant may consider whether intended users within the United States deal directly with the entity and whether the financial statements are to be used in a manner that permits such users to discuss with the entity differences from accounting and reporting practices in the United States and their significance. Accordingly, an accountant may conclude that financial statements prepared in accordance with a financial reporting framework generally accepted in another country are not appropriate for wide distribution in the United States.

.A5 Even when the form and content of the accountant's compilation or review report presented in accordance with another set of compilation or review standards appears similar to that used in the United States, the report may convey a different meaning and entail different legal responsibilities for the accountant due to custom or culture. Issuing such a compilation or review report may require the accountant to report on statutory compliance or

otherwise require an understanding of local laws and regulations. When issuing such an accountant's compilation or review report, the accountant is required by paragraph .06 to obtain an understanding of applicable legal responsibilities, in addition to the compilation or review standards and the financial reporting framework, as required by paragraphs .05 and .08–.09. Accordingly, depending on the nature and extent of the accountant's knowledge and experience, the accountant may consult with persons having expertise in the compilation or review reporting requirements in the other set of compilation or review standards and associated legal responsibilities to obtain the understanding needed to issue the compilation or review report in accordance with the other set of compilation or review standards.

Compilation or Review of Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country (Ref: par. .07)

.A6 Paragraph .13 of section 80B requires the accountant, as part of the compilation engagement, to obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. Paragraphs .15–.16 of section 90B require the accountant, as part of the review engagement, to obtain an understanding of the accounting principles and practices used by the entity sufficient to identify areas in the financial statements in which there is a greater likelihood that material misstatements may arise and to be able to design procedures to address those areas.

.A7 An understanding of the financial reporting framework generally accepted in another country may be obtained by reading the statutes or professional literature, or codifications thereof, which establish or describe the financial reporting framework generally accepted in the other country. Often, the application of accounting principles to a particular situation requires practical experience and, accordingly, the accountant may consult with persons having expertise in applying the financial reporting framework of the other country.

Application of Another Set of Compilation or Review Standards (Ref: par. .09)

.A8 When an accountant is applying another set of compilation or review standards, such as ISRS 4410 (Revised) or ISRE 2400 (Revised), the accountant may be required to perform procedures in addition to those procedures required by SSARSS.

.A9 An understanding of another set of compilation or review standards may be obtained by reading the statutes or professional literature, or codifications thereof, which establish or describe such standards.

.A10 Statutes or professional literature, or codifications thereof, however, may not include a complete description of another set of compilation or review standards. The accountant may consult with persons having expertise, including practical experience, in applying another set of compilation or review standards, as relevant.

Reporting (Ref: par. .10a and .11)

.A11 The exhibit "Illustrations of Accountant's Compilation and Review Reports on Financial Statements Prepared in Accordance With a Financial

Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Compilation or Review Standards" contains illustrations of auditor's reports on financial statements incorporating the elements required by paragraphs .10–.11.

Reporting—Use in the United States (Ref: par. .11)

.A12 When reporting on financial statements prepared in accordance with a financial reporting framework generally accepted in another country that will be used both inside and outside the United States, the accountant may issue two reports: one of the reports described in paragraph .10 for use outside the United States and a report in accordance with SSARs to be used in the United States.

.A13 An entity that prepares financial statements in accordance with GAAP may also prepare financial statements in accordance with a financial reporting framework generally accepted in another country for use outside the United States (for example, financial statements prepared in accordance with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement of compliance with IFRS as issued by the IASB). The accountant may report on the financial statements that are in accordance with a financial reporting framework generally accepted in another country by reporting in accordance with paragraph .10. The accountant may include in the reports that another report has been issued on the entity's financial statements that have been prepared in accordance with a financial reporting framework generally accepted in another country. The accountant's statement may also reference any note disclosure in the financial statements that describes significant differences between the accounting principles used and GAAP. Such a statement may be included in a separate paragraph to the accountant's compilation or review report (this paragraph would be an emphasis-of-matter paragraph in an accountant's review report). The following is an example:

We also have reported separately on the financial statements of ABC Company for the same period presented in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*]. (Note X summarizes the significant differences between the [*specify the financial reporting framework generally accepted*] in [*name of country*] and accounting principles generally accepted in the United States of America.)

.A14

Exhibit—Illustrations of Accountant's Compilation and Review Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Compilation or Review Standards (Ref: par. .A11)

Illustration 1: Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Compilation Standards and the Financial Statements Are Intended for Use Only Outside the United States

Illustration 2: Independent Accountant's Review Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Review Standards and the Financial Statements Are Intended for Use Only Outside the United States

Illustration 3: Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Compilation Standards and the Financial Statements Are Also Intended for Use in the United States

Illustration 4: Independent Accountant's Review Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Review Standards and the Financial Statements Are Also Intended for Use in the United States

Illustration 5: Independent Accountant's Review Report on Financial Statements Prepared in Accordance With SSARs and in Accordance With International Financial Reporting Standards as Issued by the International Accounting Standards Board Performed in Accordance With SSARs and International Standard on Review Engagements 2400 (Revised) Issued by the International Auditing and Assurance Standards Board

Illustration 1: Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Compilation Standards and the Financial Statements Are Intended for Use Only Outside the United States

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements, which, as described in Note X to the financial statements, have been

prepared in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*]. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and in accordance with [*identify the other set of compilation standards*]. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Accountant's city and state*]

[*Date of the accountant's report*]

Illustration 2: Independent Accountant's Review Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Review Standards and the Financial Statements Are Intended for Use Only Outside the United States

Independent Accountant's Review Report

[*Appropriate addressee*]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements, which, as described in Note X to the financial statements, have been prepared in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*]; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and in accordance with [*identify the other review standards*]. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*]. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order

for them to be in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*].

[*Signature of accounting firm or accountant, as appropriate*]

[*Accountant's city and state*]

[*Date of the accountant's review report*]

Illustration 3: Accountant's Compilation Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Compilation Standards and the Financial Statements Are Also Intended for Use in the United States

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*]. I (We) have performed compilation engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and in accordance with [*identify the other compilation standards*]. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], which is a basis of accounting other than accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Accountant's city and state*]

[*Date of the accountant's report*]

Illustration 4: Independent Accountant's Review Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country Performed in Accordance With SSARs and Another Set of Review Standards and the Financial Statements Are Also Intended for Use in the United States

Independent Accountant's Review Report

[*Appropriate addressee*]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements, which, as described in Note X to the financial statements, have been prepared in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (Our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and in accordance with *[identify the other review standards]*. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*.

Basis of Accounting

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with *[specify the financial reporting framework generally accepted]* in *[name of country]*, which is a basis of accounting other than accounting principles generally accepted in the United States of America. My (Our) conclusion is not modified with respect to this matter.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

Illustration 5: Independent Accountant's Review Report on Financial Statements Prepared in Accordance With SSARs and in Accordance With International Financial Reporting Standards as Issued by the International Accounting Standards Board Performed in Accordance With SSARs and International Standard on Review Engagements 2400 (Revised) Issued by the International Auditing and Assurance Standards Board

Independent Accountant's Review Report

[Appropriate addressee]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the statements of financial position as of December 31, 20X2 and 20X1, and the related statements of comprehensive income, changes in equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the

objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management's Responsibility for the Financial Statements

Management (Owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

My (our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and in accordance with International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, issued by the International Auditing and Assurance Standards Board. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

Accountant's Conclusion

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

[Signature of accounting firm, or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

AR-C Section 120

Compilation of Pro Forma Financial Information

(Supersedes SSARS No. 14)

Source: SSARS No. 22

Effective for compilation reports on pro forma financial information dated on or after May 1, 2017.

Introduction

Scope of This Section

.01 This section contains performance and reporting requirements and application guidance for accountants engaged to perform a compilation engagement on pro forma financial information. (Ref: par. .A1)

Effective Date

.02 This section is effective for compilation reports on pro forma financial information dated on or after May 1, 2017.

Objective

.03 The objective of the accountant in a compilation of pro forma financial information is to apply accounting and financial reporting expertise to assist management in the presentation of pro forma financial information and report in accordance with this section without undertaking to obtain or provide any assurance on the pro forma financial information.

Definition

.04 For purposes of this section, the following term has the meaning attributed as follows:

Pro forma financial information. A presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. (Ref: par. .A2–.A5)

Requirements

General Principles for Compilations of Pro Forma Financial Information

.05 In addition to complying with this section, an accountant is required to comply with section 60B, *General Principles for Engagements Performed in*

Accordance With Statements on Standards for Accounting and Review Services, adapted as necessary.

Independence

.06 In a compilation of pro forma financial information, the accountant must determine whether the accountant is independent of the entity. (Ref: par. .A6)

Acceptance and Continuance of Client Relationships

.07 As a condition for accepting an engagement to perform a compilation on pro forma financial information, in addition to the requirements in paragraph .25 of section 60B, adapted as necessary, the accountant should obtain the agreement of management that it acknowledges and understands its responsibility for the following: (Ref: par. .A7)

- a. The preparation and fair presentation of pro forma financial information in accordance with the applicable financial reporting framework (Ref: par. .A8)
- b. To include the following in any document that contains the pro forma financial information:
 - i. The complete financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or such financial statements are readily available (Ref: par. .A9)
 - ii. If pro forma financial information is presented for an interim period, either historical interim financial information for that period (which may be in condensed form) or that such interim information is readily available (Ref: par. .A10)
 - iii. In the case of a business combination, the relevant historical financial information for the significant constituent parts of the combined entity
- c. To ensure that the financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been subjected to a compilation, review, or an audit engagement
- d. To include the accountant's compilation or review report or the auditor's report on the financial statements (or to have readily available) in any document containing the pro forma financial information
- e. To present a summary of significant assumptions with the pro forma financial information
- f. To obtain the accountant's permission prior to including the accountant's compilation report in any document containing the pro forma financial information that indicates that the entity's accountant has performed a compilation engagement on such pro forma financial information

.08 If the accountant is not satisfied about any of the matters set out in paragraph .25 of section 60B or paragraph .07 of this section as preconditions for accepting a compilation engagement with respect to pro forma financial

information, the accountant should discuss the matter with management. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed compilation engagement.

Agreement on Engagement Terms

.09 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following: (Ref: par. .A11–.A16)

- a.* The objectives of the engagement
- b.* The responsibilities of management set forth in paragraph .25c of section 60B and paragraph .07 of this section
- c.* The responsibilities of the accountant
- d.* The limitations of the compilation engagement
- e.* Identification of the applicable financial reporting framework for the preparation of the pro forma financial information
- f.* The expected form and content of the accountant's compilation report and a statement that there may be circumstances in which the report may differ from its expected form and content

.10 The engagement letter or other suitable form of written agreement should be signed by

- a.* the accountant or the accountant's firm, and
- b.* management or those charged with governance, as appropriate. (Ref: par. .A12)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.11 The accountant should obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the pro forma financial information. If the entity is a combined entity, the accountant should obtain an understanding of the significant accounting policies adopted by management of each significant constituent part of the combined entity that would have been required to have been obtained by the accountant performing a compilation engagement with respect to the financial statements of each entity for the most recent annual or interim period for which the pro forma financial information is presented. (Ref: par. .A17–.A18)

Compilation Procedures

.12 In performing a compilation of pro forma financial information, the accountant should do the following:

- a.* Comply with the requirements set forth in paragraphs .13–.16 of section 80B, adapted as necessary. (Ref: par. .A19)
- b.* Obtain an understanding of the underlying transaction or event.
- c.* Ascertain that management has fulfilled its agreement pursuant to paragraph .07b of this section to include the following in any document that contains the pro forma financial information:

- i. The complete financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or such financial statements are readily available
 - ii. If pro forma financial information is presented for an interim period, either historical interim financial information for that period (which may be in condensed form) or that such interim information is readily available
 - iii. In the case of a business combination, the relevant financial information for the significant constituent parts of the combined entity
- d. Ascertain that management has fulfilled its agreement pursuant to paragraph .07c of this section to ensure that the financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been subjected to a compilation, review, or an audit engagement.
- e. Ascertain that management has fulfilled its agreement pursuant to paragraph .07d of this section to include the accountant's compilation or review report or the auditor's report on the financial statements (or have readily available) in any document containing the pro forma financial information.

The Accountant's Compilation Report on Pro Forma Financial Information

.13 The accountant's compilation report should be in writing and comply with the requirements set forth in paragraphs .17–.31 of section 80B (Ref: par. .A20–.A22)

.14 In addition to the report elements required by paragraph .17 of section 80B, an accountant's compilation report on pro forma financial information should include the following:

- a. A reference to the financial statements from which the historical financial information is derived and a statement as to whether such financial statements were subjected to an audit, a review, or a compilation engagement
- b. A reference to any modification of the audit, review, or compilation report on the historical financial information
- c. A description of the nature and limitations of pro forma financial information

Documentation

.15 The accountant should prepare documentation in connection with each compilation of pro forma financial information in sufficient detail to provide a clear understanding of the work performed, which, at a minimum, includes the following: (Ref: par. .A23)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .09–.10
- b. The results of procedures performed in accordance with paragraph .12

- c. A copy of the pro forma financial information
- d. A copy of the accountant's compilation report

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 A compilation engagement on pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation, a review, or an audit of financial statements.

Definition (Ref: par. .04)

.A2 Pro forma financial information is developed by applying pro forma adjustments to historical financial information. Appropriate pro forma adjustments are based on management's assumptions, give effect to all significant effects directly attributable to the transaction (or event), and are stated on a basis consistent with the financial reporting framework of the reporting entity and its accounting policies under that framework.

.A3 Pro forma financial information is commonly used to show the effects of a transaction (or event) such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

.A4 Adequately disclosed pro forma financial information is labeled as such to distinguish it from other historical financial information. In addition, adequately disclosed financial information

- describes the transaction (or event) that is reflected in the pro forma financial information, the date on which the transaction (or event) is assumed to occur, the financial reporting framework of the financial statements, the source of the historical financial information on which it is based, the significant assumptions used to develop the pro forma adjustments, and any significant uncertainties about those assumptions.
- indicates that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position, results of operations, and cash flows, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

.A5 Article 11 of Regulation S-X provides further guidance on the presentation of pro forma financial information included in filings with the SEC.

Independence (Ref: par. .06)

.A6 The interpretations of the "Independence Rule", (ET sec. 1.200.001) of the AICPA Code of Professional Conduct provide authoritative guidance on independence. It is in the public interest and, therefore, required by this section,

that the accountant modify the accountant's compilation report when the accountant is not independent of the entity whose pro forma financial information is the subject of the compilation engagement. The AICPA Code of Professional Conduct also defines *independence* as consisting of two elements, independence of mind and independence in appearance. Independence enhances the accountant's ability to act with integrity and be objective. Independence implies an impartiality that recognizes an obligation to be fair not only to the responsible party but also to users of the pro forma financial information who may rely upon the accountant's compilation report. In the absence of an interpretation of the "Independence Rule" that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010).

Acceptance and Continuance of Client Relationships (Ref: par. .07)

.A7 Financial statements and historical interim financial information are deemed to be *readily available* if they are obtainable by a third-party user without any further action by the entity. For example, historical interim financial information on an entity's website may be considered readily available; however being available upon request is not considered readily available.

.A8 A compilation in accordance with SSARs is conducted on the premise that management has acknowledged and understands that it has the responsibility set out in paragraph .25c of section 60B. The preparation of pro forma financial information, in whole or in part, is a nonattest service subject to the provisions of the "Nonattest Services" subtopic (ET section 1.295) of the "Independence Rule." To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the compilation engagement as required by paragraphs .13–.15.

.A9 For purposes of this standard, *complete financial statements* means the financial statement or financial statements, including related notes if presented, that have been subjected to a compilation, a review, or an audit engagement. For example, if a balance sheet, income statement, statement of cash flows, and related notes were subjected to a compilation, a review, or an audit engagement, all are presented. If only a single financial statement is subjected to a compilation, a review, or an audit engagement or financial statements that omit all or substantially all disclosures are subjected to a compilation engagement, only that financial statement is (or those statements are) presented.

.A10 Interim historical financial information may be presented as a column in the pro forma financial information.

Agreement on Engagement Terms (Ref: par. .09–.10)

.A11 Both management and the accountant have an interest in documenting the terms of the compilation engagement before the commencement of the engagement to help avoid misunderstandings about the engagement. For example, it reduces the risk that management may inappropriately rely on or expect the accountant to protect management against certain risks or perform certain functions, including those that are management's responsibility.

.A12 The roles of management and those charged with governance in agreeing upon the terms of the compilation engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management,

those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is with only those charged with governance, in accordance with paragraph .25c of section 60B, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities.

.A13 When a third party has contracted for a compilation of the entity's pro forma financial information, agreeing on the terms of the compilation with management of the entity is necessary in order to establish that the preconditions for a compilation are present.

.A14 The understanding with management regarding the services to be performed for compilation engagements is required by paragraph .09 to be in a documented form, and, accordingly, an oral understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for compilation engagements.

.A15 Although the accountant may prepare the pro forma financial information, in whole or in part, the pro forma financial information is a representation of the management, and the fairness of its presentation in accordance with the applicable financial reporting framework is management's responsibility.

.A16 Exhibit A, "Illustrative Engagement Letter," provides an example of an engagement letter for a compilation of pro forma financial information.

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .11)

.A17 The requirement that the accountant obtain an understanding of the applicable financial reporting framework intended to be used in the preparation of the pro forma financial information and the significant accounting policies adopted by management does not prevent the accountant from accepting a compilation engagement for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding by, for example, consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the framework or the industry.

.A18 If another accountant has performed a compilation engagement on the financial statements of a significant constituent part of the combined entity, the need for the accountant to obtain an understanding of the significant accounting policies adopted by management is not diminished.

Compilation Procedures (Ref: par. .12)

.A19 The requirement in paragraph .13 of section 80B that the accountant read the financial statements in light of the accountant's understanding of the applicable financial reporting framework and the significant accounting policies adopted by management and consider whether such financial statements appear to be appropriate in form and free from obvious material misstatements requires the accountant to also read the pro forma financial information and consider the following:

- Whether the underlying transaction (or event), the pro forma adjustments, the significant assumptions, and the significant uncertainties, if any, about those assumptions have been appropriately described

- Whether the source of the historical financial information on which the pro forma financial information is based has been appropriately identified

The Accountant's Compilation Report on Pro Forma Financial Information (Ref: par. .13)

.A20 The accountant's compilation report on pro forma financial information may be added to the accountant's report on financial statements or it may appear separately.

.A21 An uncertainty about whether the underlying transaction (or event) will be consummated would not require a report modification.

.A22 Exhibit B, "Illustrative Accountant's Compilation Report on Pro Forma Financial Information," provides an example of an accountant's compilation report on pro forma financial information.

Documentation (Ref: par. .15)

.A23 Documentation may include significant consultations or significant professional judgments made throughout the engagement.

.A24

Exhibit A—Illustrative Engagement Letter (Ref: par. .A16)

The illustrative engagement letter in this exhibit is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances. The accountant may seek legal advice about whether a proposed letter is suitable.

Circumstances include the following:

- The accountant will prepare, as a nonattest service, the pro forma financial information and perform a compilation on the pro forma financial information the accountant prepared.
- The pro forma financial information is presented in accordance with accounting principles generally accepted in the United States of America.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:¹

You² have requested that we prepare the pro forma financial information of ABC Company (the Company) and perform a compilation engagement with respect to that pro forma financial information. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

Pro forma financial information is a presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date.

Our Responsibilities

The objective of our engagement is to

- a. prepare the pro forma financial information in accordance with accounting principles generally accepted in the United States of America, and
- b. perform a compilation engagement on the pro forma financial information we prepared in which we will apply accounting and financial reporting expertise to assist you in the presentation of the pro forma financial information and report without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information in order for it to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public

¹ The addresses and references in the engagement letter will be those that are appropriate in the circumstances of the compilation of pro forma financial information, including the relevant jurisdiction. It is important to refer to the appropriate persons.

² Throughout this engagement letter, references to *you*, *we*, *us*, *management*, and *accountant* will be used or amended as appropriate in the circumstances.

Accountants (AICPA) and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or provide any assurance on the pro forma financial information.

Our engagement cannot be relied upon to identify or disclose any pro forma financial information misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the Company or noncompliance with laws and regulations.

Management Responsibilities

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and perform a compilation engagement on the pro forma financial information we prepared. Management has the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. For the preparation and fair presentation of the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and for the selection of accounting principles generally accepted in the United States of America as the applicable financial reporting framework
- b. To include the following in any document that contains the pro forma financial information:
 - i. The complete financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) or such financial statements are readily available
 - ii. If pro forma financial information is presented for an interim period, either historical interim financial information for that period (which may be in condensed form) or that such interim information is readily available
 - iii. In the case of a business combination, the relevant historical financial information for the significant constituent parts of the combined entity
- c. To ensure that the financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been subjected to a compilation, review, or an audit engagement.
- d. To include the accountant's compilation or review report or the auditor's report on the financial statements (or make readily available) in any document containing the pro forma financial information
- e. To present a summary of significant assumptions with the pro forma financial information
- f. To obtain the accountant's permission prior to including the accountant's compilation report in any document containing the pro

forma financial information that indicates that the entity's accountant has performed a compilation engagement on such pro forma financial information

- g. To prevent and detect fraud
- h. To ensure that the Company complies with the laws and regulations applicable to its activities
- i. For the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- j. To provide us with the following:
 - i. Assumptions that provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event)
 - ii. Documentation and other related information that is relevant to the preparation and presentation of the pro forma financial information
 - iii. Additional information that may be requested for the purpose of the preparation of the pro forma financial information
 - iv. Unrestricted access to persons within the Company of whom we determine necessary to communicate

You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and expertise to oversee our preparation of your pro forma financial information. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.

Our Report

As part of our engagement, we will issue a report that will state that we did not examine or review the pro forma financial information and that, accordingly, we do not express an opinion nor provide any assurance on it. There may be circumstances in which the report differs from the expected form and content.

We have no responsibility to update our report for events and circumstances occurring after the date of such report.

If management intends to reproduce and publish the pro forma financial information and our report thereon, they must be reproduced in their entirety, and both the first and subsequent corrected drafts of the document containing the pro forma financial information and any accompanying material must be submitted to us for approval.

Other Relevant Information

Our fees for these services . . .

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the pro forma financial information described herein except for our own intentional wrongdoing.]

3624 Statements on Standards for Accounting and Review Services

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the pro forma financial information described herein and to perform a compilation engagement with respect to that same pro forma financial information, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and title]

[Date]

.A25

Exhibit B—Illustrative Accountant's Compilation Report on Pro Forma Financial Information (Ref: par. .A22)

Management is responsible for the accompanying pro forma condensed balance sheet of XYZ Company as of December 31, 20X1, and the related pro forma condensed statement of income for the year then ended (pro forma financial information), based on the criteria in Note 1. The historical condensed financial statements are derived from the financial statements of XYZ Company, on which I (we) performed a compilation engagement, and of ABC Company, on which other accountants performed a compilation engagement. The pro forma adjustments are based on management's assumptions described in Note 1. (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (we) did not examine or review the pro forma financial information nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on the pro forma financial information.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the underlying transaction (or event) occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above mentioned transaction (or event) actually occurred at such earlier date.

[Additional paragraph(s) may be added to emphasize certain matters relating to the compilation engagement or the subject matter.]

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's report]

AR-C Appendixes

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AR-C Appendix A

Schedule of Changes in Statements on Standards for Accounting and Review Services*

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
60	.01	Amended by SSARS No. 23.	October 2016
60	.03	Amended by SSARS No. 23.	October 2016
60	.04	Amended by SSARS No. 23.	October 2016
60	.07	Amended by SSARS No. 23.	October 2016
60	.07	Amended by SSARS No. 24.	May 2018
60	.07	Amended by SSARS No. 25.	February 2020
60	.07	Amended by SSARS No. 26.	June 2022
60	.17	Added by SSARS No. 23.	October 2016
60	.20	Amended by SSARS No. 26.	June 2022
60	.21	Added by SSARS No. 25.	February 2020
60	.21	Amended by SSARS No. 26.	June 2022
60	.23	Amended by SSARS No. 26.	June 2022
60	.24–.28	Added by SSARS No. 26.	June 2022
60	.26	Amended by SSARS No. 23.	October 2016
60	.26	Amended by SSARS No. 25.	February 2020
60	.29–.30	Added by SSARS No. 26.	June 2022
60	.A1–.A3	Superseded by SSARS No. 23.	October 2016
60	.A4	Added by SSARS No. 23.	October 2016
60	.A12	Added by SSARS No. 23.	October 2016
60	.A13	Added by SSARS No. 25.	February 2020
60	.A12–.A13	Added by SSARS No. 26.	June 2022
60	.A19	Amended by SSARS No. 26.	June 2022
60	.A21	Amended by SSARS No. 23.	October 2016
60	.A26	Amended by SSARS No. 23.	October 2016
60	.A33	Amended by SSARS No. 23.	October 2016
60	.A38	Amended by SSARS No. 23.	October 2016
60	.A40	Amended by SSARS No. 25.	February 2020
60	.A42–.A45	Amended by SSARS No. 26.	June 2022
60	.A44	Superseded by SSARS No. 25.	February 2020
60	.A46	Added by SSARS No. 26.	June 2022
60	.A47	Added by SSARS No. 25.	February 2020
60	.A47	Amended by SSARS No. 26.	June 2022
60	.A51	Added by SSARS No. 24.	May 2018

(continued)

* This table lists changes resulting from Statements on Standards for Accounting and Review Services (SSARs) issued subsequent to SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, which was issued in October 2014.

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
60	.A49	Amended by SSARS No. 26.	June 2022
60	.A51–.A59	Added by SSARS No. 26.	June 2022
60	.A51	Added by SSARS No. 25.	February 2020
60	.A52	Added by SSARS No. 25.	February 2020
60	.A59–.A62	Added by SSARS No. 25.	February 2020
60	.A60	Amended by SSARS No. 25.	February 2020
60	[.A61]	Deleted by SSARS No. 26.	June 2022
70	.01	Amended by SSARS No. 23.	October 2016
70	.07	Amended by SSARS No. 25.	February 2020
70	.10	Amended by SSARS No. 23.	October 2016
70	.14	Amended by SSARS No. 23.	October 2016
70	.14	Amended by SSARS No. 25.	February 2020
70	.17	Amended by SSARS No. 25.	February 2020
70	.19	Added by SSARS No. 23.	October 2016
70	.20–.21	Amended by SSARS No. 25.	February 2020
70	.A1–.A2	Added by SSARS No. 23.	October 2016
70	.A3	Amended by SSARS No. 23.	October 2016
70	.A6	Superseded by SSARS No. 25.	February 2020
70	.A9	Amended by SSARS No. 23.	October 2016
70	.A14	Amended by SSARS No. 26.	June 2022
70	.A15–.A16	Added by SSARS No. 25.	February 2020
70	.A22–.A23	Added by SSARS No. 25.	February 2020
80	.01	Amended by SSARS No. 23.	October 2016
80	.05	Amended by SSARS No. 25.	February 2020
80	.10	Amended by SSARS No. 23.	October 2016
80	.17	Amended by SSARS No. 26.	June 2022
80	.18–.21	Amended by SSARS No. 25.	February 2020
80	.24–.25	Added by SSARS No. 23.	October 2016
80	.26	Amended by SSARS No. 25.	February 2020
80	.29–.30	Amended by SSARS No. 23.	October 2016
80	.A1–.A2	Added by SSARS No. 23.	October 2016
80	.A3	Amended by SSARS No. 23.	October 2016
80	.A4	Added by SSARS No. 23.	October 2016
80	.A5	Superseded by SSARS No. 25.	February 2020
80	.A14	Amended by SSARS No. 23.	October 2016
80	.A25	Superseded by SSARS No. 23.	October 2016
80	.A25	Reinstated by SSARS No. 26.	June 2022
80	.A26	Added by SSARS No. 26.	June 2022
80	.A28–.A29	Added by SSARS No. 25.	February 2020
80	.A34	Superseded by SSARS No. 25.	February 2020
80	.A35–.A36	Added by SSARS No. 25.	February 2020
80	.A40	Superseded by SSARS No. 23.	October 2016
90	.01	Amended by SSARS No. 23.	October 2016
90	.03	Added by SSARS No. 25.	February 2020
90	.04	Added by SSARS No. 25.	February 2020
90	.05	Amended by SSARS No. 23.	October 2016
90	.05	Amended by SSARS No. 24.	May 2018

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
90	.05	Added by SSARS No. 25.	February 2020
90	.07	Amended by SSARS No. 25.	February 2020
90	.08	Amended by SSARS No. 25.	February 2020
90	.11-.12	Amended by SSARS No. 23.	October 2016
90	.11	Added by SSARS No. 25.	February 2020
90	.13	Amended by SSARS No. 25.	February 2020
90	.15	Added by SSARS No. 25.	February 2020
90	.16	Amended by SSARS No. 25.	February 2020
90	.16	Amended by SSARS No. 26.	June 2022
90	.19-.20	Added by SSARS No. 25.	February 2020
90	.24-.25	Amended by SSARS No. 25.	February 2020
90	.29	Amended by SSARS No. 25.	February 2020
90	.34	Amended by SSARS No. 24.	May 2018
90	.32-.38	Added by SSARS No. 25.	February 2020
90	.39g	Amended by SSARS No. 23.	October 2016
90	.39	Amended by SSARS No. 24.	May 2018
90	.39	Added by SSARS No. 25.	February 2020
90	.42	Added by SSARS No. 25.	February 2020
90	.43-.44	Superseded by SSARS No. 25.	February 2020
90	.46	Superseded by SSARS No. 25.	February 2020
90	.47	Amended by SSARS No. 24.	February 2020
90	.48-.57	Added by SSARS No. 25.	February 2020
90	.60	Amended by SSARS No. 24.	February 2020
90	.65	Added by SSARS No. 24.	May 2018
90	.64-.74	Added by SSARS No. 25.	February 2020
90	.66-.69	Amended by SSARS No. 24.	May 2018
90	.76	Amended by SSARS No. 25.	February 2020
90	.76	Amended by SSARS No. 26.	June 2022
90	.79	Amended by SSARS No. 24.	May 2018
90	.80	Added by SSARS No. 24.	May 2018
90	.81	Amended by SSARS No. 24.	May 2018
90	.78-.81	Amended by SSARS No. 25.	February 2020
90	.82	Added by SSARS No. 24.	May 2018
90	.81-.83	Amended by SSARS No. 23.	October 2016
90	.88	Superseded by SSARS No. 25.	February 2020
90	.89-.91	Amended by SSARS No. 25.	February 2020
90	.92	Added by SSARS No. 25.	February 2020
90	.94-.97	Added by SSARS No. 25.	February 2020
90	.98-.102	Superseded by SSARS No. 25.	February 2020
90	.107-.108	Superseded by SSARS No. 25.	February 2020
90	.109-.111	Amended by SSARS No. 25.	February 2020
90	.112	Added by SSARS No. 25.	February 2020
90	.113-.121	Superseded by SSARS No. 25.	February 2020
90	.137-.138	Amended by SSARS No. 25.	February 2020
90	.139	Added by SSARS No. 25.	February 2020

(continued)

<i>Section</i>	<i>Paragraph</i>	<i>Changes</i>	<i>Date of Change</i>
90	.139	Amended by SSARS No. 26.	June 2022
90	.A1	Added by SSARS No. 23.	October 2016
90	.A5–.A9	Superseded by SSARS No. 25.	February 2020
90	.A10	Added by SSARS No. 24.	May 2018
90	.A10	Added by SSARS No. 25.	February 2020
90	.A11–.A12	Added by SSARS No. 23.	October 2016
90	.A12	Superseded by SSARS No. 25.	February 2020
90	.A17–.A21	Added by SSARS No. 25.	February 2020
90	.A20	Amended by SSARS No. 23.	October 2016
90	.A37–.A41	Added by SSARS No. 25.	February 2020
90	.A47	Added by SSARS No. 25.	February 2020
90	.A57	Amended by SSARS No. 25.	February 2020
90	.A60–.A69	Added by SSARS No. 25.	February 2020
90	.A71–.A75	Added by SSARS No. 25.	February 2020
90	.A76–.A77	Superseded by SSARS No. 25.	February 2020
90	.A78	Amended by SSARS No. 25.	February 2020
90	.A79–.A86	Added by SSARS No. 25.	February 2020
90	.A101–.A106	Added by SSARS No. 25.	February 2020
90	.A116–.A117	Added by SSARS No. 24.	May 2018
90	.A118–.A119	Amended by SSARS No. 24.	May 2018
90	.A119	Added by SSARS No. 25.	February 2020
90	.A120	Added by SSARS No. 24.	May 2018
90	.A121	Amended by SSARS No. 24.	May 2018
90	.A120–.A121	Added by SSARS No. 26.	June 2022
90	.A122	Superseded by SSARS No. 24.	May 2018
90	.A123	Amended by SSARS No. 24.	May 2018
90	.A124–.A125	Added by SSARS No. 24.	May 2018
90	.A124–.A125	Added by SSARS No. 25.	February 2020
90	.A126	Amended by SSARS No. 24.	May 2018
90	.A129	Superseded by SSARS No. 25.	February 2020
90	.A131	Superseded by SSARS No. 23.	October 2016
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90	.A132–.A134	Amended by SSARS No. 23.	October 2016
90	.A132	Amended by SSARS No. 25.	February 2020
90	.A138–.A140	Added by SSARS No. 24.	May 2018
90	.A137–.A140	Superseded by SSARS No. 25.	February 2020
90	.A141–.A142	Amended by SSARS No. 25.	February 2020
90	.A145	Added by SSARS No. 25.	February 2020
90	.A146	Amended by SSARS No. 25.	February 2020
90	.A152–.A156	Added by SSARS No. 25.	February 2020
90	.A157–.A162	Superseded by SSARS No. 25.	February 2020
90	.A168–.A174	Superseded by SSARS No. 25.	February 2020
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ET Section

CODE OF PROFESSIONAL CONDUCT [ET]

Effective December 15, 2014, unless early implemented.

For a feature-enhanced version of this content, visit <http://pub.aicpa.org/codeofconduct>.

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ET Preface

Applicable to All Members

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0.100 Overview of the Code of Professional Conduct

.01 The AICPA Code of Professional Conduct (the code) begins with this preface, which applies to all *members*. The term *member*, when used in part 1 of the code, applies to and means a *member in public practice*; when used in part 2 of the code, applies to and means a *member in business*; and when used in part 3 of the code, applies to and means all other *members*, such as those *members* who are retired or unemployed.

.02 A *member* may have multiple roles, such as a *member in business* and a *member in public practice*. In such circumstances, the *member* should consult all applicable parts of the code and apply the most restrictive provisions. [No prior reference: new content]

Effective Date

.03 Effective December 15, 2014.

0.100.010 Principles and Rules of Conduct

.01 The AICPA membership adopted the Code of Professional Conduct (the code) to provide guidance and rules to all *members* in the performance of their professional responsibilities. The code consists of principles and rules as well as *interpretations* and other guidance which are discussed in 0.100.020. The principles provide the framework for the rules that govern the performance of their professional responsibilities.

.02 The AICPA bylaws require that *members* adhere to the rules of the code. Compliance with the rules depends primarily on *members'* understanding and voluntary actions; secondarily on reinforcement by peers and public opinion; and ultimately on disciplinary proceedings, when necessary, against *members* who fail to comply with the rules. *Members* must be prepared to justify departures from these rules.

0.100.020 Interpretations and Other Guidance

.01 *Interpretations* of the rules of conduct are adopted after exposure to the membership, state societies, state boards, and other interested parties. The *interpretations* of the rules of conduct, "Definitions" [0.400], "Application of the AICPA Code" [0.200.020], and "Citations" [0.200.030], provide guidelines about the scope and application of the rules but are not intended to limit such scope or application. A *member* who departs from the *interpretations* shall have the burden of justifying such departure in any disciplinary hearing. *Interpretations* that existed before the adoption of the code on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior committee.

.02 A *member* should also consult the following, if applicable:

- The ethical requirements of the *member's* state CPA society and authoritative regulatory bodies such as state board(s) of accountancy
- The Securities and Exchange Commission (SEC)
- The Public Company Accounting Oversight Board (PCAOB)
- The Government Accountability Office (GAO)
- The Department of Labor (DOL)
- Federal, state and local taxing authorities

- Any other body that regulates a *member* who performs *professional services* for an entity when the *member* or entity is subject to the rules and regulations of such regulatory body. [Prior reference: Introduction]

0.200 Structure and Application of the AICPA Code

0.200.010 Structure of the AICPA Code

.01 A variety of topics appear in parts 1–3 of the code. When applicable, topics are aligned with the relevant rule or rules of conduct. Topics may be further divided into subtopics, and some subtopics include one or more sections. Topics, subtopics, and sections interpret the rules of conduct (see "Interpretations and Other Guidance" [0.100.020]).

.02 Defined terms (see "Definitions" [0.400]) as well as the plurals and possessives thereof, are shown in *italics* throughout the code. When a defined term is used in the code but is not shown in *italics*, the definition in 0.400 should not be applied. [No prior reference: new content]

Effective Date

.03 Effective December 15, 2014.

0.200.020 Application of the AICPA Code

.01 The Code of Professional Conduct (the code) was originally adopted on January 12, 1988, and was periodically revised through June 1, 2014. On June 1, 2014, the AICPA issued a codification of the code's principles, rules, *interpretations* and rulings (revised code). The revised code will be effective December 15, 2014, excluding the Conceptual Framework sections. These sections, "Conceptual Framework for Members in Public Practice" [1.000.010] and "Conceptual Framework for Members in Business" [2.000.010], will be effective December 15, 2015. *Members* are permitted to implement the revised code prior to December 15, 2014, but a member may not implement the relevant Conceptual Framework prior to implementing the entire revised code. Revisions made subsequent to June 1, 2014, are identified in appendix C, the Revision History Table, which notes the month and year of the change, the effective date of the change, the purpose for the revision, and when possible, a link to the marked revision of the content that appeared in the *Journal of Accountancy*. If the interpretation or paragraph does not contain a specific effective date or a reference to the revision history table, then the content was effective prior to June 1, 2014. [No prior reference: new content.]

.02 When used in the preface of the code, the term *member* includes *members*, *associate members*, and *affiliate members*, as well as international associates of the AICPA.

.03 The rules of conduct apply to all *professional services* performed, except

- a. when the wording of the rule indicates otherwise.
- b. that a *member* who is practicing outside the United States will not be considered in violation of a particular rule for departing from any of the rules stated herein, as long as the *member's* conduct is in accordance with the rules of the organized accounting profession in the country in which he or she is practicing. However,

when a *member* is associated with *financial statements* under circumstances that would lead the reader to assume that practices of the United States were followed, the *member* must comply with the "Compliance With Standards Rule" [1.310.001 for *members in public practice* and 2.310.001 for *members in business*] and the "Accounting Principles Rule" [1.320.001 for *members in public practice* and 2.320.001 for *members in business*].

- c. that a *member* who is a member of a group engagement team (see the clarified Statement on Auditing Standards *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]* [AICPA, *Professional Standards*, AU-C sec. 600]) will not be considered in violation of a particular rule if a foreign component auditor (accountant) departed from any of the rules stated herein with respect to the audit or review of group *financial statements* or other *attest engagement*, as long as the foreign component auditor's (accountant's) conduct, at a minimum, is in accordance with the ethics and *independence* requirements set forth in the International Ethics Standards Board for Accountants' (IESBA's) Code of Ethics for Professional Accountants, and the members of the group engagement team are in compliance with the rules stated therein.
- d. that the *independence* of the *member's firm* will not be considered *impaired* if another *firm* or entity located outside the United States that is within the *member firm's network* departed from any of the rules stated herein, as long as the other *firm* or entity's conduct, at a minimum, is in accordance with the *independence* requirements set forth in the IESBA's Code of Ethics for Professional Accountants.

.04 A *member* shall not knowingly permit a person whom the *member* has the authority or capacity to control to carry out on his or her behalf, either with or without compensation, acts that, if carried out by the *member*, would place the *member* in violation of the rules. Further, a *member* may be held responsible for the acts of all persons associated with the *member in public practice* whom the *member* has the authority or capacity to control.

.05 The *independence* of a *member in public practice* or a *covered member* may be *impaired* with respect to a *client* as the result of the actions or relationships, as described in the "Independence Rule" [1.200.001] and its *interpretations*, of certain persons or entities whom the *member* or *covered member* does not have the authority or capacity to control. Even if the *member* is unable to control the actions or relationships of such persons or entities, the *member's independence* may still be *impaired*. [Prior reference: ET section 91]

.06 The "Breach of an Independence Interpretation" [1.298.010] of the "Independence Rule" [1.200.001] contains guidance with which a *member* should comply if the *member* identifies a breach of an *independence interpretation* of the code. If a *member* identifies a breach of any other provision of this code, the *member* should evaluate the significance of the breach and its effect on the *member's* ability to comply with the rules of the code. The *member* should take whatever actions may be available, as soon as practicable, to satisfactorily address the consequences of the breach. The *member* should determine whether to report the breach, for example, to those who may have been affected by the breach, a professional body, relevant regulator, or oversight authority. In

making the evaluation and in determining what actions should be taken, the *member* should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the *member* at that time, would be likely to conclude that the *member* is able to comply with the rules of the code. A *member's* determination that the *member* has satisfactorily addressed the consequences of the breach will not, however, preclude an investigation or enforcement action concerning the underlying breach of the code and the *member* should be prepared to justify such determination.

Effective Date

.07 Paragraph .01 is effective December 15, 2014. Paragraph .06 is effective March 31, 2016, with early implementation allowed.

[See Revision History Table.]

0.200.030 Citations

Prior ET Sections

.01 The code was revised by codifying the principles, rules, *interpretations*, and rulings. These revisions were effective December 15, 2014. To facilitate implementation of the revised code, the prior ET references from the professional standards of the AICPA are included in Appendix D, "Mapping Document," and in bracketed text at the end of standards, where applicable.

[See Revision History Table.]

Numeric Citations

.02 The numbering system for the code is "ET section X.XXX.XXX." The single digit that begins the citation identifies the part wherein the content resides. Accordingly, content from the preface begins with the single digit 0.XXX.XXX, whereas content for part 1 begins with a 1.XXX.XXX, part 2 with 2.XXX.XXX, and part 3 with a 3.XXX.XXX.

.03 Next are two sets of three digit numbers that identify the topics and, when applicable, subtopics or sections. When a topic, subtopic or section appears in two or more parts of the code, the same number is used. For example, the "Acts Discreditable Rule" appears in parts 1, 2, and 3 and the citations for this rule are 1.400.001, 2.400.001, and 3.400.001, respectively. Accordingly, the two sets of three digit numbers remain the same with only the first digit changing.

.04 When only two digits appear, those digits represent the paragraph number. For example, the complete citation for this paragraph would be 0.200.030.04.

.05 All bracketed section references, such as [0.200.030.04] refer to sections within the Code of Professional Conduct. [No prior reference: new content]

Effective Date

.06 Effective December 15, 2014.

0.200.040 Transition Provisions

.01 The text of the transition provisions in effect as of May 31, 2013, has not been codified because the transition provisions apply to a limited number of situations. Nevertheless, these transition provisions are still authoritative. The texts of these transition provisions are available at <https://us.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Transition%20Periods.pdf>. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

0.200.050 Drafting Conventions

.01 The code utilizes certain drafting conventions to enhance the clarity of the interpretations and definitions. For example, when the term "should consider" is used in connection with a specified procedure or action, consideration of the procedure or action by the member is presumptively required. Actual performance of the action or procedure is up to the member, based upon the outcome of the member's consideration and the member's professional judgment. Other drafting conventions used in the code include use of the terms "consider," "evaluate," and "determine," as follows:

- a. "Consider" is used when the member is required to think about several matters.
- b. "Evaluate" is used when the member has to assess and weigh the significance of a matter.
- c. "Determine" is used when the member has to come to a conclusion and make a decision on a matter. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

A complete nonauthoritative guide, *Drafting Guide—Drafting Guidelines for Integrating the Conceptual Framework and Drafting Conventions and Style Guidance*, is also available at <https://us.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Drafting%20Guide.pdf>.

0.300 Principles of Professional Conduct

0.300.010 Preamble

.01 Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a *member* assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

.02 These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to *clients*, and to colleagues. They guide *members* in the performance of their professional responsibilities and express

the basic tenets of ethical and professional conduct. The Principles call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage. [Prior reference: ET section 51]

0.300.020 Responsibilities

.01 *Responsibilities principle.* In carrying out their responsibilities as professionals, *members* should exercise sensitive professional and moral judgments in all their activities.

.02 As professionals, *members* perform an essential role in society. Consistent with that role, *members* of the American Institute of Certified Public Accountants have responsibilities to all those who use their *professional services*. *Members* also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all *members* are required to maintain and enhance the traditions of the profession. [Prior reference: ET section 52]

0.300.030 The Public Interest

.01 *The public interest principle.* *Members* should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate a commitment to professionalism.

.02 A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of *clients*, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of *members* to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on *members*. The public interest is defined as the collective well-being of the community of people and institutions that the profession serves.

.03 In discharging their professional responsibilities, *members* may encounter conflicting pressures from each of those groups. In resolving those conflicts, *members* should act with integrity, guided by the precept that when *members* fulfill their responsibility to the public, *clients'* and employers' interests are best served.

.04 Those who rely on *members* expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

.05 All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, *members* should seek to continually demonstrate their dedication to professional excellence. [Prior reference: ET section 53]

0.300.040 Integrity

.01 *Integrity principle.* To maintain and broaden public confidence, *members* should perform all professional responsibilities with the highest sense of integrity.

.02 Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a *member* must ultimately test all decisions.

.03 Integrity requires a *member* to be, among other things, honest and candid within the constraints of *client* confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and honest difference of opinion; it cannot accommodate deceit or subordination of principle.

.04 Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance or in the face of conflicting opinions, a *member* should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a *member* to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

.05 Integrity also requires a *member* to observe the principles of objectivity and independence and of due care. [Prior reference: ET section 54]

0.300.050 Objectivity and Independence

.01 *Objectivity and independence principle.* A *member* should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A *member* in public practice should be independent in fact and appearance when providing auditing and other attestation services.

.02 Objectivity is a state of mind, a quality that lends value to a *member's* services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. *Independence* precludes relationships that may appear to impair a *member's* objectivity in rendering attestation services.

.03 *Members* often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. *Members* in public practice render attest, tax, and management advisory services. Other *members* prepare *financial statements* in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, *members* should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

.04 For a *member* in public practice, the maintenance of objectivity and *independence* requires a continuing assessment of *client* relationships and public responsibility. Such a *member* who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a *member* should maintain objectivity and avoid conflicts of interest.

.05 Although *members* not in public practice cannot maintain the appearance of *independence*, they nevertheless have the responsibility to maintain objectivity in rendering *professional services*. *Members* employed by others to prepare *financial statements* or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as *members* in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with *members* in public practice. [Prior reference: ET section 55]

0.300.060 Due Care

.01 *Due care principle.* A *member* should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the *member's* ability.

.02 The quest for excellence is the essence of due care. Due care requires a *member* to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform *professional services* to the best of a *member's* ability, with concern for the best interest of those for whom the services are performed, and consistent with the profession's responsibility to the public.

.03 Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a *member's* professional life. It is a *member's* individual responsibility. In all engagements and in all responsibilities, each *member* should undertake to achieve a level of competence that will assure that the quality of the *member's* services meets the high level of professionalism required by these Principles.

.04 Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a *member* to render services with facility and acumen. It also establishes the limitations of a *member's* capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a *member* or a *member's* firm. Each *member* is responsible for assessing his or her own competence of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

.05 *Members* should be diligent in discharging responsibilities to *clients*, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

.06 Due care requires a *member* to plan and supervise adequately any professional activity for which he or she is responsible. [Prior reference: ET section 56]

0.300.070 Scope and Nature of Services

.01 *Scope and nature of services principle.* A *member* in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.

.02 The public interest aspect of *members'* services requires that such services be consistent with acceptable professional behavior for *members*. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and *independence* require that *members* be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

.03 Each of these Principles should be considered by *members* in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific *client*. No hard-and-fast rules can be

developed to help *members* reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

.04 In order to accomplish this, *members* should

- a. Practice in *firms* that have in place internal quality control procedures to ensure that services are competently delivered and adequately supervised.
- b. Determine, in their individual judgments, whether the scope and nature of other services provided to an audit *client* would create a conflict of interest in the performance of the audit function for that *client*.
- c. Assess, in their individual judgments, whether an activity is consistent with their role as professionals. [Prior reference: ET section 57]

0.400 Definitions

Pursuant to its authority under the bylaws (paragraph .01 [3.6.2.2] of BL section 360, *Committees* [AICPA, *Professional Standards*]) to interpret the code, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code.

.01 Acceptable level. In connection with *independence*, an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's independence* is not *impaired*. When used in connection with any rule but the "Independence Rule" [1.200.001] an acceptable level is a level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's* compliance with the rules is not compromised. [Prior reference: ET section 100-1 and new content]

Effective Date

When this definition is used in connection with any rule but the "Independence Rule" [1.200.001] it is effective December 15, 2014.

.02 Affiliate. The following entities are affiliates of a *financial statement attest client*:

- a. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a *financial statement attest client* can control.
- b. An entity in which a *financial statement attest client* or an entity controlled by the *financial statement attest client* has a *direct financial interest* that gives the *financial statement attest client* *significant influence* over such entity and that is material to the *financial statement attest client*.
- c. An entity (for example, parent, partnership, or LLC) that controls a *financial statement attest client* when the *financial statement attest client* is material to such entity.
- d. An entity with a *direct financial interest* in the *financial statement attest client* when that entity has *significant influence* over the *financial statement attest client*, and the interest in the *financial statement attest client* is material to such entity.

- e. A sister entity of a *financial statement attest client* if the *financial statement attest client* and sister entity are each material to the entity that *controls* both.
- f. A trustee that is deemed to *control* a trust *financial statement attest client* that is not an investment company.
- g. The sponsor of a single employer employee benefit plan *financial statement attest client*.
- h. Any entity, such as a union, participating employer, or a group association of employers, that has *significant influence* over a multiemployer employee benefit plan *financial statement attest client* and the plan is material to such entity.
- i. The participating employer that is the plan administrator of a multiple employer employee benefit plan *financial statement attest client*.
- j. A single or multiple employer employee benefit plan sponsored by either a *financial statement attest client* or an entity *controlled* by the *financial statement attest client*. All participating employers of a multiple employer employee benefit plan are considered sponsors of the plan.
- k. A multiemployer employee benefit plan when a *financial statement attest client* or entity *controlled* by the *financial statement attest client* has *significant influence* over the plan and the plan is material to the *financial statement attest client*.
- l. An investment adviser, a general partner, or a trustee of an investment company *financial statement attest client* (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either *control* or *significant influence* over the fund. When considering materiality, *members* should consider investments in, and fees received from, the fund.

See the "State and Local Government Client Affiliates" interpretation [1.224.020] for guidance related to identifying affiliates of a financial statement attest client that is a state and local government. [Prior reference: paragraph .20 of ET section 101]

[See Revision History Table.]

Nonauthoritative questions and answers related to the application of the independence rules to affiliates of employee benefit plans are available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/tools/downloadabledocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf>.

Nonauthoritative question and answer related to the application of the affiliate definition to individuals is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>

.03 Attest client. A person or entity with respect to which an *attest engagement* is performed. [No prior reference: new content]

If the person or entity that engages a *member* or *member's firm* (member) to perform *professional services* (engaging entity) is not also the *attest client*, the member should refer to the "Client Affiliate" interpretation [1.224.010] to determine whether the engaging entity is an *affiliate* from which the member should be independent. However, because threats to the member's compliance

with the "Integrity and Objectivity Rule" [1.100.001] and the "Conflicts of Interest for Members in Public Practice" interpretation [1.110.010] may still exist with respect to the engaging entity, members should comply with this rule and interpretation.

See paragraph .06 of the "Client Affiliate" interpretation [1.224.010] for acquisitions and business combinations that involve a *financial statement attest client*.

See paragraph .03 of the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] for independence guidance related to a member in a government audit organization that performs an *attest engagement* with respect to the government entity.

Effective Date

This definition is effective December 15, 2014.

[See Revision History Table.]

.04 Attest engagement. An engagement that requires *independence*, as set forth in the AICPA Statements on Auditing Standards (SASs), Statements on Standards for Accounting and Review Services (SSARs), and Statements on Standards for Attestation Engagements (SSAEs). [Prior reference: paragraph .01 of ET section 92]

.05 Attest engagement team. Those individuals participating in the *attest engagement*, including those who perform concurring and engagement quality reviews. The attest engagement team includes all employees and contractors retained by the *firm* who participate in the *attest engagement*, regardless of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists, as discussed in AU-C section 620, *Using the Work of an Auditor's Specialist* (AICPA, *Professional Standards*), and individuals who perform only routine clerical functions, such as word processing and photocopying. [Prior reference: paragraph .02 of ET section 92]

.06 Beneficially owned, beneficial ownership interest. Describes a *financial interest* providing an individual or entity the right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or disposition of the interest or to receive the economic benefits of the ownership of the interest. [Prior reference: paragraph .17 of ET section 101]

.07 Client. Any person or entity, other than the *member's* employer that engages a *member* or *member's firm* to perform *professional services* (engaging entity) and also, a person or entity with respect to which a *member* or *member's firm* performs *professional services* (subject entity). When the engaging entity and the subject entity are different, while there is only one engagement, they are separate clients.

[Prior reference: paragraph .03 of ET section 92]

See paragraph .03 of the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] for independence guidance related to a *member* in a government audit organization that performs an *attest engagement* with respect to the government entity.

[See Revision History Table.]

.08 Close relative. A parent, sibling, or nondependent child. [Prior reference: paragraph .04 of ET section 92]

.09 Confidential client information. Any information obtained from the *client* that is not available to the public. Information that is available to the public includes, but is not limited to, information

- a. in a book, periodical, newspaper, or similar publication;
- b. in a *client* document that has been released by the *client* to the public or that has otherwise become a matter of public knowledge;
- c. on publicly accessible websites, databases, online discussion forums, or other electronic media by which members of the public can access the information;
- d. released or disclosed by the *client* or other third parties in media interviews, speeches, testimony in a public forum, presentations made at seminars or trade association meetings, panel discussions, earnings press release calls, investor calls, analyst sessions, investor conference presentations, or a similar public forum;
- e. maintained by, or filed with, regulatory or governmental bodies that is available to the public; or
- f. obtained from other public sources.

Unless the particular *client* information is available to the public, such information should be considered confidential client information. *Members* are advised that federal, state, or local statutes, rules, or regulations concerning confidentiality of *client* information may be more restrictive than the requirements in the code. [Prior reference: paragraph .05 of ET section 92]

.10 Control (s) (led). As used in FASB *Accounting Standards Codification* (ASC) 810, *Consolidation*. When used in the "Client Affiliates" interpretation [1.224.010] of the "Independence Rule" [1.200.001], control depends upon the entity in question. For example, when used for not-for-profit entities, control is as used in FASB ASC 958-805-20; for commercial entities, control is as used in FASB ASC 810. [Prior reference: numerous ET sections; also see "Breakdown of the Term Control in the Code" at <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/breakdown-of-the-term-control.pdf>]

.11 Council. The AICPA Council. [Prior reference: paragraph .06 of ET section 92]

.12 Covered member. All of the following:

- a. an individual on the *attest engagement team*.
- b. an *individual in a position to influence the attest engagement*.
- c. a *partner, partner equivalent, or manager* who provides 10 or more hours of nonattest services to the who provides more than 10 hours of nonattest services to the *attest client* within any fiscal year. Designation as *covered member* ends on the later of (i) the date that the *firm* signs the report on the *financial statements* for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the *attest client* on a recurring basis.
- d. a *partner or partner equivalent* in the *office* in which the lead *attest engagement partner or partner equivalent* primarily practices in connection with the *attest engagement*.
- e. the *firm*, including the *firm's* employee benefit plans.

- f. an entity whose operating, financial, or accounting policies can be *controlled* by any of the individuals or entities described in items a–e or two or more such individuals or entities if they act together. [Prior reference: paragraph .07 of ET section 92]

Effective Date

The addition of partner equivalents to this definition is effective for engagements covering periods beginning on or after December 15, 2014.

.13 Direct financial interest. A *financial interest* that is

- a. owned directly by an individual or entity, including those managed on a discretionary basis by others.
- b. under the control of an individual or entity, including those managed on a discretionary basis by others.
- c. *beneficially owned* through an investment vehicle, estate, trust, or other intermediary when the beneficiary
 - i. controls the intermediary or
 - ii. has the authority to supervise or participate in the intermediary's investment decisions.

When used in this definition, the term control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*. [Prior reference: paragraph .17 of ET section 101]

.14 Employing organization. Any entity that employs the *member* or engages the *member* on a contractual or volunteer basis in an executive, a staff, a governance, an advisory, or an administrative capacity to provide *professional services*. [No prior reference: new content]

Effective Date

This definition is effective December 15, 2014.

.15 Financial interest. An ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest. [Prior reference: paragraph .17 of ET section 101]

.16 Financial statement attest client. An entity whose *financial statements* are audited, reviewed, or compiled when the *member's* compilation report does not disclose a lack of *independence*. [Prior reference: paragraph .20 of ET section 101]

.17 Financial statements. A presentation of financial data, including accompanying disclosures, if any, intended to communicate an entity's economic resources or obligations, or both, at a point in time or the changes therein for a period of time, in accordance with the applicable financial reporting framework. Incidental financial data to support recommendations to a *client* or in (a) documents for which the reporting is governed by SSAEs and (b) tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion. [Prior reference: paragraph .10 of ET section 92]

.18 Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the *Council* and that is engaged in *public practice*. A firm includes the individual *partners* thereof, except for purposes of applying the "Independence Rule" [1.200.001] and related *interpretations*. For purposes of applying the "Independence Rule," a firm includes a *network*

firm when the engagement is either a *financial statement* audit or review engagement and the audit or review report is not restricted, as set forth in the AICPA SASs and SSARs (AICPA, *Professional Standards*). [Prior reference: paragraph .11 of ET section 92]

.19 Immediate family. A spouse, spousal equivalent, or dependent (regardless of whether the dependent is related). [Prior reference: paragraph .13 of ET section 92]

.20 Impair(ed)(ing). In connection with *independence*, to effectively extinguish *independence*. When a *member's independence* is impaired, the *member* is not independent. [Prior reference: paragraph .09 of ET section 100-1]

.21 Independence. Consists of two elements, defined as follows:

- a. Independence of mind is the state of mind that permits a *member* to perform an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- b. Independence in appearance is the avoidance of circumstances that would cause a reasonable and informed third party who has knowledge of all relevant information, including the *safeguards* applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a *firm* or member of the *attest engagement team* is compromised.

This definition should not be interpreted as an absolute. For example, the phrase "without being affected by influences that compromise professional judgment" is not intended to convey that the *member* must be free of any and all influences that might compromise objective judgment. Instead, the *member* should determine whether such influences, if present, create a *threat* that is not at an *acceptable level* that a *member* would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement or would be perceived as not being able to do so by a reasonable and informed third party with knowledge of all relevant information. [Prior reference: paragraphs .06–.08 of ET section 100-1]

.22 Indirect financial interest. A *financial interest* *beneficially owned* through an investment vehicle, an estate, a trust, or an other intermediary when the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions. When used in this definition, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*. [Prior reference: paragraph .17 of ET section 101]

.23 Individual in a position to influence the attest engagement. One who

- a. evaluates the performance or recommends the compensation of the *attest engagement partner*;
- b. directly supervises or manages the *attest engagement partner*, including all successively senior levels above that individual through the *firm's* chief executive;
- c. consults with the *attest engagement team* regarding technical or industry-related issues specific to the *attest engagement*; or

- d. participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific *attest engagement*.

[Prior reference: paragraph .14 of ET section 92]

.24 Institute. The AICPA. [Prior reference: paragraph .15 of ET section 92]

.25 Interpretation. Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct. [Prior reference: paragraph .16 of ET section 92]

.26 Joint closely held investment. An investment in an entity or a property by the *member* and the *attest client* (or the *attest client's* officers or directors or any owner who has the ability to exercise *significant influence* over the *attest client*) that enables them to *control* the entity or property. [Prior reference: paragraph .17 of ET section 92]

[See Revision History Table.]

.27 Key position. A position in which an individual has

- a. primary responsibility for significant accounting functions that support material components of the *financial statements*;
- b. primary responsibility for the preparation of the *financial statements*; or
- c. the ability to exercise influence over the contents of the *financial statements*, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of *attest engagements* not involving *financial statements*, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the *attest engagement*, as previously described. [Prior reference: paragraph .18 of ET section 92]

[See Revision History Table.]

.28 Lending institution. An entity that, as part of its normal business operations, makes *loans*. This definition is not meant to include an organization that might schedule payment for services for a client over a period of time. Examples of such entities are banks, credit unions, certain retailers, and insurance and finance companies. For example, for automobile leases addressed by the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001], an entity is considered a lending institution if it leases automobiles as part of its normal business operations. [Prior reference: paragraph .09 of ET section 92]

Effective Date

This revised definition is effective December 15, 2014.

.29 Loan. A contractual obligation to pay or right to receive money on demand or on a fixed or determinable date and includes a stated or implied rate of return to the lender. For purposes of this definition, loans include, among other things, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment. However, for purposes of this definition, a loan would not include debt

securities (which are considered a *financial interest*) or lease arrangements. [Prior reference: paragraph .19 of ET section 92]

Effective Date

This revised definition is effective December 15, 2014.

.30 Manager. A professional employee of the *firm* who has continuing responsibility for the planning and supervision of engagements for specified *clients*. [Prior reference: paragraph .20 of ET section 92]

.31 Member. A member, associate member, affiliate member, or international associate of the AICPA. When the term member is used in part 1 of the code, it means a member in *public practice*; when used in part 2 of the code, it means a *member in business*; and when used in part 3 of the code, it means all other members. [Prior reference: paragraph .21 of ET section 92]

.32 Member(s) in business. A *member* who is employed or engaged on a contractual or volunteer basis in a(n) executive, staff, governance, advisory, or administrative capacity in such areas as industry, the public sector, education, the not-for-profit sector, and regulatory or professional bodies. This does not include a *member* engaged in *public practice*. [Prior reference: paragraph .22 of ET section 92]

.33 Network. For purposes of the "Network and Network Firms" interpretation [1.220.010] of the "Independence Rule" [1.200.001], a network is an association of entities that includes one or more *firms* that (a) cooperate for the purpose of enhancing the *firms'* capabilities to provide *professional services* and (b) share one or more of the following characteristics:

- a. The use of a common brand name, including common initials, as part of the *firm* name
- b. Common *control* among the *firms* through ownership, management, or other means
- c. Profits or costs, excluding costs of operating the association; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the *firm*
- d. A common business strategy that involves ongoing collaboration amongst the *firms* whereby the *firms* are responsible for implementing the association's strategy and are held accountable for performance pursuant to that strategy
- e. A significant part of professional resources
- f. Common quality control policies and procedures that *firms* are required to implement and that are monitored by the association

A network may comprise a subset of entities within an association only if that subset of entities cooperates and shares one or more of the characteristics set forth in the preceding list. [Prior reference: paragraph .23 of ET section 92]

.34 Network firm. A *firm* or other entity that belongs to a *network*. This includes any entity (including another *firm*) that the network firm, by itself or through one or more of its owners, *controls*, is *controlled* by, or is under common *control* with. [Prior reference: paragraph .24 of ET section 92]

.35 Normal lending procedures, terms, and requirements. In connection with a *covered member's* loan from a *lending institution*, lending procedures, terms, and requirements that are reasonably comparable with those relating to *loans* of a similar character committed to other borrowers during the period in which the *loan* to the *covered member* is committed. Accordingly, in

making such comparison and evaluating whether a *loan* was made under normal lending procedures, terms, and requirements, the *covered member* should consider all the circumstances under which the *loan* was granted, including the following:

- a. The amount of the *loan* in relation to the value of the collateral pledged as security and the credit standing of the *covered member*
- b. Repayment terms
- c. Interest rate, including points
- d. Closing costs
- e. General availability of such *loans* to the public

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such *lending institutions*. Broker-dealers, for example, are subject to regulation by the SEC. [Prior reference: paragraph .25 of ET section 92]

.36 Office. A reasonably distinct subgroup within a *firm*, whether constituted by formal organization or informal practice, in which personnel who make up the subgroup generally serve the same group of *clients* or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location. [Prior reference: paragraph .26 of ET section 92]

.37 Partner. A proprietor, a shareholder, an equity or a nonequity partner, or any individual who assumes the risks and benefits of *firm* ownership or is otherwise held out by the *firm* to be the equivalent of any of the aforementioned. [Prior reference: paragraph .27 of ET section 92]

.38 Partner equivalent. A professional employee who is not a *partner* of the *firm* but who either

- a. has the ultimate responsibility for the conduct of an *attest engagement*, including the authority to sign or affix the *firm's* name to an attest report or issue, or authorize others to issue, an attest report on behalf of the *firm* without *partner* approval; or
- b. has the authority to bind the *firm* to conduct an *attest engagement* without *partner* approval. For example, the professional employee has the authority to sign or affix the *firm's* name to an *attest engagement* letter or contract to conduct an *attest engagement* without *partner* approval.

Firms may use different titles to refer to professional employees with this authority, although a title is not determinative of a partner equivalent. For purposes of this definition, *partner* approval does not include any partner approvals that are part of the *firm's* normal approval and quality control review procedures applicable to a partner.

This definition is solely for the purpose of applying the "Independence Rule" [1.200.001] and its *interpretations* and should not be used or relied upon in any other context, including the determination of whether the partner equivalent is an owner of the *firm*. [Prior reference: paragraph .28 of ET section 92.]

Effective Date

This definition is effective for engagements covering periods beginning on or after December 15, 2014.

.39 Period of the professional engagement. The period begins when a *member* either signs an initial engagement letter or other agreement to perform attest services or begins to perform an *attest engagement*, whichever is earlier. The period lasts for the entire duration of the professional relationship, which could cover many periods, and ends with the formal or informal notification, either by the *member* or *client*, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's *attest engagement*. [Prior reference: paragraph .29 of ET section 92]

[See Revision History Table.]

.40 Professional services. Include all services requiring accountancy or related skills that are performed by a *member* for a *client*, an employer, or on a volunteer basis. These services include, but are not limited to accounting, audit and other attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by *Council*. [Prior reference: paragraph .31 of ET section 92]

.41 Public interest entities. All of the following:

- a. All listed entities, including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body.
- b. Any entity for which an audit is required by regulation or legislation to be conducted in compliance with the same *independence* requirements that apply to an audit of listed entities (for example, requirements of the SEC, the PCAOB, or other similar regulators or standard setters).

Members may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include

- the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders;
- size; and
- number of employees.

Members should refer to the *independence* regulations of applicable authoritative regulatory bodies when a *member* performs attest services and is required to be independent of the *attest client* under such regulations. [Prior reference: paragraph .20 of ET section 100-1]

[See Revision History Table.]

.42 Public practice. Consists of the performance of *professional services* for a *client* by a *member* or *member's firm*. [Prior reference: paragraph .30 of ET section 92]

.43 Safeguards. Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*. [Prior reference: paragraph .20 of ET section 100-1]

.44 Share-based compensation arrangements. As defined in the FASB ASC glossary under the term share-based payment arrangements. [Prior reference: paragraph .02 ET section 101]

.45 Significant influence. As defined in FASB ASC 323-10-15. [Prior reference: paragraph .32 of ET section 92]

.46 Source documents. The documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports that do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Prior reference: footnote 17 in paragraph .05 of ET section 101]

.47 Third-party service provider. All of the following:

- a. An entity that the *member* does not *control*, individually or collectively with his or her *firm* or with *members* of his or her *firm*.
- b. An individual not employed by the *member* who assists the *member* in providing *professional services* to *clients* (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions). [Prior reference: paragraphs .224–.225 of ET section 191, .023–.024 of ET section 291, and .001–.002 of ET section 391]

.48 Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

When an *interpretation* requires communicating with those charged with governance, the *member* should determine the appropriate person(s) within the entity's governance structure with whom to communicate, based on the nature and importance of the particular circumstances and matter to be communicated. If the *member* communicates with a subgroup of those charged with governance (for example, an audit committee or an individual), the *member* should determine whether communication with all of those charged with governance is also necessary, so that they are adequately informed. [Prior reference: paragraph .33 of ET section 92]

Effective Date

This definition is effective April 30, 2014.

.49 Threat(s). In connection with independence, threats are relationships or circumstances that could *impair independence*. In connection with any rule but the "Independence Rule" [1.200.001], threats are relationships or circumstances that could compromise a *member's* compliance with the rules. [Prior reference: paragraph .10 of ET section 100-1]

Effective Date

When this definition is used in connection with any rule but the "Independence Rule" it is effective December 15, 2014.

0.500 Nonauthoritative Guidance

.01 The code is the only authoritative source of AICPA ethics rules and *interpretations*. The staff of the Professional Ethics Division has issued nonauthoritative guidance to assist *members* and others in their implementation of the code. Such guidance does not amend or override the code. Further, the guidance is not meant to be exhaustive and does not establish best practices, set

standards, or serve as official pronouncements of the AICPA. These documents were not approved in accordance with normal due process, which requires proposed changes to be exposed to the public and requires consideration of *members'* and others' comments.

.02 References to relevant nonauthoritative guidance, when available, are provided throughout the code in boxed text at the end of the applicable *interpretation*. [No prior reference: new content]

Effective Date

.03 Effective December 15, 2014.

0.600 New, Revised, and Pending Interpretations and Other Guidance

0.600.010 New and Revised Interpretations and Other Guidance

.01 Periodically, new or revised authoritative ethics *interpretations* and other guidance are issued. Publication of the text of a new or revised pronouncement or a notice with a link to the text of a new or revised authoritative *interpretation* and other guidance in the *Journal of Accountancy* constitutes notice to *members*. Hence, the effective date of the *interpretation* and other guidance is the last day of the month in which the pronouncement or notice is published in the *Journal of Accountancy*, unless otherwise noted. The Professional Ethics Division takes into consideration the time that would have been reasonable for the *member* to comply with the pronouncement. This section lists the citation and title of any new or revised *interpretation* or other guidance for a period of 12 months after its effective date. When an *interpretation* or other guidance is not yet effective, it will appear as a pending *interpretation* or other guidance (see "Pending Interpretations and Other Guidance" [0.600.020]).

- "Information Systems Services" [1.295.145] (Revised June 2019. Effective January 1, 2023. Early implementation permitted.)
- "State and Local Government Client Affiliates" [1.224.020] (Revised June 2019. Effective for years beginning after December 15, 2021.)
- Temporary Enforcement Policies [0.600.030.03] (Added December 21, 2021. Effective November 16, 2021.)
- Staff Augmentation Arrangements [1.275.007] (Added March 2021. Effective November 30, 2021.)
- Client Affiliates [1.224.010] (Revised March 2021. Effective November 30, 2021.)
- Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs [1.297.020] (Revised March 2021. Effective November 30, 2021.)
- Scope and Applicability of Nonattest Services [1.295.010] (Revised March 2021. Effective November 30, 2021.)
- Records Requests [1.400.200] (Revised March 2021. Effective July 31, 2021.)
- "Responding to Noncompliance With Laws and Regulations" [1.180.010 and 2.180.010] (Added May 2022. Effective June 30, 2023. Early implementation permitted.)

- "Ethical Conflicts" [1.000.020 and 2.000.020] (Revised May 2022. Effective June 30, 2023. Early implementation permitted.)
- "Assisting Attest Clients With Implementing Accounting Standards" [1.295.113] (Added May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Unpaid Fees" [1.230.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- Definition of "beneficially owned" [0.400.06] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Conceptual Framework for Independence" [1.210.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Client Affiliates" [1.224.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Loans" [1.260.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Loans and Leases With Lending Institutions" [1.260.020] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Immediate Family Members" [1.270.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)

Effective Date

.02 Paragraph .01, excluding the bulleted text, is effective December 15, 2014.

0.600.020 Pending Interpretations and Other Guidance

.01 Periodically, new or revised authoritative ethics *interpretations* and other guidance are issued. This section lists the titles and citations of any pending new or revised *interpretations* or other guidance until they are effective and notes whether early application is permitted or encouraged. Once the *interpretation* or other guidance becomes effective, it will appear under the "New and Revised Interpretation and Other Guidance" section of the preface [0.600.010].

- "Information Systems Services" [1.295.145] (Revised June 2019. Effective January 1, 2023. Early implementation permitted.)
- "Responding to Noncompliance With Laws and Regulations" [1.180.010 and 2.180.010] (Added May 2022. Effective June 30, 2023. Early implementation permitted.)
- "Ethical Conflicts" [1.000.020 and 2.000.020] (Revised May 2022. Effective December 15, 2014.)
- "Assisting Attest Clients With Implementing Accounting Standards" [1.295.113] (Added May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Unpaid Fees" [1.230.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- Definition of "beneficially owned" [0.400.06] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)

- "Conceptual Framework for Independence" [1.210.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Client Affiliates" [1.224.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Loans" [1.260.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Loans and Leases With Lending Institutions" [1.260.020] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)
- "Immediate Family Members" [1.270.010] (Revised May 2022. Effective December 31, 2022. Early implementation permitted.)

Effective Date

.02 Paragraph .01, excluding the bulleted text, is effective December 15, 2014.

0.600.030 Temporary Enforcement Policies

.01 Periodically the Professional Ethics Executive Committee (PEEC) may publicly agree not to take enforcement action in certain circumstances and may issue a temporary enforcement policy. This section sets forth any temporary enforcement policies that are in effect.

.02 Temporary Policy Statement of the AICPA Professional Ethics Executive Committee Related to Amendments of Rule 2-01 of Regulation S-X.

On October 16, 2020, the SEC announced that it adopted final amendments to certain auditor independence requirements in Rule 2-01 of Regulation S-X (SEC amendments). The SEC amendments will be effective on June 9, 2021, with early adoption permitted. PEEC has agreed to evaluate the SEC amendments and determine if any revisions should be made to the AICPA Code of Professional Conduct (code) in light of the SEC amendments. While this evaluation is underway, PEEC will consider a member to be in compliance with the code if the member implements and complies with the SEC amendments or complies with the existing code. This temporary enforcement policy will be effective until PEEC rescinds it. [Adopted December 21, 2020.]

.03 Temporary policy statement of the AICPA Professional Ethics Executive Committee related to simultaneous employment or association with an attest client and the Uniformed Services Employment and Reemployment Rights Act (USERRA) and parallel state statutes.

USERRA and parallel state statutes provide certain employment protections to individuals who serve, may serve, or have served in the armed services. On November 16, 2021, PEEC agreed it will consider a member or member's firm to be in compliance with the code if the member or member's firm employs individuals who serve in federal or state armed services and provides attest services to the armed services, as long as the individual is not in a key position with the armed services attest client, is not in a position to influence the attest engagement and is not on the attest engagement team. This temporary enforcement policy will be effective until PEEC rescinds it. [Adopted November 16, 2021]

Effective Date

.04 Paragraph .01 is effective December 21, 2020.

[See Revision History Table.]

0.700 Deleted Interpretations and Other Guidance

.01 The following interpretations and other guidance were deleted from the code during the 10 years prior to the 2014 edition:

- Definition of *holding out* (ET sec. 92 par. .12) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 65, "Use of the CPA Designation by Member Not in Public Practice" (ET sec. 191 par. .130) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 38, "CPA Title, Controller of Bank" (ET sec. 591 par. .075–.076) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 78, "Letterhead: Lawyer-CPA" (ET sec. 591 par. .155–.156) (Deleted March 2013, effective May 31, 2013)
- Ethics Ruling No. 134, "Association of Accountants Not Partners" (ET sec. 591 par. .267–.268) (Deleted August 2012)
- Ethics Ruling No. 74, "Audits, Reviews, or Compilations and a Lack of Independence" (ET sec. 191 par. .148–.149) (Deleted April 2012).
- Ethics Ruling No. 135, "Association of Firms Not Partners" (ET sec. 591 par. .269–.270) (Deleted April 2012).
- Interpretation No. 101-8, "Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Covered Member's Client" (ET sec. 101 par. .10) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18.***)
- Ethics Ruling No. 9, "Member as Representative of Creditor's Committee" (ET sec. 191 par. .017–.018) (Deleted November 2011)
- Ethics Ruling No. 10, "Member as Legislator" (ET sec. 191 par. .019–.020) (Deleted November 2011)
- Ethics Ruling No. 12, "Member as Trustee of Charitable Foundation" (ET sec. 191 par. .023–.024) (Deleted November 2011)
- Ethics Ruling No. 16, "Member on Board of Directors of Nonprofit Social Club" (ET sec. 191 par. .031–.032) (Deleted November 2011)
- Ethics Ruling No. 19, "Member on Deferred Compensation Committee" (ET sec. 191 par. .037–.038) (Deleted November 2011)
- Ethics Ruling No. 21, "Member as Director and Auditor of an Entity's Profit Sharing and Retirement Trust" (ET sec. 191 par. .041–.042) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 29, "Member as Bondholder" (ET sec. 191 par. .057–.058) (Deleted November 2011)
- Ethics Ruling No. 38, "Member as Co-Fiduciary With Client Bank" (ET sec. 191 par. .075–.076) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 48, "Faculty Member as Auditor of a Student Fund" (ET sec. 191 par. .095–.096) (Deleted November 2011)

- Ethics Ruling No. 60, "Employee Benefit Plans—Member's Relationships With Participating Employer," (ET sec. 191 par. .119–.120) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 69, "Investment With a General Partner" (ET sec. 191 par. .138–.139) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 81, "Member's Investment in a Limited Partnership" (ET sec. 191 par. .162–.163) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 98, "Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client" (ET sec. 191 par. .196–.197) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 103, "Attest Report on Internal Controls" (ET sec. 191 par. .206–.207) (Deleted November 2011)
- Ethics Ruling No. 106, "Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client" (ET sec. 191 par. .212–.213) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 111, "Employee Benefit Plan Sponsored by Client" (ET sec. 191 par. .222–.223) (Deleted November 2011. ***Reestablished and effective October 31, 2012 until the earlier of January 1, 2014, or adoption of Interpretation 101-18***)
- Ethics Ruling No. 11, "Applicability of Rule 203 to Members Performing Litigation Support Services" (ET sec. 291 par. .021–.022) (Deleted November 2011)
- Ethics Ruling No. 2, "Fees: Collection of Notes Issued in Payment" (ET sec. 591 par. .003–.004) (Deleted November 2011)
- Ethics Ruling No. 33, "Course Instructor" (ET sec. 591 par. .065–.066) (Deleted November 2011)
- Ethics Ruling No. 108, "Member Interviewed by the Press" (ET sec. 591 par. .215–.216) (Deleted November 2011)
- Ethics Ruling No. 117, "Consumer Credit Company Director" (ET sec. 591 par. .233–.234) (Deleted November 2011)
- Ethics Ruling No. 140, "Political Election" (ET sec. 591 par. .279–.280) (Deleted November 2011)
- Ethics Ruling No. 144, "Title: Partnership Roster" (ET sec. 591 par. .287–.288) (Deleted November 2011)
- Ethics Ruling No. 176, "Member's Association With Newsletters and Publications" (ET sec. 591 par. .351–.352) (Deleted November 2011)
- Ethics Ruling No. 177, "Data Processing: Billing Services" (ET sec. 591 par. .353–.354) (Deleted November 2011)

- Ethics Ruling No. 179, "Practice of Public Accounting Under Name of Association or Group" (ET sec. 591 par. .357–.358) (Deleted November 2011)
- Ethics Ruling No. 101, "Client advocacy and Expert Witness Services" (ET sec. 191 par. .202–.203) (Deleted July 2007)
- Ethics Ruling No. 182, "Termination of Engagement Prior to Completion" (ET sec. 591 par. .363–.364) (Deleted April 2006).
- Ethics Ruling No. 1, "Acceptance of a Gift" (ET sec. 191 par. .001–.002) (Deleted January 2006).
- Ethics Ruling No. 35, "Stockholder in Mutual Funds" (ET sec. 191 par. .069–.070) (Deleted December 2005).
- Ethics Ruling No. 36, "Participant in Investment Club" (ET sec. 191 par. .071–.072) (Deleted December 2005).
- Ethics Ruling No. 79, "Member's Investment in a Partnership That Invests in Client" (ET sec. 191 par. .158–.159) (Deleted December 2005).
- Ethics Ruling No. 109, "Member's Investment in Financial Services Products that Invest in Clients" (ET sec. 191 par. .218–.219) (Deleted December 2005).
- Ethics Ruling No. 66, "Member's Retirement or Savings Plan Has Financial Interest in Client" (ET sec. 191 par. .132–.133) (Deleted December 2005).
- Ethics Ruling No. 68, "Blind Trust" (ET sec. 191 par. .136–.137) (Deleted December 2005).

The content of these deleted standards is available in a nonauthoritative document at <https://us.aicpa.org/InterestAreas/ProfessionalEthics/Community/DownloadableDocuments/Deletions.pdf>.

ET Part 1***Members in Public Practice***

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1.000 Introduction

.01 Part 1 of the Code of Professional Conduct (the code) applies to *members in public practice*. Accordingly, when the term *member* is used in part 1 of the code, the requirements apply only to *members in public practice*. When a *member in public practice* is also a *member in business* (for example, serves as a member of an entity's board of directors), the *member* should also consult part 2 of the code, which applies to a *member in business*.

.02 Government auditors within a government audit organization who audit federal, state, or local governments or component units thereof, that are structurally located within the government audit organization, are considered in *public practice* with respect to those entities provided the head of the government audit organization meets at least one of the following criteria:

- a. Is directly elected by voters of the government entity with respect to which attest engagements are performed
- b. Is appointed by a legislative body and is subject to removal by a legislative body
- c. Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

[No prior reference: new content]

Effective Date

.03 Effective December 15, 2014.

[See Revision History Table.]

1.000.010 Conceptual Framework for Members in Public Practice

Introduction

.01 *Members* may encounter various relationships or circumstances that create *threats* to the *member's* compliance with the rules. The rules and *interpretations* seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an *interpretation* that addresses a particular relationship or circumstance, a *member* should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a *threat* to the *member's* compliance with the rules that is not at an *acceptable level*. When making that evaluation, the *member* should apply the conceptual framework approach as outlined in this interpretation.

.02 The code specifies that in some circumstances no *safeguards* can reduce a *threat* to an *acceptable level*. For example, the code specifies that a *member* may not subordinate the *member's* professional judgment to others without violating the "Integrity and Objectivity Rule" [1.100.001]. A member may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in the code.

.03 The "Conceptual Framework for Independence" interpretation [1.210.010] of the "Independence Rule" [1.200.001] provides authoritative guidance that *members* should use when making decisions on *independence* matters that are not explicitly addressed by the "Independence Rule" and its *interpretations*.

Definitions Used in Applying the Conceptual Framework

.04 Acceptable level. A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's* compliance with the rules is not compromised.

.05 Safeguards. Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*.

.06 Threats. Relationships or circumstances that could compromise a *member's* compliance with the rules.

Conceptual Framework Approach

.07 Under the conceptual framework approach, *members* should identify *threats* to compliance with the rules and evaluate the significance of those threats. *Members* should evaluate identified *threats* both individually and in the aggregate because *threats* can have a cumulative effect on a *member's* compliance with the rules. *Members* should perform three main steps in applying the conceptual framework approach:

- a. *Identify threats.* The relationships or circumstances that a *member* encounters in various engagements and work assignments will often create different *threats* to complying with the rules. When a *member* encounters a relationship or circumstance that is not specifically addressed by a rule or an *interpretation*, under this approach, the *member* should determine whether the relationship or circumstance creates one or more *threats*, such as those identified in paragraphs .10–.16 that follow. The existence of a *threat* does not mean that the *member* is in violation of the rules; however, the *member* should evaluate the significance of the *threat*.
- b. *Evaluate the significance of a threat.* In evaluating the significance of an identified *threat*, the *member* should determine whether a *threat* is at an *acceptable level*. A *threat* is at an *acceptable level* when a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* would not compromise the *member's* compliance with the rules. *Members* should consider both qualitative and quantitative factors when evaluating the significance of a *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*. If the *member* evaluates the *threat* and concludes that a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* does not compromise a *member's* compliance with the rules, the *threat* is at an *acceptable level*, and the *member* is not required to evaluate the *threat* any further under this conceptual framework approach.
- c. *Identify and apply safeguards.* If, in evaluating the significance of an identified *threat*, the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. The *member* should apply judgment in determining the nature of the *safeguards* to be applied because the effectiveness of *safeguards* will vary, depending on the circumstances. When identifying appropriate *safeguards* to apply, one *safeguard* may eliminate or reduce

multiple *threats*. In some cases, the *member* should apply multiple *safeguards* to eliminate or reduce one *threat* to an *acceptable level*. In other cases, an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* will be unable to implement effective *safeguards*. Under such circumstances, providing the specific *professional services* would compromise the *member's* compliance with the rules, and the *member* should determine whether to decline or discontinue the *professional services* or resign from the engagement.

Threats

.08 Many *threats* fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

.09 Examples of *threats* associated with a specific relationship or circumstance are identified in the *interpretations* of the code. Paragraphs .10–.16 of this section define and provide examples, which are not all inclusive, of each of these *threat* categories.

.10 Adverse interest threat. The *threat* that a *member* will not act with objectivity because the *member's* interests are opposed to the *client's* interests. Examples of adverse interest *threats* include the following:

- a. The *client* has expressed an intention to commence litigation against the *member*.
- b. A *client* or officer, director, or significant shareholder of the *client* participates in litigation against the *firm*.
- c. A subrogee asserts a claim against the *firm* for recovery of insurance payments made to the *client*.
- d. A class action lawsuit is filed against the *client* and its officers and directors and the *firm* and its professional accountants.

.11 Advocacy threat. The *threat* that a *member* will promote a *client's* interests or position to the point that his or her objectivity or *independence* is compromised. Examples of advocacy *threats* include the following:

- a. A *member* provides forensic accounting services to a *client* in litigation or a dispute with third parties.
- b. A *firm* acts as an investment adviser for an officer, a director, or a 10 percent shareholder of a *client*.
- c. A *firm* underwrites or promotes a *client's* shares.
- d. A *firm* acts as a registered agent for a *client*.
- e. A *member* endorses a *client's* services or products.

.12 Familiarity threat. The *threat* that, due to a long or close relationship with a *client*, a *member* will become too sympathetic to the *client's* interests or too accepting of the *client's* work or product. Examples of familiarity *threats* include the following:

- a. A *member's* immediate family or close relative is employed by the *client*.
- b. A *member's* close friend is employed by the *client*.
- c. A former *partner* or professional employee joins the *client* in a key position and has knowledge of the *firm's* policies and practices for the *professional services* engagement.

- d. Senior personnel have a long association with a *client*.
- e. A *member* has a significant close business relationship with an officer, a director, or a 10 percent shareholder of a *client*.

Nonauthoritative questions and answers regarding long association of senior personnel of the engagement team is available in the FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

.13 Management participation threat. The *threat* that a *member* will take on the role of *client* management or otherwise assume management responsibilities, such may occur during an engagement to provide nonattest services.

.14 Self-interest threat. The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, a *client* or persons associated with the *client*. Examples of self-interest *threats* include the following:

- a. The *member* has a *financial interest* in a *client*, and the outcome of a *professional services* engagement may affect the fair value of that *financial interest*.
- b. The *member's* spouse enters into employment negotiations with the *client*.
- c. A *firm* enters into a contingent fee arrangement for a tax refund claim that is not a predetermined fee.
- d. Excessive reliance exists on revenue from a single *client*.

.15 Self-review threat. The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the *member* or an individual in the *member's firm* and that the *member* will rely on that service in forming a judgment as part of another service. Examples of self-review *threats* include the following:

- a. The *member* relies on the work product of the *member's firm*.
- b. The *member* performs bookkeeping services for a *client*.
- c. A *partner* in the *member's office* was associated with the *client* as an employee, an officer, a director, or a contractor.

.16 Undue influence threat. The *threat* that a *member* will subordinate his or her judgment to an individual associated with a *client* or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. The *firm* is threatened with dismissal from a *client* engagement.
- b. The *client* indicates that it will not award additional engagements to the *firm* if the *firm* continues to disagree with the *client* on an accounting or tax matter.
- c. An individual associated with a *client* or any relevant third party threatens to withdraw or terminate a *professional service* unless the *member* reaches certain judgments or conclusions.

Safeguards

.17 Safeguards may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards*

applied will depend on many factors. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

.18 *Safeguards* that may eliminate a *threat* or reduce it to an *acceptable level* fall into three broad categories:

- a. *Safeguards* created by the profession, legislation, or regulation.
- b. *Safeguards* implemented by the *client*. It is not possible to rely solely on *safeguards* implemented by the *client* to eliminate or reduce significant *threats* to an *acceptable level*.
- c. *Safeguards* implemented by the *firm*, including policies and procedures to implement professional and regulatory requirements.

.19 The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) who will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*
- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the *client* is a *public interest entity*

.20 Examples of *safeguards* within each category are presented in the following paragraphs. Because these are only examples and are not intended to be all inclusive, it is possible that *threats* may be sufficiently mitigated through the application of other *safeguards* not specifically identified herein.

.21 The following are examples of *safeguards* created by the profession, legislation, or regulation:

- a. Education and training requirements on *independence* and ethics rules
- b. Continuing education requirements on *independence* and ethics
- c. Professional standards and the threat of discipline
- d. External review of a *firm's* quality control system
- e. Legislation establishing prohibitions and requirements for a *firm* or a *firm's* professional employees
- f. Competency and experience requirements for professional licensure
- g. Professional resources, such as hotlines, for consultation on ethical issues

.22 Examples of *safeguards* implemented by the *client* that would operate in combination with other *safeguards* are as follows:

- a. The *client* has personnel with suitable skill, knowledge, or experience who make managerial decisions about the delivery of *professional services* and makes use of third-party resources for consultation as needed.
- b. The tone at the top emphasizes the *client's* commitment to fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.

- c. Policies and procedures are in place to achieve fair financial reporting and compliance with the applicable laws, rules, regulations, and corporate governance policies.
 - d. Policies and procedures are in place to address ethical conduct.
 - e. A governance structure, such as an active audit committee, is in place to ensure appropriate decision making, oversight, and communications regarding a *firm's* services.
 - f. Policies are in place that bar the entity from hiring a *firm* to provide services that do not serve the public interest or that would cause the *firm's independence* or objectivity to be considered *impaired*.
- .23** The following are examples of *safeguards* implemented by the *firm*:
- a. *Firm* leadership that stresses the importance of complying with the rules and the expectation that engagement teams will act in the public interest.
 - b. Policies and procedures that are designed to implement and monitor engagement quality control.
 - c. Documented policies regarding the identification of *threats* to compliance with the rules, the evaluation of the significance of those *threats*, and the identification and application of *safeguards* that can eliminate identified *threats* or reduce them to an *acceptable level*.
 - d. Internal policies and procedures that are designed to monitor compliance with the *firm's* policies and procedures.
 - e. Policies and procedures that are designed to identify interests or relationships between the *firm* or its *partners* and professional staff and the *firm's clients*.
 - f. The use of different *partners*, *partner equivalents*, and engagement teams from different offices or that report to different supervisors.
 - g. Training on, and timely communication of, a *firm's* policies and procedures and any changes to them for all *partners* and professional staff.
 - h. Policies and procedures that are designed to monitor the *firm's*, *partner's*, or *partner equivalent's* reliance on revenue from a single *client* and that, if necessary, trigger action to address excessive reliance.
 - i. Designation of someone from senior management as the person responsible for overseeing the adequate functioning of the *firm's* quality control system.
 - j. A means for informing *partners* and professional staff of *attest clients* and related entities from which they must be independent.
 - k. A disciplinary mechanism that is designed to promote compliance with policies and procedures.
 - l. Policies and procedures that are designed to empower staff to communicate to senior members of the *firm* any engagement issues that concern them without fear of retribution.
 - m. Policies and procedures relating to *independence* and ethics communications with audit committees or others charged with *client* governance.

- n. Discussion of *independence* and ethics issues with the audit committee or others responsible for the *client's* governance.
- o. Disclosures to the audit committee or others responsible for the *client's* governance regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged.
- p. The involvement of another professional accountant who (a) reviews the work that is done for a *client* or (b) otherwise advises the engagement team. This individual could be someone from outside the *firm* or someone from within the *firm* who is not otherwise associated with the engagement.
- q. Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant.
- r. Rotation of senior personnel who are part of the engagement team.
- s. Policies and procedures that are designed to ensure that members of the engagement team do not make or assume responsibility for management decisions for the *client*.
- t. The involvement of another *firm* to perform part of the engagement.
- u. Having another *firm* to reperform a nonattest service to the extent necessary for it to take responsibility for that service.
- v. The removal of an individual from an *attest engagement team* when that individual's *financial interests* or relationships pose a *threat to independence* or objectivity.
- w. A consultation function that is staffed with experts in accounting, auditing, *independence*, ethics, and reporting matters who can help engagement teams
 - i. assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment; and
 - ii. resist undue pressure from a *client* when the engagement team disagrees with the *client* about such issues.
- x. *Client* acceptance and continuation policies that are designed to prevent association with *clients* that pose a *threat* that is not at an *acceptable level* to the *member's* compliance with the rules.
- y. Policies that preclude audit *partners* or *partner equivalents* from being directly compensated for selling nonattest services to the *attest client*.
- z. Policies and procedures addressing ethical conduct and compliance with laws and regulations. [No prior reference: new content]

Effective Date

.24 Effective December 15, 2015. Early implementation is allowed provided the member has implemented the revised code.

A nonauthoritative Conceptual Framework Toolkit for Members in Public Practice is available at https://us.aicpa.org/content/dam/aicpa/interest_areas/professionalethics/resources/downloadabledocuments/toolkits/andaids/conceptualframeworktoolkitformembersinpublicpractice.docm.

1.000.020 Ethical Conflicts

.01 An ethical conflict arises when a *member* encounters one or both of the following:

- a. Obstacles to following an appropriate course of action due to internal or external pressures
- b. Conflicts in applying relevant professional standards or legal standards

.02 Once an ethical conflict is encountered, a *member* may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the *member* should consider factors such as the following:

- a. Relevant facts and circumstances, including applicable rules, laws, or regulations
- b. Ethical issues involved
- c. Established internal procedures

.03 The *member* should also be prepared to justify any departures that the *member* believes were appropriate in applying the relevant rules and law. If the *member* was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the *member* may have to address the consequences of any violations.

.04 Before pursuing a course of action, the *member* should consider consulting with appropriate persons within the *firm* or the organization that employs the *member*.

.05 If a *member* decides not to consult with appropriate persons within the *firm* or the organization that employs the *member* and the conflict remains unresolved after pursuing the selected course of action, the *member* should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The *member* also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

.06 If the ethical conflict remains unresolved, the *member* will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the *member* should consider his or her continuing relationship with the engagement team, specific assignment, *client*, *firm*, or employer. [No prior reference: new content.]

.07 Refer to the "Responding to Noncompliance With Laws and Regulations" interpretation [1.180.010] of the "Integrity and Objectivity Rule" [1.100.001] for additional guidance.

Effective Date

.08 Effective December 15, 2014.

[See Revision History Table.]

1.100 Integrity and Objectivity

1.100.001 Integrity and Objectivity Rule

.01 In the performance of any *professional service*, a *member* shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not

knowingly misrepresent facts or subordinate his or her judgment to others. [Prior reference: paragraph .01 of ET section 102]

Interpretations Under the Integrity and Objectivity Rule

1.100.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Integrity and Objectivity Rule" [1.100.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Integrity and Objectivity Rule" [1.100.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.110 Conflicts of Interest

1.110.010 Conflicts of Interest for Members in Public Practice

.01 A *member* or his or her *firm* may be faced with a conflict of interest when performing a *professional service*. In determining whether a *professional service*, relationship or matter would result in a conflict of interest, a *member* should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

.02 A conflict of interest creates adverse interest and self-interest *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001]. For example, *threats* may be created when

- a. the *member* or the *member's firm* provides a *professional service* related to a particular matter involving two or more *clients* whose interests with respect to that matter are in conflict, or
- b. the interests of the *member* or the *member's firm* with respect to a particular matter and the interests of the *client* for whom the *member* or the *member's firm* provides a *professional service* related to that matter are in conflict.

.03 Certain professional engagements, such as audits, reviews and other attest services require *independence*. *Independence* impairments under the "Independence Rule" [1.200.001], its *interpretations*, and rulings cannot be eliminated by the *safeguards* provided in this interpretation or by disclosure and consent.

.04 The following are examples of situations in which conflicts of interest may arise:

- a. Providing corporate finance services to a *client* seeking to acquire an audit *client* of the *firm*, when the *firm* has obtained confidential information during the course of the audit that may be relevant to the transaction
- b. Advising two *clients* at the same time who are competing to acquire the same company when the advice might be relevant to the parties' competitive positions
- c. Providing services to both a vendor and a purchaser who are *clients* of the *firm* in relation to the same transaction
- d. Preparing valuations of assets for two *clients* who are in an adversarial position with respect to the same assets
- e. Representing two *clients* at the same time regarding the same matter who are in a legal dispute with each other, such as during divorce proceedings or the dissolution of a partnership
- f. Providing a report for a licensor on royalties due under a license agreement while at the same time advising the licensee of the correctness of the amounts payable under the same license agreement
- g. Advising a *client* to invest in a business in which, for example, the *immediate family* member of the *member* has a *financial interest* in the business
- h. Providing strategic advice to a *client* on its competitive position while having a joint venture or similar interest with a competitor of the *client*
- i. Advising a *client* on the acquisition of a business which the *firm* is also interested in acquiring
- j. Advising a *client* on the purchase of a product or service while having a royalty or commission agreement with one of the potential vendors of that product or service
- k. Providing forensic investigation services to a *client* for the purpose of evaluating or supporting contemplated litigation against another *client* of the *firm*
- l. Providing tax or personal financial planning services for several members of a family whom the *member* knows to have opposing interests
- m. Referring a personal financial planning or tax *client* to an insurance broker or other service provider, which refers *clients* to the *member* under an exclusive arrangement
- n. A *client* asks the *member* to provide tax or personal financial planning services to its executives, and the services could result in the *member* recommending to the executives actions that may be adverse to the company. [Prior reference: paragraphs .198–.199 of ET section 191]
- o. A *member* serves as a director or an officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are *clients* of the *member's firm*. [Prior reference: paragraphs .186–.187 of ET section 191]

- p. A *member* who is an officer, a director, or a shareholder of an entity has *significant influence* over the entity, and that entity has a loan to or from a *client* of the *firm*. [Prior reference: paragraphs .220–.221 of ET section 191]

Identification of a Conflict of Interest

.05 Before accepting a new *client* relationship, engagement, or business relationship, a *member* should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

- a. the nature of the relevant interests and relationships between the parties involved and
- b. the nature of the service and its implication for relevant parties.

.06 The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a *member* is asked to conduct an engagement for a *client* in a situation that may become adversarial with respect to another *client* or the *member* or *member's firm*, even though the parties who engage the *member* may not initially be involved in a dispute. A *member* should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

.07 For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a *member* in identifying actual or potential conflicts of interest that may create significant *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example *clients* or potential *clients*. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a *member* being able to apply *safeguards* to eliminate or reduce significant *threats* to an *acceptable level*. The process to identify actual or potential conflicts of interest will depend on such factors as

- a. the nature of the *professional services* provided,
- b. the size of the *firm*,
- c. the size and nature of the *client* base, and
- d. the structure of the *firm*, for example the number and geographic location of offices.

.08 If the *firm* is a member of a *network*, the *member* is not required to take specific steps to identify conflicts of interest of other *network firms*; however, if the *member* knows or has reason to believe that such conflicts of interest may exist or might arise due to interests and relationships of a *network firm*, the *member* should evaluate the significance of the *threat* created by such conflicts of interest as described below.

Evaluation of a Conflict of Interest

.09 When an actual conflict of interest has been identified, the *member* should evaluate the significance of the *threat* created by the conflict of interest to determine if the *threat* is at an *acceptable level*. Members should consider both qualitative and quantitative factors when evaluating the significance of the *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*. In evaluating the significance of an identified *threat*, *members* should consider both of the following:

- a. The significance of relevant interests or relationships.

- b. The significance of the *threats* created by performing the *professional service* or services. In general, the more direct the connection between the *professional service* and the matter on which the parties' interests are in conflict, the more significant the *threat* to compliance with the rule will be.

.10 If the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. Examples of *safeguards* include the following:

- a. Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing *professional services* related to a particular matter for two or more *clients* whose interests with respect to that matter are in conflict. This could include
 - i. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
 - ii. creating separate areas of practice for specialty functions within the *firm*, which may act as a barrier to the passing of *confidential client information* from one practice area to another within a *firm*;
 - iii. establishing policies and procedures to limit access to *client* files, the use of confidentiality agreements signed by employees and *partners* of the *firm* and the physical and electronic separation of confidential information.
- b. Regularly reviewing the application of *safeguards* by a senior individual not involved with the *client* engagement or engagements.
- c. Having a member of the *firm* who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
- d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

.11 In cases where an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* is unable to implement effective *safeguards*, the *member* should (a) decline to perform or discontinue the *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an *acceptable level*.

Disclosure of a Conflict of Interest and Consent

.12 When a conflict of interest exists, the *member* should disclose the nature of the conflict of interest to *clients* and other appropriate parties affected by the conflict and obtain their consent to perform the *professional services*. The *member* should disclose the conflict of interest and obtain consent even if the *member* concludes that *threats* are at an *acceptable level*.

.13 Disclosure and consent may take different forms. The following are examples:

- a. General disclosure to *clients* of circumstances in which the *member*, in keeping with common commercial practice, does not provide services exclusively for any one *client* (for example, in a particular service in a particular market sector) in order for the *client* to provide general consent accordingly. Such disclosure might be

made in a *member's* standard terms and conditions for the engagement.

- b. Specific disclosure to affected *clients* of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the *client* to make an informed decision with respect to the matter and to provide specific consent.

.14 The *member* should determine whether the nature and significance of the conflict of interest is such that specific disclosure and specific consent are necessary, as opposed to general disclosure and general consent. For this purpose, the *member* should exercise professional judgment in evaluating the circumstances that create a conflict of interest, including the parties that might be affected, the nature of the issues that might arise and the potential for the particular matter to develop in an unexpected manner.

.15 When a *member* has requested specific consent from a *client* and that consent has been refused by the *client*, the *member* should (a) decline to perform or discontinue *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an *acceptable level*, such that consent can be obtained, after applying any additional *safeguards*, if necessary.

.16 The *member* is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the *safeguards* applied to eliminate or reduce the *threats* to an *acceptable level*, and the consent obtained.

.17 When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a *member* should remain alert to the requirements of the "Confidential Client Information Rule" [1.700.001] and the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of *client* information may be more restrictive than the requirements contained in the Code of Professional Conduct.

.18 When practicing before the IRS or other taxing authorities, *members* should ensure compliance with any requirements that are more restrictive. For example, Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, provides more restrictive requirements concerning written consent by the *client* when a conflict of interest exists.

[See Revision History Table.]

A nonauthoritative question and answer regarding independent contractors retained by the firm who are simultaneously employed or associated with an attest client is available in the FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.110.020 Director Positions

.01 When a *member* serves as a director of an entity, such as a bank, the *member's* fiduciary responsibilities to the entity may create *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. For example, an adverse interest *threat* to the *member's* objectivity may exist if the *member's clients* are customers of the entity or likely to engage in significant transactions with the

entity. A *member's* general knowledge and experience may be very helpful to an entity in formulating policies and making business decisions. Nevertheless, if the *member's clients* are likely to engage in significant transactions with the entity, it would be more appropriate for the *member* to serve as a consultant to the board. Under such an arrangement, the *member* could limit activities to those that do not *threaten* the *member's* compliance with these rules. If, however, the *member* serves as a board member, the *member* should evaluate the significance of any *threats* and apply *safeguards*, when necessary, to eliminate or reduce the *threats* to an *acceptable level*.

.02 Refer to the "Disclosing Client Information in Director Positions" interpretation [1.700.080] of the "Confidential Client Information Rule" [1.700.001] for additional guidance. [Prior reference: paragraphs .170–.171 of ET section 191]

Effective Date

.03 This revised interpretation is effective December 15, 2014.

1.120 Gifts and Entertainment

1.120.010 Offering or Accepting Gifts or Entertainment

.01 For purposes of this interpretation, a client includes the *client*, an individual in a *key position* with the *client*, or an individual owning 10 percent or more of the *client's* outstanding equity securities or other ownership interests.

.02 When a *member* offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist.

.03 *Threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and the *member* would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

- a. The *member* offers to a client or accepts gifts or entertainment from a client that violate the member's or client's policies or applicable laws, rules, and regulations; and
- b. The *member* knows of the violation or demonstrates recklessness in not knowing.

.04 A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* when gifts or entertainment are reasonable in the circumstances. The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment
- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment

- f. Whether other clients also participated in the entertainment
- g. The individuals from the client and *member's firm* who participated in the entertainment

.05 *Threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of safeguards if a *member* offers to a client or accepts gifts or entertainment from a client that is not reasonable in the circumstances. The *member* would be presumed to lack objectivity in violation of the "Integrity and Objectivity Rule" under these circumstances.

.06 Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [1.285.010] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraphs .226–.227 of ET section 191]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/gifts_basis_document.pdf.

A nonauthoritative question and answer regarding campaign contributions is available at the following address. The subject is member contributions made to the campaign of an individual who holds a key position with or has a financial interest in an attest client. <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.130 Preparing and Reporting Information

1.130.010 *Knowing Misrepresentations in the Preparation of Financial Statements or Records*

.01 *Threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and the *member* would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the *member*

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity's *financial statements* or records;
- b. fails to correct an entity's *financial statements* or records that are materially false and misleading when the *member* has the authority to record the entries; or
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .02 of ET section 102]

1.130.020 *Subordination of Judgment*

.01 The "Integrity and Objectivity Rule" [1.100.001] prohibits a *member* from knowingly misrepresenting facts or subordinating his or her judgment when performing *professional services* for a *client*, for an employer, or on a volunteer basis. This interpretation addresses differences of opinion between a

member and his or her supervisor or any other person within the *member's* organization.

.02 Self-interest, familiarity, and undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a *member* and his or her supervisor or any other person within the *member's* organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

.03 A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* if the *member* concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If *threats* are not at an *acceptable level*, the *member* should apply the *safeguards* in paragraphs .06–.08 to eliminate or reduce the *threat(s)* to an *acceptable level* so that the *member* does not subordinate his or her judgment.

.04 In evaluating the significance of any identified *threats*, the *member* should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;
- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

.05 If the *member* concludes that *threats* are at an *acceptable level* the *member* should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.

.06 If the *member* concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then *threats* would not be at an *acceptable level*. In such circumstances, the *member* should discuss his or her concerns with the supervisor.

.07 If the difference of opinion is not resolved after discussing the concerns with the supervisor, the *member* should discuss his or her concerns with the appropriate higher level(s) of management within the *member's* organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

.08 If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the *member's* organization, the *member* concludes that appropriate action was not taken, then the *member* should consider, in no specific order, the following *safeguards* to ensure that *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] are eliminated or reduced to an *acceptable level*:

- a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.
- b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external accountant. In considering such communications, the *member* should be cognizant of his or her obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] of the "Acts Discreditable Rule" [1.400.001].

- c. Consult with his or her legal counsel regarding his or her responsibilities.
- d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

.09 If the *member* concludes that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level* or if the *member* concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the *member's* organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

.10 Nothing in this interpretation precludes a *member* from resigning from the organization at any time. However, resignation may not relieve the *member* of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

.11 A *member* should use professional judgment and apply similar *safeguards*, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the *member* does not subordinate his or her judgment. [Prior reference: paragraph .05 of ET section 102]

1.140 Client Advocacy

1.140.010 Client Advocacy

.01 An advocacy *threat* to compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a *member* or the *member's firm* is engaged to perform nonattest services, such as tax and consulting services, that involve acting as an advocate for the *client* or to support a *client's* position on accounting or financial reporting issues either within the *firm* or outside the *firm* with standard setters, regulators, or others.

.02 The code governs these types of *professional services*, and the *member* shall perform such services in compliance with the "General Standards Rule" [1.300.001], the "Compliance With Standards Rule" [1.310.001], the "Accounting Principles Rule" [1.320.001], and any *interpretations* thereof. The *member* shall also comply with the "Integrity and Objectivity Rule" [1.100.001] that requires maintaining objectivity and integrity and prohibits subordinating one's judgment to others.

.03 Some *professional services* involving *client* advocacy may stretch the bounds of performance standards, go beyond sound and reasonable professional practice, or compromise credibility, thereby creating *threats* to the *member's* compliance with the rules and damaging the reputation of the *member* and the *member's firm*. If such circumstances exist, the *member* and *member's firm* should determine whether it is appropriate to perform the *professional services*.

.04 When performing *professional services* requiring *independence*, a *member* shall also comply with the "Independence Rule" [1.200.001]. [Prior reference: paragraph .07 of ET section 102]

1.150 Use of a Third-Party Service Provider

1.150.040 Use of a Third-Party Service Provider

.01 When a *member* uses a *third-party service provider* to assist the *member* in providing *professional services*, *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist.

.02 *Clients* might not have an expectation that a *member* would use a *third-party service provider* to assist the *member* in providing the *professional services*. Therefore, before disclosing *confidential client information* to a *third-party service provider*, the *member* should inform the *client*, preferably in writing, that the *member* may use a *third-party service provider*. If the *client* objects to the *member's* use of a *third-party service provider*, the *member* either should not use the *third-party service provider* to perform the *professional services* or should decline to perform the engagement.

.03 A *member* is not required to inform the *client* when he or she uses a *third-party service provider* to provide administrative support services to the *member* (for example, record storage, software application hosting, or authorized e-file tax transmittal services).

.04 Refer to the "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001] and the "Disclosing Information to a Third-Party Service Provider" interpretation [1.700.040] of the "Confidential Client Information Rule" [1.700.001] for additional guidance. [Prior reference: paragraphs .224–.225 of ET section 191]

A nonauthoritative basis for conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsoutsourcing.pdf>.

In addition, nonauthoritative sample client disclosure language a member could use to fulfill the requirement discussed in this interpretation is also available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/sample_disclosure_notification.pdf.

1.180 Responding to Noncompliance With Laws and Regulations

1.180.010 Responding to Noncompliance With Laws and Regulations

Introduction

.01 When a *member* encounters or is made aware of noncompliance or suspected noncompliance with laws and regulations in the course of providing a *professional service* to a *client*, *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist. The purpose of this interpretation is to set out the *member's* responsibilities when encountering such noncompliance or suspected noncompliance and guide the *member* in evaluating the implications of the matter and the possible courses of action when responding to it. The *member's* responsibilities in this interpretation are owed to a person or

entity that engages the *member* or *member's firm* to perform professional services (engaging entity). Therefore, when the engaging entity and subject entity are different, the term client refers to the engaging entity.

.02 Noncompliance with laws and regulations (noncompliance) comprises acts of omission or commission, intentional or unintentional, that are contrary to the prevailing laws or regulations and are committed by a client or by *those charged with governance*, by management, or by other individuals working for or under the direction of a client.

.03 When responding to noncompliance or suspected noncompliance in the course of providing a *professional service* to a client, the *member* should consider the *member's* obligations under the "Confidential Client Information Rule" [1.700.001]. For example, a *member* should not disclose the noncompliance or suspected noncompliance to a third party without the client's consent unless expressly permitted under the "Confidential Client Information Rule," such as when reporting the noncompliance or suspected noncompliance to a regulatory authority in order to comply with applicable laws and regulations or the "Compliance With Standards Rule" [1.310.001], as discussed in paragraphs .04 and .05d, respectively.

.04 Some regulators, such as the SEC or state boards of accountancy, may have regulatory provisions governing how a *member* should address noncompliance or suspected noncompliance which may differ from or go beyond this interpretation. In some circumstances, state and federal civil and criminal laws may also impose additional requirements. When encountering noncompliance or suspected noncompliance, a *member* has a responsibility to obtain an understanding of those legal or regulatory provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the client prior to making any disclosure.

.05 A distinguishing mark of the accounting profession is its acceptance of the responsibility to act in the public interest. When responding to noncompliance or suspected noncompliance, the objectives of a *member* are as follows:

- a. To comply with the "Integrity and Objectivity Rule" [1.100.001]
- b. To alert management or, when appropriate, *those charged with governance* of the client, to enable them to
 - i. rectify, remediate, or mitigate the consequences of the identified or suspected noncompliance or
 - ii. deter the commission of the noncompliance when it has not yet occurred
- c. To determine whether withdrawal from the engagement and the professional relationship is necessary, when permitted by law and regulation
- d. To take such further action as appropriate in the public interest
- e. To comply with applicable laws, regulations, and the "Compliance With Standards Rule" [1.310.001]

Applicability

.06 This interpretation does not apply to the following:

- a. Personal misconduct unrelated to the business activities of the client
- b. Noncompliance by parties other than
 - i. the client,

- ii. *those charged with governance*,
- iii. management, or
- iv. other individuals working for or under the direction of the client.

This includes, for example, circumstances in which a *member* has been engaged by a client to perform a due diligence assignment on a third-party entity (that is, subject entity) and the identified or suspected noncompliance has been committed by that third party.

- c. A litigation or investigation engagement as defined in AICPA Statement on Standards for Forensic Services No. 1
- d. An engagement where the primary purpose is to identify, reach a conclusion regarding, or otherwise respond to a known or potential noncompliance with laws and regulations (NOCLAR)
- e. An engagement pursuant to which the protections set forth in IRC Section 7525 or any comparable state or local statutes apply
- f. An engagement where compliance with this interpretation would cause a violation of law or regulation

A *member* may nevertheless find the guidance in this interpretation helpful in considering how to respond in these situations.

Scope

.07 This interpretation sets out the approach to be taken by a *member* who encounters or is made aware of noncompliance or suspected noncompliance with the following:

- a. Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client's *financial statements*
- b. Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's *financial statements*, but compliance with which may be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties

.08 Examples of laws and regulations which this interpretation addresses may include those that deal with the following:

- a. Fraud, corruption, and bribery
- b. Money laundering
- c. Securities markets and trading
- d. Banking and other financial products and services
- e. Data protection
- f. Tax and pension liabilities and payments
- g. Environmental protection
- h. Public health and safety

.09 Noncompliance may result in fines, litigation, or other consequences for the client that may have a material effect on its *financial statements*. Importantly, such noncompliance may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees, or the general public. For the purposes of this interpretation, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or nonfinancial terms.

.10 A *member* who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this interpretation with respect to such matters.

Responsibilities of the Client's Management and Those Charged With Governance

.11 The client's management is responsible, with the oversight of *those charged with governance*, to ensure that the client's business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and *those charged with governance* to identify and address any noncompliance by the client, by an individual charged with governance of the entity, by a member of management, or by other individuals working for or under the direction of the client.

Responsibilities of Members in Public Practice

.12 When a *member* becomes aware of a matter to which this interpretation applies, the *member* should take timely steps to comply with this interpretation, taking into account the *member's* understanding of the nature of the matter and the potential harm to the interests of the entity, investors, creditors, employees, or the general public.

Members Providing Financial Statement Audit or Review Services

Obtaining an Understanding of the Matter

.13 If a *member* engaged to perform financial statement audit or review services becomes aware of credible information concerning an instance of noncompliance or suspected noncompliance, whether in the course of performing the engagement or through information provided by other parties, the *member* should obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or is likely to occur.

.14 A *member* is expected to apply knowledge, professional judgment, and expertise but is not expected to have a level of knowledge of laws and regulations greater than that required to undertake the engagement. Whether an act constitutes noncompliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

.15 If the *member* identifies or suspects that noncompliance has occurred or is likely to occur, the *member* should discuss the matter with the appropriate level of management and, when appropriate, *those charged with governance*.

.16 Such discussion may serve to clarify the *member's* understanding of the facts and circumstances relevant to the matter and its potential consequences.

.17 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider may include these:

- a. The nature and circumstances of the matter
- b. The individuals actually or potentially involved
- c. The likelihood of collusion
- d. The potential consequences of the matter
- e. Whether that level of management is able to investigate the matter and take appropriate action

.18 The appropriate level of management is generally at least one level above the person or persons involved or potentially involved in the matter. If a *member* believes that management is involved in the noncompliance or suspected noncompliance, the *member* should discuss the matter with *those charged with governance*. The *member* may also consider discussing the matter with internal auditors, when applicable. In the context of a group audit engagement, the appropriate level may be management at an entity that controls the client.

Addressing the Matter

.19 In discussing the noncompliance or suspected noncompliance with management and, when appropriate, *those charged with governance*, the *member* should advise them to take appropriate and timely actions, if they have not already done so, which may include the following:

- a. Rectifying, remediating, or mitigating the consequences of the noncompliance
- b. Deterring the commission of the noncompliance if it has not yet occurred
- c. Disclosing the matter to an appropriate authority where required by law or regulation or when otherwise considered necessary

.20 The *member* should consider whether the client's management and, if applicable, *those charged with governance* understand their legal or regulatory responsibilities with respect to the noncompliance or suspected noncompliance. If not, the *member* may want to suggest appropriate sources of information or recommend that they obtain legal advice.

.21 The *member* should comply with the following:

- a. Applicable laws and regulations, including legal or regulatory provisions governing the reporting of noncompliance or suspected noncompliance to an appropriate authority. In this regard, some laws and regulations may stipulate a period within which reports are to be made.
- b. Applicable requirements under professional standards, including those relating to
 - i. identifying and responding to noncompliance, including fraud;
 - ii. communicating with *those charged with governance*;
 - iii. considering the implications of the noncompliance or suspected noncompliance on the audit, review, or compilation report for the current or prior engagements; and
 - iv. communicating a former client's noncompliance to the successor auditor to the extent required under professional standards.

Communication With Respect to Group Audit Engagements

.22 A *member* may, for purposes of a group audit engagement, be requested by the group engagement team to perform work on financial or other information related to a component of the group.

If the *member* becomes aware of noncompliance or suspected noncompliance, the *member* should, in addition to responding to the matter in accordance with the provisions of this section, communicate the noncompliance or suspected noncompliance to the group audit engagement partner in accordance with AU-C section 600, *Special Considerations — Audits of Group Financial Statements*

(Including the Work of Component Auditors), unless prohibited from doing so by law or regulation.

.23 If the group audit engagement *partner* becomes aware of noncompliance or suspected noncompliance in the course of a group audit engagement, including as a result of being informed of such a matter in accordance with paragraph .22, the group audit engagement *partner* should, in addition to responding to the matter in the context of the group audit engagement in accordance with the provisions of this section, consider whether the matter may be relevant to one or more components whose financial or other information is subject to procedures performed for purposes of the group audit engagement.

In these circumstances, the group audit engagement *partner* should take steps to have the noncompliance or suspected noncompliance communicated to those performing work at components where the matter may be relevant, unless prohibited from doing so by law or regulation.

Determining Whether Withdrawal From the Engagement Is Necessary

.24 The *member* should evaluate the appropriateness of the response of management and, if applicable, *those charged with governance*.

.25 Relevant factors to consider when evaluating the appropriateness of the response of management and, where applicable, *those charged with governance* may include whether

- a. the response is timely.
- b. the noncompliance or suspected noncompliance has been adequately investigated.
- c. action has been, or is being, taken to rectify, remediate, or mitigate the consequences of any noncompliance.
- d. action has been or is being taken to deter the commission of any noncompliance if it has not yet occurred.
- e. appropriate steps have been, or are being, taken to reduce the risk of recurrence; for example, additional controls or training.
- f. the noncompliance or suspected noncompliance has been disclosed to an appropriate authority when appropriate and, if so, whether the disclosure appears adequate.

.26 In light of the response of management and, if applicable, *those charged with governance*, the *member* should determine whether withdrawing from the engagement and the professional relationship is necessary, where permitted by law and regulation.

.27 The determination of whether withdrawing from the engagement and the professional relationship is necessary may depend on various factors, including these:

- a. The legal and regulatory framework
- b. The urgency of the matter
- c. The pervasiveness of the matter throughout the client
- d. Whether the *member* continues to have confidence in the integrity of management and, if applicable, *those charged with governance*
- e. Whether the noncompliance or suspected noncompliance is likely to reoccur
- f. Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees, or the general public

.28 Examples of circumstances that may cause a *member* no longer to have confidence in the integrity of management and, where applicable, *those charged with governance* include situations such as the following:

- a. The *member* suspects or has evidence of management's involvement or intended involvement in any noncompliance.
- b. The *member* is aware that management has knowledge of such noncompliance and, contrary to legal or regulatory requirements, has not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

.29 As consideration of the matter may involve complex analysis and judgments, a *member* may want to consider consulting internally or externally, including obtaining legal or other advice to understand the *member's* options and the implications of taking any particular course of action.

Documentation

.30 In relation to an identified or suspected act of noncompliance that falls within the scope of this section, the *member* should, in addition to complying with the documentation requirements under applicable professional standards, document the following:

- a. The matter
- b. The results of discussion with management and, where applicable, *those charged with governance* and other parties
- c. How management and, where applicable, *those charged with governance*, have responded to the matter
- d. The judgments made and the courses of action the *member* took

Members Providing Services Other Than a Financial Statement Audit or Review Service

Obtaining an Understanding of the Matter and Addressing the Matter

.31 If a *member* engaged to perform professional services other than a financial statement audit or review service becomes aware of credible information concerning an instance of noncompliance or suspected noncompliance, whether in the course of performing the engagement or through information provided by other parties, the *member* should seek to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or is likely to occur.

.32 A *member* is expected to apply knowledge, professional judgment, and expertise but is not expected to have a level of knowledge of laws and regulations greater than that required to undertake the engagement. Whether an act constitutes noncompliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

.33 If the *member* identifies or suspects that noncompliance has occurred or is likely to occur the *member* should discuss the matter with the appropriate level of management and, if the *member* has access to them and when appropriate, *those charged with governance*.

.34 Such discussion may serve to clarify the *member's* understanding of the facts and circumstances relevant to the matter and its potential consequences.

.35 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider may include the following:

- a. The nature and circumstances of the matter
- b. The individuals actually or potentially involved
- c. The likelihood of collusion
- d. The potential consequences of the matter
- e. Whether that level of management is able to investigate the matter and take appropriate action

Communicating the Matter to the Client's Financial Statement Audit or Review Services Provider

.36 *Members performing a service, other than a financial statement audit or review service, for a financial statement audit or review client.* If the member is performing a service other than a *financial statement* audit or review service for a *financial statement* audit or review client of the *firm* or a component of a *financial statement* audit or review client of the *firm*, the *member* should communicate the noncompliance or suspected noncompliance within the *firm*. The communication should be made in accordance with the *firm's* protocols or procedures or, in the absence of such protocols and procedures, directly to the *financial statement* audit or review engagement partner.

.37 If the *member* is performing a service for a *financial statement* audit or review client of a *network firm* or a component of a *financial statement* audit or review client of a *network firm*, the *member* should consider whether to communicate the noncompliance or suspected noncompliance to the *network firm*. If the communication is made, it should be made in accordance with the *network's* protocols or procedures or, in the absence of such protocols and procedures, directly to the *financial statement* audit or review engagement partner.

.38 In all cases, the communication is to enable the *financial statement* audit or review engagement partner to be informed about the noncompliance or suspected noncompliance and to determine whether it should be addressed in accordance with the provisions of this interpretation and, if so, how.

.39 *Members providing services to a client that is not a financial statement audit or review client.* If the *member* is performing services for a client that is not a *financial statement* audit or review client of the *firm*, except as required by law or regulation, the *member* is not permitted to communicate the noncompliance or suspected noncompliance to the *firm* that is the client's external auditor, if one exists. See the "Confidential Client Information Rule" [1.700.001].

Determining Whether Withdrawal From the Engagement Is Necessary

.40 The *member* should determine whether withdrawal from the engagement and the professional relationship is necessary, where permitted by law and regulation.

.41 Whether withdrawal from the engagement is necessary may depend on various factors, including the *member's* understanding of the following:

- a. The legal and regulatory framework
- b. The appropriateness and timeliness of the response of management and, where applicable, *those charged with governance*
- c. The urgency of the matter
- d. Whether the *member* continues to have confidence in the integrity of management and, if applicable, *those charged with governance*
- e. The likelihood of actual or potential substantial harm to the interests of the entity, investors, creditors, employees, or the general public
- f. The pervasiveness of the matter throughout the client

- g. Whether the noncompliance or suspected noncompliance is likely to reoccur

.42 Examples of circumstances that may cause the *member* no longer to have confidence in the integrity of management and, where applicable, *those charged with governance* include such situations as the following:

- a. The *member* suspects or has evidence of management's involvement or intended involvement in any noncompliance.
- b. The *member* is aware that management has knowledge of such noncompliance and, contrary to legal or regulatory requirements, has not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.

.43 As consideration of the matter may involve complex analysis and judgments, a *member* may want to consider consulting internally or externally, including obtaining legal or other advice to understand the *member's* options and the implications of taking any particular course of action.

Documentation

.44 In relation to an identified or suspected act of noncompliance that falls within the scope of this section, the *member* is encouraged to document the following, in addition to complying with the documentation requirements under applicable professional standards:

- a. The matter
- b. The results of discussion with management and, where applicable, *those charged with governance* and other parties
- c. How management and, where applicable, *those charged with governance* have responded to the matter
- d. The judgments made and the courses of action the *member* took

Effective Date

.45 This interpretation is effective June 30, 2023. Early implementation is allowed.

[See Revision History Table.]

1.200 Independence

1.200.001 Independence Rule

.01 A *member* in public practice shall be independent in the performance of *professional services* as required by standards promulgated by bodies designated by *Council*. [Prior reference: paragraph .01 of ET section 101]

Interpretations Under the Independence Rule

1.200.005 Application of the Conceptual Framework for Independence and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Independence Rule" [1.200.001] that addresses a particular relationship or circumstance, a

member should apply the "Conceptual Framework for Independence" interpretation [1.210.010].

.02 A *member* would be considered in violation of the "Independence Rule" [1.200.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*. [Prior reference: "Other Considerations" section of paragraph .02 of ET section 101]

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraph .03 is effective December 15, 2014.

1.210 Conceptual Framework Approach

1.210.010 Conceptual Framework for Independence

Introduction

.01 It is impossible to enumerate all relationships or circumstances in which the appearance of *independence* might be questioned. Thus, in the absence of an *independence interpretation* that addresses a particular relationship or circumstance, a *member* should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a *threat* to either the *member's* or *firm's independence*, or both, that is not at an *acceptable level*. When making that evaluation, a *member* should apply the conceptual framework approach as outlined in this interpretation to analyze *independence* matters. A *member* may also wish to consider the conceptual framework approach described in this interpretation to gain a better understanding of the conclusions reached in other *interpretations* in ET section 1.200, "Independence." [Prior reference: "Other Considerations" section of paragraph .02 of ET section 101]

.02 The code specifies that in some circumstances no *safeguards* can reduce an *independence threat* to an *acceptable level*. For example, the code specifies that a *covered member* may not own even an immaterial *direct financial interest* in an *attest client* because there is no *safeguard* to reduce the self-interest *threat* to an *acceptable level*. A *member* may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in an *independence interpretation*.

Definitions Used in Applying the Conceptual Framework for Independence

.03 Acceptable level. A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's independence* is not *impaired*.

.04 Impair(ed). In connection with *independence*, to effectively extinguish *independence*. When a *member's independence is impaired*, the *member* is not independent.

.05 Safeguards. Actions or other measures that may eliminate a *threat* or reduce a *threat* to an *acceptable level*.

.06 Threats. Relationships or circumstances that could *impair independence*.

Conceptual Framework Approach

.07 The conceptual framework approach entails identifying *threats* and evaluating the *threat* that the *member* would not be independent or would be perceived by a reasonable and informed third party who is aware of the relevant information as not being independent. The *member* must eliminate or reduce that *threat* to an *acceptable level* to conclude that the *member* is independent. *Threats* are at an *acceptable level* either because of the types of *threats* and their potential effect or because *safeguards* have eliminated or reduced the *threat*, so that a reasonable and informed third party who is aware of the relevant information would perceive that the *member's* professional judgment is not compromised.

.08 Refer to paragraph .07 of the "Conceptual Framework for Members in Public Practice" [1.000.010.07] for a detailed description of the conceptual framework approach. [Prior reference: ET section 100-1]

Documentation

.09 When the *member* applies *safeguards* to eliminate or reduce significant *threats* to an *acceptable level*, as described in paragraph .07c of the "Conceptual Framework for Members in Public Practice" [1.000.010.07], the *member* should document the identified *threats* and *safeguards* applied. Failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001] rather than the "Independence Rule" [1.200.001] if the *member* can demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*. [Prior reference: "Other Considerations" section of paragraph .02 of ET section 101]

Threats

.10 Many different relationships or circumstances (or combinations of relationships or circumstances) can create *threats* to compliance with the "Independence Rule" [1.200.001]. It is impossible to identify every relationship or circumstance that creates a *threat*. Many *threats* fall into one or more of the following seven broad categories: adverse interest, advocacy, familiarity, management participation, self-interest, self-review, and undue influence.

.11 Examples of *threats* associated with a specific relationship or circumstance are identified in the *interpretations* of the code. Paragraphs .12–.18 in this section define and provide examples, which are not all inclusive, of each of these *threat* categories. In certain circumstances, the code specifies that because of the type of *threat* and its potential effect, either no *safeguards* can eliminate or reduce the *threat* to an *acceptable level*, or a *member* would need to apply specific *safeguards* to eliminate or reduce an *independence threat* to an *acceptable level*. When *independence interpretations* in the code address one of these examples, a specific reference to the *independence interpretation* is provided in brackets after that example. If an example does not contain a specific reference to an *independence interpretation*, a *member* should use this "Conceptual

Framework for Independence" interpretation to evaluate whether a *threat* is significant.

.12 Adverse interest threat. The *threat* that a *member* will not act with objectivity because the *member's* interests are in opposition to the interests of an *attest client*. An example is either the *attest client* or the *member* commencing litigation against the other or expressing the intent to commence litigation. [1.290.010]

.13 Advocacy threat. The *threat* that a *member* will promote an *attest client's* interests or position to the point that his or her *independence* is compromised. Examples of advocacy *threats* include the following:

- a. A *member* promotes the *attest client's* securities as part of an initial public offering. [1.295.130]
- b. A *member* provides expert witness services to an *attest client*. [1.295.140]
- c. A *member* represents an *attest client* in U.S. tax court or other public forum. [1.295.160]

.14 Familiarity threat. The *threat* that, because of a long or close relationship with an *attest client*, a *member* will become too sympathetic to the *attest client's* interests or too accepting of the *attest client's* work or product. Examples of familiarity *threats* include the following:

- a. A *member* of the *attest engagement team* has an *immediate family member* or *close relative* in a *key position* at the *attest client*, such as the *attest client's* CEO. [1.270.020 and 1.270.100]
- b. A *partner* or *partner equivalent* of the *firm* has been a *member* of the *attest engagement team* for a prolonged period.
- c. A *member* of the *firm* has recently been a *director* or an *officer* of the *attest client*. [1.277.010]
- d. A *member* of the *attest engagement team* has a *close friend* who is in a *key position* at the *attest client*.

.15 Management participation threat. The *threat* that a *member* will take on the role of *attest client* management or otherwise assume management responsibilities for an *attest client*. Examples of management participation *threats* include the following:

- a. A *member* serves as an *officer* or a *director* of the *attest client*. [1.275.005]
- b. A *member* accepts responsibility for designing, implementing, or maintaining internal controls for the *attest client*. [1.295.030]
- c. A *member* hires, supervises, or terminates the *attest client's* employees. [1.295.135]

.16 Self-interest threat. The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, an *attest client* or persons associated with the *attest client*. Examples of self-interest *threats* include the following:

- a. A *member* has a *direct financial interest* or *material indirect financial interest* in the *attest client*. [1.240.010]
- b. A *member* has a *loan* from the *attest client*, an *officer* or a *director* of the *attest client* with the ability to affect decision-making, or any individual with a *beneficial ownership interest* (known through reasonable inquiry) that gives the individual *significant influence* over the *attest client*. [1.260.010]

- c. A *member* or his or her *firm* relies excessively on revenue from a single *attest client*.
- d. A *member* or *member's firm* has a material joint venture or other material joint business arrangement with the *attest client*. [1.265]

[See Revision History Table.]

.17 Self-review threat. The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made, or service performed or supervised by the *member* or an individual in the *member's firm* and that the *member* will rely on that service in forming a judgment as part of an *attest engagement*. Certain self-review *threats*, such as preparing *source documents* used to generate the *attest client's financial statements* [1.295.120], pose such a significant self-review *threat* that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level*.

.18 Undue influence threat. The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with an *attest client* or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. Management threatens to replace the *member* or *member's firm* over a disagreement on the application of an accounting principle.
- b. Management pressures the *member* to reduce necessary audit procedures in order to reduce audit fees.
- c. The *member* receives a gift from the *attest client*, its management, or its significant shareholders. [1.285.010]

Safeguards

.19 Safeguards may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards* applied will depend on many factors, including the size of the *firm* and whether the *attest client* is a *public interest entity*. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

.20 The following are three broad categories of *safeguards*:

- a. *Safeguards* created by the profession, legislation, or regulation.
- b. *Safeguards* implemented by the *attest client*. It is not possible to rely solely on *safeguards* implemented by the *attest client* to eliminate or reduce significant *threats* to an *acceptable level*.
- c. *Safeguards* implemented by the *firm*, including policies and procedures to implement professional and regulatory requirements.

.21 The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) that will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*

- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the *attest client* is a *public interest entity*

.22 Examples of various *safeguards* within each category are presented in paragraphs .21–.23 of the "Conceptual Framework for Members in Public Practice" [1.000.010]. The examples presented in these paragraphs are not intended to be all inclusive. In addition, *threats* may be sufficiently mitigated through the application of other *safeguards* not specifically identified in these paragraphs. [Prior reference: ET section 100-1]

Effective Date

.23 The addition of *partner equivalents* to paragraph .14b is effective for engagements covering periods beginning on or after December 15, 2014.

A nonauthoritative Conceptual Framework Toolkit for Independence is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/conceptualframeworktoolkitforindependence.docm>.

Nonauthoritative questions and answers regarding senior personnel's long association on an attest engagement are available in the ethics FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.220 Accounting Firms

A nonauthoritative question and answer regarding letter of intent to purchase practice is available in the Ethics FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.220.010 Network and Network Firms

General

.01 To enhance their capabilities to provide *professional services*, *firms* frequently join larger groups, which typically are membership associations that are separate legal entities and otherwise unrelated to their members. The associations facilitate their members' use of association services and resources. They do not themselves typically engage in *public practice* or provide *professional services* to their members' *clients* or other third parties.

.02 *Firms* and other entities in the association cooperate with the *firms* and other entities that are members of the association to enhance their capabilities to provide *professional services*. For example, a *firm* may become a member of an association in order to refer work to, or receive referrals from, other association members. That characteristic alone would not be sufficient for the association to constitute a *network* or for the *firm* to be considered a *network firm*.

.03 However, an association would be considered a *network* if, in addition to cooperation among member *firms* and other entities to enhance their capabilities to provide *professional services*, member *firms* and other entities share one or more additional characteristics described in paragraphs .07–.18 of this

section. If an association is considered a *network* and an entity is considered a *network firm* the classification should be applied consistently by all members of the association. When determining if one or more additional characteristics exist, *members* should give due consideration to what a reasonable and informed third party who is aware of the relevant information would be expected to conclude.

.04 A *network firm* is required to comply with the "Independence Rule" [1.200.001] with respect to the *financial statement* audit and review *clients* of the other *network firms* if the use of the audit or review report for the *client* is not restricted, as defined by professional standards. For all other *attest clients*, the *covered member* should consider any *threats* that the *covered member* knows or has reason to believe may be created by another *network firm's* interests and relationships. If those *threats* are not at an *acceptable level*, the *covered member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*. If *safeguards* cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, *independence* will be *impaired*. Entities within the *network* that meet the definition of a *network firm* are subject to the "Independence Rule."

.05 The determination that a *firm* or other entity or an association of *firms* or other entities meets the definition of a *network firm* and *network* is solely for purposes of this interpretation and may not be used or relied upon in any other context. In particular, determining whether a *firm* or other entity is a *network firm* or whether an association of *firms* or other entities is a *network* for purposes of defining legal responsibilities from one *firm* to the other or to third parties is beyond the scope of this interpretation.

Characteristics of a Network

.06 When an association is formed for the purpose of cooperating to enhance the *firms'* capabilities to provide *professional services*, and one of the characteristics described in paragraphs .07–.18 of this section also applies, the association is considered to be a *network*.

.07 *Sharing a common brand name*. This characteristic exists when the association's members or entities *controlled* by the association's members share the use of a common brand name or share common initials as part of the *firm* name.

.08 A *firm* that does not use a common brand name as part of its *firm* name but makes reference in its stationery or promotional materials to being a member of an association of *firms* should carefully consider how it describes that membership and take steps to avoid the perception that it belongs to a *network*. The *firm* may wish to avoid such perception by clearly describing the nature of its membership in the association (for example, by stating on its stationery or promotional material that it is "an independently owned and operated member firm of XYZ Association").

.09 *Sharing common control*. This characteristic exists when entities within the association are under common *control* with other firms in the association through ownership, management, or other means (for example, by contract). However, compliance with association requirements as a condition of membership does not indicate that members are under common *control*; rather, it reflects the type of cooperation that is expected when an entity joins the association.

.10 *Sharing profits or costs*. This characteristic exists when entities within the association share profits or costs. Following are examples of profit and cost sharing that would not create a *network*:

- a. Sharing immaterial costs
- b. Sharing costs related to operating the association
- c. Sharing costs related to the development of audit methodologies, manuals, and training courses
- d. Arrangements between a *firm* and an otherwise unrelated entity to jointly provide a service or develop a product

.11 *Sharing a common business strategy.* This characteristic exists when entities within the association share a common business strategy. Sharing a common business strategy involves ongoing collaboration among the *firms* whereby the *firms* are responsible for implementing the association's strategy and held accountable for performance pursuant to that strategy. An entity's ability to pursue an alternative strategy may be limited by the common business strategy because, as a member, it must act in accordance with the common business strategy and, therefore, in the best interest of the association.

.12 An entity is not considered to be a *network firm* merely because it cooperates with another entity solely to market *professional services* or responds jointly to a request for a proposal for the provision of a *professional service*.

.13 *Sharing significant professional resources.* This characteristic exists when entities within the association share a significant part of professional resources. *Members* should consider both qualitative and quantitative factors in determining whether the shared professional resources are significant.

.14 Examples of professional resources include the following:

- a. Common systems that enable *firms* to exchange information, such as *client* data, billing, and time records
- b. *Partners* and staff
- c. Technical departments to consult on technical or industry-specific issues, transactions, or events for assurance engagements
- d. Audit methodology or audit manuals
- e. Training courses and facilities

.15 When shared professional resources involve the exchange of *client* information or personnel, such as when staff are drawn from a shared pool or a common technical department is created within the association to provide participating *firms* with technical advice that the *firms* are required to follow, a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the shared professional resources are significant.

.16 When the entities within the association do not share a significant amount of human resources (for example, a *firm* occasionally uses personnel of another member *firm* to assist with an engagement, such as observing a *client's* physical inventory count) or significant *client* information (for example, *client* data, billing, and time records) and have the ability to make independent decisions regarding technical matters, audit methodology, training, and the like, the entities are not considered to be sharing a significant part of professional resources.

.17 When the shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities and do not include a significant amount of human resources or *clients* or markets, the shared professional resources are not considered significant.

.18 *Sharing common quality control policies and procedures.* This characteristic exists when entities within the association are required to follow common quality control policies and procedures that the association monitors.

Monitoring is the ongoing consideration and evaluation of the *firms'* systems of quality control, which enables the association to obtain reasonable assurance that the *firms'* systems of quality control are designed appropriately and operating effectively.

.19 Refer to paragraph .03d of the "Application of the AICPA Code" [0.200.020] for additional guidance. [Prior reference: paragraph .19 of ET section 101]

Nonauthoritative implementation guidance can be found at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-division-network-firm-implementation-guidance.pdf>.

Nonauthoritative frequently asked questions (FAQ) and case studies can be found at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/networkfirmfaqandcasestudies.pdf>

1.220.020 Alternative Practice Structures

.01 *Members* practicing public accounting in nontraditional practice structures (alternative practice structures [APS]) should apply this interpretation to determine whether they are in compliance with the "Independence Rule" [1.200.001].

.02 All such structures must be organized in a form that complies with applicable laws, rules, and regulations, the "Form of Organization and Name Rule" [1.800.001] and the related "Alternative Practice Structures" interpretation [1.810.050] of the "Form of Organization and Name Rule."

.03 For example, in an APS, a substantial piece of the nonattest portion of a *member's* practice may be conducted under public or private ownership, and the attest portion of the practice may be conducted through a separate *firm* that the *member* owns and *controls*.

Terminology

.04 The following terms are defined solely for the purpose of applying this interpretation:

- a. APS is a form of organization in which a *firm* that provides attest services is closely aligned with another public or private organization that performs other *professional services*.
- b. A covered member includes both employed and leased individuals who meet the definition of a *covered member*.
- c. The term direct superiors includes those persons so closely associated with a *partner* or *manager* who is a covered member that such persons can directly control the *partner's* or *manager's* activities. For this purpose, a person who can directly control is the immediate superior of the *partner* or *manager* who has the power to direct the activities of that person so as to be able to directly or indirectly (for example, through another entity over which the direct superior can exercise significant influence) derive a benefit from that person's activities. An example is the person who has day-to-day responsibility for the activities of the *partner* or *manager* and is in a position to recommend promotions and compensation levels. This group of persons is so closely aligned through

direct reporting relationships that their interests seem to be inseparable.

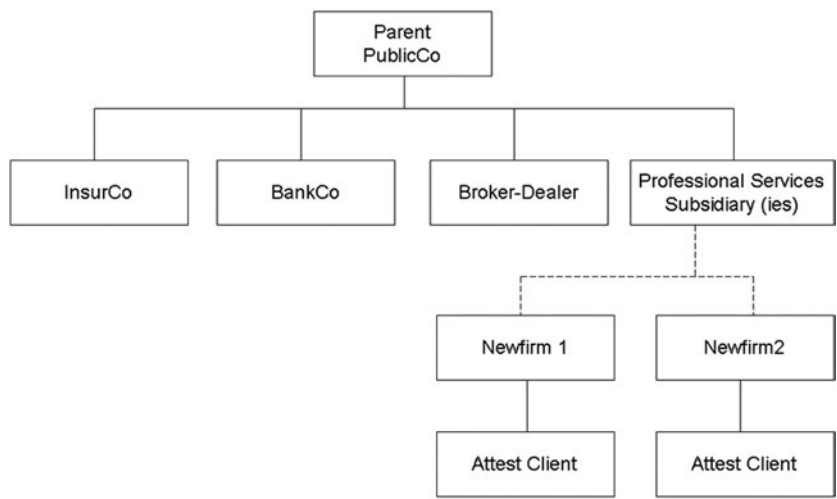
- d. Indirect superiors are not connected with *partners* and *managers* who are covered members through direct reporting relationships; rather, they are one or more levels above direct superiors of covered members (that is, there always is a level in between). Generally, this starts with persons in an organization structure to whom direct superiors report and go up the line from there. Indirect superiors also include the *immediate family* of indirect superiors.
- e. Other public company entities include the public company and all entities consolidated in the public company *financial statements* that are not subject to the "Independence Rule" [1.200.001] and its *interpretations* in their entirety.
- f. Significant influence is having the ability to exercise significant influence over the financial, operating, or accounting policies of the entity by, for example
 - i. being connected with the entity as a promoter, an underwriter, a voting trustee, a general partner, or a director;
 - ii. being in a policy-making position, such as chief executive officer, chief operating officer, chief financial officer, or chief accounting officer; or
 - iii. meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity.

APS Model

.05 The APS described in paragraphs .06–.07 in this section and the related chart provides an example of a structure in use at the time that this interpretation was developed. Many of the references in this interpretation are to the example, but *members* should apply the concepts in spirit and substance to variations of the example structure as they develop.

.06 The example APS in this interpretation is one in which an existing CPA practice (Oldfirm) is sold by its owners to another (possibly public) entity (PublicCo). PublicCo has subsidiaries or divisions, such as a bank, an insurance company, or a broker-dealer. It also has one or more professional service subsidiaries (PSS) or divisions that offer nonattest services (for example, tax, personal financial planning, and management consulting) to *clients*. The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA *firm* (Newfirm) to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (with regard to voting and financial interests). Attest services are performed by Newfirm and supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space, and equipment; the performance of back-office functions, such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

.07 The chief executive of the local office of the PSS where the *partners* of Newfirm are employed would be a direct superior. The chief executive of the PSS itself would be an indirect superior, and there may be indirect superiors in between, such as a regional chief executive of all PSS offices within a geographic area.



Interpretation

.08 The "Independence Rule" [1.200.001] and *interpretations* normally extend only to those persons and entities included in the definition of *covered members*. However, in an APS environment, the self-interest, management participation, self-review, advocacy, or undue influence *threats* to a covered member's compliance with the "Independence Rule" may not be at an *acceptable level* unless certain *safeguards* are implemented by other individuals or entities.

.09 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* when the following individuals or entities fail to apply the "Independence Rule" and *interpretations* with respect to *attest clients* of Newfirm:

- a. Covered members of Newfirm
- b. Direct superiors of any *partner* or *manager* who is a covered member of Newfirm and entities within the APS over which such individuals can exercise *significant influence*

.10 In addition, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* in the following circumstances:

- a. Indirect superiors and other public company entities have a material relationship with an *attest client* of Newfirm that is prohibited by the "Overview of Financial Interests" interpretation [1.240.010], the "Trustee or Executor" interpretation [1.245.010], the "Loans" interpretation [1.260.010], or the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence Rule" (for example, investments, *loans*, and so on). In making the test for materiality for financial relationships of an indirect superior, all the financial relationships with an *attest client* held by that person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of other public company

entities, all the financial relationships with an *attest client* held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated *financial statements* of PublicCo.

- b. Any other public company entity over which an indirect superior has direct responsibility has a financial relationship with an *attest client* during the *period of the professional engagement* that is material in relation to the other public company entity's *financial statements*.
- c. Financial relationships of indirect superiors or other public company entities allow such persons or entities to exercise significant influence over the *attest client* during the *period of the professional engagement*. In making the test for significant influence, financial relationships of all indirect superiors and other public company entities should be aggregated.
- d. Other public company entities or any of their employees are connected with an *attest client* of Newfirm as a promoter, an underwriter, a voting trustee, a director, or an officer during the *period of the professional engagement* or during the period covered by the *financial statements*.

.11 Indirect superiors and other public company entities may provide services to an *attest client* of Newfirm that would *impair independence* if performed by Newfirm, except as noted in paragraph .10d.

.12 When Newfirm and its *partners* and professional employees perform *attest engagements* for PublicCo or any of its subsidiaries or divisions, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.13 If an *attest client* of Newfirm holds an investment in PublicCo that is material to the *attest client* or that allows the *attest client* to exercise significant influence over PublicCo during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.14 When making referrals of services between Newfirm and any of the entities within PublicCo, a *member* should consider the provisions of the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] and the "Alternative Practice Structures" interpretation [1.810.050] of the "Form of Organization and Name Rule" [1.800.001]. [Prior reference: paragraph .16 of ET section 101]

1.220.030 Use of a Nonindependent CPA Firm on an Engagement

.01 If *partners* or professional employees from another *firm* that was not independent of an *attest client* participate on the *attest engagement team*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, the *firm's independence* would be *impaired*.

.02 However, the *firm* may use the work of such individuals in a manner similar to internal auditors, provided that the *firm* complies with AU-C

section 610, *Using the Work of Internal Auditors* (AICPA, *Professional Standards*). [Prior reference: paragraphs .142–.143 of ET section 191]

1.220.040 Firm Mergers and Acquisitions

.01 When (1) a *member's firm* merges with or acquires another firm or entity or all or part of the business thereof (acquired firm) or (2) a *member's firm*, or all or part of the business thereof, is merged with or acquired by another *firm* (acquiring firm), *threats* to compliance with the "Independence Rule" [1.200.001] may exist as a result of employment or association with, or the provision of nonattest services to, an *attest client* of the acquired or acquiring firm.

.02 When determining which *firm* is the acquirer, *members* should consider the guidance contained in paragraphs 11–15 of FASB ASC 805-10-55, among other sources.

Employment or Association With an Attest Client

.03 If a *partner* or professional employee was formerly employed by or associated with an entity as a director, officer, employee, promoter, underwriter, voting trustee, trustee of any pension or profit-sharing trust of the entity, or in any capacity equivalent to that of a member of management and that entity becomes an *attest client* through a merger or acquisition, then *threats* will be at an *acceptable level* and *independence* will not be *impaired* provided all of the following *safeguards* are met:

- a. The *partner* or professional employee terminates the relationship with the *attest client* (for example, resigns as a director) prior to the closing date of the merger or acquisition.
- b. The *partner* or professional employee does not participate on the *attest engagement team* and is not an *individual in a position to influence the attest engagement* for the *attest client* when the *attest engagement* covers any period that includes his or her former employment or association with that *attest client*.
- c. The applicable disassociation *safeguards* in paragraph .04 of the "Former Employment or Association With an Attest Client" interpretation [1.277.010] are implemented prior to the closing date of the merger or acquisition.
- d. As soon as practicable under the circumstances but before issuing the attest report, a responsible individual within the *firm* assesses the prior relationship of the *partner* or professional employee with the *attest client*, as well as the position he or she holds at the *firm*, to determine if *threats* are created that are not at an *acceptable level*. If the responsible individual determines that *threats* are not at an *acceptable level*, he or she should be satisfied that *safeguards* are applied to eliminate or reduce the *threats* to an *acceptable level*. *Threats* will not be at an *acceptable level* if
 - i. the *partner* or professional employee will have interaction with members of the *attest engagement team* regarding the *attest client* or
 - ii. the *attest engagement team* is placed in a position of evaluating the *partner* or professional employee's representations and work while he or she was employed or associated with the *attest client*.

In such situations, an individual within the *firm* with the appropriate stature, expertise, and objectivity should review the

subsequent *attest engagement* prior to issuing the attest report to determine whether the *attest engagement team* maintained integrity; objectivity; and, as appropriate, professional skepticism.

- e. As soon as practicable under the circumstances but before issuing the attest report, the nature of the relationship and any *safeguards* that were applied are discussed with *those charged with governance*. Documentation of the substance of the discussion with *those charged with governance* is encouraged.

Nonattest Services

.04 Nonattest services provided to an entity that becomes an *attest client* through a merger or an acquisition may create self-review, management participation, and advocacy *threats* to the *member's* compliance with the "Independence Rule" [1.200.001]. Specifically, *threats* may exist if, during the *period of the professional engagement* or the period covered by the *financial statements*, nonattest services that would otherwise *impair independence* (prohibited nonattest services) under the interpretations of the "Nonattest Services" subtopic [1.295] are performed by

- a. the acquiring firm, with respect to an *attest client* of the acquired firm or
- b. the acquired firm, with respect to an *attest client* of the acquiring firm.

Prohibited Nonattest Services Provided by Acquiring Firm

.05 If the acquiring firm provided prohibited nonattest services to an *attest client* of the acquired firm during the period covered by the *financial statements*, *threats* to compliance with the "Independence Rule" [1.200.001] will not be at an *acceptable level* and cannot be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, the acquiring firm's *independence* will be *impaired* with respect to the *attest client*.

Prohibited Nonattest Services Provided by Acquired Firm

.06 If the acquired firm provided prohibited nonattest services to an *attest client* of the acquiring firm prior to the financial statement period covered by the acquiring firm's next attest report, the acquiring firm's *independence* would not be *impaired*.

.07 If the acquired firm provided prohibited nonattest services to an *attest client* of the acquiring firm during the *period of the professional engagement* (except as provided for in paragraph .06) or the period covered by the *financial statements*, the acquiring firm's *independence* would be *impaired* unless all of the following conditions are satisfied:

- a. The acquired firm terminates the prohibited nonattest services (or modifies the service offerings such that they would not *impair independence*) prior to the closing date of the merger or acquisition.
- b. Any individual who participated in the engagement to provide the prohibited nonattest services is neither on the *attest engagement team* nor an *individual in a position to influence the attest engagement*.
- c. An evaluation of the *threats* is performed and *threats* are determined to be at an *acceptable level* or reduced to an *acceptable level* by the application of *safeguards*. The evaluation should be

conducted on the basis of the attribution of the results of the nonattest services to the acquiring firm. That is, if the nonattest services

- i. can be attributed to the acquiring firm because the acquiring firm will assume responsibility for the results of the nonattest services, then the evaluation should assess all prohibited nonattest services that the acquired firm performed for the *attest client* during the financial statement period to be covered by the acquiring firm's next attest report; or
- ii. cannot be attributed to the acquiring firm, then the evaluation should assess all prohibited nonattest services that the acquired firm performed for the *attest client* during the period in which the merger or acquisition was pending (that is, from the commencement of negotiations through the closing date of the merger or acquisition).

.08 In evaluating the significance of any *threats*, consideration should also be given to the following:

- a. Whether the nonattest service is attributed to the acquiring firm and whether the work performed or its results will be subject to attest procedures.
- b. The significance of the results of the nonattest service to the *attest client's financial statements*.
- c. The extent to which the *attest client* and its management were involved in overseeing the nonattest services performed (including making any significant judgments and decisions with respect to the nonattest services) and whether the *attest client* and its management possessed the suitable skill, knowledge and/or experience to oversee such services.
- d. Whether the nonattest services involved the assumption of a management responsibility.

.09 If the *member* concludes that the *threats to independence* are not at an *acceptable level*, the *member* should apply *safeguards* to reduce *threats* to an *acceptable level*.

.10 Examples of *safeguards* include the following:

- a. An individual not associated with the nonattest engagement reviews the nonattest services work performed.
- b. Another *firm* performs an *attest engagement* on the subject matter of the nonattest service.
- c. Another *firm* re-performs the nonattest service to the extent necessary for it to take responsibility for that service.

If no *safeguards* exist that will eliminate or reduce the *threats* to an *acceptable level*, *independence* will be *impaired*.

Communications With Those Charged With Governance

.11 As soon as practicable under the circumstances but before issuing the attest report, the nature of the prohibited nonattest services performed by the acquired firm that are subject to evaluation in paragraph .07c and any *safeguards* applied should be discussed with *those charged with governance*.

Documentation of the substance of the discussion with *those charged with governance* is encouraged.

Other Interests in and Relationships With an Attest Client

.12 This interpretation addresses only *threats to independence* that may arise as a result of a merger or an acquisition relating to employment or association with, or the provision of nonattest services to, an *attest client*. However other interests in, and relationships with, an *attest client* may also result in *threats to compliance* with the "Independence Rule" [1.200.001] or other rules during a merger or acquisition. Accordingly, *members* should take whatever pre-merger actions are necessary to be satisfied that the *firm* is in compliance with all relevant rules prior to the closing date of the merger or acquisition.

Confidentiality Considerations

.13 Refer to the "Disclosing Client Information in Connection With a Review of the Member's Practice" interpretation [1.700.050] of the "Confidential Client Information Rule" [1.700.001] for additional guidance.

Effective Date

.14 This interpretation is effective for mergers or acquisitions with closing dates on or after January 31, 2016. Early implementation is allowed.

1.224 Affiliates, Including State and Local Government Affiliates

1.224.010 Client Affiliates

.01 *Financial interests* in, and other relationships with, *affiliates* of a *financial statement attest client* may create *threats to a member's compliance* with the "Independence Rule" [1.200.001].

.02 When a *client* is a *financial statement attest client*, *members* should apply the "Independence Rule" [1.200.001] and related *interpretations* applicable to the *financial statement attest client* to their *affiliates*, except in the following situations:

- a. During the *period of the professional engagement*, a *covered member* may have a *loan* to or from an
 - i. officer or director of an *affiliate* of a *financial statement attest client*, unless the officer or director has the ability to affect the decision-making at the *financial statement attest client*.
 - ii. individual with a *beneficial ownership interest* (known through reasonable inquiry) in an *affiliate* of a *financial statement attest client*, unless the ownership interest gives the individual *significant influence* over the *financial statement attest client*.
- b. A *member* or the *member's firm* may provide prohibited nonattest services to entities described under items c–l of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided that it is reasonable to conclude that the services do not create a self-review *threat* with respect to the *financial statement attest client* because the results of the nonattest services will not be subject to *financial statement attest procedures*. For any other *threats* that are created by the provision of the nonattest services that are not

at an *acceptable level* (in particular, those relating to management participation), the *member* should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*.

- c. A *firm* will only have to apply the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] of the "Independence Rule" if the former employee, by virtue of his or her employment at an entity described under items c–l of the definition of *affiliate*, is in a *key position* with respect to the *financial statement attest client*. *Individuals in a position to influence the attest engagement* and on the *attest engagement team* who are considering employment with an *affiliate* of a *financial statement attest client* will still need to report consideration of employment to an appropriate person in the *firm* and remove themselves from the *financial statement attest engagement*, even if the position with the *affiliate* is not a *key position*.
- d. A *covered member's immediate family members* and *close relatives* may be employed in a *key position* at an entity described under items c–l of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided they are not in a *key position* with respect to the *financial statement attest client*.
- e. A *covered member* who is an individual on the *attest engagement team*, an individual in a position to influence the *attest engagement*, or the *firm* may have a lease that does not meet the requirements of the "Leases" interpretation [1.260.040] under the "Independence Rule" with an entity described under items c–l of the definition of *affiliate* during the period of the professional engagement. The *covered member* should use the "Conceptual Framework for Independence" to evaluate whether any *threats* created by the lease are at an *acceptable level*. If the *covered member* concludes that *threats* are not at an *acceptable level*, the *covered member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*.
- f. A *member* or *member's firm* may enter into a staff augmentation arrangement with entities described under items (c)–(l) of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*. The *member* should use the "Conceptual Framework for Independence" to evaluate whether any *threats* created by the staff augmentation arrangement are at an *acceptable level*. If the *member* concludes that *threats* are not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*. If *safeguards* are not available or cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, the *member* should not enter into the staff augmentation arrangement.

.03 A *member* must expend best efforts to obtain the information necessary to identify the *affiliates* of a *financial statement attest client*. If, after expending best efforts, a *member* is unable to obtain the information to determine which entities are *affiliates* of a *financial statement attest client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the *member* (a) discusses the matter, including the potential impact on *independence*, with those *charged with governance*; (b) documents the results of that discussion and the efforts taken to obtain the information; and (c) obtains written assurance from

the *financial statement attest client* that it is unable to provide the *member* with the information necessary to identify the *affiliates* of the *financial statement attest client*.

.04 This interpretation does not apply with respect to a *financial statement attest client* that is covered by the "State and Local Government Client Affiliates" interpretation [1.224.020] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .20 of ET section 101]

Acquisition or Other Transaction Involving a Financial Statement Attest Client or Its Affiliates That Results in the Creation of a New Affiliate

.05 An entity may become a new *affiliate* of an existing *financial statement attest client* because of an acquisition or other transaction. A *threat to independence* and, therefore, to the ability of a *member* or *member's firm* to continue a *financial statement attest engagement* might be created by previous or current interests or relationships between the *member* or *member's firm* and the new *affiliate*. Paragraphs .06–.13 provide guidance on how independence is affected when such interests in or relationships with a new affiliate exist.

An Existing Financial Statement Attest Client Is Acquired and the Member or Member's Firm Will Not Continue Providing Financial Statement Attest Services to Such Client After the Current Attest Report Is Issued and the Report Does Not Cover Periods After the Effective Date of the Acquisition

.06 When a *member* or *member's firm* has an interest in or relationship with an acquirer that may *impair independence* as a result of the requirements of this interpretation, *independence* with respect to the *financial statement attest client* will not be considered *impaired* if all the following conditions are met:

- a. The acquisition occurs during the *period of the professional engagement*.
- b. The *financial statement attest engagement* covers only periods prior to the effective date of the acquisition.
- c. The *member* or *member's firm* will not continue to provide *financial statement attest services* to the existing *financial statement attest client* for periods after the effective date of the acquisition.

An Existing Financial Statement Attest Client or Its Affiliate Is Involved in an Acquisition or Other Transaction and the Member or Member's Firm Expects to Continue Providing Financial Statement Attest Services to Such Client

.07 When an acquisition or other transaction creates a new *affiliate* of a *financial statement attest client* during the *period of the professional engagement* and the *member* or *member's firm* expects to continue providing *financial statement attest services* to the *financial statement attest client* after the effective date of the acquisition or other transaction, the following conditions should be met:

- a. The *member* or *member's firm* should identify and evaluate previous and current interests in and relationships with the new *affiliate*, including actions taken to address the *threat to independence*, that might affect *independence* and therefore the *member's* or *member's firm's* ability to continue the *financial statement attest engagement* after the effective date of the acquisition or other transaction.

- b. Except as provided for in paragraph .08, the *member* or *member's firm* should take steps to end any interests in or relationships with the new *affiliate* that would *impair independence* by the effective date of the acquisition or other transaction.

.08 As an exception to paragraph .07b, if the interest in or relationship with the new *affiliate* cannot reasonably be ended by the effective date of the acquisition or other transaction (for example, the new *affiliate* is not able to transition a nonattest service in an orderly manner to another service provider by that date), the *member* or *member's firm* should do the following:

- a. Evaluate the *threat to independence* that is created by the interest or relationship. Factors that are relevant in evaluating the significance of a *threat* when there are interests and relationships with a new *affiliate* that cannot reasonably be ended could include these:
 - i. The nature and significance of the interest or relationship
 - ii. The nature and significance of the *affiliate* relationship (for example, whether the *affiliate* is a subsidiary, parent, or sister entity)
 - iii. The length of time until the interest or relationship can reasonably be ended
- b. Discuss with *those charged with governance* the evaluation of the significance of *threat* and the reasons that the interest or relationship cannot reasonably be ended by the effective date of the acquisition or other transaction.

.09 Following the discussion in paragraph .08b, if *those charged with governance* request the *member* or *member's firm* to continue to provide *financial statement* attest services to the *financial statement attest client*, the *member* or *member's firm* should do so only under the following circumstances:

- a. The interest in or relationship with the new *affiliate* that would *impair independence* will end as soon as reasonably possible but no later than six months after the effective date of the acquisition or other transaction.
- b. Any individual who has such an interest in or relationship with the new *affiliate*, including one that has arisen through performing a nonattest service that would *impair independence* under the "Nonattest Services" subtopic [1.295] of the "Independence Rule" [1.200.001], will not be a member of the *attest engagement team* or an individual responsible for the engagement quality control review.
- c. *Safeguards* will be applied, as necessary, and discussed with *those charged with governance*.

An Existing Financial Statement Attest Client or Its Affiliate Is Involved in an Acquisition or Other Transaction and the Member or Member's Firm Will Complete the Existing Financial Statement Attest Engagement but Will Not Continue Providing Such Services After the Current Attest Report Is Issued but the Report May Cover Periods After the Effective Date of the Acquisition or Other Transaction

.10 When a *member* or *member's firm* will not continue to provide *financial statement* attest services to the *financial statement attest client* that is involved in an acquisition or other transaction, the *member* or *member's firm* may issue

the current report covering a period after the effective date of the acquisition or other transaction if all the following conditions are met:

- a. The *member* or *member's firm* completed a significant amount of work on the current *financial statement attest engagement* prior to the effective date of the acquisition or other transaction. Whether a significant amount of work has been completed will depend upon the remaining procedures as compared to the overall engagement procedures.
- b. The *member* or *member's firm* expects to complete the remaining *financial statement attest* procedures and issue the attest report within a reasonable period of time. A reasonable period of time will be dependent upon facts and circumstances.
- c. *Those charged with governance* request that the *member* or *member's firm* complete the *financial statement attest engagement* despite the *member* or *member's firm* continuing to have an interest in or relationship with the new *affiliate* that will *impair independence*.
- d. The *member* or *member's firm* has evaluated the significance of the *threat* to *independence* and discussed the results with *those charged with governance*.
- e. The *member* or *member's firm* complies with the requirements of paragraph .09b-c.
- f. The *member* or *member's firm* ceases to be the auditor no later than the date that the attest report is issued.

Other Considerations When an Existing Financial Statement Attest Client or Its Affiliate Is Involved in an Acquisition or Other Transaction

.11 Objectivity. Even if all the requirements of paragraphs .06-.10 could be met, the *member* or *member's firm* should consider whether the requirements of the "Conflicts of Interest for Members in Public Practice" interpretation [1.110.010] under the "Integrity and Objectivity Rule" [1.100.001] are applicable, with regard to any circumstances identified in paragraphs .06, .07, or .10.

.12 Documentation. The *member* or *member's firm* should consider documenting the following:

- a. Any interests or relationships identified in paragraphs .07 or .10 that will not be ended by the effective date of the acquisition or other transaction and the reasons they will not be ended
- b. The *safeguards* applied, if appropriate
- c. The results of the discussion with *those charged with governance*
- d. The reasons the previous and current interests and relationships do not create a *threat* that will compromise objectivity

.13 Circumstances involving foreign network firms. A *member* should refer to paragraph .03 of "Application of the AICPA Code" [0.200.020] for guidance on circumstances involving foreign *network firms*.

Effective Date

.14 Paragraphs .01-.04 are effective for engagements covering periods beginning on or after January 1, 2014. Early implementation is allowed.

[See Revision History Table.]

Nonauthoritative questions and answers regarding the application of the independence rules to affiliates of employee benefit plans are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf>.

1.224.020 State and Local Government Client Affiliates

Applicability

.01 This interpretation applies to state and local government entities (as defined in paragraph .03d of this interpretation) that are *financial statement attest clients*.

.02 When an *interpretation* of the "Independence Rule" [1.200.001] is applied in a state or local government environment and the *interpretation* uses terminology that is not applicable in this environment, the *member* should use professional judgment to determine if there is an equivalent term. For example, certain *interpretations* use the phrase "officer, director, or owner of the *attest client*." In some state or local government environments, it may be necessary for the *member* to extend these *interpretations* to officials of the *financial statement attest client* when the official has governance responsibilities or control over financial reporting.

Terminology

.03 The following terms are defined here solely for use with this interpretation:

- a. An affiliate of a *financial statement attest client* exists in all the following situations:
 - i. The entity is included in the *financial statement attest client's financial statements* and the *member* or *member's firm* does not make reference to another auditor's report on the entity.
 - ii. The entity is included in the *financial statement attest client's financial statements*, the *member* or *member's firm* makes reference to another auditor's report on the entity, and
 - (1) the entity is material to the *financial statement attest client's financial statements* as a whole and
 - (2) the *financial statement attest client* has more than minimal influence over the entity's accounting or financial reporting process. There is a rebuttable presumption that the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of funds and blended component units.
 - iii. The entity is a material excluded entity, and the *financial statement attest client* has more than minimal influence over the entity's accounting or financial reporting process. A material excluded entity is an entity that is required under the applicable financial reporting framework to be

included in the *financial statements* of the *financial statement attest client* but is, nevertheless, excluded by the *financial statement attest client* and is material to the *financial statement attest client's financial statements* as a whole. There is a rebuttable presumption that the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of funds and blended component units.

- iv. The investor, which is either the *financial statement attest client* or an affiliate as defined in item (i) of this definition, has an investment in an investee when the investor either
 - (1) *controls* the investee, unless the investment in the investee is trivial and clearly inconsequential to the *financial statement attest client's financial statements* as a whole, or
 - (2) has *significant influence* over the investee and the investment in the investee is material to the *financial statement attest client's financial statements* as a whole.
- b. An entity is intended to be broadly defined and can include funds, component units, departments, agencies, programs, organizational units, fiduciary activities, custodial activities, employee benefit plans, and suborganizational units of the preceding entities.
- c. An investment is a security or other asset that an investor, which is either the *financial statement attest client* or an affiliate, as defined in item (ai) of this paragraph, holds primarily for the purpose of income or profit and has a present-service capacity based solely on its ability to generate cash or to be sold to generate cash. This includes investments and ownership of an equity interest in common stock accounted for using the equity method of accounting as provided for in GASB Codification Section I50. The following interests are not considered investments for purposes of this interpretation:
 - i. Interests obtained by an investor as a result of an action by a third party, such as through a bequest or a grant, and that the investor does not intend to retain and does not retain for more than a reasonable period of time given the temporary nature of the investment
 - ii. Equity interests in joint ventures, partnerships, LLCs, or other types of entities where the investor's principal purpose is to directly enhance its ability to provide governmental services
 - iii. Equity interests in component units where the investor's principal purpose is to directly enhance its ability to provide governmental services
 - iv. Interests that would otherwise be considered an entity as defined in item (b) of this paragraph
- d. State and local government entities are entities whose generally accepted accounting principles standard setter is GASB. Examples of state and local government entities include general purpose governments and special purpose governments. Examples of general purpose governments include states, counties, cities,

towns, villages, and Indian tribes. Examples of special purpose governments include cemetery districts, school districts, universities and colleges, utilities, hospitals or other health care organizations, public airports, public housing authorities, financing authorities, public transportation systems, public employee retirement systems (PERs), post-employment benefit plans, pension plans, public-entity risk pools, external investment pools, state tuition programs, and other special districts.

Interpretation

.04 *Financial interests* in, and other relationships with, affiliates of a *financial statement attest client* may create *threats* to a *member's* compliance with the "Independence Rule."

.05 *Members* should apply the "Independence Rule" and related *interpretations* applicable to a *financial statement attest client* to their affiliates except as provided for in paragraph .07 of this interpretation.

.06 However, if the *member* encounters circumstances or relationships that may create *threats* to *independence*, the *member* should apply the "Conceptual Framework for Independence" [1.210.010] to evaluate whether *threats* are at an *acceptable level*. Examples of such circumstances or relationships could include the following:

- a. A *covered member's* immediate family member is in a *key position* with a nonaffiliate that includes the *financial statement attest client* in its *financial statements* and the nonaffiliate provides accounting staff, shares financial information systems, or establishes internal controls over financial reporting for the *financial statement attest client*.
- b. The *member* or *member's firm* is considering providing financial information system design services to a nonaffiliate in which the same financial information system would also be used by the *financial statement attest client*.
- c. A *covered member* has a *financial interest* in a nonaffiliate that includes the *financial statement attest client* in its *financial statements*, and the nonaffiliate prepares the *financial statements* for the *financial statement attest client*.
- d. The *financial statement attest client* participates in a public-private partnership or joint venture that does not meet the definition of an investment in paragraph .03c of this interpretation. A *covered member* has a *financial interest* in an organization that is also involved with the public-private partnership or joint venture.
- e. A *covered member* owns utility bonds issued by a nonaffiliate, and the *financial statement attest client* is responsible for payment of the utility bond debt service.
- f. A *covered member* owns conduit debt issued by the *financial statement attest client* on behalf of a nonaffiliate. The conduit debt is not accounted for on the *financial statements* of the *financial statement attest client*, and the debt service is paid by the nonaffiliate.

Exception

.07 The *member* and *member's firm* may provide prohibited nonattest services to entities described under items (a_{ii}) and (a_{iii}) of paragraph .03 during the *period of the professional engagement* or during the period covered by the

financial statements provided that it is reasonable to conclude that the services do not create a self-review *threat* with respect to the *financial statement attest client* because the results of the nonattest services will not be subject to the *covered member's* financial statement attest procedures. For any other *threats* created by the provision of the nonattest services that are not at an *acceptable level* (in particular, those relating to management participation), the *member* should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*.

Best Efforts

.08 A *member* must expend best efforts to obtain the information necessary to identify affiliates of a *financial statement attest client*. If, after expending best efforts, a *member* is unable to obtain the information to determine which entities are affiliates of a *financial statement attest client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the *member*

- a. discusses the matter, including the potential impact on *independence*, with *those charged with governance*;
- b. documents the results of that discussion and the efforts taken to obtain the information; and
- c. obtains written assurance from the *financial statement attest client* that it is unable to provide the *member* with the information necessary to identify the affiliates of the *financial statement attest client*.

More Than Minimal Influence Over Accounting and Financial Reporting Process

.09 The overall facts and circumstances should be considered when evaluating the level of influence the *financial statement attest client* has over the accounting or financial reporting process of an entity in the *financial statement attest client's financial statements*. The targeted analysis is applied solely to the accounting and financial reporting process of the entity as opposed to the analysis of what entities are included in the *financial statement attest client's financial statements*. Factors such as the following may assist *members* with this evaluation:

- a. The extent of involvement the *financial statement attest client* has in preparing the *financial statements* of the entity
- b. The extent of operational control the *financial statement attest client* has over the entity
- c. The extent to which both the *financial statement attest client* and the entity have the same
 - i. accounting or finance staff;
 - ii. accounting systems; and
 - iii. internal control over financial reporting systems
- d. The extent to which the *financial statement attest client*
 - i. can direct the behaviors or actions of the governing board of the entity;
 - ii. can add or remove members of the governing board of the entity;
 - iii. issues or pays for the entity's debt;
 - iv. finances the entity's deficits; and
 - v. uses or takes the entity's financial resources

.10 Whereas some factors may indicate influence, others may indicate little to no influence. Some factors may be weighted differently depending on the circumstances and the subject matter of any potential impairment. *Members* should take a substantive approach to evaluating the factors (for example, the *financial statement attest client* exercises a right) rather than merely considering form (for example, the *financial statement attest client* has a right that is not exercised). The consideration of these factors will require the *member* to exercise professional judgment when determining whether more than minimal influence exists.

Material to the Financial Statement Attest Client's Financial Statements as a Whole

.11 Determination of materiality is a matter of professional judgment. *Members* should consider both quantitative and qualitative factors when determining whether an entity or investment is material to a *financial statement attest client's financial statements* as a whole. For purposes of this interpretation, materiality is intended to be applied at the level of the *financial statement attest client's financial statements*, rather than individual opinion units in circumstances in which there may be more than one opinion unit.

[See Revision History Table.]

A nonauthoritative implementation guide to help understand which entities are affiliates of state and local government financial statement attest clients is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/implementation-guide-state-and-local-government-client-affiliates.pdf>. Additional related nonauthoritative tools include an excel template <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/interactive-slg-affiliate-matrix.xlsx> and two survey tools at <https://www.surveymonkey.co.uk/r/Entityaffiliateevaluator> and <https://www.surveymonkey.co.uk/r/Investmentaffiliateevaluator>.

1.226 Reissued Reports

1.226.010 Consenting to the Use of a Previously Issued Report

.01 A *member* or *member's firm* who was in compliance with the "Independence Rule" [1.200.001] when initially issuing a report may reissue the previously issued report or consent to, or acknowledge the inclusion or incorporation by reference of, the report when the *member* or *member's firm's independence* is *impaired*, provided that the *member* or *member's firm* does not perform procedures that require updating the date or dual dating the report.

.02 In order to consent to, or acknowledge the inclusion or incorporation by reference of, a previously issued report, the *member* or *member's firm* may perform procedures required by applicable professional standards when the *member's* or *member's firm's independence* is *impaired*. Such procedures include making inquiries of successor auditors, reading the subsequent *financial statements*, or other procedures that the *member* believes are necessary to assess the effect of subsequently discovered facts on the *financial statements*.

covered by the previously issued report. [Prior reference: paragraphs .200–.201 of ET section 191]

1.228 Engagement Contractual Terms

1.228.010 Indemnification of a Covered Member

.01 *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and a *covered member's independence* would not be *impaired* if the *covered member* includes in engagement letters a clause that provides that its *attest client* would release, indemnify, defend, and hold the *covered member* (and the *covered member's partners*, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. [Prior reference: paragraphs .188–.189 of ET section 191]

.02 Refer to the "Indemnification and Limitation of Liability Provisions" interpretation [1.400.060] of the "Acts Discreditable Rule" [1.400.001].

1.228.020 Indemnification of an Attest Client

.01 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* enters into an agreement providing, among other things, that the *covered member* indemnifies the *attest client* for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to the *attest client's* acts. The *covered member's independence* would be *impaired* under these circumstances. [Prior reference: paragraphs .204–.205 of ET section 191]

1.228.030 Alternative Dispute Resolution

.01 A *covered member* may include in an engagement letter a provision to use alternative dispute resolution (ADR) techniques to resolve disputes relating to past services (in lieu of litigation). *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* because the *covered member* and *attest client* would not be in positions of material adverse interests due to threatened or actual litigation.

.02 The *covered member* should exercise professional judgment when rendering current services, regardless of the existence of the provision. [Prior reference: paragraphs .190–.191 of ET section 191]

.03 If ADR techniques are initiated to resolve a dispute with the *attest client*, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* when the ADR techniques are designed to facilitate negotiation, and the conduct of those negotiations does not place the *covered member* and the *attest client* in positions of material adverse interests. *Independence* would not be *impaired* under these circumstances. If, however, the ADR proceedings are sufficiently similar to litigation (as in the case of binding arbitration), an adverse interest *threat* may exist and place the *covered member* and the *attest client* in a position of material adverse interests. Under such circumstances, the *member* should apply the guidance under the "Actual or

Threatened Litigation" interpretation [1.290.010] of the "Independence Rule." [Prior reference: paragraphs .192–.193 of ET section 191]

1.230 Fees

A nonauthoritative question and answer regarding *pro bono* and below cost fees is available in the Ethics FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.230.010 Unpaid Fees

.01 The existence of unpaid fees to a *covered member* for *professional services* previously rendered to an *attest client* may create self-interest or undue influence *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001]. Unpaid fees include fees that are unbilled or a note receivable arising from such fees.

.02 Factors to consider when evaluating whether *threats* are at an *acceptable level* include the following:

- a. The significance of the unpaid fees to the *covered member*
- b. The length of time the fees have been due from the *attest client*
- c. The *attest client's* agreement to pay the unpaid fees
- d. The *covered member's* assessment of factors affecting the ability of the *attest client* to pay the fees

.03 *Threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] are at an *acceptable level* if, when the current-year attest report is issued, unpaid fees are both clearly insignificant to the *covered member* and relate to *professional services* provided less than one year prior to the date of the current-year attest report. Alternatively, *threats* would not be at an *acceptable level* if, when the current-year attest report is issued, unpaid fees are both significant to the *covered member* and relate to *professional services* provided more than one year prior to the issue date of the current-year attest report. Other situations may require judgment to assess whether there are *threats* to the *covered member's* compliance with the "Independence Rule."

.04 If the *covered member* concludes that *threats* are not at an *acceptable level*, then the *covered member* should apply safeguards to eliminate the threats or reduce them to an acceptable level. Application of more than one safeguard may be required to eliminate or reduce threats to an acceptable level. If safeguards are not available or cannot be applied to eliminate or reduce the threats to an acceptable level, then independence would be impaired. Examples of actions that might be safeguards include the following:

- a. Have an appropriate reviewer who has not provided attest or nonattest services to the *attest client* review the attest work performed before the current-year attest report is issued.
- b. Obtain partial payment of the unpaid fees balance before the current-year attest report is issued such that the remaining unpaid balance is insignificant to the *covered member*.
- c. Obtain an agreement from the *attest client* to a payment schedule before the current-year attest report is issued.
- d. Suspend further work on current attest engagements and not accept new engagements with this *attest client*.

.05 Communication with those charged with governance regarding evaluation of the unpaid fees and safeguards applied is not a sufficient safeguard when applied alone; however, it may be considered a safeguard when supplemented by other safeguard(s), such as those noted in paragraph .04a–d.

.06 This interpretation does not apply to unpaid fees from an *attest client* in bankruptcy. [Prior reference: paragraphs .103–.104 of ET section 191]

.07 Refer to the "Fees and Other Types of Remuneration" topic [1.500] for additional guidance.

[See Revision History Table.]

1.230.020 Fees and Other Types of Remuneration

.01 See the "Fees and Other Types of Remuneration" topic [1.500] for guidance on contingent fees, commissions, and referral fees. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

1.240 Financial Interests

1.240.010 Overview of Financial Interests

.01 If a *covered member* had or was committed to acquire any *direct financial interest* in an *attest client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

.02 If a *covered member* had or was committed to acquire any *material indirect financial interest* in an *attest client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

.03 If a *partner* or professional employee of the *firm*, his or her *immediate family*, or any group of such persons acting together owned more than 5 percent of an *attest client's* outstanding equity securities or other ownership interests during the *period of the professional engagement*, the self-interest *threat* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02B of ET section 101]

.04 Refer to the "Joint Closely Held Investments" interpretation [1.265.020] for additional guidance.

1.240.020 Unsolicited Financial Interests

.01 When a *covered member* becomes aware that he or she will receive, or has received, an *unsolicited financial interest* in an *attest client* during the

period of the professional engagement, such as through a gift or an inheritance, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if both of the following *safeguards* are met:

- a. The *covered member* disposes of the *financial interest* as soon as practicable but no later than 30 days after the *covered member* has knowledge of and obtains the right to dispose of the *financial interest*.
- b. The *covered member* does not participate on the *attest engagement team* during the period in which the *covered member* does not have the right to dispose of a material *direct financial interest* or material *indirect financial interest*. [Prior reference: paragraph .17 of ET section 101]

[See Revision History Table.]

1.240.030 *Mutual Funds*

.01 A *covered member* who owns shares in a mutual fund has a *direct financial interest* in the mutual fund. However, whether the underlying investments in the mutual fund are considered to be the *covered member's direct financial interests* or *indirect financial interests* depends on the proportion of the mutual fund's outstanding shares that the *covered member* owns and whether the mutual fund is diversified.

.02 If a *covered member* owns 5 percent or less of the outstanding shares of a diversified mutual fund, the underlying investments would be considered immaterial *indirect financial interests*. Accordingly, the self-interest *threat* would be at an *acceptable level*, and *independence* would not be *impaired*. To determine if the mutual fund is diversified, the *covered member* should consider referring to (a) the mutual fund's prospectus for disclosure regarding fund management's determination regarding diversification and (b) Section 5(b)(1) of the Investment Company Act of 1940.

.03 If a *covered member* owns more than 5 percent of a diversified mutual fund's outstanding shares, or if a *covered member* owns a *financial interest* in a nondiversified mutual fund, the *covered member* should evaluate the mutual fund's underlying investments to determine whether the *covered member* holds a material *indirect financial interest* in any of the underlying investments.

.04 The following example illustrates how to determine if the underlying investments are material to a *covered member's* net worth. If

- a nondiversified mutual fund owns shares in client company A,
- the mutual fund's net assets are \$10 million,
- the *covered member* owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000, and
- the mutual fund has 10 percent of its assets invested in company A,

then the *covered member's indirect financial interest* in company A is \$10,000 (\$100,000 × 10%). The *covered member* would then compare the \$10,000 *indirect financial interest* with his or her net worth, including the net worth of his or her *immediate family*, to determine if the *indirect financial interest* in company A is material. [Prior reference: paragraph .17 of ET section 101]

1.240.040 Retirement, Savings, Compensation, or Similar Plans

.01 Depending upon the facts and circumstances, *financial interests* held in a retirement, savings, compensation, or similar plan are either *direct financial interests* or *indirect financial interests*.

.02 Investments held by a retirement, savings, compensation, or similar plan sponsored by a *firm* are *direct financial interests* of the *firm*.

.03 If a *covered member* or his or her *immediate family* self-directs the investments in a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan's investment decisions, the *financial interests* held by the plan are *direct financial interests* of the *covered member*. For example,

- a. when a *covered member* or his or her *immediate family member* is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan's investment decisions (including through the selection of investment managers or pooled investment vehicles), the underlying investments are *direct financial interests* of the *covered member*.
- b. for self-directed or participant-directed plans (that is, the *covered member* or his or her *immediate family member* selects the underlying plan investments or selects from investment alternatives offered by the plan), the underlying investments are *direct financial interests* of the *covered member*.

.04 When the *covered member* or his or her *immediate family* do not participate in a self-directed or participant-directed plan and have no authority to supervise or participate in the plan's investment decisions, the underlying investments would be considered to be *indirect financial interests* of the *covered member*.

.05 *Financial interests* held by a defined benefit plan are not considered *financial interests* of the *covered member* unless the *covered member* or his or her *immediate family member* is a trustee of the plan or otherwise has the ability to supervise or participate in the plan's investment decisions.

.06 Allocated shares held in an employee stock ownership plan (ESOP) are considered *beneficially owned* by the *covered member*. Until the *covered member* or his or her *immediate family member* has the right to dispose of the allocated shares of the ESOP, the beneficial ownership is considered an *indirect financial interest*. Once the participant has the right to dispose of the *financial interests*, the *financial interests* are *direct financial interests* of the *covered member*.

.07 Rights to acquire equity interests, restricted stock awards, or other *share-based compensation arrangements* are considered the *direct financial interests* of the *covered member*, regardless of whether such *financial interests* are vested or exercisable.

.08 See the "Plan Is an Attest Client or Is Sponsored by an Attest Client" interpretation [1.250.010] and the "Former Employment or Association With an Attest Client" interpretation [1.277.010] of the "Independence Rule" [1.200.001] and the interpretations of the "Family Relationships With Attest Clients" subtopic [1.270] under the "Independence Rule." [Prior reference: paragraph .17 of ET section 101]

1.240.050 Partnerships

.01 When used in this interpretation, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*.

.02 The ownership of a general or limited partnership interest is considered a *direct financial interest* in the partnership.

.03 *General partner.* If the *covered member* is a general partner, the *financial interests* held by a partnership are a *covered member's direct financial interests* because the *covered member* is in a position to control the partnership or supervise or participate in the partnership's investment decisions.

.04 *Limited partner.* If the *covered member* is a limited partner, the *financial interests* held by a limited partnership are a *covered member's indirect financial interests* as long as the *covered member* does not control the partnership or supervise or participate in the partnership's investment decisions. However, if the *covered member* has the ability to replace the general partner or has the authority to supervise or participate in the partnership's investment decisions, the partnership's *financial interests* would be the *covered member's direct financial interests*.

.05 Refer to the "Client Affiliates" interpretation [1.224.010] [1.200.001] and the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence Rule" for additional guidance. [Prior reference: paragraph .17 of ET section 101]

1.240.060 Limited Liability Companies

.01 When used in this interpretation, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*.

.02 Ownership of an interest in a limited liability company (LLC) is a *direct financial interest* in the LLC.

.03 In an LLC, managing members control the LLC and have the authority to supervise or participate in the LLC's investment decisions. Accordingly, if a *covered member* is a manager of the LLC, the *financial interests* of the LLC are the *covered member's direct financial interests*. When a *covered member* is not a managing member of the LLC, the *covered member* should review the LLC's operating agreement to determine whether he or she can control the LLC or has the authority to supervise or participate in the LLC's investment decisions. In situations in which the *covered member* does not control the LLC and does not have the authority to supervise or participate in the LLC's investment decisions, the *financial interests* held by the LLC are the *covered member's indirect financial interests*. [Prior reference: paragraph .17 of ET section 101]

1.240.070 Section 529 Plans

.01 Section 529 plans are sponsored by states or higher education institutions and may be prepaid tuition plans or savings plans. An account owner establishes both types of plans for the benefit of a single beneficiary. The account owner may change the beneficiary at any time to another individual who is a relative of the previous beneficiary.

.02 *Prepaid tuition plan.* A *covered member* who is the account owner of a Section 529 prepaid tuition plan is considered to have a *direct financial*

interest in the plan. The account owner does not have any *financial interests* in the plan's underlying investments because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the plan's investment performance or the cost of the education at the future date.

.03 *Savings plan.* A *covered member* who is the account owner of a Section 529 savings plan is considered to have a *direct financial interest* in both the plan and the plan's underlying investments because the account owner elects which sponsor's Section 529 savings plan to invest in, and prior to making the investment decision, the *covered member* has access to information about the plan's investment options or funds. However, if the Section 529 savings plan does not hold *financial interests* in an *attest client* at the time of the investment but the plan subsequently invests in that *attest client*, the financial interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if the *covered member* applies both of the following *safeguards*:

- a. The *covered member* transfers the account to another sponsor's Section 529 savings plan.
- b. The *covered member* transfers the account to another account owner who is not a *covered member*.

When the transfer of the account will result in a penalty or tax that is significant to the account, the *covered member* may continue to own the account until the account can be transferred without significant penalty or tax, provided that the *covered member* does not participate on the *attest engagement team* and is not an *individual in a position to influence the attest engagement*.

.04 *Beneficiary of Section 529 account.* A *covered member* who is a beneficiary of a Section 529 account is not considered to have a *financial interest* in the plan or the plan's underlying investments because the *covered member* does not own the account or possess any of the underlying benefits of ownership. The beneficiary's only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

.05 *Government or governmental entity sponsors Section 529 plan.* Before becoming engaged to perform an *attest engagement* for a government or governmental entity that sponsors a Section 529 plan, *covered members* who are account owners of a Section 529 plan should consider the guidance in the "State and Local Government Client Affiliates" interpretation [1.224.020]. [Prior reference: paragraph .17 of ET section 101]

1.245 Trusts and Estates

1.245.010 *Trustee or Executor*

.01 The designation of a *covered member* to serve as a trustee of a trust or an executor or administrator of an estate that held, or was committed to acquire, any *direct financial interest* or any material *indirect financial interest* in an *attest client* during the *period of the professional engagement* does not in itself create a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001]. [Prior reference: paragraphs .021–.022 of ET section 191]

.02 However, when the *covered member* serves as the trustee or executor during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if

- a. the *covered member* (individually or with others) has the authority to make investment decisions for the trust or estate,
- b. the trust or estate owned or was committed to acquire more than 10 percent of the *attest client's* outstanding equity securities or other ownership interests, or
- c. the value of the trust's or estate's holdings in the *attest client* exceeds 10 percent of the total assets of the trust or estate.

Accordingly, in these situations, *independence* would be *impaired*. [Prior reference: paragraph .02A(2) of ET section 101]

1.245.020 Trust Investments

.01 When used in this interpretation, control includes situations in which the *covered member* has the ability to exercise such control, either individually or acting together with his or her *firm* or other *partners* or professional employees of his or her *firm*.

.02 When a *covered member* is a grantor of a trust, including a blind trust, the trust and its underlying investments are considered to be the *covered member's direct financial interest* if any of the following rights or responsibilities exist:

- a. The *covered member* has the ability to amend or revoke the trust.
- b. The *covered member* has authority to control the trust.
- c. The *covered member* has ability to supervise or participate in the trust's investment decisions.
- d. The underlying trust investments will ultimately revert to the *covered member* as the grantor of the trust.

However, the trust and the trust's underlying investments are not considered to be *financial interests* of a *covered member* if the *covered member* is the grantor of the trust and the *covered member* does not have any of the rights or responsibilities in items a–d.

.03 When a *covered member* is only a beneficiary of a trust and does not have any of the rights or responsibilities noted in paragraph .02, the trust is considered to be the *direct financial interest* of the *covered member*, and the trust's underlying investments are considered to be *indirect financial interests* of the *covered member*. [Prior reference: paragraph .17 of ET section 101]

Effective Date

.04 This revised interpretation is effective December 15, 2014.

A nonauthoritative question and answer regarding the use of blind trusts is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.250 Participation in Employee Benefit Plans

1.250.010 Plan Is an Attest Client or Is Sponsored by an Attest Client

.01 When a *covered member* participates in an employee benefit plan that is an *attest client* or is sponsored by an *attest client*, during the *period of the*

professional engagement or during the period covered by the *financial statements*, the self-interest *threat* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*. *Independence* with respect to the employee benefit plan and the sponsor would be *impaired* except in the following specific situations:

- a. *Governmental organization*. When a *covered member* is an employee of a governmental organization that sponsors, cosponsors, or participates with other governmental organizations in a public employee retirement plan (the plan) and the *covered member* is required by law, rule, or regulation to audit the plan, *threats to independence* would be at an *acceptable level* if all of the following *safeguards* are met:
 - i. The *covered member* is required to participate in the plan as a condition of employment.
 - ii. The plan is offered to all employees in comparable employment positions.
 - iii. The *covered member* is not associated with the plan in any capacity prohibited by the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule."
 - iv. The *covered member* has no influence or control over the investment strategy, benefits, or other management activities associated with the plan.
- b. *Former employment or association with the attest client*. The requirements of paragraph .04 of the "Former Employment or Association With an Attest Client" interpretation [1.277.010] must be met. [Prior reference: paragraphs .214–.215 of ET section 191]

.02 When an *immediate family* member participates as a result of his or her employment, in an employee benefit plan that is an *attest client* or is sponsored by an *attest client*, the requirements of the "Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)" interpretation [1.270.030] of the "Independence Rule" [1.200.001] must be met. [Prior reference: paragraph .17 of ET section 101]

1.250.020 Former Partners and Professional Employees Participation in a Firm-Sponsored Plan

.01 When *partners* and professional employees leave a *firm* and are subsequently employed by, or associated with, an *attest client* of the *firm* in a *key position*, the requirements of paragraph .02a–c of the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] must be met to reduce the familiarity, self-interest, or management participation *threats* to an *acceptable level*. [Prior reference: paragraph .04 of ET section 101]

1.255 Depository, Brokerage, and Other Accounts

1.255.010 Depository Accounts

.01 If a *covered member* maintains checking, savings, certificates of deposit, money market, or other depository accounts (depository accounts) at a

bank or similar depository institution that is an *attest client* during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. For specific guidance applicable to any other types of custodial accounts (for example, brokerage accounts), see the "Brokerage and Other Accounts" interpretation [1.255.020] of the "Independence Rule."

.02 When the *covered member* is a *firm*, the *threat* would be at an *acceptable level*, and *independence* would not be *impaired* if the *firm* concludes that the likelihood is remote that the bank or similar depository institution will experience financial difficulties.

.03 When the *covered member* is an individual, the *threat* would be at an *acceptable level*, and *independence* would not be *impaired* if

- a. the balance in the depository account(s) is fully insured by the appropriate state or federal government deposit insurance agencies or by any other insurer, or
- b. any uninsured amounts, in the aggregate, were not material to the *covered member's* net worth, or
- c. if uninsured amounts were considered material, any uninsured amounts, in the aggregate, are reduced to an immaterial amount no later than 30 days from the date that the uninsured amount becomes material to the *covered member's* net worth.

.04 Refer to the "Member of a Credit Union" interpretation [1.280.040] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraphs .140–.141 of ET section 191]

1.255.020 Brokerage and Other Accounts

.01 If an *attest client* in the financial services industry, such as an insurance company, an investment adviser, a broker-dealer, a bank, or similar depository institution, has custody of a *covered member's* assets other than depository accounts, including retirement plan assets, during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. For specific guidance applicable to depository accounts held at a bank or similar depository institution, see the "Depository Accounts" interpretation [1.255.010] of the "Independence Rule."

.02 *Threats* would not be at an *acceptable level* and *independence* would be *impaired* unless the following safeguards are met

- a. The *attest client's* services were rendered under the *attest client's* normal terms, procedures, and requirements.
- b. Any *covered member's* assets subject to the risk of loss are immaterial to the *covered member's* net worth.

.03 In determining if there is a risk of loss, the *covered member* should consider losses arising from the *attest client's* insolvency, bankruptcy, or acts of fraud or other illegal acts but should not consider potential losses arising from a market decline in the value of the assets.

.04 When considering the materiality of assets subject to the risk of loss, the *covered member* should consider the following:

- a. Protection that state or federal regulators provide for the assets, such as state insurance funds

- b. Private insurance or other forms of protection that the financial services company obtains to protect its customers' assets, such as coverage by the Securities Investor Protection Corporation
- c. Protection from creditors, such as assets held in a pooled separate account or separate escrow accounts [Prior reference: paragraphs .081–.082 of ET section 191]

1.257 Insurance Products

1.257.010 Insurance Policies With No Investment Option

.01 An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered a *financial interest*.

.02 If during the *period of the professional engagement*, a *covered member* owns an insurance policy with no investment option issued by an *attest client*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through the application of *safeguards*, if the *covered member* purchased the policy not under the normal terms, procedures, and requirements. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .17 of ET section 101]

1.257.020 Insurance Policies With Investment Options

.01 If during the *period of the professional engagement* the *covered member* owns an insurance policy with investment options issued by an *attest client*, but the *covered member* did not purchase the policy under the insurance company's normal terms, procedures, and requirements, *threats* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.02 When a *covered member* purchases an insurance policy, under the insurance company's normal terms, procedures, and requirements, which offers an investment option that allows the *covered member* to invest part of the policy's cash value in various investment products, the policy's underlying investments are considered to be *financial interests* of the *covered member*. Accordingly, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.03 If the *covered member* has the ability to select the policy's underlying investments or the authority to supervise or participate in the investment decisions and the *covered member* invests in an *attest client* during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired* because the investment would be considered a *direct financial interest*. For example, if the *covered member* invested the policy's cash value into a mutual fund that is an *attest client*, the investment in the mutual fund would be considered a *direct financial interest* and *independence* would be *impaired*. However, the mutual fund's underlying investments are considered to be *indirect financial interests*.

.04 Refer to the "Financial Interests" subtopic [1.240] and the "Joint Closely Held Investments" interpretation [1.265.020] of the "Independence

Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .17 of ET section 101]

1.257.030 Insurer Undergoes Demutualization

.01 If a mutual insurance company begins demutualization, a *covered member* who holds an insurance policy from the insurer should apply the guidance in the "Unsolicited Financial Interests" interpretation [1.240.020] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .17 of ET section 101]

1.260 Loans, Leases, and Guarantees

1.260.010 Loans

.01 If a *covered member* has a *loan* to or from an *attest client*, any officer or director of the *attest client* with the ability to affect decision-making, or any individual with a *beneficial ownership interest* (known through reasonable inquiry) that gives the individual *significant influence* over the *attest client*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would not be at an *acceptable level* and *independence* would be *impaired* if the *loan* exists during the *period of the professional engagement*, except as provided for in the

- a. "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule."
- b. "Client Affiliates" interpretation [1.224.010] of the "Independence Rule."

[See Revision History Table.]

1.260.020 Loans and Leases With Lending Institutions

.01 The "Loans" interpretation [1.260.010] of the "Independence Rule" [1.200.001] provides that a self-interest *threat* would not be at an *acceptable level* and *independence* would be *impaired* if a *covered member* had a *loan* to or from an *attest client*, any officer or director of the *attest client* with the ability to affect decision-making, or any individual with a *beneficial ownership interest* (known through reasonable inquiry) that gives the individual *significant influence* over the *attest client*, except as provided for in this interpretation.

Home Mortgages, Other Secured Loans, Immaterial Unsecured Loans, and Student Loans

.02 The *loans* covered by paragraph .03 include home mortgages, other secured *loans*, unsecured *loans* that are not material to the *covered member's* net worth (that is, immaterial unsecured *loans*), and student *loans*.

.03 *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* or his or her *immediate family* has any of the *loans* identified in paragraph .02 from a *lending institution attest client*, if all the following *safeguards* are met:

- a. The *loans* were obtained under the *lending institution's normal lending procedures, terms, and requirements*.
- b. The *loans* were obtained in one of the following ways (in determining when the *loans* were obtained, the date a commitment

or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained):

- i. From the *lending institution* prior to it becoming an *attest client*
 - ii. From a *lending institution* for which *independence* was not required and that was later sold to an *attest client*
 - iii. From a *lending institution attest client* by a borrower prior to the *member* becoming a *covered member* with respect to that *attest client*
 - iv. Prior to May 31, 2002, and the requirements of the loan transition provision in <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf> are met
- c. After an individual becomes a *covered member*, any *loans* must be kept current regarding all terms, at all times, and the terms may not change in any manner not provided for in the original agreement. Examples of changed terms are a new or extended maturity date, a new interest rate or formula, revised collateral, and revised or waived covenants.
 - d. The estimated fair value of the collateral for home mortgages or other secured *loans* should equal or exceed the outstanding balance during the term of the home mortgages or other secured *loans*. If the estimated fair value of the collateral is less than the outstanding balance of the home mortgages or other secured *loans*, the portion that exceeds the estimated fair value of the collateral may not be material to the *covered member's* net worth.

Loans to Partnerships and Other Similar Entities

.04 For purposes of applying the loan provision in paragraph .03 when the *covered member* is a partner in a partnership, a *loan* to a limited partnership (or similar type of entity) or general partnership would be ascribed to each *covered member* who is a partner in the partnership on the basis of his or her legal liability as a limited or general partner if

- a. the *covered member's* interest in the limited partnership, either individually or combined with the interest of one or more *covered members*, exceeds 50 percent of the total limited partnership interest, or
- b. the *covered member*, either individually or together with one or more *covered members*, can control the general partnership.

Even if no amount of a partnership *loan* is ascribed to the *covered member(s)* previously identified, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if the partnership renegotiates a loan or obtains a new *loan* that is not a permitted *loan*, as described in paragraph .05 of this interpretation. Accordingly, *independence* would be *impaired*.

Other Loans and Leases

.05 *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* obtains one of the following types of *loans* or leases under the *lending institution's* normal *lending procedures, terms, and*

requirements, provided the *covered member* complies with the terms of the loan or lease agreement at all times (for example, keeping payments current):

- a. Automobile *loans* and leases collateralized by the automobile
- b. *Loans* fully collateralized by the cash surrender value of an insurance policy
- c. *Loans* fully collateralized by cash deposits at the same *lending institution* (for example, passbook *loans*)

.06 *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* has consumer *loans* (for example, credit cards, retail installment *loans*, and home improvement *loans*) and overdraft reserve accounts from the same *lending institution* that have an aggregate outstanding balance of \$10,000 or less on a current basis, taking into consideration the payment due date and any available grace period.

Other Matters

.07 *Members* should consider that certain state and federal agencies may proscribe more restrictive requirements over *lending institutions* that are subject to their oversight and that, in turn, impose more restrictive requirements upon *members* that perform *attest engagements* for these *lending institutions*. For example, the SEC proscribes more restrictive requirements over *members* providing attest services to *lending institutions* and broker-dealers within their purview. [Prior reference: paragraph .07 of ET section 101 and paragraphs .150–.151 of ET section 191]

.08 *Covered members* may be subject to additional restrictions, as described in the "Depository Accounts" interpretation [1.255.010], the "Member of a Credit Union" interpretation [1.280.040], and the "Leases" interpretation [1.260.040] of the "Independence Rule" [1.200.001].

[See Revision History Table.]

1.260.030 Servicing of a Loan

.01 The self-interest *threat* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if a *lending institution* *attest client* services a *loan* originally extended to a *covered member* by another *lending institution*. [Prior reference: paragraphs .134–.135 of ET section 191]

1.260.040 Leases

.01 When a *covered member* enters into or has a lease with an *attest client*, self-interest, familiarity, and undue influence *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

New or Renegotiated Leases

.02 If a *covered member* who is an individual on the *attest engagement team*, an individual in a position to influence the *attest engagement*, or the *firm* enters into a lease or renegotiates terms of an existing lease with an *attest client* during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. *Independence* would be *impaired*, unless all of the following *safeguards* are met at the time of entering into or renegotiating the lease:

- a. The lease is on market terms and established at arm's length.
- b. The lease is not material to any of the parties to the lease. When evaluating materiality, all leases between the *covered member* and the *attest client* should be considered in the aggregate.

.03 Once the *covered member* enters into or renegotiates the lease, *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if the lease amounts are not paid in accordance with the lease terms or provisions by the due date or within any available grace periods during the *period of the professional engagement*.

Existing Leases

.04 Under the circumstances in paragraph .05, the *covered member* should evaluate the significance of any *threats* to determine whether the *threats* are at an *acceptable level*. If the *covered member* determines that *threats* are not at an *acceptable level*, the *covered member* should apply *safeguards* to eliminate or reduce the *threats* to an acceptable level. If no *safeguards* are available to eliminate or reduce *threats* to an *acceptable level*, *independence* would be *impaired*.

.05 A *covered member* who is an individual on the *attest engagement team*, an *individual in a position to influence the attest engagement*, or the *firm* has a lease with an *attest client* that was

- a. entered into or renegotiated prior to the
 - i. *period of the professional engagement*,
 - ii. *member becoming a covered member*, or
 - iii. *counterparty becoming an attest client* or an affiliate of a *financial statement attest client*, or
- b. entered into or renegotiated during the *period of the professional engagement*, in compliance with paragraph .02, but, due to a change in circumstances after the lease is entered into or renegotiated, the lease becomes material to any party to the lease during the *period of the professional engagement*.

.06 The significance of the *threats* will depend on factors such as the following:

- a. The role of the *covered member* on the *attest engagement* or with the *firm*
- b. The materiality of the lease to the *covered member* or the *attest client* during the *period of the professional engagement*
- c. Whether multiple leases exist with the *attest client* and, if so, the aggregate materiality of those leases to the *covered member* or the *attest client*
- d. The extent to which the lease will be subject to attest procedures or financial statement disclosures
- e. The duration of the lease term
- f. Whether the lease is on market terms or established at arm's length

.07 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if the lease amounts are not paid in accordance with the lease terms

or provisions by the due date or within any available grace periods during the *period of the professional engagement*.

Applicability

.08 This interpretation excludes leases addressed by paragraph .04 of the "Loans and Leases With Lending Institutions" interpretation [1.260.020] under the "Independence Rule" [1.200.001].

.09 Refer to the "Client Affiliates" interpretation [1.224.010] under the "Independence Rule" [1.200.001] for additional guidance on leases held with certain affiliates of a *financial statement attest client*. [Prior reference: paragraph .17 of ET section 101]

.10 This interpretation is effective for fiscal years beginning after December 15, 2020, with early implementation allowed.

[See Revision History Table.]

1.260.050 Association With an Entity That Has a Loan To or From an Attest Client

.01 If a *covered member* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an *attest client* during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* has *control* over the entity. Accordingly, *independence* would be *impaired* because the lease would be considered to be a *loan* with an *attest client*. This paragraph excludes a lending relationship that is permitted under the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule."

.02 If any *partner* or professional employee of the *firm* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an *attest client*, *threats* to the *partner's* or professional employee's objectivity may exist. If the *partner* or professional employee is able to exercise *significant influence* over the entity but is not a *covered member* who can *control* the entity (see paragraph .01), the *partner* or professional employee should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001].

.03 When making the decision about whether to perform a *professional service* and in making disclosure to the appropriate parties, the *member* should consider the "Confidential Client Information Rule" [1.700.001]. [Prior reference: paragraphs .220–.221 of ET section 191]

1.265 Business Relationships

1.265.010 Cooperative Arrangements With Attest Clients

.01 If a *member* or his or her *firm* has a cooperative arrangement with an *attest client*, self-interest, familiarity, and undue influence *threats* to the *member* or his or her *firm's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if, during the *period of the professional engagement*,

the cooperative arrangement is material to the *firm* or *attest client*. Accordingly, *independence* would be *impaired*.

.02 A cooperative arrangement exists when a *member* or the *member's firm* and an *attest client* jointly participate in a business activity. However, a cooperative arrangement would not exist when all of the following *safeguards* are met:

- a. The participation of the *firm* and *attest client* are governed by separate agreements, arrangements, or understandings that do not create rights or obligations between the *firm* and *attest client*.
- b. Neither the *firm* nor the *attest client* assumes responsibility for the other's activities or results.
- c. Neither party has the authority to act as the other's representative or agent.

.03 Examples of cooperative arrangements include the following:

- a. Prime and subcontractor arrangements to provide services or products to a third party
- b. Joint ventures to develop or market products or services
- c. Arrangements to combine one or more of the *firm's* services or products with one or more of the *attest client's* services or products and market the package with references to both parties
- d. Arrangements under which the *firm* acts as a distributor or marketer of the *attest client's* products or services or the *attest client* acts as the distributor or marketer of the *firm's* products or services

.04 Refer to the "Contingent Fees Rule" [1.510.001] and the "Commissions and Referral Fees Rule" [1.520.001] for additional guidance. [Prior reference: paragraph .14 of ET section 101]

1.265.020 Joint Closely Held Investments

.01 If a *covered member* has a *joint closely held investment*, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* holds a material *joint closely held investment* during the *period of the professional engagement*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02A(3) of ET section 101]

.02 A *joint closely held investment* includes a joint interest in a vacation home shared by a *covered member* and an *attest client* (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the *attest client*), if the *covered member* and *attest client* (or one of the client's officers or directors or any owner who has the ability to exercise significant influence over the *attest client*) control the investment and the vacation home is material to the *covered member*. Such is the case even if the vacation home is solely intended for the personal use of the owners. [Prior reference: paragraphs .184–.185 of ET section 191]

1.270 Family Relationships With Attest Clients

1.270.010 Immediate Family Members

.01 The *immediate family* of a *covered member* must comply with the "Independence Rule" [1.200.001] and its *interpretations*, except as permitted in the following interpretations:

- a. "Immediate Family Member Is Employed by the Attest Client" [1.270.020]
- b. "Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)" [1.270.030]
- c. "Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest Client" [1.270.040]
- d. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients" [1.270.050]
- e. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client" [1.270.060]
- f. "Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation" [1.270.070]
- g. "Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan" [1.270.080]

.02 Notwithstanding any exceptions provided for in paragraph .01, the ownership interests of a *covered member's immediate family* may not exceed those specified in paragraph .03 of the "Overview of Financial Interests" interpretation [1.240.010] of the "Independence Rule" [1.200.001].

.03 When materiality of a *financial interest* or a *loan* is identified as a factor affecting *independence* in the *interpretations* of the "Independence Rule" [1.200.001], interests of the *immediate family* member and the *covered member* should be combined to determine materiality to the *covered member*. [Prior reference: paragraph .02 of ET section 101]

[See Revision History Table.]

A nonauthoritative white paper, *Independence Rules Modernization Project*, provides some discussion on changes made to the independence provisions that are applicable to close relatives. The white paper is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/independencemodernizationwhitepaper.doc>.

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.020 Immediate Family Member Is Employed by the Attest Client

.01 When an individual in a *covered member's immediate family* is employed by an *attest client*, management participation, familiarity, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If a *covered member's immediate family* is employed by an *attest client* but is not in a *key position*, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

.03 If a *covered member's immediate family* is in a *key position* with an *attest client* during the period covered by the *financial statements* or during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

Grandfathered Employment Relationships

.04 For information about grandfathered employment relationships for immediate family members, refer to <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf>. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative white paper, *Independence Rules Modernization Project*, provides some discussion on changes made to the independence provisions that are applicable to close relatives. The white paper is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/independencemodernizationwhitepaper.doc>.

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.030 Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)

.01 If during the period covered by the *financial statements* or during the *period of the professional engagement*, an *immediate family member* of a *covered member* participates in an employee benefit plan (plan) that is an *attest client* or is sponsored by an *attest client* (other than an *attest client's share-based compensation arrangement* and nonqualified deferred compensation plan), *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].

- b. The plan is offered to all employees in comparable employment positions.
- c. The *immediate family* member does not serve in a position of governance (for example, board of trustees) for the plan.
- d. The *immediate family* member does not have the ability to supervise or participate in the plan's investment decisions or in the selection of the investment options made available to plan participants. [Prior reference: paragraph .02 of ET section 101]

.02 *Share-based compensation arrangements* and nonqualified deferred compensation plans are discussed in the following interpretations:

- a. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients" interpretation [1.270.050] of the "Independence Rule" [1.200.001]
- b. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client" interpretation [1.270.060] of the "Independence Rule"
- c. "Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation" interpretation [1.270.070] of the "Independence Rule"
- d. "Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan" interpretation [1.270.080] of the "Independence Rule"

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.040 Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest Client

.01 If during the *period of the professional engagement*, an *immediate family* member of a *covered member* is employed at a nonclient or employed in a non-key position at an *attest client*, the *immediate family* member may hold a *direct financial interest* or material *indirect financial interest* in an *attest client* through participation in an employee benefit plan if *threats* are at an *acceptable level*. *Threats* would be at an *acceptable level*, and *independence* would not be *impaired*, if all of the following *safeguards* were met:

- a. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- b. Such investment is an unavoidable consequence of such participation. Unavoidable consequence means that the *immediate family* member has no other investment options available for selection, including money market or invested cash options, except for selecting an investment option in an *attest client*.
- c. In the event that a plan provides an option that permits the *immediate family* member to invest in a nonattest client or a nonclient investment option that becomes available, the *immediate family*

member is required to select the investment option in the non-client or nonattest *client* and dispose of *financial interests* in the *attest client* as soon as practicable but no later than 30 days after such option becomes available. When legal or other similar restrictions exist on an *immediate family* member's right to dispose of a *financial interest* at a particular time, the *immediate family* member need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family* member is not required to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not fall within this exception. [Prior reference: paragraph .02 of ET section 101]

This paragraph excludes participation in *share-based compensation arrangements* and nonqualified deferred compensation arrangements (see paragraph .02).

.02 *Share-based compensation arrangements* and nonqualified deferred compensation plans are discussed in the following interpretations:

- a. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients" interpretation [1.270.050] of the "Independence Rule" [1.200.001]
- b. "Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client" interpretation [1.270.060] of the "Independence Rule"
- c. "Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation" interpretation [1.270.070] of the "Independence Rule"
- d. "Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan" interpretation [1.270.080] of the "Independence Rule"

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.050 Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients

.01 If during the *period of the professional engagement*, an *immediate family* member of a *covered member* participates in a *share-based compensation arrangement* of an *attest client*, such as an ESOP, that results in the *immediate family* member holding a *financial interest* in an *attest client* that is *beneficially owned*, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The *immediate family* member does not serve as a trustee for the *share-based compensation arrangement* and does not have the ability to supervise or participate in the selection of any investment options made available to plan participants.
- d. When the *financial interests* that are *beneficially owned* are distributed or the *immediate family* member has the right to dispose of the *financial interests*, the *immediate family* member is required to do one of the following:
 - i. Dispose of the *financial interests* as soon as practicable but no later than 30 days after he or she has the right to dispose of the *financial interests*.
 - ii. Exercise his or her put option to require the employer to repurchase the *financial interests* as soon as permitted by the terms of the *share-based compensation arrangement*. In addition, any repurchase obligation due to the *immediate family* member arising from exercise of the option that is outstanding for more than 30 days needs to be immaterial to the *covered member* during the payout period. When legal or other similar restrictions exist on an *immediate family* member's right to dispose of a *financial interest* at a particular time, the *immediate family* member need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family* member does not have to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest does not qualify for this exception.
- e. Benefits payable from the *share-based compensation arrangement* to the *immediate family* member upon termination of employment, whether through retirement, death, disability, or voluntary or involuntary termination, are funded by investment options other than the employer's *financial interests*, and any unfunded benefits payable are immaterial to the *covered member* at all times during the payout period. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.060 Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client

.01 If during the *period of the professional engagement* an *immediate family member of a covered member* participates in a *share-based compensation arrangement* resulting in a right to acquire shares in an *attest client*, such as an ESOP or restricted stock rights plan, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The *immediate family member* exercises or forfeits these rights once he or she is vested, and the closing market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days (market period). The exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period. In addition, if the *immediate family member* exercises his or her right to acquire shares in the *attest client*, he or she should dispose of the shares as soon as practicable but no later than 30 days after the exercise date. Also, note the following:
 - i. When legal or other similar restrictions exist on an *immediate family member's* right to dispose of a *financial interest* at a particular time, the *immediate family member* need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family member* does not have to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not qualify for this exception.
 - ii. If the employer repurchases the shares, any employer repurchase obligation due to the *immediate family member* that is outstanding for more than 30 days needs to be immaterial to the *covered member* during the payout period.

.02 Refer to paragraph .06 of the "Retirement, Savings, Compensation, or Similar Plans" interpretation [1.240.040] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.070 Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation

.01 If during the *period of the professional engagement* an *immediate family member* of a *covered member* participates in a *share-based compensation arrangement* based on the appreciation of an *attest client's* underlying shares, such as a stock appreciation plan or phantom stock plan, *threats* are at an *acceptable level* and *independence* would not be impaired if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *share-based compensation arrangement* does not provide for the issuance of rights to acquire the employer's *financial interests*.
- c. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- d. The *immediate family member* exercises or forfeits these rights once he or she is vested, if the underlying price of the employer's shares equals or exceeds the exercise price for 10 consecutive days (market period). Exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period.
- e. Any resulting compensation payable to the *immediate family member* that is outstanding for more than 30 days is immaterial to the *covered member* during the payout period. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.080 Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan

.01 If during the *period of the professional engagement* an *immediate family member* of a *covered member* participates in a nonqualified deferred compensation plan of an *attest client* as a result of his or her employment, *threats* are at an *acceptable level* and *independence* would not be impaired if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest client*, as discussed in the "Immediate Family Member Is Employed by the Attest Client" interpretation [1.270.020] of the "Independence Rule" [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.

- c. The amount of the deferred compensation payable to the *immediate family* member is funded through life insurance, an annuity, a trust, or similar vehicle, and any unfunded portion is immaterial to the *covered member*.
- d. Any funding of the deferred compensation does not include *financial interests* in the *attest client*. [Prior reference: paragraph .02 of ET section 101]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsimmediatefamilymember6-1-10final.doc>.

1.270.100 Close Relatives

.01 When a *close relative* of a *covered member* is employed by an *attest client* or has *financial interests* in an *attest client*, management participation, familiarity, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if an individual participating on the *attest engagement team* has a *close relative* who has either of the following:

- a. A *key position* with the *attest client* during the period covered by the *financial statements* or during the *period of the professional engagement*.
- b. A *financial interest* in the *attest client* during the *period of the professional engagement* that
 - i. the individual knows or has reason to believe was material to the *close relative* or
 - ii. enabled the *close relative* to exercise *significant influence* over the *attest client*.

.03 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and *independence* will be *impaired* if an *individual in a position to influence the attest engagement* or any *partner* or *partner equivalent* in the *office* in which the lead *attest engagement partner* or *partner equivalent* primarily practices in connection with the *attest engagement* has a *close relative* who has either of the following:

- a. A *key position* with the *attest client* during the period covered by the *financial statements* or during the *period of the professional engagement*.
- b. A *financial interest* in the *attest client* during the *period of the professional engagement* that
 - i. the individual, *partner*, or *partner equivalent* knows or has reason to believe was material to the *close relative* and
 - ii. enabled the *close relative* to exercise *significant influence* over the *attest client*.

Grandfathered Employment Relationships

.04 For information about grandfathered employment relationships for close relatives, refer to <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf>. [Prior reference: paragraph .02 of ET section 101]

Effective Date

.05 The addition of partner equivalents to paragraph .03 is effective for engagements covering periods beginning on or after December 15, 2014.

A nonauthoritative white paper, *Independence Rules Modernization Project*, provides some discussion about changes made to the independence provisions that are applicable to close relatives. The white paper is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/independencemodernizationwhitepaper.doc>.

1.275 Current Employment or Association With an Attest Client

1.275.005 Simultaneous Employment or Association With an Attest Client

.01 In this interpretation, simultaneous employment or association with an *attest client* is serving as a director, an officer, an employee, a promoter, an underwriter, a voting trustee, a trustee for any pension or profit-sharing trust of the *attest client*, or in any capacity equivalent to that of a member of management of an *attest client* during the period covered by the *financial statements* or the *period of the professional engagement*.

.02 If a *partner* or professional employee of the *member's firm* is simultaneously employed or associated with an *attest client*, familiarity, management participation, advocacy, or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02C of ET section 101]

.03 However, *threats* will be at an *acceptable level* and *independence* will not be *impaired* when either of the following situations exists:

- a. A *partner* or professional employee of a *firm* serves as an adjunct faculty member of an educational institution that is an *attest client* of the *firm* and the *partner* or professional employee meets all of the following *safeguards*:
 - i. Does not hold a *key position* at the educational institution
 - ii. Does not participate on the *attest engagement team*
 - iii. Is not an *individual in a position to influence the attest engagement*
 - iv. Is employed by the educational institution on a part-time and non-tenure basis
 - v. Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required

- vi. Does not assume any management responsibilities or set policies for the educational institution

Upon termination of employment, the *partner* or professional employee should comply with the requirements of the "Former Employment or Association With an Attest Client" interpretation [1.277.010] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .21 of ET section 101]

- b. A *member* in a government audit organization performs an *attest engagement* with respect to the government entity and the head of the government audit organization meets at least one of the following:
 - i. Is directly elected by voters of the government entity with respect to which *attest engagements* are performed
 - ii. Is appointed by a legislative body and is subject to removal by a legislative body
 - iii. Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

.04 *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

Effective Date

.05 Paragraph .04 of this interpretation is effective December 15, 2014.

A nonauthoritative question and answer regarding independent contractors retained by the firm who are simultaneously employed or associated with an attest client is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

[See Revision History Table.]

1.275.007 Staff Augmentation Arrangements

.01 In this interpretation, staff augmentation arrangements involve lending *firm* personnel (augmented staff) to an *attest client* whereby the attest client is responsible for the direction and supervision of the activities performed by the augmented staff. Under such arrangements, the *firm* bills the *attest client* for the activities performed by the augmented staff but does not direct or supervise the actual performance of the activities.

.02 If a *partner* or professional employee of the *member's firm* serves as augmented staff for an *attest client*, familiarity, management participation, advocacy, or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would not be at an *acceptable level* and *independence* would be impaired unless all the following *safeguards* are met:

- a. The staff augmentation arrangement is being performed due to an unexpected situation that would create a significant hardship for the *attest client* to make other arrangements.

- b. The augmented staff arrangement is not expected to reoccur.
- c. The augmented staff arrangement is performed for only a short period of time. There is a rebuttable presumption that a short period of time would not exceed 30 days.
- d. The augmented staff neither participates in, nor is in a position to influence, an *attest engagement* covering any period that includes the staff augmentation arrangement.
- e. The augmented staff performs only activities that would not be prohibited by the "Nonattest Services" subtopic [1.295] of the "Independence Rule" [1.200.001].
- f. The *member* is satisfied that management of the *attest client* designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for
 - i. determining the nature and scope of the activities to be provided by the augmented staff;
 - ii. supervising and overseeing the activities performed by the augmented staff; and
 - iii. evaluating the adequacy of the activities performed by the augmented staff and the findings resulting from the activities.

.03 Refer to the "Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs" interpretation [1.297.020] and paragraph .02*f* of the "Client Affiliates" interpretation [1.224.010] of the "Independence Rule" [1.200.001] for additional guidance.

Effective Date

.04 This interpretation is effective November 30, 2021.

[See Revision History Table.]

1.275.010 Honorary Director or Trustee of a Not-for-Profit Organization

.01 When a *partner* or professional employee of a *member's firm* is asked to lend the prestige of his or her name to a not-for-profit organization (the assumption is that the organization limits its activities to charitable, religious, or civic or other matters of a similar nature) by serving as an honorary director or trustee of the organization during the period covered by the *financial statements* or during the *period of the professional engagement*, familiarity, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The position is clearly honorary and the individual holds the position in name only.
- b. The individual cannot vote or otherwise participate in board or management responsibilities.
- c. If the individual is named in letterheads and externally circulated materials, the individual is identified as an honorary director or honorary trustee. [Prior reference: paragraph .06 of ET section 101]

.02 *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

Effective Date

.03 Paragraph .02 of this interpretation is effective December 15, 2014.

1.275.015 Member of Advisory Board

.01 If a *partner* or professional employee of a *member's firm* serves on an advisory board of an *attest client*, familiarity, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The responsibilities of the advisory board are in fact advisory in nature.
- b. The advisory board has no authority to make nor does it appear to make management decisions on behalf of the *attest client*.
- c. The advisory board and those having authority to make management decisions, including the board of directors or its equivalent, are distinct groups with minimal, if any, common membership. [Prior reference: paragraphs .144–.145 of ET section 191]

.02 *Members* in such positions should consider their obligations as *members in business* under part 2 of the code. [No prior reference: new content]

Effective Date

.03 Paragraph .02 of this interpretation is effective December 15, 2014.

1.275.020 Member of Governmental Advisory Committee

.01 If a *partner* or professional employee of the *firm* serves on a citizens' advisory committee that is studying possible changes in the form of a county government that is an *attest client* of the *member's firm*, familiarity, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* with respect to the county.

.02 If a *partner* or professional employee of the *firm* serves on an advisory committee appointed to study the financial status of the state in which the county is located, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*. Accordingly, *independence* would not be *impaired* with respect to the county. [Prior reference: paragraphs .039–.040 of ET section 191]

.03 *Members* in such positions should consider their obligations as *members in business* under part 2 of the code. [No prior reference: new content]

Effective Date

.04 Paragraph .03 of this interpretation is effective December 15, 2014.

1.275.025 Individual in a Campaign Treasurer or Similar Financial Position

.01 For purposes of this interpretation, a campaign treasurer would also include individuals with similar financial responsibilities as a campaign treasurer. While other campaign positions may result in *threats* to compliance with the "Independence Rule" [1.200.001], such positions are not covered by this interpretation. Accordingly, *members* should consult the Conceptual Framework for Independence [1.210.010] if *partners* or professional employees serve in campaign positions not specifically addressed by this interpretation.

Campaign Organization Is Attest Client

.02 If during the *period of the professional engagement* or during the period covered by the *financial statements*, a *partner* or professional employee of a *member's firm* serves as a campaign treasurer and the campaign organization is an *attest client*, the management participation *threat* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

Candidate Running for Election of a Governmental Entity That Is an Attest Client

.03 If, during the *period of the professional engagement* or during the period covered by the *financial statements*, a *partner* or professional employee serves as a campaign treasurer for either (a) an elected official of a governmental entity that is an *attest client*, or (b) for a candidate who is running for election but is not yet an elected official of such *attest client*, then advocacy, adverse interest, and familiarity *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

Political Party Is Attest Client

.04 If during the *period of the professional engagement* or during the period covered by the *financial statements* a *partner* or professional employee serves as a campaign treasurer for a candidate and the political party for which the candidate is a member is an *attest client*, advocacy and familiarity *threats* may exist. Accordingly, a responsible individual within the *firm* should evaluate the significance of the *threats* to determine if the *threats* are at an *acceptable level*. If the responsible individual within the *firm* determines that *threats* are not at an *acceptable level*, he or she should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*. However, *threats* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and *independence* would be *impaired* if the candidate is a member of one of the political party's governing bodies.

General

.05 In the state and local government environment, *members* should consult the "State and Local Government Client Affiliates" interpretation [1.224.020] to determine which entities related to their *attest client* require the

member's independence. Also refer to the "Conflicts of Interest for Members in Public Practice" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] for additional guidance. In addition, *members* in such positions should consider their obligations as *members in business* under part 2 of the code. [Prior reference: paragraphs .164–.165 of ET section 191]

Grandfathered Positions

.06 *Independence* would not be *impaired* as a result of the more restrictive requirements of this interpretation that are effective on May 31, 2015, provided the *attest engagement* commenced prior to April 30, 2015, and the *member* was in compliance with the preexisting requirements of this interpretation.

[See Revision History Table.]

1.275.030 Member of Federated Fund-Raising Organization

.01 When a *partner* or professional employee of a *member's firm* serves as a director or an officer of a federated fund-raising organization, such as United Way (the organization), during the period covered by the *financial statements* or during the *period of the professional engagement*, and a charity that receives funds from the organization is an *attest client* of the *member's firm*, management participation or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the organization has managerial control over the charity, the *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.03 Even if the organization does not have managerial control over the charity, a conflict of interest could arise that may create a *threat* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001]. In such situations, the *member* should consult the "Conflicts of Interest" interpretation [1.110.010]. [Prior reference: paragraphs .027–.028 of ET section 191]

.04 In addition, *members* in such positions should consider their obligations as *members in business* under part 2 of the code. [No prior reference: new content]

Effective Date

.05 Paragraph .04 of this interpretation is effective December 15, 2014.

1.275.035 Member of Organization that Receives Funds From Fund-Raising Organization

.01 When a *partner* or professional employee of a *member's firm* serves on the board of directors of an organization during the period covered by the *financial statements* or during the *period of the professional engagement* and the organization receives funds from a fund-raising foundation that is an *attest client*, management participation or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the fund-raising foundation functions solely to raise funds for that organization, the *threat* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.03 However, if the directorship is clearly honorary, in accordance with the "Honorary Director or Trustee of a Not-for-Profit Organization" interpretation [1.275.010] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level*. Accordingly, *independence* would not be *impaired*. [Prior reference: paragraphs .128–.129 of ET section 191]

.04 *Members* in such positions should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

Effective Date

.05 Paragraph .04 of this interpretation is effective December 15, 2014.

1.277 Former Employment or Association With an Attest Client

1.277.010 Former Employment or Association With an Attest Client

.01 This interpretation applies to *covered members* who were formerly employed by an entity or associated with an entity as an officer, a director, a promoter, an underwriter, a voting trustee, or a trustee for the entity's pension or profit sharing trust and subsequently became employed by a *firm* that provides attest service to that entity.

.02 When a *member* becomes a *partner* or professional employee of a *firm* that provides attest services to an entity where the *member* was formerly employed or otherwise associated, familiarity, self-interest, self-review, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist.

.03 If a *covered member* participates on the *client's attest engagement* or is an *individual in a position to influence the attest engagement* covering any period that includes the *covered member's* former employment or association with the *attest client*, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.04 If a *member* fails to disassociate from the *attest client* before becoming a *covered member*, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless all of the following *safeguards* are met:

- a. The *covered member* ceases to participate in all employee health and welfare plans sponsored by the *attest client*, unless the *attest client* is legally required to allow the *member* to participate in the plan (for example, the Consolidated Omnibus Budget Reconciliation Act [COBRA]) and the *member* pays 100 percent of the *member's* portion of the cost of participation on a current basis.
- b. The *covered member* ceases to participate in all other employee benefit plans by liquidating or transferring, at the earliest date permitted under the plan, all vested benefits in the *attest client's* defined benefit plans, defined contribution plans, *share-based compensation arrangements*, deferred compensation plans, and other similar arrangements.

However, when a *covered member's* participation in one of these plans results from former employment or association with an *attest client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* provided the liquidation or transfer

of any vested benefits is either not permitted under the terms of the plan or would result in a penalty significant to the benefits being imposed upon such liquidation or transfer and the *covered member*

- i. does not participate on the *attest engagement team* or
- ii. is not an *individual in a position to influence the attest engagement*.

A penalty includes an early withdrawal penalty levied under the applicable tax law but excludes other income taxes that would be owed, or market losses that may be incurred, as a result of such liquidation or transfer.

- c. The *covered member* disposes of any *direct financial interest* or material *indirect financial interests* in the *attest client*.
- d. The *covered member* collects or repays any *loans* to or from the *attest client*, except for *loans* specifically permitted or grandfathered by the *interpretations* of the "Loans, Leases, and Guarantees" subtopic [1.260] under the "Independence Rule."
- e. *Covered members* should evaluate whether other relationships with the *attest client* create *threats* that require the *member* to apply *safeguards* to reduce those *threats* to an *acceptable level*. [Prior reference: paragraph .02 of ET section 101]

1.279 Considering or Subsequent Employment or Association With an Attest Client

1.279.010 Considering Employment or Association With an Attest Client

.01 This interpretation applies to a member of the *attest engagement team* or an *individual in a position to influence the attest engagement* (individual) who intends to seek or discuss potential employment or association with an *attest client* or is in receipt of a specific offer of employment from an *attest client*.

.02 The undue influence and self-interest *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The individual promptly reports such consideration or offer to an appropriate person in the *firm*.
- b. The individual immediately ceases participation in the engagement and does not provide any services to the *attest client* until the employment offer is rejected or employment is no longer sought.
- c. If a *covered member* becomes aware that an individual is considering employment or association with an *attest client*, the *covered member* should notify an appropriate person in the *firm*.
- d. The appropriate person in the *firm* should consider whether, based on the nature of the engagement and the individual involved, the *firm* should perform additional procedures to provide reasonable assurance that any work that the individual performed for the *attest client* was performed in compliance with the "Integrity and Objectivity Rule" [1.100.001].

.03 If the individual accepts an offer of employment or otherwise becomes associated with the *attest client* in a *key position*, see the "Subsequent Employment or Association With an Attest Client" interpretation [1.279.020] of the "Independence Rule" [1.200.001] for additional requirements. [Prior reference: paragraph .04 of ET section 101]

1.279.020 Subsequent Employment or Association With an Attest Client

.01 This interpretation applies to *partners* and professional employees who leave their *firms* and are subsequently employed by, or associated with, one of the *firm's attest clients* in a *key position*.

.02 The familiarity, self-interest, undue influence, or management participation *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless all of the *safeguards* in items *a–e* of the following list are met:

Individual Safeguards

- a. Amounts due to the former *partner* or professional employee for his or her previous interest in the *firm* and unfunded, vested retirement benefits cannot be material to the *firm*, and the underlying formula used to calculate the payments remain fixed during the payout period. The *firm* may adjust the retirement benefits for inflation and pay interest on amounts due.
- b. The former *partner* or professional employee is not in a position to influence the *firm's* operations or financial policies.
- c. The former *partner* or professional employee does not participate or appear to participate in the *firm's* business and is not otherwise associated with the *firm*, regardless of whether he or she is compensated for such participation or association, once employment or association with the *attest client* begins. For example, the individual would appear to participate in, or be associated with, the *firm* if
 - i. the individual provides consultation to the *firm*;
 - ii. the *firm* provides the individual with an *office* and related amenities, such as administrative and technology services;
 - iii. the individual's name is included in the *firm's office* directory; or
 - iv. the individual is identified as a member of the *firm* in membership lists of business, professional, or civic organizations, unless the *member* is clearly designated as retired.

Ongoing Attest Engagement Team Safeguards

- d. The ongoing *attest engagement team* should consider whether to modify the engagement procedures to adjust for the risk that the former *partner's* or professional employee's prior knowledge of the audit plan could reduce audit effectiveness. In addition, if the individual will have significant interaction with the *attest engagement team*, an appropriate individual in the *firm* should evaluate whether the existing *attest engagement team* members have sufficient experience and stature to deal effectively with the individual in conducting the engagement.
- e. If the former *partner* or professional employee joins the *attest client* in a *key position* within one year of disassociating from the *firm* and has significant interaction with the *attest engagement*

team, an appropriate professional in the *firm* should review the subsequent *attest engagement* to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the individual's representations and work. The professional applying this *safeguard* should have appropriate stature, expertise, and objectivity. In performing this review, the professional should consider relevant factors, such as the following:

- i. The position that the individual assumed at the *attest client*.
- ii. The position that the individual held at the *firm*.
- iii. The nature of the services that the individual provided to the *attest client*. The professional should take appropriate actions, as deemed necessary, based on the results of this review.

.03 The procedures performed in applying items *d–e* of paragraph .02 of this interpretation will depend on several factors, including the following:

- a. Whether the individual served on the engagement team
- b. The positions that the individual held at the *firm* and has accepted at the *attest client*
- c. The length of time that has elapsed since the individual left the *firm*
- d. The circumstances of the individual's departure

.04 An inadvertent and isolated failure to apply items *d–e* in paragraph .02 of this interpretation would not *impair independence* provided that the relevant parties perform the required procedures promptly upon discovery of the failure to do so and all other provisions of this interpretation are met. [Prior reference: paragraph .04 of ET section 101]

1.280 Memberships

1.280.010 Member of a Social Club

.01 If a *covered member* belongs to a social club (for example, a country club, tennis club) that is an *attest client* and is required to acquire a pro rata share of the club's equity or debt securities, then management participation, self-review, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would be at an *acceptable level* if the club membership is essentially a social matter, because such equity or debt ownership would not be considered to be a *direct financial interest*. Accordingly, *independence* would not be *impaired*.

.02 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the *attest client's* social club as described in the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule." Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .033–.034 of ET section 191]

1.280.020 Member of a Trade Association

.01 If a *covered member* belongs to a trade association that is an *attest client*, management participation or self-review *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the trade association as described in the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule." Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .003–.004 of ET section 191]

1.280.030 Member of Common Interest Realty Association

.01 If a *covered member* belongs to a common interest realty association (CIRA) because the *covered member* owns or leases real estate, then management participation, self-interest, self-review, or advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. Examples of CIRAs include cooperatives, condominium associations, planned unit developments, homeowners associations, and timeshare developments.

.02 *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The CIRA performs functions similar to local governments, such as public safety, road maintenance, and utilities.
- b. The *covered member's* annual assessment is not material to either the *covered member* or the CIRA's operating budgeted assessments.
- c. The liquidation of the CIRA or the sale of common assets would not result in a distribution to the *covered member*.
- d. The CIRA's creditors would not have recourse to the *covered member's* assets if the CIRA became insolvent.

.03 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and cannot be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the CIRA as described in the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule." Accordingly, *independence* would be *impaired*.

.04 A *member* who has a personal or professional relationship with a real estate developer or management company that is associated with the CIRA should consider the "Conflicts of Interest" interpretation [1.110.010] under the "Integrity and Objectivity Rule" [1.100.001]. [Prior reference: paragraphs .061–.062 of ET section 191]

1.280.040 Member of a Credit Union

.01 When a *covered member* is a member of a credit union that is an *attest client*, the self-interest *threat* would be at an *acceptable level*, and *independence* would not be *impaired*, if the *covered member* individually qualifies to join the credit union other than by virtue of the *professional services* provided to the credit union. However, if during the *period of the professional engagement*

the *member's* qualification to join the credit union is a result of the *professional services* provided to the credit union, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.02 *Covered members* may be subject to additional restrictions, as described in the "Depository Accounts" interpretation [1.255.010] and the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001]. In addition, *partners* and professional employees may be subject to additional restrictions, as described in paragraph .03 of the "Overview of Financial Interests" interpretation [1.240.010] of the "Independence Rule." [Prior reference: paragraphs .150–.151 of ET section 191]

[See Revision History Table.]

1.285 Gifts and Entertainment

1.285.010 Offering or Accepting Gifts or Entertainment

.01 For purposes of this interpretation, the *attest client* also includes an individual in a *key position* with the *attest client* and individuals owning 10 percent or more of the *attest client's* outstanding equity securities or other ownership interests.

.02 Accepting a gift from an attest client during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *member's firm*, a member of the *attest engagement team*, or an *individual in a position to influence the attest engagement* accepts a gift from an attest client and the value is not clearly insignificant to the recipient, the *threat* to the *member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.03 Accepting entertainment from an attest client during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *covered member* accepts entertainment from an attest client that is not reasonable in the circumstances, the *threats* to the *member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.04 Offering gifts or entertainment to an attest client during the *period of the professional engagement* may create a familiarity *threat* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *covered member* offers a gift or entertainment to an attest client that is not reasonable in the circumstances, the *threat* to the *member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

.05 The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Examples of relevant facts and circumstances include the following:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment

- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f. Whether other attest clients also participated in the entertainment
- g. The individuals from the attest client's and *member's firm* who participated in the entertainment

.06 Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [1.120.010] of the "Integrity and Objectivity Rule" [1.100.001] for additional guidance. [Prior reference: paragraphs .228–.229 of ET section 191]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/gifts_basis_document.pdf.

A nonauthoritative question and answer regarding campaign contributions made to the campaign of an individual that is associated with an attest client in a key position or holds a financial interest in an attest client that is material or enables the individual to exercise significant influence over the attest client is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.290 Actual or Threatened Litigation

1.290.010 Actual or Threatened Litigation

.01 The relationship between an *attest client's* management and a *covered member* must be characterized by complete candor and full disclosure regarding all aspects of the *attest client's* business operations. In addition, the *covered member* must not be biased so that the *covered member* can exercise professional judgment and objectivity in evaluating management's financial reporting decisions.

.02 Litigation or the expressed intention to commence litigation between a *covered member* and an *attest client* or its management and, in some cases, other parties during the *period of the professional engagement* may create self-interest or adverse interest *threats* to the *member's* compliance with the "Independence Rule" [1.200.001]. Accordingly, *covered members* should evaluate all such circumstances in accordance with this interpretation.

.03 Litigation or the expressed intention to commence litigation between a *covered member* and an *attest client* or its management and, in some cases, other parties requires the *covered member* to assess the materiality of the litigation to the *covered member*, the *covered member's firm*, and the *attest client*. The *covered member's* assessment should include an evaluation of the nature of the matter(s) underlying the litigation and all other relevant factors.

Litigation Between the Attest Client and Member

.04 When an *attest client's* present management commences, or expresses an intention to commence, legal action against a *covered member*, the *covered member* and the *attest client's* management may be placed in adversarial positions in which self-interest may affect the *covered member's* objectivity and management's willingness to make complete disclosures.

.05 Accordingly, *independence* may be *impaired* whenever the *covered member* and the *covered member's attest client* or its management are in threatened or actual positions of material adverse interests due to threatened or actual litigation.

.06 Situations involving threatened or actual litigation are complex and diverse, making it difficult to identify precise points at which *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*. There are situations regarding litigation between *covered members* and *attest clients* in which *threats* to the *covered member's* compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by *safeguards* and *independence* would be *impaired*. Examples of these situations are:

- a. An *attest client's* present management commences litigation alleging deficiencies in audit work performed for the *attest client* or expresses its intention to commence such litigation, and the *covered member* concludes that it is probable that such a claim will be filed.
- b. A *covered member* commences litigation against an *attest client's* present management alleging management fraud or deceit.

.07 If threatened or actual litigation is unrelated to the performance of an *attest engagement* and is for an amount that is not material to the *covered member's firm* or the *attest client*, *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*, and *independence* would not be *impaired*. Such claims may arise, for example, out of immaterial disputes regarding billings for services, results of tax or management services advice, or similar matters.

Litigation by Security Holders

.08 A *covered member* may also become involved in litigation (primary litigation) in which the *covered member* and the *attest client* or its management are defendants. For example, one or more stockholders may bring a stockholders' derivative action or class-action lawsuit against the *attest client* or its management, the *attest client's* officers, directors, or underwriters, and *covered members*.

.09 Such primary litigation by itself would not *threaten* the *covered member's* compliance with the "Independence Rule" [1.200.001]. However, if other circumstances exist that may create *threats*, the *covered member* should apply the "Conceptual Framework for Independence" interpretation [1.210.010] to evaluate whether the *threats* are at an *acceptable level*. For example, *threats* will exist if cross-claims are filed against the *covered member* alleging that the *covered member* is responsible for any deficiencies in work performed for the *attest client* or if the *covered member*, as a defense, alleges that the *attest client's* management engaged in fraud or deceit.

.10 The following are examples of situations in which *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would not

be at an *acceptable level* and could not be reduced to an acceptable level by *safeguards*, thereby *impairing independence*:

- a. The *attest client* or its management or directors have filed cross-claims to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations), and there is a significant risk that the cross-claim will result in a settlement or judgment in an amount that is material to the *covered member's firm* or the *attest client*.
- b. The *attest client's* underwriter and the *attest client* or its present management assert cross-claims against the *covered member*.

.11 If only the underwriter or officers or directors of the *covered member's* other *attest clients* file cross-claims against the *covered member*, *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* unless other circumstances create *threats* to compliance with the "Independence Rule."

Other Third-Party Litigation

.12 A *lending institution* or other creditor, security holder, or insurance company that alleges reliance on the *attest client's financial statements* as a basis for having extended credit or insurance coverage to an *attest client* may commence third-party litigation against the *covered member* to recover their loss. An example is an insurance company commencing litigation either as a result of receiving an assignment of a claim or under subrogation rights against the *covered member* in the *attest client's* name to recover losses that the insurer reimbursed to the *attest client*. If the *attest client* is only the nominal plaintiff, *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* unless other circumstances exist, such as when the *covered member* alleges, as a defense, that present management engaged in fraud or deceit. The *attest client* is a nominal plaintiff when the insurance company or lender sues in the name of the *attest client* as a result of obtaining subrogation rights or an assignment from the *attest client* and the *attest client* does not have a beneficial interest in the claim.

.13 If the real party in interest in the litigation (for example, the insurance company) is also the *covered member's attest client* (the plaintiff client), *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist if the litigation carries a significant risk of a settlement or judgment in an amount that would be material to the *covered member's firm* or the plaintiff client.

Termination of Impairment

.14 *Threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] would be eliminated or reduced to an *acceptable level* when the parties reach a final resolution of the matter(s) at issue and the matter(s) no longer affects the relationship between the *covered member* and the *attest client*, as described in paragraph .01 of this interpretation. The *covered member* should determine whether the conditions of such resolution have effectively eliminated such *threats* or reduced them to an *acceptable level*. [Prior reference: paragraph .08 of ET section 101]

[See Revision History Table.]

1.295 Nonattest Services

1.295.010 Scope and Applicability of Nonattest Services

.01 When a *member* performs nonattest services for an *attest client*, self-review, management participation, or advocacy *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] may exist. When significant *independence threats* exist during the *period of the professional engagement* or the period covered by the *financial statements* (except as provided for in paragraph .03), *independence* will be *impaired* unless the *threats* are reduced to an *acceptable level* and any requirements included in the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" have been met.

.02 For purposes of the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" [1.200.001], the term *member* includes the *member's firm*.

.03 *Period of engagement.* A *member's independence* would not be *impaired* if the *member* performed nonattest services that would have otherwise *impaired independence* during the period covered by the *financial statements* if all of the following conditions exist:

- a. The nonattest services were provided prior to *period of the professional engagement*.
- b. The nonattest services related to periods prior to the period covered by the *financial statements*.
- c. The *financial statements* for the period to which the nonattest services relate were audited by another *firm* (or in the case of a review engagement, reviewed or audited by another *firm*).

Nonauthoritative questions and answers regarding the period of the professional engagement are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

.04 *Activities related to attest services.* Performing attest services often involves communications between the *member* and *client* management regarding

- a. the *client's* selection and application of accounting standards or policies and *financial statement* disclosure requirements;
- b. the appropriateness of the *client's* methods used in determining accounting and financial reporting;
- c. adjusting journal entries that the *member* has prepared or proposed for *client* management consideration; and
- d. the form or content of the *financial statements*.

These communications are considered a normal part of the *attest engagement* and are not considered nonattest services subject to the "General Requirements for Performing Nonattest Services" [1.295.040] and "Documentation Requirements When Providing Nonattest Services" [1.295.050] interpretations.

.05 However, the *member* should exercise judgment in determining whether his or her involvement has become so extensive that it would constitute performing a separate service which would be subject to the "General Requirements for Performing Nonattest Services" interpretation [1.295.040].

.06 For example, activities such as *financial statement* preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of

the *attest engagement* and, therefore, constitute a nonattest service. Such activities would not *impair independence* if the requirements of the *interpretations* of the "Nonattest Services" subtopic [1.295] are met.

Nonauthoritative questions and answers regarding routine activities are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

.07 *Engagements subject to independence rules of certain regulatory or standard-setting bodies.* *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a member is not in compliance with the *independence* regulations of authoritative regulatory bodies that are more restrictive than the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" (examples of such authoritative bodies are the SEC, the Government Accountability Office [GAO], the Department of Labor [DOL], the Public Company Accounting Oversight Board [PCAOB], and state boards of accountancy) when a member performs nonattest services for an *attest client* and is required to be independent of the *attest client* under the regulations of the applicable regulatory body. Independence would be *impaired* under these circumstances. [Prior reference: paragraph .05 of ET section 101]

.08 Refer to the "Staff Augmentation Arrangements" interpretation [1.275.007] when the engagement involves lending *firm* personnel (augmented staff) to an *attest client* whereby the *attest client* is responsible for the direction and supervision of the activities performed by the augmented staff.

Effective Date

.09 Paragraph .06 of this interpretation is effective for engagements covering periods beginning on or after December 15, 2014.

[See Revision History Table.]

1.295.020 Cumulative Effect on Independence When Providing Multiple Nonattest Services

.01 The *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" [1.200.001] include various examples of nonattest services that individually would not *impair independence* because the *safeguards* in the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] reduce the self-review and management participation *threats* to an *acceptable level*. However, performing multiple nonattest services can increase the significance of these *threats* as well as other *threats* to *independence*.

.02 Before agreeing to perform nonattest services, the member should evaluate whether the performance of multiple nonattest services by the *member* or *member's firm* in the aggregate creates a significant *threat* to the member's *independence* that cannot be reduced to an *acceptable level* by the application of the *safeguards* in the "General Requirements for Performing Nonattest Services" interpretation [1.295.040].

.03 In situations in which a member determines that *threats* are not at an *acceptable level*, *safeguards* in addition to those in the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] should be applied to eliminate the *threats* or reduce them to an *acceptable level*. If no

safeguards exist that will eliminate or reduce the *threats* to an *acceptable level*, *independence* would be *impaired*.

.04 For purposes of this interpretation, the member is not required to consider the possible *threats* to *independence* created due to the provision of nonattest services by other *network firms* within the *firm's network*. [Prior reference: paragraph .05 of ET section 101]

Effective Date

.05 This interpretation is effective for engagements covering periods beginning on or after December 15, 2014.

1.295.030 Management Responsibilities

.01 If a member were to assume a management responsibility for an *attest client*, the management participation *threat* would be so significant that no *safeguards* could reduce the *threat* to an *acceptable level* and *independence* would be *impaired*. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

.02 Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered management responsibilities and, as such, *impair independence* if performed for an *attest client*, include

- a. setting policy or strategic direction for the *attest client*.
- b. directing or accepting responsibility for actions of the *attest client's* employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- c. authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of an *attest client* or having the authority to do so.
- d. preparing *source documents*, in electronic or other form, that evidence the occurrence of a transaction.
- e. having custody of an *attest client's* assets.
- f. deciding which recommendations of the member or other third parties to implement or prioritize.
- g. reporting to *those charged with governance* on behalf of management.
- h. serving as an *attest client's* stock transfer or escrow agent, registrar, general counsel or equivalent.
- i. accepting responsibility for the management of an *attest client's* project.
- j. accepting responsibility for the preparation and fair presentation of the *attest client's financial statements* in accordance with the applicable financial reporting framework.
- k. accepting responsibility for designing, implementing, or maintaining internal control.
- l. performing ongoing evaluations of the *attest client's* internal control as part of its monitoring activities.

[Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding management responsibilities and controllership services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.295.040 General Requirements for Performing Nonattest Services

.01 When a member performs a nonattest service for an *attest client*, *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist. Unless an *interpretation* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" states otherwise, *threats* would be at an *acceptable level*, and *independence* would not be *impaired*, when all the following *safeguards* are met:

- a. The member determines that the *attest client* and its management agree to
 - i. assume all management responsibilities as described in the "Management Responsibilities" interpretation [1.295.030].
 - ii. oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.
 - iii. evaluate the adequacy and results of the services performed.
 - iv. accept responsibility for the results of the services.
- b. The member does not assume management responsibilities (See the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule") when providing nonattest services and the member is satisfied that the *attest client* and its management will
 - i. be able to meet all of the criteria delineated in item *a*;
 - ii. make an informed judgment on the results of the member's nonattest services; and
 - iii. accept responsibility for making the significant judgments and decisions that are the proper responsibility of management.

If the *attest client* is unable or unwilling to assume these responsibilities (for example, the *attest client* cannot oversee the nonattest services provided or is unwilling to carry out such responsibilities due to lack of time or desire), the member's performance of nonattest services would *impair independence*.

- c. Before performing nonattest services the member establishes and documents in writing his or her understanding with the *attest client* (board of directors, audit committee, or management, as appropriate in the circumstances) regarding
 - i. objectives of the engagement,
 - ii. services to be performed,

- iii. *attest client's* acceptance of its responsibilities,
- iv. member's responsibilities, and
- v. any limitations of the engagement.

.02 The *safeguards* in paragraph .01 and the "Documentation Requirements When Providing Nonattest Services" interpretation [1.295.050] of the "Independence Rule" [1.200.001] do not apply to certain routine activities performed by the member, such as providing advice and responding to the *attest client's* questions as part of the *attest client*-member relationship. However, in providing such services, the member must not assume management responsibilities, as described in the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule." [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding suitable skill, knowledge, and experience are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.295.050 Documentation Requirements When Providing Nonattest Services

.01 Before performing nonattest services, the member should document in writing the member's understanding established with the *attest client*, as described in paragraph .01c of the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001].

.02 Failure to prepare the required documentation does not *impair independence* provided that the member did establish the understanding with the *attest client*. However, failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001].

.03 The documentation requirement does not apply to nonattest services performed prior to the *period of the professional engagement* for an *attest client*. However, for nonattest services provided during the period covered by the *financial statements*, the member should document in writing that the requirements of the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] were met prior to the *period of the professional engagement*, including the requirement to establish an understanding with the *attest client*. [Prior reference: paragraph .05 of ET section 101]

Sample language for how to document your understanding with the *attest client* is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.295.105 Advisory Services

.01 Self-review or management participation *threats* to compliance with the "Independence Rule" [1.200.001] may exist when a member performs advisory services for an *attest client*.

.02 If the member's services are only advisory in nature and the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. provide advice, research materials, and recommendations to assist management in performing its functions and making decisions.
- b. attend board meetings as a nonvoting advisor.
- c. interpret *financial statements*, forecasts, or other analyses.
- d. provide management with advice regarding its potential plans, strategies, or relationships.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a member assumes any management responsibilities, as described in the "Management Responsibilities" interpretation [1.295.030]. Accordingly, *independence* is *impaired*. [Prior reference: paragraph .05 of ET section 101 and paragraphs .015–.016 of ET section 191]

1.295.110 Appraisal, Valuation, and Actuarial Services

.01 Self-review or management participation *threats* to compliance with the "Independence Rule" [1.200.001] may exist when a member performs appraisal, valuation, or actuarial service for an *attest client*.

.02 *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the member performs an appraisal, a valuation, or an actuarial service for an *attest client* when (a) the services involve a significant degree of subjectivity and (b) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the *attest client's financial statements*. Accordingly, *independence* would be *impaired* under these circumstances.

.03 When performing appraisal, valuation, and actuarial services for an *attest client* that are permitted under this interpretation, all requirements of the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001] should be met, including that all significant assumptions and matters of judgment are determined or approved by the *attest client*, and the *attest client* is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

Valuations Involving a Significant Degree of Subjectivity

.04 Examples of valuations that generally involve a significant degree of subjectivity include, ESOPs, business combinations, or appraisals of assets or liabilities. Accordingly, if these services produce results that are material to the *attest client's financial statements*, *independence* would be *impaired*.

Actuarial Valuations of Pension or Postemployment Benefit Liabilities

.05 An actuarial valuation of an *attest client's* pension or postemployment benefit liabilities generally does not involve a significant degree of subjectivity because reasonably consistent results are produced when the same

assumptions and information are used in performing the valuation. Therefore, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

Appraisal, Valuations, and Actuarial Services for Nonfinancial Statement Purposes

.06 *Threats* would be at an *acceptable level* if a member provided appraisal, valuation, or actuarial services solely for nonfinancial statement purposes. Some examples are appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. Accordingly, *independence* would not be *impaired*. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding appraisal, valuation, and actuarial services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.295.113 Assisting Attest Clients With Implementing Accounting Standards

.01 When a *member* assists an *attest client* with planning and executing the implementation of an accounting standard, self-review or management participation *threats* to compliance with the "Independence Rule" [1.200.001] may exist.

.02 If a *member* applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if, for example, a *member* does the following:

- a. Develops and provides training to *attest client* personnel on the effects of the accounting standard
- b. Researches, provides advice, makes recommendations, and assists management in identifying *financial statement* account balances, contracts, and transactions to be assessed under the accounting standard
- c. Provides advice and recommendations related to the application of the accounting standard, including
 - i. analyzing and advising management on the potential impact of the accounting standard on the entity's accounting policies, procedures, and internal controls
 - ii. recommending possible revisions to existing policies, procedures, and internal controls
 - iii. assisting the *attest client* with summarizing the *attest client's* analysis and policies related to the accounting positions under the accounting standard
 - iv. preparing transition-related calculations to illustrate the impact of the application of the accounting standard for management's consideration and selection

- d. Provides observations and recommendations on management's existing overall project plan timeline or assists management in developing an overall project plan timeline to adopt the accounting standard
- e. Assists management in drafting implementation strategies or methods used to implement the accounting standard
- f. Assists the *attest client* in developing implementation templates or provides the *attest client* with firm-developed templates or tools, including those related to specific calculations under the accounting standard that meet the exception in paragraph .03a of the "Information Systems Services" interpretation [1.295.145] under the "Independence Rule," provided the attest client's management understands the nature of any underlying calculations and the impact the results will have on the financial statements
- g. Proposes standard journal entries or adjustments to existing journal entries necessary for adoption of the accounting standard, subject to *attest client* approval in accordance with paragraph .02e of the "Bookkeeping, Payroll, and Other Disbursements" interpretation [1.295.120]
- h. Provides recommendations related to existing or new information systems as a result of the accounting standard

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if, for example, a *member* does any of the following:

- a. Leads or supervises any *attest client* implementation team
- b. Makes decisions on which recommendations to prioritize or how to implement the accounting standard
- c. Sets any policy or procedures related to the accounting standard
- d. Accepts responsibility for designing new or redesigning existing internal controls over financial reporting
- e. Designs or develops new or redesigns existing financial information systems as described in the "Information System Services" interpretation [1.295.145] under the "Independence Rule"

Effective Date

.04 This interpretation is effective December 31, 2022. Early implementation is allowed.

[See Revision History Table.]

Nonauthoritative questions and answers regarding suitable skill, knowledge, and experience are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

A nonauthoritative practice aid related to the "Information Systems Services" interpretation [1.295.145] is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/isspracticeaid.pdf>.

1.295.115 *Benefit Plan Administration*

.01 When a member provides benefit plan administration services to an *attest client*, self-review and management participation *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist.

.02 Notwithstanding the conclusions reached in paragraph .03 of this interpretation, a member should comply with the more restrictive independence provisions of the Employee Retirement Income Security Act (ERISA) of 1974 and DOL regulations when performing audits of employee benefit plans subject to those regulations.

.03 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, the member may

- a. communicate summary plan data to a plan trustee.
- b. advise management regarding the application and impact of provisions in a plan document.
- c. process certain transactions that have been initiated by plan participations or approved by the plan administrators using the member's electronic media, such as an interactive voice response system or Internet connection or other media. Such transactions may include processing investment or benefit elections, changes in contributions to the plan, data entry, participant confirmations, and distributions and *loans*.
- d. prepare account valuations for plan participants using data collected through the member's electronic or other media.
- e. prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other media.

.04 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if, for example, a member

- a. makes policy decisions on behalf of management.
- b. interprets the provisions in a plan document for a plan participant on behalf of management without first obtaining management's concurrence.
- c. makes disbursements on behalf of the plan.
- d. has custody of the plan's assets.
- e. serves in a fiduciary capacity, as defined by ERISA. [Prior reference: paragraph .05 of ET section 101]

1.295.120 *Bookkeeping, Payroll, and Other Disbursements*

.01 When a member provides bookkeeping, payroll, and other disbursement services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule"

[1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. record transactions to an *attest client's* general ledger when management has determined or approved the account classifications for the transaction.
- b. post transactions coded by the *attest client* to the *attest client's* general ledger.
- c. prepare *financial statements* based on information in the *attest client's* trial balance.
- d. post *client*-approved journal or other entries to an *attest client's* trial balance.
- e. propose standard, adjusting, or correcting journal entries or other changes affecting the *financial statements* to the *attest client*. Prior to the member posting these journal entries or changes, the member should be satisfied that management has reviewed the entries and understands the nature of the proposed entries and the effect the entries will have on the *attest client's financial statements*.
- f. generate unsigned checks using *source documents* or other records provided and approved by the *attest client*.
- g. process an *attest client's* payroll using payroll time records that the *attest client* has provided and approved.
- h. transmit *client*-approved payroll or other disbursement information to a bank or similar entity subsequent to the *attest client's* review and authorization for the member to make the transmission. Prior to such transmission, the *attest client* is responsible for making the arrangements with the bank or similar entity to limit the corresponding individual payments regarding the amount and payee. In addition, once transmitted, the *attest client* must authorize the bank or similar entity to process the payroll information.
- i. prepare a reconciliation (for example, bank and accounts receivable) that identifies reconciling items for the *client's* evaluation.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. determines or changes journal entries, any account coding or classification of transactions, or any other accounting records without first obtaining the *attest client's* approval.
- b. authorizes or approves transactions.
- c. prepares *source documents*.
- d. makes changes to *source documents* without the *attest client's* approval.
- e. accepts responsibility to authorize payment of *attest client* funds, electronically or otherwise, except for electronic payroll tax payments when the member complies with the requirements of the "Tax Services" interpretation [1.295.160] of the "Independence Rule."
- f. accepts responsibility to sign or cosign an *attest client's* checks, even if only in emergency situations.

- g. maintains an *attest client's* bank account or otherwise has custody of an *attest client's* funds or makes credit or banking decisions for the *attest client*.
- h. approves vendor invoices for payment. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers about bookkeeping services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

[See Revision History Table.]

1.295.125 Business Risk Consulting

.01 When a member provides business risk consulting services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. assist management in its assessment of the *attest client's* business risk control processes.
- b. recommend improvements to an *attest client's* business risk control processes and assists in the implementation of these improvements.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes or approves business risk decisions.
- b. presents business risk considerations to the board or others on behalf of management. [Prior reference: paragraph .05 of ET section 101]

1.295.130 Corporate Finance Consulting

.01 When a member provides corporate finance consulting services to an *attest client*, self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. assist management in developing its corporate strategies.
- b. assist management in identifying possible sources of capital that meet the *attest client's* specifications or criteria.
- c. introduce management to possible sources of capital that meet the *attest client's* specifications or criteria.

- d. assist management in analyzing the effects of proposed transactions with potential buyers, sellers, or capital sources.
- e. advise an *attest client* during its negotiations with potential buyers, sellers, or capital sources.
- f. assist the *attest client* in drafting its offering document or memorandum.
- g. participate with management in its transaction negotiations in an advisory capacity.
- h. be named as a financial adviser in an *attest client's* private placement memoranda or offering documents.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest client* to the terms of a transaction.
- b. consummates a transaction on behalf of the *attest client*.
- c. acts as a promoter, an underwriter, a broker-dealer, or a guarantor of an *attest client's* securities or as a distributor of private placement memoranda or offering documents.
- d. maintains custody of an *attest client's* securities. [Prior reference: paragraph .05 of ET section 101]

1.295.135 Executive or Employee Recruiting

.01 When a member provides executive or employee recruiting services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. recommend a position description or candidate specifications.
- b. solicit and screen candidates based on criteria approved by the *attest client*, such as required education, skills, or experience.
- c. recommend qualified candidates to the *attest client* for their consideration based on criteria approved by the *attest client*.
- d. participate in employee hiring or compensation discussions in an advisory capacity.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest client* to employee compensation or benefit arrangements.
- b. hires or terminates the *attest client's* employees. [Prior reference: paragraph .05 of ET section 101]

[See Revision History Table.]

1.295.140 Forensic Accounting

.01 Forensic accounting services. For purposes of this interpretation, forensic accounting services are nonattest services that involve the application of (a) special skills in accounting, auditing, finance, quantitative methods or certain areas of the law, and research and (b) investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings. Forensic accounting services consist of investigative services and litigation services.

.02 Attest client. For purposes of this interpretation, the term *attest client* refers to the *attest client* with respect to which the member is providing litigation services, not the law firm that engages the member on behalf of the law firm's client. If the law firm that engages the member on behalf of the member's *attest client* is also an *attest client* of the member, the member should consider the applicability of the "Cooperative Arrangements With Attest Clients" interpretation [1.265.010] of the "Independence Rule" [1.200.001].

.03 Investigative services. For purposes of this interpretation, investigative services include all forensic services that do not involve actual or threatened litigation, such as performing analyses or investigations that may require the same skills used in litigation services. When a member provides investigative services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. However, if the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* will be at an *acceptable level* and *independence* will not be *impaired*.

.04 Litigation services. For purposes of this interpretation, litigation services recognize the role of the member as an expert or a consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of expert witness services, litigation consulting services, or other litigation services:

- a. **Expert witness services.** For purposes of this interpretation, expert witness services are those litigation services in which a member is engaged to render an opinion before a trier of fact about the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events:
 - i. Expert witness services create the appearance that a member is advocating or promoting an *attest client's* position. Therefore, the advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, if a member is engaged conditionally or unconditionally to provide expert witness services or expert testimony for an *attest client*, *independence* would be *impaired*, except as discussed in the following item ii.
 - ii. *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and *independence* would not be *impaired*, if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more *attest clients* of the *firm*, provided that at the outset of the engagement

1. the member's *attest clients* constitute less than 20 percent of the members of the group, voting interests of the group, and the claim;
 2. no *attest client* within the group is designated as the lead plaintiff or defendant of the group; and
 3. no *attest client* has the sole decision-making power to select or approve the selection of the expert witness.
- iii. *Fact witness testimony.* Acting as a fact witness (also referred to as a "percipient witness" or "sensory witness") would not be considered a nonattest service. Fact witness testimony is based on the member's direct knowledge of the matters, facts, or events in dispute obtained through the member's performance of prior *professional services* for the *attest client*. As a fact witness, the member's role is to provide factual testimony to the trier of fact. While testifying as a fact witness, the trier of fact or counsel may question a member about the member's opinions pertaining to matters within the member's area of expertise. Answering such questions would not *impair* the member's *independence*.
- iv. In determining whether the member's services are considered expert witness services or fact witness testimony, members should refer to Rules 701–703 of Article VII, "Opinions and Expert Testimony," of the *Federal Rules of Evidence* and also refer to other applicable laws, regulations, and rules.
- v. When providing expert witness services or fact witness testimony, members are required to comply with the "Integrity and Objectivity Rule" [1.100.001].
- b. *Litigation consulting services.* For purposes of this interpretation, litigation consulting services are those litigation services in which a member provides advice about the facts, issues, or strategy pertaining to a matter. The consultant does not testify as an expert witness before a trier of fact:
- i. When a member provides litigation consulting services, advocacy and management participation *threats* to the *covered member's* compliance with the "Independence Rule" may exist. If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For purposes of complying with paragraph .01b of the "General Requirements for Performing Nonattest Services" interpretation of the "Independence Rule," the *attest client* may designate its attorney to oversee the litigation consulting services.
 - ii. However, if the member providing litigation consulting services subsequently agrees to serve as an expert witness, *threats* to the member's compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

- c. *Other litigation services.* The advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a member serves as a trier of fact, a special master, a court-appointed expert, or an arbitrator (including serving on an arbitration panel) in a matter involving an *attest client*. These services create the appearance that the member is not independent; accordingly, *independence* would be *impaired*.
- d. However, if the member applies the "General Requirements for Performing Nonattest Services" interpretation of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member serves as a mediator or any similar role in a matter involving an *attest client*, provided that the member is not making any decisions on behalf of the parties but, rather, is acting as a facilitator by assisting the parties in reaching their own agreement. When providing such services, the member should consider the requirements of the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule." [Prior reference: paragraph .05 of ET section 101]

.05 See <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf> for information about transition provision for engagements commenced prior to February 28, 2007.

.06 When providing any type of forensic accounting service, members are required to comply with the "Integrity and Objectivity Rule" [1.100.001].

[See Revision History Table.]

1.295.143 Hosting Services

.01 For purpose of this interpretation, hosting services are nonattest services that involve a *member* accepting responsibility for the following:

- a. Acting as the sole host of a financial or non-financial information system of an *attest client*
- b. Taking custody of or storing an *attest client's* data or records whereby, that data or records are available only to the *attest client* from the *member*, such that the *attest client's* data or records are otherwise incomplete
- c. Providing electronic security or back-up services for an *attest client's* data or records

.02 When a *member* provides hosting services, the *member* is maintaining the *attest client's* internal control over its data or records. Accordingly, the management participation threat to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*.

.03 Examples of activities that are considered hosting services, and as such will *impair independence* if performed for an *attest client*, include accepting responsibility for the following:

- a. Housing the *attest client's* website or other non-financial information system
- b. Keeping the *attest client's* data or records on the *attest client's* behalf, for example, the *attest client's* general ledger information, supporting schedules (such as, depreciation or amortization

schedules), lease agreements or other legal documents are stored on the *member's firm's* servers or servers licensed by the *member's firm* or the *member* is responsible for storing hard copy versions of the data or records

- c. Being the *attest client's* business continuity or disaster recovery provider

.04 Examples of activities that are not considered to be hosting services, and as such will not *impair independence* provided *members* comply with the requirements of the other *interpretations* of the "Nonattest Services" subtopic include these:

- a. Retaining a copy of an *attest client's* data or records as documentation to support a service the *member* provided to the *attest client*. Some examples are as follows:
 - i. The payroll data that support a payroll tax return prepared by the *member* for the *attest client*
 - ii. A bank reconciliation that supports attest procedures performed by the *member* on the *attest client's* cash account
 - iii. The *attest client's* vendor data used to prepare an analysis of vendor activity
- b. Retaining, for a *member's* records, a copy of a work product prepared by the *member* (for example, a tax return).
- c. Using general ledger software to facilitate the delivery of bookkeeping services when either of the following occurs:
 - i. The *member* and the *attest client* maintain separate instances of the software on their respective servers, and the *member* provides updated financial information electronically to the *attest client*.
 - ii. The *attest client* enters into an agreement with a third-party service provider to maintain its software in a cloud-based solution and grants the *member* access to the software so that the *member* can perform the bookkeeping service for the *attest client*.
- d. Retaining data collected by the *member* related to a work product that the *member* prepared for an *attest client*. For example, the *member* conducts an employee survey and provides the *attest client* with a report. The *member* retains the survey data collected to support the work product.
- e. Electronically exchanging data, records, or the *member's* work product with an *attest client* or on behalf of an *attest client* at the *attest client's* request. For example, the *member* uses a portal as follows:
 - i. To exchange data and records with the *attest client* related to *professional services* provided by the *member* to the *attest client*
 - ii. To deliver the *member's* work product to third parties at the *attest client's* request

To avoid providing hosting services, *members* should terminate the *attest client's* access to the data or records in the portal within a reasonable period of time after the conclusion of the engagement.

- f. Licensing software to an *attest client* that the *attest client* uses to input its data and receive an output that the *attest client* is responsible for maintaining, provided the software does not perform an activity that, if performed directly by the *member*, would *impair independence*.
- g. Having possession of a depreciation schedule prepared by the *member*, provided the depreciation schedule and calculation are given to the *attest client* so that *attest client's* books and records are complete.
- h. Retaining an *attest client's* original data or records to facilitate the performance of a nonattest service (for example, obtaining original records to prepare the attest client's tax return), provided that the data or records are returned to the *attest client* at the end of the engagement or, in a multi-year engagement, at least annually. This does not apply to ongoing hosting services as described in paragraph .01 of this interpretation.

Effective Date

.05 This interpretation is effective July 1, 2019.

[See Revision History Table.]

Nonauthoritative questions and answers regarding hosting services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.295.145 Information Systems Design, Implementation, or Integration

.01 When a member provides information systems design, implementation, or integration services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. install or integrate an *attest client's* financial information system that the member did not design or develop (for example, an off-the-shelf accounting package).
- b. assist in setting up the *attest client's* chart of accounts and *financial statement* format with respect to the *attest client's* financial information system.
- c. design, develop, install, or integrate an *attest client's* information system that is unrelated to the *attest client's financial statements* or accounting records.
- d. provide training and instruction to an *attest client's* employees on an information and control system.
- e. perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings consistent with management's request.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. designs or develops an *attest client's* financial information system.
- b. makes other than insignificant modifications to source code underlying an *attest client's* existing financial information system.
- c. supervises *attest client* personnel in the daily operation of an *attest client's* information system.
- d. operates an *attest client's* network. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding information systems design, implementation, and integration services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

June 2019

The revised interpretation "Information Systems Services," formerly "Information Systems Design, Implementation, or Integration" (ET sec. 1.295.145) under the "Independence Rule" (ET sec. 1.200.001) is effective January 1, 2023, and early implementation is allowed.

Information Systems Services

Introduction

.01 Self-review and management participation *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist when a member provides nonattest services related to an attest client's information systems.

.02 This interpretation applies to all attest engagements, including those in which the subject matter of the engagement is not financial statements. In these cases, the member should define a financial information system as any information system that is subject to the member's attest procedures considering the relevant factors in paragraph .03a.

Terminology

.03 The following terms are defined solely for the purpose of applying this interpretation:

- a. A financial information system (FIS) is a system that aggregates source data underlying the *financial statements* or generates information that is significant to either the financial statements or financial processes as a whole. An FIS includes a tool that calculates results unless
 - i. the tool performs only discrete calculations;
 - ii. the attest client evaluates and accepts responsibility for the input and assumptions; and

- iii. the attest client has sufficient information to understand the calculation and the results.
- b. Designing an information system means determining how a system or transaction will function, process data, and produce results (for example, reports, journal vouchers, and documents such as sales and purchase orders) to provide a blueprint or schematic for the development of software code (programs) and data structures.
- c. Developing an information system entails creating software code, for individual or multiple modules, and testing such code to confirm it is functioning as designed.
- d. Commercial off-the-shelf (COTS) refers to software developed, distributed, maintained, and supported by an entity or entities that are not the member or member's firm (a third-party vendor), sometimes referred to as an "off-the-shelf" package or solution. COTS solutions have generally referred to traditional on-premise software that runs on a customer's own computers or on a third-party vendor's "cloud" infrastructure. COTS solutions range from software packages that require only installation on a computer and are ready to run to large-scale, complex enterprise applications.

Design, Development, or Implementation Services Not Related to an FIS

.04 When performing design, development, or implementation services described in this interpretation for an *attest client* that are not related to an FIS, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* provided all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" are met, including that the attest client has not outsourced a function, process, or activity to the *member*, which would result in the member assuming a management responsibility.

Design or Develop an FIS

.05 When a *member* designs or develops an *attest client's* FIS, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards* and *independence* would be *impaired*.

.06 To determine whether a nonattest service is related to an FIS, *members* should consider all relevant factors, such as whether the nonattest service will affect the following:

- a. System controls or system output that will be subject to attest procedures.
- b. A system that generates data that are used as input to the financial statements, including data or information that is either reflected in or used in determining amounts and disclosures included in the financial statements.
- c. A data-gathering system, such as an analytical or reporting tool, that is used in management's decision-making about matters that could significantly affect financial reporting.

- d. A system that is part of the *attest client's* internal controls over financial reporting, including information systems used to effect internal controls over financial reporting (for example, a system used to ensure that information produced for the financial statements is accurate). However, information systems used only in connection with controlling the efficiency and effectiveness of operations are considered unrelated to the financial statements and accounting records.

Implement a COTS FIS Software Solution

.07 Implementation services involve activities related to an *attest client's* information systems after the design and development of the system. Implementation ceases when the system is available on a regular basis to the attest client for its intended use. For example, implementation services can include activities such as installing, configuring, interfacing, customizing, and data translation. Services that are performed post-implementation, such as the maintenance, support, and monitoring of the system, are not implementation services.

.08 *Threats* created by certain COTS implementation services related to the *attest client's* FIS may be reduced to an *acceptable level* by the application of *safeguards*; however, in other situations, threats to compliance with the "Independence Rule" [1.200.001] would be significant and could not be reduced to an acceptable level by the application of safeguards. These situations are addressed in paragraphs .09–.20 of this interpretation.

Install a COTS FIS Software Solution

.09 To install a COTS FIS software solution means the initial loading of software on the client's designated hosting site. Software configuration, interfacing, customizing and data translation activities may follow installation.

.10 When a *member* installs a COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level*, provided all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" are met.

Configure a COTS FIS Software Solution

.11 To configure a COTS FIS software solution means inputting the client-selected features, functionality options, and settings within the third-party vendor's software, which determines how the software will perform certain transactions and process data. Configuration options may also include selecting the predefined format of certain data attributes and the inclusion or exclusion of such attributes. However, if the member were to design or develop new software code or features to modify or alter the functionality of the COTS software solution in ways not predefined by the third-party vendor, this would be considered designing or developing activities, as described in items (b)–(c) of paragraph .03.

.12 When a *member* configures a COTS FIS software solution based on client-selected features, functionality options, and settings within the third-party vendor's software, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* provided all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" are met.

Customize a COTS FIS Software Solution

.13 To customize a COTS FIS software solution means to modify or enhance the features and functions in ways that go beyond the options provided by the third-party vendor when configuring the COTS software solution.

- a. Modification involves altering the COTS software solution code to change or add to the functionality provided by the third-party vendor.
- b. Enhancements involve developing new code, external to the COTS software solution, that works in concert with the COTS software solution to provide altered or additional functionality.

.14 If a *member* customizes an *attest client's* COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of *safeguards*; *independence* would be *impaired*.

Interface a COTS FIS Software Solution

.15 Providing interface services for a COTS FIS software solution means connecting two or more systems by designing and developing software code that passes data from one system to another. Interfaces may flow in one direction or be bidirectional. Interfaces may involve the performance of an end-to-end transaction or they may pass data from one system to another.

.16 If a *member* provides interface services for a COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards*; *independence* would be *impaired* except as provided for in paragraph .17.

.17 If a *member* uses a third-party vendor's application, such as an application programming interface (API), to interface legacy or COTS FIS software solutions, *threats* to *independence* would be at an *acceptable level*, provided the member will not be designing or developing code for the application to work and all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" [1.200.001] are met.

Data Translation Services Related to a COTS FIS Software Solution

.18 Performing data translation services for a COTS FIS software solution involves designing and developing the rules or logic necessary to convert legacy system data to a format compatible with that of the new system.

.19 If a *member* performs data translation services for a COTS FIS software solution, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards* and *independence* would be *impaired* except as provided for in paragraph .20.

.20 If a *member* uses a third-party vendor's application, such as an API, to perform data translation services for a COTS FIS software solution, *threats* to *independence* would be at an *acceptable level*, provided the member will not be designing or developing code for the application to work and all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" [1.200.001] are met.

System and Network Maintenance, Support, and Monitoring

.21 Maintenance, support, and monitoring services are activities that are provided after a financial or nonfinancial system or network is implemented. If post-implementation services involve the *attest client* outsourcing an ongoing function, process, or activity to the *member* that would result in the member assuming a management responsibility, compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by the application of *safeguards* and *independence* would be *impaired*. Examples of services that involve an ongoing function, process, or activity that would result in the member assuming a management responsibility include services in which the *member* directly or indirectly does any of the following:

- a. Operates the attest client's network, such as managing the attest client's systems or software applications
- b. Supervises client personnel involved in the operation of the attest client's information systems
- c. Has responsibility for monitoring or maintaining the attest client's network performance
- d. Operates or manages the attest client's information technology help desk
- e. Has responsibility to perform ongoing network maintenance, such as updating virus protection solutions, applying routine updates and patches, or configuring user settings
- f. Has responsibility for maintaining the security of the attest client's networks and systems

.22 *Independence* will not be *impaired* provided all requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" [1.200.001] are met and the maintenance, support, or monitoring services are individually separate, distinct, and not ongoing engagements in which the *attest client* has outsourced no function, process, or activity to the *member* that would result in the member assuming a management responsibility. Examples of services that would not impair independence may include any of the following services:

- a. Analyzing a network and providing observations or recommendations
- b. Applying virus protection solutions or updates that the member did not design or develop
- c. Applying certain updates and patches that the member did not design or develop
- d. Providing advice, training, or instruction on a software solution
- e. Assessing the design or operating effectiveness of an attest client's security over information technology systems
- f. Assessing the attest client's information technology security policies or practices

A nonauthoritative practice aid is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposuredrafts/downloadabledocuments/2021/isspracticeaid.pdf>

Nonauthoritative questions and answers regarding information systems services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.295.150 Internal Audit

.01 For purposes of this interpretation, internal audit services involve assisting the *attest client* in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." When a member provides internal audit services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 The *attest client's* management is responsible for directing the internal audit function, including the management thereof. Such responsibilities include, but are not limited to, designing, implementing and maintaining internal control. *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, cannot be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if the *attest client* outsources the internal audit function to the member, whereby the member, in effect, manages the *attest client's* internal audit activities.

.03 However, except for the outsourcing services discussed in paragraph .02, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if the member assists the *attest client* in performing financial and operational internal audit activities, provided that, in addition to the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," the member is satisfied that management

- a. designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for the internal audit function.
- b. determines the scope, risk, and frequency of internal audit activities, including those the member will perform in providing the services.
- c. evaluates the findings and results arising from the internal audit activities, including those the member will perform in providing the services.
- d. evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

.04 For example, if the member applies the *safeguards* in paragraph .03, the member may assess whether performance is in compliance with management's policies and procedures, identify opportunities for improvement, and recommend improvement or further action for management consideration and decision making.

.05 The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit

plans, and recommending audit priorities. The member should also be satisfied that *those charged with governance* are informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide *those charged with governance* a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

.06 *Threats to compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and independence would be impaired, if, for example, in addition to those activities listed in the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule," a member*

- a. performs ongoing evaluations (see paragraph .10 that follows) or control activities (for example, reviewing *loan* originations as part of the *attest client's* approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed or accounted for, or both, and performs routine activities in connection with the *attest client's* operating or production processes that are equivalent to those of an ongoing compliance or quality control function.
- b. performs separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the *attest client's* business process.
- c. has *attest client* management rely on the member's work as the primary basis for the *attest client's* assertions on the design or operating effectiveness of internal controls.
- d. determines which, if any, recommendations for improving the internal control system should be implemented.
- e. reports to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function.
- f. approves or is responsible for the overall internal audit work plan, including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures.
- g. is connected with the *attest client* as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the *attest client's* directories or other *attest client* publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the *attest client's* internal audit function, or using the *attest client's* letterhead or internal correspondence forms in communications).

.07 *Monitoring activities.* Designing, implementing, or maintaining the *attest client's* monitoring activities are management responsibilities. Accordingly, *independence* would be *impaired* if a member accepts responsibility for performing such activities. Monitoring activities are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to the *attest client's* business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the

components of internal control in the ordinary course of managing the business. A member who performs such activities for an *attest client* would be considered to be accepting responsibility for maintaining the *attest client's* internal control. Accordingly, the management participation *threat* created by a member performing ongoing evaluations is so significant that no *safeguards* could reduce the *threat* to an *acceptable level*, and thus *independence* would be *impaired*.

.08 Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the *attest client's* business process, separate evaluations generally do not create a significant management participation *threat* to *independence*.

.09 Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Internal Control—Integrated Framework*, for additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

.10 Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation *threat* to *independence*, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall *financial statements* of the *attest client*, as well as the frequency of the internal audit services. If the *threat* to *independence* is considered significant, the member should apply *safeguards* to eliminate or reduce the *threat* to an *acceptable level*. If no *safeguards* could reduce the *threat* to an *acceptable level*, then *independence* would be *impaired*.

.11 *Attest-related services*. Services considered extensions of the member's audit scope applied in the audit of the *attest client's financial statements*, such as confirming accounts receivable and analyzing fluctuations in account balances, are not considered internal audit services and would not be subject to this interpretation even if the extent of such testing exceeds that required by generally accepted auditing standards (GAAS). In addition, engagements performed under the attestation standards would not be considered internal audit services and, therefore, would not *impair independence*.

.12 When a member performs internal audit services that would not *impair independence* under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, *independence* would not be considered *impaired*, provided the member is satisfied that *attest client* management does not rely on the member's work as the primary basis for its assertion. [Prior reference: paragraph .05 of ET section 101]

[See Revision History Table.]

1.295.155 Investment Advisory or Management

.01 When a member provides investment advisory or management services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

.02 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may

- a. recommend the *attest client's* allocation of funds among various investments or asset classes based upon the *attest client's* desired rate of return, risk tolerance, or other parameters.
- b. perform recordkeeping and reporting of the *attest client's* portfolio balances, including providing the *attest client* with a comparative analysis of the *attest client's* investments to third-party benchmarks.
- c. evaluate the manner in which an *attest client's* portfolio is being managed by investment account managers, including assessing whether the managers are
 - i. following the guidelines of the *attest client's* investment policy statement.
 - ii. meeting the *attest client's* investment objectives.
 - iii. conforming to the *attest client's* stated investment parameters or risk tolerance.
- d. transmit an *attest client's* investment selection, with the *attest client's* consent, to the *attest client's* broker-dealer or equivalent, provided that the *attest client* has authorized the broker-dealer or equivalent to execute the transaction.

.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes investment decisions on behalf of management or otherwise has discretionary authority over an *attest client's* investments.
- b. executes a transaction to buy or sell an *attest client's* investments.
- c. has custody of an *attest client's* assets, such as taking temporary possession of securities purchased by an *attest client*. [Prior reference: paragraph .05 of ET section 101]

1.295.160 Tax Services

.01 For purposes of this interpretation, tax services include preparation of a tax return, transmittal of a tax return, and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, having a power of attorney limited strictly to tax matters; and authorized representation of *attest clients* in administrative proceedings before a taxing authority.

.02 For purposes of this interpretation, a tax return includes all tax filings, including informational tax forms (such as estimated tax vouchers), extension forms, and Forms 990, 5500, 1099, and W-2, filed with a taxing authority or other regulatory agency.

.03 *Preparation and transmittal*. When a member prepares a tax return and transmits the tax return and related tax payment to a taxing authority in paper or electronic form, self-review and management participation *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist. If the member applies the "General Requirements for Performing Nonattest

Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member does not have custody or control over the *attest client's* funds or assets and the individual designated by the *attest client* to oversee the tax services

- a. reviews and approves the tax return and related tax payment.
- b. if required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

The following are not considered having custody or control over an *attest client's* funds: making electronic tax payments authorized by an *attest client* pursuant to a taxing authority's prescribed criteria (as discussed in paragraph .04), affixing the *attest client's* depository account information on a tax return, or remitting an *attest client's* check made payable to the taxing authority.

.04 If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member signs and files a tax return on behalf of management, provided that the member has the legal authority to do so and

- a. the taxing authority has prescribed procedures in place for an *attest client* to permit a member to sign and file a tax return on behalf of the *attest client* (for example, Forms 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in Form 8879, or
- b. an individual in management who is authorized to sign and file the *attest client's* tax return provides the member with a signed statement that clearly identifies the return being filed and represents that such individual
 - i. is authorized to sign and file the tax return.
 - ii. has reviewed the tax return, including accompanying schedules and statements, and it is true, correct, and complete to the best of the individual's knowledge and belief.
 - iii. authorizes the *member* or another named individual in the *member's firm* to sign and file the tax return on the *attest client* behalf.

.05 *Authorized representation in administrative proceedings.* If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a member acts as the *attest client's* authorized representative in administrative proceedings before a taxing authority, provided that the member obtains the *attest client's* agreement prior to committing the *attest client* to a specific resolution with the taxing authority. [Prior reference: paragraph .05 of ET section 101]

.06 *Power of attorney.* When a member has an *attest client's* power of attorney, the self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member's use of the power of attorney is limited strictly to tax matters and the member does not bind the *attest client* to any agreement with a taxing authority or other regulatory agency. [No prior reference: new content]

.07 *Representation in court.* *Threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through the application of *safeguards*, and *independence* would be *impaired* if a member represents an *attest client* in court to resolve a tax dispute. For purposes of this interpretation, court encompasses a tax, district, or federal court of claims and the equivalent state, local, or foreign forums. [Prior reference: paragraph .05 of ET section 101]

.08 For information about transition provision for engagements commenced prior to February 28, 2007, see <https://us.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf>.

Effective Date

.09 Paragraph .06 of this interpretation is effective December 15, 2014.

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsnonattestservices.doc>.

In addition, nonauthoritative questions and answers regarding performance tax services are available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf>.

1.297 Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements

1.297.010 Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements

.01 The "Independence Rule" [1.200.001] and its *interpretations* apply to all *attest engagements*. However, when performing engagements to issue reports in accordance with Statements on Standards for Attestation Engagements (SSAEs), when *independence* is required or when the *member's* compilation report does not disclose a lack of *independence*, the *covered member* needs to be independent with respect to the responsible party(ies), as defined in the SSAEs.

.02 If the individual or entity that engages the *covered member* (engaging entity) is not the responsible party, the *covered member* need not be *independent* of that engaging entity. However, because *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Conflicts of Interest" interpretation [1.110.010] may still exist with respect to the engaging entity, *members* should comply with this rule and interpretation.

.03 In addition, application of the "Independence Rule" [1.200.001] is further modified as set forth in the "Agreed-Upon Procedures Engagements in Accordance With SSAEs" interpretation [1.297.020] and the "Engagements, Other

Than AUPs, Performed in Accordance With SSAEs" interpretation [1.297.030] of the "Independence Rule." [Prior reference: paragraph .13 of ET section 101]

[See Revision History Table.]

1.297.020 Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs

.01 For purposes of this interpretation, subject matter is as defined in the SSAEs.

.02 When performing agreed-upon procedures (AUP) engagements in accordance with the SSAEs, the application of the "Independence Rule" [1.200.001] is modified, as described in the "Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation [1.297.010] of the "Independence Rule" and this interpretation.

.03 When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the nonattest services do not relate to the specific subject matter of the SSAE engagement. *Threats* would be at an *acceptable level* and *independence* would also not be *impaired* if the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" were not applied when providing the nonattest services, provided that the nonattest services do not relate to the specific subject matter of the AUP engagement.

.04 When a *member* or *member's firm* enters into a staff augmentation arrangement as described in paragraph .01 of the "Staff Augmentation Arrangements" interpretation [1.275.007], *threats* would be at an *acceptable level* and *independence* would not be *impaired* provided that the services performed by the augmented staff are unrelated to the specific subject matter of the AUP engagement.

.05 In addition, when performing an AUP engagement under the SSAEs, *threats* would be at an *acceptable level* and *independence* would not be *impaired*, if the following *covered members* and their *immediate families* are independent of the responsible party(ies):

- a. Individuals participating on the AUP engagement team
- b. Individuals who directly supervise or manage the AUP engagement *partner* or *partner equivalent*
- c. Individuals who consult with the *attest engagement team* regarding technical or industry-related issues specific to the AUP engagement

.06 Furthermore, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if the *firm* had a material financial relationship with the responsible party(ies) that was covered by any of the following interpretations of the "Independence Rule":

- a. Paragraphs .01–.02 of "Overview of Financial Interests" [1.240.010]
- b. "Trustee or Executor" [1.245.010]

- c. "Joint Closely Held Investments" [1.265.020]
- d. "Loans" [1.260.010] [Prior reference: paragraph .13 of ET section 101]

Effective Date

.07 The addition of *partner equivalents* to paragraph .05 is effective for engagements covering periods beginning on or after December 15, 2014.

[See Revision History Table.]

1.297.030 Engagements, Other Than AUPs, Performed in Accordance With SSAEs

.01 For purposes of this interpretation, subject matter is as defined in the SSAEs.

.02 When performing an engagement, other than an AUP, in accordance with the SSAEs, the application of the "Independence Rule" [1.200.001] is modified, as described in the "Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" interpretation [1.297.010] of the "Independence Rule" and this interpretation.

.03 When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the "Nonattest Services" subtopic [1.295], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the following safeguards are met:

- a. Nonattest services do not relate to the specific subject matter of the SSAE engagement.
- b. The "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule" [1.200.001] are met when providing the nonattest service. [Prior reference: paragraph .13 of ET section 101]

1.298 Breach of an Independence Interpretation

1.298.010 Breach of an Independence Interpretation

Introduction

.01 AICPA bylaws require *members* to comply with the "Independence Rule" [1.200.001]. This interpretation provides guidance to assist *members* in evaluating and addressing the consequences of a breach of an *independence interpretation* and the effect on the *attest engagement team's* integrity, objectivity, and professional skepticism so the *member* or *member's firm* can determine if the consequences of a breach can be satisfactorily addressed. This interpretation also provides specific steps and actions the *member* should take when the *member* becomes aware that a breach of an *independence interpretation* has occurred. However, a *member's* determination that the consequences of a breach of an *independence interpretation* have been satisfactorily addressed will not preclude an investigation or enforcement action. In any case, the *member* should be prepared to justify such determination.

Required Policies and Procedures Established by the Firm

.02 In order for the consequences of an *independence* breach to be addressed by a *member* or the *member's firm* pursuant to the provisions of this interpretation, the *firm* must be compliant with QM section 10A, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), which requires the *member's firm* to have established policies and procedures designed to provide it with reasonable assurance that the *firm*, its personnel, and, when applicable, others subject to *independence* requirements, maintain *independence* when required. The policies and procedures should enable the *firm* to communicate its *independence* requirements to its personnel and, when applicable, others subject to them; to identify and evaluate circumstances and relationships that create *threats* to *independence*; and to take appropriate action to eliminate those *threats* or reduce them to an *acceptable level* by applying *safeguards* or, if effective *safeguards* cannot be applied, withdrawing from the engagement. These policies and procedures should be designed to provide the *firm* with reasonable assurance that it is notified of breaches of *independence* requirements and to enable it to take appropriate actions to resolve such situations.

Breaches Resulting in Significant Threats

.03 In situations in which a *partner* or professional employee of the *firm* breaches an *independence interpretation* and the *threat* to *independence* resulting from the breach is significant such that the *attest engagement team's* integrity, objectivity, and professional skepticism are compromised, the provisions of this interpretation could not address the consequences of the breach as no actions could be taken to satisfactorily address the consequences of the breach.

.04 In situations in which the lead *attest engagement* partner or an *individual in a position to influence the attest engagement* either (1) committed the breach or (2) knows of a breach and fails to ensure the breach is promptly communicated to or known by an appropriate individual within the firm as described in this interpretation, there is a rebuttable presumption the provisions of this interpretation would not be able to address the breach as the *threats* to the *attest engagement team's* integrity, objectivity, and professional skepticism and the threats to the appearance of *independence* would be considered so significant that no actions could be taken to satisfactorily address the consequences of the breach.

Identifying and Communicating a Breach

.05 When a breach is identified, the *member* should, in accordance with his or her *firm's* policies and procedures, promptly communicate the breach to an appropriate individual within the *firm*, for example, an individual or individuals with responsibility for the policies and procedures relating to *independence*, or the *attest engagement partner* (the responsible individual).

.06 The responsible individual should report the breach to those who need to take appropriate action and, when appropriate, should report the breach to relevant *network firms*. The responsible individual should be satisfied that the interest or relationship that caused the breach has been terminated, suspended, or eliminated and should address the consequences of the breach. A consequence of a breach may be that termination of the *attest engagement* is necessary.

Evaluating the Significance of a Breach

.07 The responsible individual should evaluate the significance of the breach and its effect on the *attest engagement team's* integrity, objectivity, and professional skepticism and the ability to issue an attest report. The significance of the breach will depend on factors such as the following:

- a. The nature and duration of the breach
- b. The number and nature of any previous breaches with respect to the current *attest engagement*
- c. Whether a *member* of the *attest engagement team* had knowledge of the interest or relationship that caused the breach
- d. Whether the individual who caused the breach is a *member* of the *attest engagement team* or another individual for whom there are *independence* requirements
- e. The role of the individual if the breach relates to a *member* of the *attest engagement team*
- f. The effect of the service, if any, on the accounting records or the *attest client's financial statements* if the breach was caused by the provision of a *professional service*
- g. Whether a *partner* or *partner equivalent* of the *firm* had knowledge of the breach and failed to ensure that the breach was promptly communicated to an appropriate individual within the *firm*
- h. Whether the breach involved solely an *affiliate* of a *financial statement attest client* and if so, the nature of the *affiliate* relationship
- i. The extent of the self-interest, advocacy, undue influence, or other *threats* created by the breach

Addressing the Consequences of a Breach

.08 Depending upon the significance of the breach, it may be necessary to terminate the *attest engagement* or it may be possible to take action that satisfactorily addresses the consequences of the breach. Certain breaches described in this interpretation cannot be addressed by the provisions of this interpretation. For all other breaches, the responsible individual should determine whether satisfactory action can be taken and is appropriate in the circumstances. In making this determination, the responsible individual should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the *member* at that time, would likely conclude that the *attest engagement team's* integrity, objectivity, and professional skepticism would be compromised and therefore whether *independence* is *impaired*.

.09 Examples of actions that the responsible individual may consider include the following:

- a. Removing the relevant individual from the *attest engagement team*
- b. Conducting an additional review of the affected attest work or re-performing that work to the extent necessary; in either case, using different personnel

- c. Recommending that the *attest client* engage another *firm* to review or re-perform the affected attest work to the extent necessary
- d. Engaging another *firm* to evaluate the results of the nonattest service or having another firm re-perform the nonattest service to the extent necessary to enable it to take responsibility for the service if the breach relates to a nonattest service that affects the accounting records or an amount that is recorded in the *financial statements*

Communicating With Those Charged With Governance at the Attest Client

.10 If the responsible individual determines that action cannot be taken to satisfactorily address the consequences of the breach, the responsible individual should inform *those charged with governance* as soon as practicable and take the steps necessary to terminate the *attest engagement* in compliance with any applicable legal or regulatory requirements relevant to terminating the *attest engagement*. Where termination is not permitted by law or regulation, the responsible individual should comply with any reporting or disclosure requirements.

.11 If the responsible individual determines that action can be taken to satisfactorily address the consequences of the breach, the responsible individual should discuss the breach and the action taken or proposed to be taken with *those charged with governance* as soon as practicable, unless *those charged with governance* have specified an alternative timing for reporting less significant breaches. The matters to be discussed should include the following:

- a. The significance of the breach, including its nature and duration
- b. How the breach occurred and how it was identified
- c. The action taken or proposed to be taken and the responsible individual's rationale for how the action will satisfactorily address the consequences of the breach and enable the *firm* to issue the attest report
- d. The conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the *attest engagement team* has not been compromised and the rationale for that conclusion
- e. Any steps that the responsible individual has taken or proposes to take to reduce or avoid the risk of further breaches occurring

.12 The responsible individual should communicate in writing with *those charged with governance* all matters discussed in accordance with the paragraph above and obtain the concurrence of *those charged with governance* that action can be, or has been, taken to satisfactorily address the consequences of the breach. The communication shall include a description of the *firm's* policies and procedures relevant to the breach designed to provide it with reasonable assurance that *independence* is maintained and any steps that the *firm* has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring. If *those charged with governance* do not concur that the action satisfactorily addresses the consequences of the breach, the responsible individual should take the steps necessary to terminate the *attest engagement*, where permitted by law or regulation, in compliance with any applicable legal or regulatory requirements relevant to terminating the *attest engagement*. Where termination is not permitted by law or regulation, the responsible individual should comply with any reporting or disclosure requirements.

Breaches Relating to Previously Issued Reports

.13 If the breach occurred prior to the issuance of the previous attest report, the responsible individual should comply with this section in evaluating the significance of the breach and its effect on the *attest engagement team's* objectivity, integrity, and professional skepticism and its ability to issue an attest report in the current period. The responsible individual should also consider the effect of the breach, if any, on the *attest engagement team's* integrity, objectivity, and professional skepticism in relation to any previously issued attest reports, and the possibility of withdrawing such attest reports in accordance with professional standards, and discuss the matter with *those charged with governance*.

Documentation

.14 The responsible individual should document the breach, the action taken, key decisions made and all the matters discussed with *those charged with governance* and any discussions with a professional body, relevant regulator, or oversight authority. When the *firm* continues with the *attest engagement*, the matters to be documented should also include the conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the *attest engagement team* have not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the *firm* could issue an attest report. Failure to prepare the required documentation does not *impair independence* provided the *member* can demonstrate the *member* satisfactorily addressed the consequences of the breach and discussed the breach, the action taken, and key decisions made with *those charged with governance*, and as applicable, a professional body, relevant regulator, or oversight authority. However, failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001].

.15 Refer to the "Unsolicited Financial Interests" interpretation [1.240.020] of the "Independence Rule" [1.200.001] for guidance on unsolicited financial interests.

Effective Date

.16 This interpretation is effective March 31, 2016. Early implementation is allowed.

1.300 General Standards

1.300.001 General Standards Rule

.01 *A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council:*

- a. Professional Competence. Undertake only those *professional services* that the *member* or the *member's firm* can reasonably expect to be completed with professional competence.
- b. Due Professional Care. Exercise due professional care in the performance of *professional services*.
- c. Planning and Supervision. Adequately plan and supervise the performance of *professional services*.

- d. Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any *professional services* performed.

(See appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards.") [Prior reference: paragraph .01 of ET section 201]

Interpretations Under the General Standards Rule

1.300.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "General Standards Rule" [1.300.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "General Standards Rule" [1.300.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.300.010 Competence

.01 Competence, in this context, means that the *member* or *member's* staff possess the appropriate technical qualifications to perform *professional services* and that the *member*, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession's standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of *professional services*.

.02 A *member's* agreement to perform *professional services* implies that the *member* has the necessary competence to complete those services according to professional standards and to apply the *member's* knowledge and skill with reasonable care and diligence. However, the *member* does not assume a responsibility for infallibility of knowledge or judgment.

.03 The *member* may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing *professional services* involves performing additional research or consulting with others to gain sufficient competence.

.04 If a *member* is unable to gain sufficient competence, the *member* should suggest, in fairness to the *client* and public, the engagement of a competent

person to perform the needed *professional service*, either independently or as an associate. [Prior reference: paragraph .02 of ET section 201]

1.300.020 Supervision of a Specialist on Consulting Engagements

.01 A *member* who employs a specialist to perform consulting services for the *member's clients* must be qualified to supervise and evaluate the work of that specialist. Although the *member* is not required to be able to perform each of the specialist's tasks, the *member* should be able to define the tasks and evaluate the end product. [Prior reference: paragraphs .017–.018 of ET section 291]

1.300.030 Submission of Financial Statements

.01 When a *member* prepares or submits *financial statements* as a stockholder, a partner, a director, an officer, or an employee of an entity using the *firm's* letterhead or similar identification, the *member* should comply with the "Compliance With Standards Rule" [1.310.001], including any requirements to disclose a lack of *independence* in the *member's* report.

.02 Refer to the "Use of a CPA Credential" interpretation [2.400.100] of the "Acts Discreditable Rule" [2.400.001] and the "Submission of Financial Statements" interpretation [2.300.030] of the "General Standards Rule" [2.300.001] for additional guidance. [Prior reference: paragraphs .019–.020 of ET section 291]

1.300.040 Use of a Third-Party Service Provider

.01 A *member* who uses a *third-party service provider* to assist the *member* in providing *professional services* such as bookkeeping, tax preparation, or consulting or attest services, including related clerical or data entry functions, is required to comply with the "General Standards Rule" [1.300.001] and the "Compliance With Standards Rule" [1.310.001]. To accomplish this,

- a. before using a *third-party service provider*, the *member* should ensure that the *third-party service provider* has the required professional qualifications, technical skills, and other resources. Factors that can be helpful in evaluating a prospective *third-party service provider* include business, financial, and personal references from banks, other CPAs, and other customers of the *third-party service provider*; the *third-party service provider's* professional reputation and recognition in the community; published materials (articles and books that he or she has authored); and the *member's* personal evaluation of the *third-party service provider*.
- b. the *member* must adequately plan and supervise the *third-party service provider's professional services* so that the *member* ensures that the services are performed with competence and due professional care. The *member* must also obtain sufficient relevant data to support the work product and comply with all technical standards applicable to the *professional services*.

.02 The *member's* responsibility for planning and supervising the *third-party service provider's* work does not extend beyond the requirements of applicable professional standards, which may vary depending upon the nature of the *member's* engagement.

.03 Refer to the "Use of a Third-Party Service Provider" interpretation [1.150.040] of the "Integrity and Objectivity Rule" [1.100.001] and the "Disclosing Information to a Third-Party Service Provider" interpretation [1.700.040] of the "Confidential Client Information Rule" [1.700.001] for additional guidance. [Prior references: paragraphs .015–.016 and .023–.024 of ET section 291]

A nonauthoritative basis-for-conclusion document summarizing considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsoutsourcing.pdf>.

1.310 Compliance With Standards

1.310.001 Compliance With Standards Rule

.01 A *member* who performs auditing, review, compilation, management consulting, tax, or other *professional services* shall comply with standards promulgated by bodies designated by *Council*.

.02 See Appendix A "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 202]

A nonauthoritative question and answer regarding use of standards that have not been established by a body designated by AICPA Council is available in the FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

In addition, a nonauthoritative question and answer regarding whether a member needs to comply with the Standards for Consulting Services when providing consulting services but not holding out as a CPA is available in the FAQ document at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

Interpretations Under the Compliance with Standards Rule

1.310.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Compliance With Standards Rule" [1.310.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Compliance With Standards Rule" [1.310.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member*

encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.320 Accounting Principles

1.320.001 Accounting Principles Rule

.01 A *member* shall not (1) express an opinion or state affirmatively that the *financial statements* or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by *Council* to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the *member* can demonstrate that due to unusual circumstances the *financial statements* or data would otherwise have been misleading, the *member* can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

.02 See appendix A "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 203]

Interpretations Under the Accounting Standards Rule

1.320.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Accounting Principles Rule" [1.320.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Accounting Principles Rule" [1.320.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.320.010 Responsibility for Affirming That Financial Statements Are in Conformity With the Applicable Financial Reporting Framework

.01 A *member* shall not state affirmatively that an entity's *financial statements* or other financial data are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by *Council* to establish such principles. *Members* who affirm that *financial statements* or other financial data are presented in conformity with GAAP should comply with the "Accounting Principles Rule" [1.320.001]. A *member's* representation in a letter or other communication that an entity's *financial statements* are in conformity with GAAP may be considered an affirmative statement within the meaning of this rule with respect to the *member* who signed the letter or other communication (for example, the *member* signed a report to a regulatory authority). [Prior reference: paragraph .05 of ET section 203]

1.320.020 Status of Financial Accounting Standards Board, Governmental Accounting Standards Board, Federal Accounting Standards Advisory Board, and International Accounting Standards Board Interpretations

.01 The "Accounting Principles Rule" [1.320.001] authorizes *Council* to designate bodies to establish accounting principles. *Council* has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB *Accounting Standards Codification*® (ASC) constitutes accounting principles as contemplated in the rule. *Council* designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities, pursuant to the "Accounting Principles Rule." *Council* designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities, pursuant to the "Accounting Principles Rule." *Council* designated the International Accounting Standards Board (IASB) as an accounting body for purposes of establishing international financial accounting and reporting principles.

.02 Reference to GAAP in the "Accounting Principles Rule" [1.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in paragraph .01 and in appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards."

.03 The Professional Ethics Division will look to the codification or statements and any *interpretations* thereof issued by FASB, GASB, FASAB, or IASB in determining whether a *member* has departed from an accounting principle established by a designated accounting standard-setter in FASB ASC, a Statement of Governmental Accounting Standards, a Statement of Federal

Accounting Standards, or International Financial Reporting Standards (IFRS). [Prior reference: paragraph .03 of ET section 203]

1.320.030 Departures From Generally Accepted Accounting Principles

.01 It is difficult to anticipate all the circumstances in which accounting principles may be applied. However, there is a strong presumption that adherence to GAAP would, in nearly all instances, result in *financial statements* that are not misleading. The "Accounting Principles Rule" [1.320.001] recognizes that, upon occasion, there may be unusual circumstances when the literal application of GAAP would have the effect of rendering *financial statements* misleading. In such cases, the proper accounting treatment to apply is that which will not render the *financial statements* misleading.

.02 The question of what constitutes unusual circumstances, as referred to in the "Accounting Principles Rule" [1.320.001], is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle within GAAP would be regarded generally by reasonable persons as producing misleading *financial statements*.

.03 Examples of circumstances that may justify a departure from GAAP include new legislation or evolution of a new form of business transaction. Examples of circumstances that do not justify departures from GAAP include an unusual degree of materiality or conflicting industry practices. [Prior reference: paragraph .02 of ET section 203]

.04 If the statements or data contain such departures, see the "Accounting Principles Rule" [1.320.001] for further guidance.

1.320.040 Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other Than GAAP

.01 Reference to GAAP in the "Accounting Principles Rule" [1.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in appendix A. The bodies designed by *Council* to promulgate accounting principles are

- a. FASAB,
- b. FASB,
- c. GASB, and
- d. IASB.

.02 *Financial statements* prepared pursuant to other accounting principles would be considered financial reporting frameworks other than GAAP within the context of the "Accounting Principles Rule" [1.320.001].

.03 However, the "Accounting Principles Rule" [1.320.001] does not preclude a *member* from preparing or reporting on *client financial statements* that have been prepared pursuant to financial reporting frameworks other than GAAP, such as

- a. financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the *client's financial statements* do not meet the requirements for full compliance with IFRS, as promulgated by the IASB;
- b. financial reporting frameworks prescribed by an agreement or a contract; or

- c. other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign governmental regulatory body to whose jurisdiction the entity is subject.

.04 In such circumstances, however, the *client's financial statements* and *member's* reports thereon should not purport that the *financial statements* are in accordance with GAAP, and the *financial statements* or reports on those *financial statements*, or both, should clarify the financial reporting framework(s) used. [Prior reference: paragraph .06 of ET section 203]

1.400 Acts Discreditable

1.400.001 Acts Discreditable Rule

.01 A *member* shall not commit an act discreditable to the profession. [Prior reference: paragraph .01 of ET section 501]

Interpretations Under the Acts Discreditable Rule

1.400.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Acts Discreditable Rule" [1.400.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.400.010 Discrimination and Harassment in Employment Practices

.01 A *member* would be presumed to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [1.400.001] if a final determination, no longer subject to appeal, is made by a court or an administrative agency of competent jurisdiction that a *member* has violated any antidiscrimination laws of the United States, a state, or a municipality, including those related to sexual and other forms of harassment. [Prior reference: paragraph .03 of ET section 501]

1.400.020 Solicitation or Disclosure of CPA Examination Questions and Answers

.01 A *member* who solicits or knowingly discloses the Uniform CPA Examination question(s) or answer(s), or both, without the AICPA's written authorization shall be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraph .07 of ET section 501]

1.400.030 Failure to File a Tax Return or Pay a Tax Liability

.01 A *member* who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the *member's* personal tax returns or tax returns of the *member's firm* that the *member* has the authority to timely file or (b) the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraph .08 of ET section 501]

1.400.040 Negligence in the Preparation of Financial Statements or Records

.01 A *member* shall be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member*, by virtue of his or her negligence, does any of the following:

- a. Makes, or permits or directs another to make, materially false and misleading entries in the *financial statements* or records of an entity.
- b. Fails to correct an entity's *financial statements* that are materially false and misleading when the *member* has the authority to record an entry.
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .05 of ET section 501]

1.400.050 Governmental Bodies, Commissions, or Other Regulatory Agencies

.01 Many governmental bodies, commissions, or other regulatory agencies have established requirements, such as audit standards, guides, rules, and regulations, that *members* are required to follow in the preparation of *financial statements* or related information or in performing attest or similar services for entities subject to their jurisdiction. For example, the SEC; the Federal Communications Commission; state insurance commissions; and other regulatory agencies, such as the PCAOB, have established such requirements.

.02 If a *member* prepares *financial statements* or related information for purposes of reporting to such bodies, commissions, or regulatory agencies, the *member* should follow the requirements of such organizations, in addition to the applicable financial reporting framework.

.03 If a *member* agrees to perform an attest or a similar service for the purpose of reporting to such bodies, commissions, or regulatory agencies, the *member* should follow such requirements, in addition to the applicable financial reporting framework.

.04 A *member's* material departure from such requirements would be considered a violation of the "Acts Discreditable Rule" [1.400.001] unless the *member* discloses in the *financial statements* or his or her report, as applicable, that such requirements were not followed and the applicable reasons. [Prior reference: paragraph .06 of ET section 501]

1.400.055 Governmental Audits

.01 Engagements for audits of government grants, government units, or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to GAAS.

.02 If a *member* accepts such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules, and regulations, the *member* is obligated to follow such requirements, in addition to GAAS.

.03 Failure to do so is a violation of the "Acts Discreditable Rule" [1.400.001] unless the *member* discloses in his or her report that such requirements were not followed and the applicable reasons for not following the requirements. [Prior reference: paragraph .04 of ET section 501]

1.400.060 Indemnification and Limitation of Liability Provisions

.01 Certain governmental bodies, commissions, or other regulatory agencies (collectively, regulators) have established requirements through laws, regulations, or published interpretations that

- a. prohibit entities subject to their regulation (regulated entity) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or
- b. provide that the existence of such provisions disqualifies a *member* from rendering such services to these entities.

For example, federal banking regulators, state insurance commissions, and the SEC have established such requirements.

.02 If a *member* enters into or directs or knowingly permits another individual to enter into a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the *member* should not include or knowingly permit or direct another individual to include an indemnification or limitation of liability provision that would cause the regulated entity or a *member* to be in violation of such requirements or disqualify a *member* from providing such services to the regulated entity. A *member* who enters into or directs or knowingly permits another individual to enter into such an agreement for the performance of audit or other attest services would be considered in violation of the "Acts Discreditable Rule" [1.400.001].

.03 Refer to the "Indemnification of a Covered Member" [1.228.010] and "Indemnification of an Attest Client" [1.228.020] interpretations of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .09 of ET section 501]

1.400.070 Confidential Information Obtained From Employment or Volunteer Activities

.01 A *member* should maintain the confidentiality of his or her employer's or *firm's* (employer) confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the *member* is working in a volunteer capacity).

.02 For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the *member* may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

.03 A *member* should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or *close relative* or *immediate family member*. The *member* should also take reasonable steps to ensure that staff under his or her control or others within the *employing organization* and persons from whom advice and assistance are obtained are aware of the confidential nature of the information.

.04 When a *member* changes employment, a *member* should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer's confidential information continues even after the end of the relationship between a *member* and the employer. However, the *member* is entitled to use experience and expertise gained through prior employment relationships.

.05 A *member* would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the *member* may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

.06 The following are examples of situations in which *members* are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
 - i. comply with a validly issued and enforceable subpoena or summons or
 - ii. inform the appropriate public authorities of violations of law that have been discovered.
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
 - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;

- ii. protect the *member's* professional interests in legal proceedings;
 - iii. comply with professional standards and other ethics requirements; or
 - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the employer to
- i. obtain financing with lenders;
 - ii. communicate with vendors, *clients*, and customers; or
 - iii. communicate with the employer's external accountant, attorneys, regulators, and other business professionals.

.07 In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, the *member* should use professional judgment in determining the type of disclosure to be made, if any.
- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

.08 A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

.09 Refer to the "Subordination of Judgment" interpretation [1.130.020] of the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Information" topic [1.700] for additional guidance. [Prior reference: paragraph .10 of ET section 501]

1.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services

.01 A *member* would be in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* promotes or markets the *member's* abilities to provide *professional services* or makes claims about the *member's* experience or qualifications in a manner that is false, misleading, or deceptive.

.02 Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body.

.03 Refer to the "False, Misleading, or Deceptive Acts in Advertising or Solicitations" interpretation [1.600.010] of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] for additional guidance. [No prior reference: new content]

Effective Date

.04 Effective December 15, 2014.

1.400.100 Use of the CPA Credential

.01 A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference .12 section 501]

1.400.200 Records Requests

Terminology

.01 The following terms are defined here solely for use with this interpretation:

- a. A client includes current and former *clients*.
- b. A member means the *member* or the *member's firm*.
- c. Client-provided records are accounting or other records, including hardcopy and electronic reproductions of such records, belonging to the client that were provided to the member by, or on behalf of, the client.
- d. Member-prepared records are accounting or other records that the member was not specifically engaged to prepare and that are not in the client's books and records or are otherwise not available to the client, thus rendering the client's financial information incomplete. Examples include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) and supporting schedules and documents that the member proposed or prepared as part of an engagement (for example, an audit).
- e. Member's work products are deliverables set forth in the terms of the engagement, such as tax returns.
- f. Working papers are all other items prepared solely for purposes of the engagement and include items prepared by the
 - i. member, such as audit programs, analytical review schedules, and statistical sampling results and analyses.
 - ii. client at the request of the member and reflecting testing or other work done by the member.
- g. Make records available means to provide the records in any format that is usable and accessible, whether electronic or otherwise, regardless of the format in which they were received.
- h. Beneficiary is a person or entity for which the engaging entity has requested the member to perform *professional services*.

Applicability

.02 When a person or entity engages a member to perform *professional services* (engaging entity) with respect to a beneficiary, the member will be considered in compliance with the requirements of this interpretation related to client-provided records if the member makes these records available to the person or entity that provided the records to the member or to the individual designated or held out as the entity's or individual's representative.

.03 The member will be considered in compliance with the requirements of this interpretation related to member-prepared records and a member's work products if the member makes such records and work products available to the beneficiary or to the individual designated or held out as the beneficiary's representative. For example, if a company engages a member to perform personal tax services for the benefit of its executives, the member would be in compliance with the interpretation if the member made the tax returns available to the executives (see the "Confidential Client Information Rule" [1.700.001]).

.04 When an engaging entity engages a member to perform *professional services* with respect to another entity that is not the beneficiary of the *professional services*, absent an agreement stating otherwise, the member would be in compliance with the requirements of this interpretation related to a member's work products if the member made such work products available to the engaging entity or to the individual designated or held out as the engaging entity's representative. For example, if a company engaged a member to value the assets of another company for a possible acquisition, absent an agreement stating otherwise, the member would be in compliance with this interpretation if the member made the valuation report available only to the engaging entity.

Interpretation

.05 Members must comply with the rules and regulations of authoritative regulatory bodies, such as the member's state board(s) of accountancy, when the member performs services for a client and is subject to the rules and regulations of such regulatory bodies. For example, a member's state board(s) of accountancy may not permit a member to withhold certain records, even though fees are due to the member for the work performed. Failure to comply with the more restrictive provisions of the applicable regulatory body's rules and regulations concerning the return of certain records would constitute a violation of this *interpretation*.

.06 When an initial request for client-provided records is received, the member should make those records in the member's custody or control available to the person or entity that provided the records to the member. The member may charge a reasonable fee for the time and expense incurred to retrieve, copy, and ship such records; however, the client-provided records may not be withheld for nonpayment of such fees.

.07 A member and the client or beneficiary may agree to terms other than those stated in this paragraph. When this occurs, the member should respond in accordance with such agreement. Otherwise, a member should respond to a request for member-prepared records or a member's work products that are in the member's custody or control and that have not previously been made available to the client or, if applicable, to the beneficiary as follows:

- a. The member should make available member-prepared records relating to a completed and issued work product; however, such records may be withheld if fees are due to the member for that specific work product.
- b. Member's work products should be made available; however, such work products may be withheld if
 - i. fees are due to the member for the specific work product;
 - ii. the work product is incomplete;
 - iii. for purposes of complying with professional standards (for example, withholding an audit report with outstanding audit issues); or

- iv. threatened or outstanding litigation exists concerning the engagement or the member's work.

.08 Once a member has complied with paragraphs .02–.07, the member is under no ethical obligation to

- a. comply with any subsequent requests to again make records or copies of records available. However, if after complying with a request, a loss of records due to a natural disaster or an act of war is experienced, the member should, when practicable, comply with an additional request to make such records available.
- b. retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed. [Prior reference: paragraph .02 of ET section 501]
- c. make the records available to any other associated party, such as the general partner, majority shareholder, or spouse. [Prior reference: paragraphs .377–.378 of ET section 591]

.09 Working papers are the member's property, and the member is not required to make such information available. However, state and federal statutes and regulations and contractual agreements may impose additional requirements on the member.

.10 In fulfilling a request for the member's copy of client-provided records that was previously made available to the client or a party identified in paragraph .02, member-prepared records, or a member's work products, the member may

- a. charge a reasonable fee for the time and expense incurred to retrieve, copy, and ship such records and require payment before the member makes the records available.
- b. make the requested records available in any usable and accessible format. However, the member is not required to convert records that are not in electronic format to electronic format. If the records are requested in a specific format and the records are available in such format within the member's custody and control, the request should be honored. In addition, the member is not required to make formulas available, unless the member was engaged to make such formulas available as part of a completed work product or the formulas were used to create member-prepared records without which the client's financial information would be incomplete.
- c. make and retain copies of any records that the member already made available.

.11 When a member is required to return or make records available, the member should comply as soon as practicable but, absent extenuating circumstances, no later than 45 days after the request is made.

.12 The fact that the statutes of the state in which the member practices grant the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this *interpretation*. [Prior reference: paragraph .02 of ET section 501]

.13 A member would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the member does not comply with the requirements of this interpretation.

Nonauthoritative questions and answers are available in the Ethics FAQ at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

[See Revision History Table.]

1.400.205 Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice

Sale or Transfer of Member's Practice

.01 A *member* or *member's firm* (member) that sells or transfers all or part of the member's practice to another person, *firm*, or entity (successor firm) and will no longer retain any ownership in the practice should do all of the following:

- a.* Submit a written request to each *client* subject to the sale or transfer, requesting the *client's* consent to transfer its files to the successor firm and, notify the *client* that its consent may be presumed if it does not respond to the member's request within a period of not less than 90 days, unless prohibited by law, including but not limited to the rules and regulations of the applicable state boards of accountancy. The member should not transfer any *client* files to the successor firm until either the *client's* consent is obtained or the 90 days has lapsed, whichever is shorter. The member is encouraged to retain evidence of consent, whether obtained from the *client* or presumed after 90 days.
- b.* With respect to files not subject to the sale or transfer, make arrangements to return any *client* records that the member is required to provide to the *client* as set forth in the "Records Request" interpretation [1.400.200] unless the member and *client* agree to some other arrangement.

.02 In cases in which the member is unable to contact the *client*, *client* files and records not transferred should be retained in a confidential manner and in accordance with the *firm's* record retention policy or as required by applicable legal or regulatory requirements, whichever is longer. When practicing before the IRS or other taxing authorities or regulatory bodies, members should ensure compliance with any requirements that are more restrictive.

Discontinuance of Member's Practice

.03 A member who discontinues his or her practice but does not sell or transfer the practice to a successor firm, should do all of the following:

- a.* Notify each *client* in writing of the discontinuance of the practice. The member is encouraged to retain evidence of notification made to *clients*. The member is not required to provide notification to former *clients* of the *firm*.
- b.* Make arrangements to return any *client* records that the member is required to provide to the *client* as set forth in the "Records Request" interpretation [1.400.200] unless the member and *client* agree to some other arrangement.

.04 In cases in which the member is unable to contact the *client*, *client* files should be retained in a confidential manner and in accordance with the *firm's* record retention policy or as required by applicable legal or regulatory requirements, whichever is longer. When practicing before the IRS or other taxing authorities or regulatory bodies, members should ensure compliance with any requirements that are more restrictive.

Acquisition of Practice by a Member

.05 A member who acquires all or part of a practice from another person, *firm*, or entity (predecessor firm) should be satisfied that all *clients* of the predecessor firm subject to the acquisition have, as required in paragraph .01, consented to the member's continuation of *professional services* and retention of any *client* files or records the successor firm retains

.06 A member will be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the member does not comply with any of the requirements of this interpretation.

Effective Date

.07 This interpretation is effective June 30, 2017. Early implementation is allowed.

Nonauthoritative questions and answers related to form of communication and transfer of client files to another partner in the firm or during a merger are available in the FAQ document at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.400.210 Removing Client Files or Proprietary Information From a Firm

.01 A *member* whose employment relationship is terminated would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the *member* takes or retains (a) originals or copies (in any format) from the *firm's client* files or (b) proprietary information without the *firm's* permission, unless the *member* has a contractual arrangement with the *firm* allowing such action. [Prior reference: paragraphs .381–.382 of ET section 591]

.02 A *firm's* ownership agreement would govern ownership of *client* files and proprietary information; accordingly, this interpretation would not apply to owners of *firms*. [No prior reference: new content]

Effective Date

.03 Paragraph .02 of this interpretation is effective December 15, 2014.

1.400.240 Use of Confidential Information From Nonclient Sources

.01 If a *member* discloses confidential information obtained from a prospective *client* or nonclient without consent, the *member* would be in violation of the

"Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraphs .027–.028 of ET section 391 and new content]

Effective Date

.02 This interpretation is effective December 15, 2014.

1.500 Fees and Other Types of Remuneration

1.500.008 Unpaid Fees

.01 Refer to the "Fees" topic [1.230] of the "Independence Rule" [1.200.001] for guidance. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

1.510 Contingent Fees

1.510.001 Contingent Fees Rule

.01 A *member in public practice* shall not

- a. Perform for a contingent fee any *professional services* for, or receive such a fee from a *client* for whom the *member* or the *member's firm* performs,
 - i. an audit or review of a *financial statement*; or
 - ii. a compilation of a *financial statement* when the *member* expects, or reasonably might expect, that a third party will use the *financial statement* and the *member's* compilation report does not disclose a lack of *independence*; or
 - iii. an examination of prospective financial information; or
- b. Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any *client*.

.02 The prohibition in a. above applies during the period in which the *member* or *member's firm* is engaged to perform any of the services listed above and the period covered by any historical *financial statements* involved in any such listed services.

.03 Except as stated in the next sentence, a contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

.04 A *member's* fees may vary depending, for example, on the complexity of services rendered. [Prior reference: paragraph .01 of ET section 302]

Interpretations Under the Contingent Fees Rule

1.510.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Contingent Fees Rule" [1.510.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Contingent Fees Rule" [1.510.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.510.010 Tax Matters

.01 This interpretation defines certain terms used in the "Contingent Fees Rule" [1.510.001] and provides examples of the application of the rule in tax matters. When practicing before the IRS or before other taxing authorities, *members* should also comply with other applicable and more restrictive requirements.

Contingent Fee Language

.02 Preparation of an original or amended tax return or claim for tax refund includes giving advice on events that have occurred at the time that the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, an entry, or another portion of a return or claim for refund

.03 A fee is considered determined based on the findings of governmental agencies and, therefore, is not a contingent fee if the *member* can demonstrate a reasonable expectation, at the time of a fee arrangement, that a government agency will provide substantive consideration of the subject matter with respect to the *member's client*. Such an expectation is not reasonable if the *member* prepares a *client's* original tax returns as outlined in paragraph .02 above.

Examples of When a Contingent Fee Is Permitted

.04 The following are examples of circumstances in which a contingent fee is permitted under the "Contingent Fees Rule" [1.510.001]:

- a. Representing a *client* in connection with a revenue agent's examination of the *client's* federal or state income tax return

- b. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is the subject of a test case involving a different taxpayer or with respect to which the taxing authority is developing a position
- c. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Taxation or state taxing authority
- d. Requesting a refund of either overpayments of interest or penalties charged to a *client's* account or tax deposits that a federal or state taxing authority improperly accounted for in circumstances in which the taxing authority has established procedures for the substantive review of such refund requests
- e. Requesting, by means of a protest or similar document, the state or local taxing authority's consideration of a reduction in a property's assessed value under an established taxing authority's review process for hearing all taxpayer arguments relating to assessed value
- f. Representing a *client* in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute

Example of When a Contingent Fee Is Not Permitted

.05 A contingent fee is not permitted if a *member* prepared a *client's* amended federal or state income tax return claiming a refund of taxes because a valid deduction was inadvertently omitted from the originally filed return. [Prior reference: paragraph .02 of ET section 302]

1.510.020 Receipt of Contingent Fee

.01 A contingent fee is considered to be received when the *member* has completed the related services and the fee is determined. [Prior reference: paragraphs .033–.034 of ET section 391]

1.510.030 Services Performed by a Member's Spouse For a Contingent Fee

.01 A *member's* spouse may provide services for a contingent fee to a *client* with respect to which the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001] without causing the *member* to be in violation of the "Contingent Fees Rule" if

- a. the activities of the *member's* spouse are separate from the *member's* practice and
- b. the *member* is not significantly involved in the spouse's activities.

.02 In all such situations, the *members* should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] to determine the appropriate action. [Prior reference: paragraphs .037–.038 of ET section 391]

[See Revision History Table.]

1.510.040 Contingent Fee Arrangements With an Investment Advisory Services Nonattest Client That Is Related to a Client

.01 A *member* or *member's firm* may provide investment advisory services for a contingent fee to

- a. owners, officers, or employees of a *client* with respect to which the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001].
- b. a nonattest *client* employee benefit plan that is sponsored by an *attest client* with respect to which the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule."

.02 The *member* should also consider the "Conflicts of Interest" interpretation [1.110.010] and the "Confidential Client Information Rule" [1.700.001] to determine the appropriate action(s). [Prior reference: paragraphs .049–.050 of ET section 391]

[See Revision History Table.]

1.510.050 Investment Advisory Services

.01 A *member* or *member's firm* may provide investment advisory services for a fee based on a percentage of the investment portfolio to a *client* with respect to which the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001] without violating that rule if all of the following *safeguards* are met:

- a. The fee is determined based on a specified percentage of the *attest client's* investment portfolio.
- b. The dollar amount of the portfolio on which the fee is based is determined at the beginning of each quarter (or longer period of time as may be agreed upon) and is adjusted only for the *attest client's* additions or withdrawals during the period.
- c. The fee arrangement is not renewed with the *attest client* more frequently than on a quarterly basis. [Prior reference: paragraphs .047–.048 of ET section 391]

.02 When performing such services, the *member* should also consider the "Independence Rule" [1.200.001], especially the *interpretations* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule."

[See Revision History Table.]

1.520 Commissions and Referral Fees

1.520.001 Commissions and Referral Fees Rule

.01 *Prohibited commissions.* A *member* in *public practice* shall not for a commission recommend or refer to a *client* any product or service, or for a commission recommend or refer any product or service to be supplied by a *client*, or receive a commission, when the *member* or *member's firm* also performs for that *client*

- a. an audit or review of a *financial statement*; or
- b. a compilation of a *financial statement* when the *member* expects, or reasonably might expect, that a third party will use the *financial statement* and the *member's* compilation report does not disclose a lack of *independence*; or
- c. an examination of prospective financial information.

.02 This prohibition applies during the period in which the *member* is engaged to perform any of the services listed above and the period covered by any historical *financial statements* involved in such listed services.

.03 *Disclosure of permitted commissions.* A *member* in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the *member* recommends or refers a product or service to which the commission relates.

.04 *Referral fees.* Any *member* who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a *client* shall disclose such acceptance or payment to the *client*. [Prior reference: paragraph .01 of ET section 503]

A nonauthoritative question and answer regarding disclosure of a commission is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

Interpretations Under the Commission and Referral Fees Rule

1.520.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Commissions and Referral Fees Rule" [1.520.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Commissions and Referral Fees Rule" [1.520.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.520.020 Receipt of Commission

.01 A commission is considered to be received when the performance of the related services is complete and the fee has been determined. For example, if in one year a *member* sells a life insurance policy to a *client*, and the *member's* commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year that the policy is sold. [Prior reference: paragraphs .367–.368 of ET section 591]

1.520.030 Services Performed by a Member's Spouse For a Commission

.01 A *member's* spouse may receive a commission for referring products or services to or from a *client* with respect to which the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001] without causing the *member* to be in violation of the "Commissions and Referral Fees Rule" if both

- a. the activities of the *member's* spouse are separate from the *member's* practice and
- b. the *member* is not significantly involved in the spouse's activities.

.02 In such situations, *members* should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] to determine the appropriate action. [Prior reference: paragraphs .373–.374 of ET section 591]

[See Revision History Table.]

1.520.040 Referral of Products of Others

.01 Paragraph .04 of the "Application of the AICPA Code" [0.200.020] section of the preface provides that a *member* shall not permit others to perform acts on the *member's* behalf that, if carried out by the *member*, would place the *member* in violation of the rules. Therefore, the *member* would be held responsible for the actions of third parties, such as distributors or agents, that act on the *member's* behalf.

.02 For example, if the *member* or *member's* firm performs for a *client* a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001], the *member* may not recommend or refer to that *client* any product or services for a commission that will be paid through a distributor or an agent or receive a commission for the recommendation or referral. This prohibition applies during the period in which the *member* is engaged to perform any of the services listed in paragraph .01 of the rule and during the period covered by any historical *financial statements* in such services.

.03 In addition, if a *member* receives a commission for referring a third party's product or service to a *client* with respect to which the *member* does not perform a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001] through a distributor or an agent and receives a commission from the third party, the *member* should disclose the commission, as discussed in paragraph .03 of the "Commissions and Referral Fees Rule." However, any subsequent performance of a service listed in paragraph .01 of that rule during a period in which the commission was received would be considered to violate the rule. [Prior reference: paragraphs .375–.376 of ET section 591]

A nonauthoritative question and answer regarding disclosure of a commission is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

[See Revision History Table.]

1.520.050 Commission Arrangements With an Investment Advisory Services Nonattest Client That Is Related to a Client

.01 A *member* or *member's* firm may receive a commission for referring a nonclient or nonattest *client's* products or services to the following:

- a. Owners, officers, or employees of a *client* with respect to which the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001]
- b. A nonattest *client* employee benefit plan that is sponsored by a *client* with respect to which the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule"

.02 In such instances, the *member* should disclose the commission arrangement to the *client's* owners, officers, or employees or the employee benefit plan. The *member's* failure to disclose the commission would be in violation of the "Commissions and Referral Fees Rule" [1.520.001].

.03 When making the disclosure, *members* should also consider the applicability of the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001] and the *member's* professional responsibilities under the "Confidential Client Information Rule" [1.700.001] to determine the appropriate action(s). [Prior reference: paragraphs .383–.384 of ET section 591]

A nonauthoritative question and answer regarding disclosure of a commission is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

[See Revision History Table.]

1.520.060 Sale of Products to Clients

.01 If a *member* purchases a product, taking title to the product and assuming all the associated risks of ownership, any profit the *member* receives on reselling it to a *client* would not constitute a commission. [Prior reference: paragraphs .369–.370 of ET section 591]

1.520.070 Billing for a Subcontractor's Services

.01 If, in providing *professional services* to a *client*, a *member* subcontracts the services of another person or entity, any mark-up of the cost of the subcontracted services would not constitute a commission.

.02 Refer to the following for additional guidance:

- "Use of a Third-Party Service Provider" interpretation [1.150.040] of the "Integrity and Objectivity Rule" [1.100.001]
- "Fees" subtopic [1.230] under the "Independence Rule" [1.200.001]
- "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001]
- "Disclosing Information to a Third-Party Service Provider" interpretation [1.700.040] of the "Confidential Client Information Rule" [1.700.001] [Prior reference: paragraphs .371–.372 of ET section 591]

Effective Date

.03 The revisions to this interpretation are effective December 15, 2014.

1.520.080 Disclosure of Commissions and Referral Fees

.01 The member should make the disclosures required by paragraphs .03 and .04 of the "Commissions and Referral Fees Rule" [1.520.001] in writing.

Effective Date

.02 Effective for commission or a referral fee arrangements entered into on or after January 31, 2017.

A nonauthoritative question and answer regarding disclosure of a commission is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf>.

1.600 Advertising and Other Forms of Solicitation

1.600.001 Advertising and Other Forms of Solicitation Rule

.01 A *member* in *public practice* shall not seek to obtain *clients* by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited. [Prior reference: paragraph .01 of ET section 502]

Interpretations Under the Advertising and Other Forms of Solicitation Rule

1.600.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.600.010 False, Misleading, or Deceptive Acts in Advertising or Solicitations

.01 A *member* would be in violation of the "Advertising and Other Forms of Solicitation Rule" [1.600.001] if the *member's* promotional efforts are false, misleading, or deceptive. If a *member* is asked to perform *professional services* for a *client* or customer of a third party, the *member* should determine that the third party's promotional efforts comply with the "Advertising and Other Forms of Solicitation Rule." Such action is required because the *member* will receive the benefits of such efforts by third parties, and *members* must not do through others what they are prohibited from doing themselves. [Prior reference: paragraph .06 of ET section 502]

.02 Promotional efforts would be considered false, misleading, or deceptive if they

- a. create false or unjustified expectations of favorable results.
- b. imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
- c. contain a representation that the *member* will perform specific *professional services* in current or future periods for a stated fee, estimated fee, or fee range when it was likely at the time of the representation that such fees would be substantially increased and the *member* failed to advise the prospective *client* of that likelihood.
- d. contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived. [Prior reference: paragraph .03 of ET section 502]

1.600.030 Use of AICPA-Awarded Designation

.01 A *member* who holds an AICPA-awarded designation, such as the Personal Financial Specialist (PFS) designation, may use the designation after the *member's* name.

.02 A *member's firm* may use an AICPA-awarded designation, such as the PFS designation, on *firm* letterhead and in marketing materials if all the *firm's* partners hold the AICPA-awarded designation. [Prior reference: paragraphs .365–.366 of ET section 591]

Effective Date

.03 The revisions to this interpretation are effective December 15, 2014.

1.600.100 Use of the CPA Credential

.01 A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Advertising and Other Forms of Solicitation Rule" [1.600.001]. [Prior reference .07 section 502.]

1.700 Confidential Information

1.700.001 Confidential Client Information Rule

.01 A *member* in *public practice* shall not disclose any *confidential client information* without the specific consent of the *client*.

.02 This rule shall not be construed (1) to relieve a *member* of his or her professional obligations of the "Compliance With Standards Rule" [1.310.001] or the "Accounting Principles Rule" [1.320.001], (2) to affect in any way the *member's* obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a *member's* compliance with applicable laws and government regulations, (3) to prohibit review of a *member's* professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a *member* from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the *Institute* or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. *Members* of any of the bodies identified in (4) above and *members* involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any *member's confidential client information* that comes to their attention in carrying out those activities. This prohibition shall not restrict *members'* exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above. [Prior reference: paragraph .01 of ET section 301]

Interpretations Under the Confidential Client Information Rule

1.700.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Confidential Client Information Rule" [1.700.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Confidential Client Information Rule" [1.700.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.700.010 Client Competitors

.01 When a *member* provides *professional services* to *clients* that are competitors, *threats* to compliance with the "Confidential Client Information Rule" [1.700.001] may exist because the *member* may have access to *confidential client information*, such as sales, purchases, and gross profit percentages of the respective competitors.

.02 To reduce the *threat* of disclosing *confidential client information* to a competitor, the *member* should emphasize to all relevant parties, including employees of the *firm* and affected *clients*, that the "Confidential Client Information Rule" [1.700.001] prohibits *members* from revealing to others any *confidential client information* obtained in their professional capacity. [Prior reference: paragraphs .011–.012 of ET section 391]

1.700.020 Disclosing Information From Previous Engagements

.01 When a *member* evaluates whether to accept a new *client* engagement, the *member* should consider whether knowledge and experience that the *member* or *member's firm* will share while providing the *professional services* to the prospective *client* would be *confidential client information*. If such information would be *confidential client information*, and the circumstances are such that the prospective *client* would be able to identify the *client* or *clients* that are the source of the information, the engagement should not be accepted unless the *member* obtains the original *client's* specific consent to disclose the information. [Prior reference: paragraphs .029–.030 of ET section 391]

.02 When a *member* withdraws from an engagement due to, for example, discovery of irregularities in a *client's* tax return, if contacted by the successor, the *member* should suggest that the successor ask the *client* to permit the *member* to discuss all matters freely with the successor. The successor is then on notice of some conflict.

.03 The "Confidential Client Information Rule" [1.700.001] is not intended to help an unscrupulous *client* cover up illegal acts or otherwise hide information by changing CPAs. Due to the possibility of legal implications in such matters, the *member* should seek legal advice on the *member's* status and obligations in the matter. [Prior reference: paragraphs .005–.006 of ET section 391]

1.700.030 Disclosing Information to Clients

.01 When a *member* is engaged by either spouse to prepare a married couple's joint tax return, the two spouses are considered to be one *client*, even if the *member* deals exclusively with one spouse. Accordingly, if the married couple is undergoing a divorce and one spouse directs the *member* to withhold joint tax information from the other spouse, the *member* may provide the information to both spouses, in compliance with the "Confidential Client Information Rule" [1.700.001], because both are the *member's client*. The *member* should consider reviewing

- a. the legal implications of such disclosure with an attorney and
- b. responsibilities under any tax performance standards, such as Section 10.29 of IRS Circular 230. [Prior reference: paragraphs .031–.032 of ET section 391]

.02 When a person or entity engages a *member* to perform *professional services* (engaging entity) for the benefit of another person or entity (beneficiary), the engaging entity and the beneficiary are considered two separate *clients*. Accordingly, the *member* should not disclose *confidential client information* of

either *client* to the other without consent of the *client* whose confidential information is to be disclosed. For example, if a company engages a *member* to perform personal tax services for the benefit of its executives, the *member's* disclosure of the executives' *confidential client information* to the company without the consent of the applicable executive would be a violation of the "Confidential Client Information Rule" [1.700.001]. [Prior reference: paragraphs .041–.042 of ET section 391]

[See Revision History Table.]

1.700.040 Disclosing Information to a Third-Party Service Provider

.01 When a *member* uses a *third-party service provider* to assist the *member* in providing *professional services*, *threats* to compliance with the "Confidential Client Information Rule" [1.700.001] may exist.

.02 *Clients* may not expect the *member* to use a *third-party service provider* to assist the *member* in providing the *professional services*. Therefore, before disclosing *confidential client information* to a *third-party service provider*, the *member* should do one of the following:

- a. Enter into a contractual agreement with the *third-party service provider* to maintain the confidentiality of the information and provide reasonable assurance that the *third-party service provider* has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the *third-party service provider's* controls and procedures to *safeguard confidential client information*.
- b. Obtain specific consent from the *client* before disclosing *confidential client information* to the *third-party service provider*.

.03 Refer to the "Use of a Third-Party Service Provider" interpretation [1.150.040] of the "Integrity and Objectivity Rule" [1.100.001] and the "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001] for additional guidance. [Prior reference: paragraphs .001–.002 of ET section 391]

A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsoutsourcing.pdf>.

In addition, nonauthoritative sample client disclosure language that could be used to fulfill the requirement discussed in this interpretation is also available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/sample_disclosure_notification.pdf.

1.700.050 Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice

.01 For purposes of the "Confidential Client Information Rule" [1.700.001], a review of a *member's* professional practice includes a review performed in conjunction with a prospective purchase, sale, or merger of all or part of a *member's* practice. Such reviews may *threaten* a *member's* compliance with the "Confidential Client Information Rule." To reduce the *threat* to an *acceptable level*, a *member* must take appropriate precautions (for example, through a written confidentiality agreement with the prospective purchaser) to help ensure that the prospective purchaser does not disclose any *confidential client information* obtained in the course of the review.

.02 *Members* who perform such reviews should not use to their advantage or disclose any *confidential client information* that comes to their attention during the review. [Prior reference: paragraph .04 of ET section 301]

.03 *Members* who obtain *client* files as the result of acquiring all or part of another *member's* professional practice should not disclose any *confidential client information* contained in such files. *Members* should refer to the "Transfer of Files and Return of Client Records in Sale, Transfer Discontinuance or Acquisition of a Practice" interpretation under the "Acts Discreditable Rule" [1.400.205] for guidance related to *client* files obtained through acquiring a practice.

[See Revision History Table.]

1.700.060 Disclosure of Client Information to Third Parties

.01 When a *member* receives a request from a third party (for example, a trade association, member of academia, or surveying or benchmarking organization) to disclose *client* information or intends to use such information for the *member's* own purposes (for example, publication of benchmarking data or studies) in a manner that may result in the *client's* information being disclosed to others without the *client* being specifically identified, *threats* to compliance with the "Confidential Client Information Rule" [1.700.001] may exist.

.02 If the information is considered to be *confidential client information*, the *member* would be in violation of the "Confidential Client Information Rule" [1.700.001] if the *member* discloses or uses the information unless the *member* has the *client's* specific consent, preferably in writing, for the disclosure or use of such information. The consent should specify the nature of the information that may be disclosed, the type of third party to whom it may be disclosed, and its intended use.

.03 If the information is not considered to be *confidential client information*, the disclosure or use of the information is not subject to the "Confidential Client Information Rule" [1.700.001]. However, the *member* should be cautious in the disclosure or use of the information so as not to disclose *client* information that may go beyond what is available to the public or that the *client* has agreed may be disclosed.

.04 A *member* is not prohibited from marketing his or her services or advising a third party, such as a current or prospective *client*, of information based on his or her expertise or knowledge obtained from prior experiences with *clients* (for example, the nature of services provided to other *clients* or common practices within a *client's* industry). However, if the information may be identifiable to one or more *clients*, specific consent, preferably in writing, is required from such *client(s)*. Prior to disclosing *confidential client information*

to a third party, the *member* should consider whether a contractual agreement with the third party to maintain the confidentiality or limit the use of the information is necessary.

.05 In addition, the *member* should consider whether federal, state, or local statutes, rules, or regulations concerning the confidentiality of *client* information may be more restrictive than the requirements in this interpretation.

.06 Refer to the "Use of a Third-Party Service Provider" interpretation [1.300.040] of the "General Standards Rule" [1.300.001] for additional guidance. [Prior reference: paragraphs .003–.004 of ET section 391]

A nonauthoritative table providing examples of client information that is available to the public, client information not available to the public, and other information in the member's possession is available at <https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/categories-of-information.pdf>.

1.700.070 Disclosing Client Information During Litigation

.01 The "Confidential Client Information Rule" [1.700.001] is not intended to prohibit a *member* from disclosing information necessary to initiate, pursue, or defend the *member* in an actual or a threatened lawsuit or alternative dispute resolution proceeding. Accordingly, releasing *confidential client information* to the *member's* liability insurance carrier solely to assist in the defense against an actual or a potential claim against the *member* would not violate the "Confidential Client Information Rule." [Prior reference: paragraphs .039–.040 and .045–.046 of ET section 391]

1.700.080 Disclosing Client Information in Director Positions

.01 When a *member* serves as a director of an organization, such as a bank or an insurance company, the *member's* fiduciary responsibilities to the organization may create *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. For example, the *member's* fiduciary duty to the organization may conflict with the *member's* obligations pursuant to the "Confidential Client Information Rule" (for example, failure to disclose information may constitute a breach of the director's fiduciary responsibilities) when the *member's clients* are customers of the organization.

.02 A *member's* general knowledge and experience may be very helpful to an organization in formulating a policy and making business decisions. Nevertheless, if the *member's clients* are likely to engage in significant transactions with the organization, it would be more appropriate for the *member* to serve as a consultant to the board. Under such an arrangement, the *member* could limit activities to those that do not *threaten* the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. If, however, the *member* serves as a board member of the organization, the *member* should evaluate the significance of any *threats* and apply *safeguards*, when necessary, to eliminate or reduce the *threats* to an *acceptable level*.

.03 See the "Director Positions" interpretation [1.110.020] of the "Integrity and Objectivity Rule" [1.100.001]. [Prior reference: paragraphs .035–.036 of ET section 391]

Effective Date

.04 The revisions to this interpretation are effective December 15, 2014.

1.700.090 Disclosing Client Names

.01 The *member's* disclosure of a *client's* name would not violate the "Confidential Client Information Rule" [1.700.001] if disclosure of the *client's* name does not constitute the release of *confidential client information*. For example, if a *member's* practice is limited to bankruptcy matters, disclosure of the *client's* name could suggest that the *client* may be experiencing financial difficulties, which may be *confidential client information*. [Prior reference: paragraphs .013–.014 of ET section 391]

1.700.100 Disclosing Confidential Client Information as a Result of a Subpoena or Summons

.01 The *member's* disclosure of *confidential client information* in compliance with a validly issued and enforceable subpoena or summons would not violate the "Confidential Client Information Rule" [1.700.001].

.02 When complying with such subpoena or summons, the *member* is not required to notify the *client* that its records have been subpoenaed or that a summons related to the *client's* records has been issued. The *member* may also wish to consult with legal counsel to determine the validity and enforceability of the subpoena or summons and the specific *client* information required to be provided. The *member* may also wish to consult with his or her state board of accountancy. [No prior reference: New content from informal policy position]

Effective Date

.03 Effective December 15, 2014.

1.700.110 Disclosing Client Information in Connection With a Quality Review

.01 For purposes of the "Confidential Client Information Rule" [1.700.001], a review of a *member's* professional practice includes a quality review of a *member's* tax practice (for example, a voluntary tax practice review) performed under the monitoring function of the member's tax practice quality control policies and procedures. When a *member* uses a third party to perform such reviews of the *member's* tax practice, *threats* to compliance with the "Confidential Client Information Rule" may exist.

.02 To reduce the *threat* to an acceptable level, the *member* should, at a minimum, be satisfied that the *member* complies with the requirements of Treasury Regulation 301.7216-2(p) and any applicable state or local regulations related to disclosures of any federal, state, or local tax return information during such reviews. In addition, the *member* should be satisfied that the third-party reviewer is aware of and subject to the requirements of Treasury Regulation 301.7216-2(p) and any applicable state or local regulations. If the *member* determines that *threats* have not been reduced to an *acceptable level*, the *member* should apply additional *safeguards* to reduce the *threats* to an *acceptable level* (for example, enter into a written confidentiality agreement with the reviewer or de-identify tax return information provided to the reviewer).

.03 *Members* who perform such reviews should not use to their advantage or disclose any *confidential client information* that comes to their attention

during the review. *Members* should refer to Treasury Regulation 301.7216-2(p) and any applicable state or local regulations for further guidance related to tax return information obtained during such reviews.

Effective Date

.04 This interpretation is effective December 31, 2018.

[See Revision History Table.]

1.800 Form of Organization and Name

1.800.001 Form of Organization and Name Rule

.01 A *member* may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of *Council*.

.02 A *member* shall not practice public accounting under a *firm* name that is misleading.

.03 Names of one or more past owners may be included in the *firm* name of a successor organization.

.04 A *firm* may not designate itself as "*Members of the American Institute of Certified Public Accountants*" unless all its CPA owners are *members* of the AICPA.

.05 See appendix B, "*Council Resolution Concerning Form of Organization and Name*." [Prior reference: paragraph .01 of ET section 505]

Interpretations Under the Form of Organization and Name Rule

1.800.005 Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Form of Organization and Name Rule" [1.800.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Public Practice" [1.000.010].

.02 A *member* would be considered in violation of the "Form of Organization and Name Rule" [1.800.001] if the *member* cannot demonstrate the application of *safeguards* that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [1.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

1.810 Form of Organization and Related Practice Issues

1.810.010 Ownership of a Separate Business

.01 A *member* may own an interest in a separate business that performs for *clients* accounting, tax, personal financial planning, or litigation support services or other services for which standards are promulgated by bodies designated by *Council*.

.02 If the *member*, either individually or collectively with the *member's firm* or others in the *firm*, *controls* the separate business, then the separate business, its owners (including the *member*), and its professional employees must comply with the code. For example, if one or more *members* individually or collectively *control* the separate business, the *member(s)* and others associated with the separate business are subject to the "Commissions and Referral Fees Rule" [1.520.001] and its *interpretations*. With respect to an *attest client*, the "Independence Rule" [1.200.001] and its *interpretations* would apply to the activities of the separate business, its owners, and its professional employees.

.03 When the *member*, individually or collectively with the *member's firm* or others in the *firm*, does not *control* the separate business, the provisions of the code would apply to the *member's* actions but not to the separate business, its other (nonmember) owners, and its professional employees. For example, the separate business could enter into a contingent fee arrangement with the *member's attest client* or accept commissions for the referral of products or services to the *member's attest client*. [Prior reference: paragraph .03 of ET section 505]

.04 When the owners of the separate business are non-CPAs, to prevent any misunderstanding or misrepresentation, the CPA *member* should advise *clients* and other interested parties that the CPA *member* is an owner in two separate businesses: one made up of non-CPAs (except for the CPA *member*) and another that is a CPA *firm*. [Prior reference: paragraphs .275–.276 of ET section 591]

.05 See the "Network and Network Firms" interpretation [1.220.010] of the "Independence Rule" [1.200.001] and the definitions of *networks* and *network firms* for guidance applicable to these entities.

1.810.020 Partner Designation

.01 Only *members* of a *firm* who are legally *partners* should use the designation *partner*. *Members* who are not parties to the *firm's* partnership agreement should not hold themselves out in any manner that might lead *clients* or the public to believe that they are *partners*. For example, using the designation "nonproprietary partner" to describe a high-ranking professional employee would be misleading and in violation of the "Form of Organization and Name Rule" [1.800.001] even if the professional employee was a *partner* in one of the predecessor *firms* that merged into the *firm*. [Prior reference: paragraphs .273–.274 of ET section 591]

1.810.030 A Member's Responsibility for Nonmember Practitioners

.01 A *member* who becomes an employee of a *firm* made up of one or more nonmember practitioners must still comply with the code. If the *member* becomes an owner in the *firm*, the *member* will be responsible for *firm's* professional employees, including the nonmember practitioners.

.02 Similarly, if a *member* forms a partnership with a nonmember, the *member* is ethically responsible for all the activities of the partnership. If the nonmember *partner* violates the code, the *member* would be held accountable for that *partner's* actions.

.03 See paragraph .04 of the "Application of the AICPA Code" [0.200.020] section of the preface and appendix B. [Prior reference: paragraphs .005–.006 and .281–.282 of ET section 591]

1.810.040 Attest Engagement Performed With a Former Partner

.01 Unless there are laws, rules or regulations that are applicable to the *member* that conclude otherwise, two former *partners* may continue to jointly perform an *attest engagement* even if one of them is not a CPA. However, to be clear that a partnership no longer exists and to assure the *attest client* and others that both individuals performed the *attest engagement*, they should present their report on plain paper (that is, paper with no letterhead) that is signed in the following manner:

John Doe, Certified Public Accountant
Richard Roe, Accountant

[Prior reference: paragraphs .271–.272 of ET section 591]

Effective Date

.02 The revisions to this interpretation are effective December 15, 2014.

1.810.050 Alternative Practice Structures

.01 The "Form of Organization and Name Rule" [1.800.001] states, "A *member* may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of *Council*." The *Council* resolution (appendix B) requires, among other things, that CPAs own a majority of the *financial interests* in a *firm* engaged to provide attest services (as defined therein) to the public. This interpretation explains the application of this rule to an alternative practice structure (APS) in which (a) the majority of the *financial interests* in the attest *firm* is owned by CPAs and (b) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and *office space*.

.02 To protect the public interest, the overriding focus of the resolution is that CPAs remain responsible, financially and otherwise, for a *firm's* attest work. In addition to the provisions of the resolution, other requirements of the code and bylaws ensure responsibility for

- a. compliance with all aspects of applicable law or regulation,
- b. enrollment in an AICPA-approved practice monitoring program,
- c. compliance with the "Independence Rule" [1.200.001], and
- d. compliance with applicable standards promulgated by *Council*-designated bodies ("Compliance With Standards Rule" [1.310.001]) and all other provisions of the code, including "Structure and Application of the AICPA Code" [0.200].

.03 Given all the previously mentioned *safeguards* that protect the public interest, if the CPAs who own the attest *firm* remain financially responsible, under applicable law or regulation, for the *firm's* attest work, the *member* is considered to be in compliance with the financial interests provision of the resolution. [Prior reference: paragraph .04 of ET section 505]

1.820 Firm Name

1.820.010 Use of a Retired Partner's Name

.01 The "Form of Organization and Name Rule" [1.800.001] permits the use of the name(s) of former *partner(s)* in a *firm's* name. For example, if two *firms* merge, the newly formed *firm* may use in its *firm* name the name of retired or other *partners* in either or both of the merged *firms* without violating the "Form of Organization and Name Rule." [Prior reference: paragraphs .289–.290 of ET section 591]

1.820.020 A Practice With Non-CPA Partners

.01 Unless there are laws, rules, or regulations that are applicable to the *member* that conclude otherwise, a CPA *member* who is in a partnership with non-CPAs may sign reports in the *firm's* name and also affix the designation, "Certified Public Accountant," to the *member's* signature if it is clear that the partnership itself is not being held out as entirely comprising CPAs. [Prior reference: paragraphs .379–.380 of ET section 591]

1.820.030 Misleading Firm Names

.01 The "Form of Organization and Name Rule" [1.800.001] prohibits a *member* from practicing public accounting under a *firm* name that is misleading. If the *firm* name contains any representation that would be likely to cause a reasonable person to misunderstand, or be confused about, what the legal form of the *firm* is or who the owners or members of the *firm* are, the *firm* name would be misleading and the *member* would be in violation of the "Form of Organization and Name Rule." For example, the *member* should not refer to a type of organization or an abbreviation thereof that does not accurately reflect the form under which the *firm* is organized.

.02 In addition, the *member* should consider the rules and regulations of his or her state board(s) of accountancy concerning misleading *firm* names that may be more restrictive than the requirements in this interpretation. [Prior reference: paragraph .05 of ET section 505]

1.820.040 Use of a Common Brand Name in Firm Name

.01 *Firms* within a *network* sometimes share the use of a common brand or share common initials as part of the *firm* name. The sharing of a common brand name or common initials of a *network* as part of the *member's firm* name would not be considered misleading, provided the *firm* is a *network firm*.

.02 The sharing of a common brand name or common initials of a *network* as the entire name of the *member's firm* would not be considered misleading, if the *firm* is a *network firm* and shares one or more of the following characteristics with other *firms* in the *network*:

- a. Common *control* among the firms through ownership, management, or other means
- b. Profits or costs, excluding costs of operating the *network*; costs of developing audit methodologies, manuals, and training courses; and other costs that are immaterial to the *firm*
- c. Common business strategy that involves ongoing collaboration amongst the *firms* whereby the *firms* are responsible for implementing the *network's* strategy and are held accountable for performance pursuant to that strategy

- d. Significant part of professional resources
- e. Common quality control policies and procedures that *firms* are required to implement and that are monitored by the *network*

.03 Refer to the "Network and Network Firms" interpretation [1.220.010] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .06 of ET section 505]

ET Part 2

Members in Business

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2.000 Introduction

.01 Part 2 of the Code of Professional Conduct (the code) applies to *members in business*. Accordingly, when the term *member* is used in part 2 of the code, the requirements apply only to *members in business*. When a *member in business* is also a *member in public practice* (for example, a *member* has a part-time tax practice), the *member* should also consult part 1 of the code, which applies to *members in public practice*. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

2.000.010 Conceptual Framework for Members in Business

Introduction

.01 *Members* may encounter various relationships or circumstances that create *threats* to the *member's* compliance with the rules. The rules and *interpretations* seek to address many situations; however, they cannot address all relationships or circumstances that may arise. Thus, in the absence of an *interpretation* that addresses a particular relationship or circumstance, a *member* should evaluate whether that relationship or circumstance would lead a reasonable and informed third party who is aware of the relevant information to conclude that there is a *threat* to the *member's* compliance with the rules that is not at an *acceptable level*. When making that evaluation, the *member* should apply the conceptual framework approach as outlined in this interpretation.

.02 The code specifies that in some circumstances, no *safeguards* can reduce a *threat* to an *acceptable level*. For example, the code specifies that a *member* may not subordinate the *member's* professional judgment to others without violating the "Integrity and Objectivity Rule" [2.100.001]. A *member* may not use the conceptual framework to overcome this or any other prohibition or requirement in the code.

Definitions Used in Applying the Conceptual Framework

.03 Acceptable level. A level at which a reasonable and informed third party who is aware of the relevant information would be expected to conclude that a *member's* compliance with the rules is not compromised.

.04 Safeguards. Actions or other measures that may eliminate a *threat* or reduce a threat to an *acceptable level*.

.05 Threat(s). Relationships or circumstances that could compromise a *member's* compliance with the rules.

Conceptual Framework Approach

.06 Under the conceptual framework approach, *members* should identify *threats* to compliance with the rules and evaluate the significance of those *threats*. *Members* should evaluate identified *threats* both individually and in the aggregate because *threats* can have a cumulative effect on a *member's* compliance with the rules. *Members* should perform three main steps in applying the conceptual framework approach:

- a. *Identify threats.* The relationships or circumstances that a *member* encounters in various engagements and work assignments or

positions will often create different *threats* to complying with the rules. When a *member* encounters a relationship or circumstance that is not specifically addressed by a rule or an *interpretation*, under this approach, the *member* should determine whether the relationship or circumstance creates one or more *threats*, such as those identified in paragraphs .09–.14 that follow. The existence of a *threat* does not mean that the *member* is in violation of the rules; however, the *member* should evaluate the significance of the *threat*.

- b. *Evaluate the significance of a threat.* In evaluating the significance of an identified *threat*, the *member* should determine whether a *threat* is at an *acceptable level*. A *threat* is at an *acceptable level* when a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* would not compromise the *member's* compliance with the rules. *Members* should consider both qualitative and quantitative factors when evaluating the significance of a *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*. If the *member* evaluates the *threat* and concludes that a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the *threat* does not compromise a *member's* compliance with the rules, the *threat* is at an *acceptable level* and the *member* is not required to evaluate the *threat* any further under this conceptual framework approach.
- c. *Identify and apply safeguards.* If, in evaluating the significance of an identified *threat*, the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. The *member* should apply judgment in determining the nature of the *safeguards* to be applied because the effectiveness of *safeguards* will vary depending on the circumstances. When identifying appropriate *safeguards* to apply, one *safeguard* may eliminate or reduce multiple *threats*. In some cases, the *member* should apply multiple *safeguards* to eliminate or reduce one *threat* to an *acceptable level*. In other cases, an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* will be unable to implement effective *safeguards*. Under such circumstances, providing the specific *professional services* would compromise the *member's* compliance with the rules, and the *member* should determine whether to decline or discontinue the *professional services* or resign from the *employing organization*.

Threats

.07 Many *threats* fall into one or more of the following six broad categories: adverse interest, advocacy, familiarity, self-interest, self-review, and undue influence.

.08 Examples of *threats* associated with a specific relationship or circumstance are identified in the *interpretations* of the code. Paragraphs .09–.14 of this section define and provide examples, which are not all inclusive, of each of these *threat* categories.

.09 *Adverse interest threat.* The *threat* that a *member* will not act with objectivity because the *member's* interests are opposed to the interests of

the *employing organization*. Examples of adverse interest *threats* include the following:

- a. A *member* has charged, or expressed an intention to charge, the *employing organization* with violations of law.
- b. A *member* or the *member's immediate family* or *close relative* has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the *employing organization*.
- c. A *member* has sued or expressed an intention to sue the *employing organization* or its officers, directors, or employees.

.10 Advocacy threat. The *threat* that a *member* will promote an *employing organization's* interests or position to the point that his or her objectivity is compromised. Examples of advocacy *threats* include the following:

- a. Obtaining favorable financing or additional capital is dependent upon the information that the *member* includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing.
- b. The *member* gives or fails to give information that the *member* knows will unduly influence the conclusions reached by an external service provider or other third party.

.11 Familiarity threat. The *threat* that, due to a long or close relationship with a person or an *employing organization*, a *member* will become too sympathetic to their interests or too accepting of the person's work or *employing organization's* product or service. Examples of familiarity *threats* include the following:

- a. A *member* uses an *immediate family's* or a *close relative's* company as a supplier to the *employing organization*.
- b. A *member* may accept an individual's work product with little or no review because the individual has been producing an acceptable work product for an extended period of time.
- c. A *member's immediate family* or *close relative* is employed as a *member's* subordinate.
- d. A *member* regularly accepts gifts or entertainment from a vendor or customer of the *employing organization*.

.12 Self-interest threat. The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, the *employing organization* or persons associated with the *employing organization*. Examples of self-interest *threats* include the following:

- a. A *member's immediate family* or *close relative* has a *financial interest* in the *employing organization*.
- b. A *member* holds a *financial interest* (for example, shares or share options) in the *employing organization*, and the value of that *financial interest* is directly affected by the *member's* decisions.
- c. A *member* is eligible for a profit or other performance-related bonus, and the value of that bonus is directly affected by the *member's* decisions.

.13 Self-review threat. The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the *member*, or an individual in the *employing organization* and that the *member* will rely on that service in forming a judgment as part of another service. Examples of self-review *threats* include the following:

- a. When performing an internal audit procedure, an internal auditor accepts work that he or she previously performed in a different position.
- b. The *member* accepts the work previously performed by the *member*, alone or with others, that will be the basis for providing another *professional service*.

.14 Undue influence threat. The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with the *employing organization* or any relevant third party due to that individual's position, reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. A *member* is pressured to become associated with misleading information.
- b. A *member* is pressured to deviate from a company policy.
- c. A *member* is pressured to change a conclusion regarding an accounting or a tax position.
- d. A *member* is pressured to hire an unqualified individual.

Safeguards

.15 Safeguards may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards* applied will depend on many factors. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

.16 Safeguards that may eliminate a *threat* or reduce it to an *acceptable level* fall into two broad categories:

- a. *Safeguards* created by the profession, legislation, or regulation
- b. *Safeguards* implemented by the *employing organization*

.17 The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) who will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*
- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the *employing organization* is a *public interest entity*

.18 Examples of *safeguards* within each category are presented in the following paragraphs. Because these are only examples and are not intended to be all inclusive, it is possible that *threats* may be sufficiently mitigated through the application of other *safeguards* not specifically identified herein.

.19 The following are examples of *safeguards* created by the profession, legislation, or regulation:

- a. Education and training requirements on ethics and professional responsibilities

- b. Continuing education requirements on ethics
- c. Professional standards and the threat of discipline
- d. Legislation establishing prohibitions and requirements for entities and employees
- e. Competency and experience requirements for professional licensure
- f. Professional resources, such as hotlines, for consultation on ethical issues

.20 Examples of *safeguards* implemented by the *employing organization* are as follows:

- a. A tone at the top emphasizing a commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies
- b. Policies and procedures addressing ethical conduct and compliance with laws, rules, and regulations
- c. Audit committee charter, including independent audit committee members
- d. Internal policies and procedures requiring disclosure of identified interests or relationships among the *employing organization*, its directors or officers, and vendors, suppliers, or customers
- e. Internal policies and procedures related to purchasing controls
- f. Internal policies and procedures related to customer acceptance or credit limits
- g. Dissemination of corporate ethical compliance policies and procedures, including whistle-blower hotlines, the reporting structure, dispute resolution, or other similar policies, to promote compliance with laws, rules, regulations, and other professional requirements
- h. Human resource policies and procedures *safeguarding* against discrimination or harassment, such as those concerning a worker's religion, sexual orientation, gender, or disability
- i. Human resource policies and procedures stressing the hiring and retention of technically competent employees
- j. Policies and procedures for implementing and monitoring ethical policies
- k. Assigning sufficient staff with the necessary competencies to projects and other tasks
- l. Policies segregating personal assets from company assets
- m. Staff training on applicable laws, rules, and regulations
- n. Regular monitoring of internal policies and procedures
- o. A reporting structure whereby the internal auditor does not report to the financial reporting group
- p. Policies and procedures that do not allow an internal auditor to monitor areas where the internal auditor has operational or functional responsibilities
- q. Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity
- r. Use of third-party resources for consultation as needed on significant matters of professional judgment [No prior reference: new content]

Effective Date

.21 Effective December 15, 2015. Early implementation is allowed provided the member has implemented the revised code.

A nonauthoritative Conceptual Framework Toolkit for Members in Business is available at <https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/resources/downloadabledocuments/toolkitsandaids/conceptualframeworktoolkitformembersinbusiness.docm>.

2.000.020 Ethical Conflicts

.01 An ethical conflict arises when a *member* encounters one or both of the following:

- a. Obstacles to following an appropriate course of action due to internal or external pressures
- b. Conflicts in applying relevant professional and legal standards.

.02 Once an ethical conflict is encountered, a *member* may be required to take steps to best achieve compliance with the rules and law. In weighing alternative courses of action, the *member* should consider factors such as the following:

- a. Relevant facts and circumstances, including applicable rules, laws, or regulations
- b. Ethical issues involved
- c. Established internal procedures

.03 The *member* should also be prepared to justify any departures that the *member* believes were appropriate in applying the relevant rules and law. If the *member* was unable to resolve the conflict in a way that permitted compliance with the applicable rules and law, the *member* may have to address the consequences of any violations.

.04 Before pursuing a course of action, the *member* should consider consulting with appropriate persons within the organization that employs the *member*.

.05 If a *member* decides not to consult with appropriate persons within the organization that employs the *member*, and the conflict remains unresolved after pursuing the selected course of action, the *member* should consider either consulting with other individuals for help in reaching a resolution or obtaining advice from an appropriate professional body or legal counsel. The *member* also should consider documenting the substance of the issue, the parties with whom the issue was discussed, details of any discussions held, and any decisions made concerning the issue.

.06 If the ethical conflict remains unresolved, the *member* will in all likelihood be in violation of one or more rules if he or she remains associated with the matter creating the conflict. Accordingly, the *member* should consider his or her continuing relationship with the specific assignment or employer. [No prior reference; new content]

.07 Refer to the "Responding to Noncompliance With Laws and Regulations" interpretation [2.180.010] of the "Integrity and Objectivity Rule" [2.100.001] for additional guidance.

Effective Date

.08 Effective December 15, 2014.

[See Revision History Table.]

2.100 Integrity and Objectivity

2.100.001 Integrity and Objectivity Rule

.01 In the performance of any *professional service*, a *member* shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others. [Prior reference: paragraph .01 of ET section 102]

Interpretations Under the Integrity and Objectivity Rule

2.100.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Integrity and Objectivity Rule" [2.100.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "Integrity and Objectivity Rule" [2.100.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

2.110 Conflicts of Interest

2.110.010 Conflicts of Interest for Members in Business

.01 A *member* may be faced with a conflict of interest when undertaking a *professional service*. In determining whether a *professional service*, relationship, or matter would result in a conflict of interest, a *member* should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

.02 A conflict of interest creates adverse interest and self-interest *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001]. For example, *threats* may be created when

- a. a *member* undertakes a *professional service* related to a particular matter involving two or more parties whose interests with respect to that matter are in conflict, or

- b. the interests of a *member* with respect to a particular matter and the interests of a party for whom the *member* undertakes a *professional service* related to that matter are in conflict.

.03 A party may include an *employing organization*, a vendor, a customer, a lender, a shareholder, or other party.

.04 The following are examples of situations in which conflicts of interest may arise:

- a. Serving in a management or governance position for two *employing organizations* and acquiring confidential information from one *employing organization* that could be used by the *member* to the advantage or disadvantage of the other *employing organization*
- b. Undertaking a *professional service* for each of two parties in a partnership employing the *member* to assist in dissolving their partnership
- c. Preparing financial information for certain *members* of management of the *employing organization* who are seeking to undertake a management buy-out
- d. Being responsible for selecting a vendor for the *member's employing organization* when the *member* or his or her *immediate family member* could benefit financially from the transaction
- e. Serving in a governance capacity or influencing an *employing organization* that is approving certain investments for the company in which one of those specific investments will increase the value of the personal investment portfolio of the *member* or his or her *immediate family member*

Identification of a Conflict of Interest

.05 In identifying whether a conflict of interest exists or may be created, a *member* should take reasonable steps to determine

- a. the nature of the relevant interests and relationships between the parties involved and
- b. the nature of the services and its implication for relevant parties.

.06 The nature of the relevant interests and relationships and the services may change over time. The *member* should remain alert to such changes for the purposes of identifying circumstances that might create a conflict of interest.

Evaluation of a Conflict of Interest

.07 When an actual conflict of interest has been identified, the *member* should evaluate the significance of the *threat* created by the conflict of interest to determine if the *threat* is at an *acceptable level*. *Members* should consider both qualitative and quantitative factors when evaluating the significance of the *threat*, including the extent to which existing *safeguards* already reduce the *threat* to an *acceptable level*.

.08 In evaluating the significance of an identified *threat*, *members* should consider the following:

- a. The significance of relevant interests or relationships.
- b. The significance of the *threats* created by undertaking the *professional service* or services. In general, the more direct the connection between the *member* and the matter on which the parties'

interests are in conflict, the more significant the *threat* to compliance with the rule will be.

.09 If the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. Examples of *safeguards* include the following:

- a. Restructuring or segregating certain responsibilities and duties
- b. Obtaining appropriate oversight
- c. Withdrawing from the decision making process related to the matter giving rise to the conflict of interest
- d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant

.10 In cases where an identified *threat* may be so significant that no *safeguards* will eliminate the *threat* or reduce it to an *acceptable level*, or the *member* is unable to implement effective *safeguards*, the *member* should (a) decline to perform or discontinue the *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an *acceptable level*.

Disclosure of a Conflict of Interest and Consent

.11 When a conflict of interest exists, the *member* should disclose the nature of the conflict to the relevant parties, including to the appropriate levels within the *employing organization* and obtain their consent to undertake the *professional service*. The *member* should disclose the conflict of interest and obtain consent even if the *member* concludes that *threats* are at an *acceptable level*.

.12 The *member* is encouraged to document the nature of the circumstances giving rise to the conflict of interest, the *safeguards* applied to eliminate or reduce the *threats* to an *acceptable level*, and the consent obtained.

.13 When addressing a conflict of interest, a *member* is encouraged to seek guidance from within the *employing organization* or from others, such as a professional body, legal counsel, or another professional accountant. When making disclosures and seeking guidance of third parties, the *member* should remain alert to the requirements of the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070] of the "Acts Discreditable Rule" [2.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of employer information may be more restrictive than the requirements contained in the Code of Professional Conduct.

.14 A *member* may encounter other *threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001]. This may occur, for example, when preparing or reporting financial information as a result of undue pressure from others within the *employing organization* or financial, business or personal relationships that *close relatives* or *immediate family* members of the *member* have with the *employing organization*. Guidance on managing such *threats* is covered by the "Knowing Misrepresentations in the Preparation of Financial Statements or Records" interpretation [2.130.010] and the "Subordination of Judgment" interpretation [2.130.020] under the "Integrity and Objectivity Rule."

[See Revision History Table.]

2.120 Gifts and Entertainment

2.120.010 Offering or Accepting Gifts or Entertainment

.01 For purposes of this interpretation, a customer or vendor of the *member's* employer includes a representative of the customer or vendor.

.02 When a *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer, self-interest, familiarity, or undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist.

.03 *Threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and the *member* would be presumed to lack integrity in violation of the "Integrity and Objectivity Rule" in the following circumstances:

- a. The *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer that violate applicable laws, rules, or regulations or the policies of the *member's* employer or the customer or vendor.
- b. The member knows of the violation or demonstrates recklessness in not knowing.

.04 A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* when gifts or entertainment are reasonable in the circumstances. The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment
- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f. Whether other customers or vendors also participated in the entertainment
- g. The individuals from the customer or vendor and a *member's* employer who participated in the entertainment

.05 *Threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer that is not reasonable in the circumstances. The *member* would be considered to lack objectivity in violation of the "Integrity and Objectivity Rule," under these circumstances. [Prior reference: paragraphs .226–.227 of ET section 191]

A nonauthoritative basis-for-conclusions document summarizing considerations that were deemed significant in the development of this interpretation is available at https://us.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Gifts_Basis_Document.pdf.

2.130 Preparing and Reporting Information

2.130.010 *Knowing Misrepresentations in the Preparation and Presentation of Information*

.01 *Members* at all levels in an *employing organization* may be involved in the preparation and presentation of information for use both within and outside the *employing organization*. Stakeholders for whom such information is prepared or presented include the following:

- a. Management and *those charged with governance*
- b. Investors, lenders, and other creditors
- c. Regulators

.02 This information may assist stakeholders in understanding and evaluating aspects of the *employing organization's* operations and finances and in making decisions concerning the *employing organization*. This includes financial and non-financial information that may be made public or used for internal purposes such as the following:

- a. Operating and performance reports
- b. Decision support analyses
- c. Budgets and forecasts
- d. Information provided to the internal and external auditors
- e. Risk analyses
- f. General and special purpose *financial statements*
- g. Tax returns
- h. Reports filed with regulators for legal and compliance purposes

.03 *Members* who are responsible for recording, maintaining, preparing, approving, or presenting information should do so in accordance with the "Integrity and Objectivity Rule" [2.100.001] as follows:

- a. Presenting the information in accordance with a relevant reporting framework, where applicable
- b. Preparing or presenting information in a manner that is intended not to mislead, including not to influence contractual or regulatory outcomes inappropriately
- c. Preparing or presenting information without omissions that would render the information misleading

.04 This responsibility involves using professional judgment in the following:

- a. Representing the facts accurately and completely in all material respects

- b. Describing clearly the true nature of business transactions or activities
- c. Classifying and recording information in a timely and proper manner

Preparation and Presentation of Financial Statements and Records

.05 *Threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and the *member* would be considered to have knowingly misrepresented facts in violation of the "Integrity and Objectivity Rule," if the *member*

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity's *financial statements* or records;
- b. fails to correct an entity's *financial statements* or records that are materially false and misleading when the *member* has the authority to record the entries; or
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .02 of ET section 102]

.06 Preparing or presenting information may require the exercise of discretion in making professional judgments. Preparing or presenting such information in compliance with the "Integrity and Objectivity Rule" [2.100.001] requires the *member* not to exercise such discretion with the intention of misleading.

Preparation and Presentation of Information Not Subject to a Reporting Framework

.07 When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the *member* should use professional judgment to identify and take into account the purpose for which the information is to be used, the context in which it is provided, and the audience to whom it is addressed. For example, when preparing or presenting pro forma reports, budgets, or forecasts, the inclusion of relevant estimates, approximations, and assumptions, where appropriate, would enable those who may rely on such information to form their own judgments. The *member* may also consider clarifying the intended audience, context, and purpose of the information presented.

Reliance on the Work of Others

.08 A *member* who intends to rely on the work of others, either internal or external to the organization, should use professional judgment to determine what steps to take, if any, to ensure that the requirements set out in paragraphs .03, .04, and .05 are fulfilled. Factors to consider in determining whether reliance on others is reasonable include reputation, expertise, objectivity, resources available to the individual or organization, and whether the other individual is subject to applicable professional and ethical standards. Such information may be gained from prior association with, or from consulting others about, the individual or the organization.

Association With Misleading Information

.09 If the *member* knows or has reason to believe that the information with which he or she is associated is misleading, the *member* should apply appropriate *safeguards* to seek to resolve the matter, including the following:

- a. Consulting the *employing organization's* policies and procedures (for example, an ethics or whistleblowing policy) regarding how such matters should be addressed internally
- b. Discussing concerns that the information is misleading with the *member's* supervisor or the appropriate levels of management within the *member's employing organization* or *those charged with governance* and requesting such individuals to take appropriate action to resolve the matter. Such action may include the following:
 - i. Having the information corrected
 - ii. If the information has already been disclosed to the intended users, informing them of the correct information

.10 If the *member* determines that appropriate action has not been taken and continues to have reason to believe that the information is misleading, *threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] would not be at an *acceptable level*. In such circumstances, the *member*, being alert to the requirements of the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070], should consider one or more of the following *safeguards*:

- a. Consulting with a relevant professional body
- b. Consulting with the *employing organization's* internal auditor and external accountant
- c. Determining whether any requirements exist to communicate to third parties, including users of the information, the organization's external accountant, or regulatory authorities
- d. Consulting legal counsel regarding his or her responsibilities

.11 If, after exhausting all feasible options, the *member* determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the *member* should refuse to be or to remain associated with the information. The *member* also should consider whether to continue a relationship with the *employing organization*.

.12 Nothing in this *interpretation* precludes a *member* from resigning from the organization at any time. However, resignation may not relieve the *member* of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the *employing organization's* (or former *employing organization's*) external accountant.

.13 The *member* is also encouraged to document his or her understanding of the facts, the accounting principles or other relevant professional standards involved, and the communications and parties with whom these matters were discussed, the courses of action considered, and how the *member* attempted to address the matter.

.14 When *threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] are due to differences of opinion between a *member* and his or her supervisor (or any other person within the *member's* organization) relating to the application of accounting principles, auditing standards, or other relevant

professional standards, the *member* should also refer to the "Subordination of Judgment" interpretation [2.130.020].

[See Revision History Table]

2.130.020 Subordination of Judgment

.01 The "Integrity and Objectivity Rule" [2.100.001] prohibits a *member* from knowingly misrepresenting facts or subordinating his or her judgment when performing *professional services* for an employer or on a volunteer basis. This interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the *member's* organization.

.02 Self-interest, familiarity, and undue influence *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist when a *member* and his or her supervisor or any other person within the *member's* organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.

.03 A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* if the *member* concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If *threats* are not at an *acceptable level*, the *member* should apply the *safeguards* in paragraphs .06–.08 to eliminate or reduce the threat(s) to an *acceptable level* so that the *member* does not subordinate his or her judgment.

.04 In evaluating the significance of any identified *threats*, the *member* should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person

- a. fails to comply with professional standards, when applicable;
- b. creates a material misrepresentation of fact; or
- c. may violate applicable laws or regulations.

.05 If the *member* concludes that *threats* are at an *acceptable level*, the *member* should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.

.06 If the *member* concludes that the position results in a material misrepresentation of fact or a violation of applicable laws or regulations, then *threats* would not be at an *acceptable level*. In such circumstances, the *member* should discuss his or her concerns with the supervisor.

.07 If the difference of opinion is not resolved after discussing the concerns with the supervisor, the *member* should discuss his or her concerns with the appropriate higher level(s) of management within the *member's* organization (for example, the supervisor's immediate superior, senior management, and those charged with governance).

.08 If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the *member's* organization, the *member* concludes that appropriate action was not taken, then the *member* should consider, in no specific order, the following *safeguards* to ensure that *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [2.100.001] are eliminated or reduced to an *acceptable level*:

- a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.
- b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external accountant. In considering such communications, the *member* should be cognizant of his or her obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070] of the "Acts Discreditable Rule" [2.400.001] and the "Obligation of a Member to His or Her Employer's External Accountant" interpretation [2.130.030] of the "Integrity and Objectivity Rule" [2.100.001].
- c. Consult with his or her legal counsel regarding his or her responsibilities.
- d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.

.09 If the *member* concludes that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level* or if the *member* concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the *member's* organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.

.10 Nothing in this interpretation precludes a *member* from resigning from the organization at any time. However, resignation may not relieve the *member* of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

.11 A *member* should use professional judgment and apply similar *safeguards*, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the *member* does not subordinate his or her judgment. [Prior reference: paragraph .05 of ET section 102]

2.130.030 Obligation of a Member to His or Her Employer's External Accountant

.01 The "Integrity and Objectivity Rule" [2.100.001] requires a *member* to maintain objectivity and integrity in the performance of a *professional service*. When dealing with an employer's external accountant, a *member* must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which the employer's external accountant requests written representation. [Prior reference: paragraph .04 of ET section 102]

2.160 Educational Services

2.160.010 Educational Services

.01 *Members* who perform educational services, such as teaching full or part time at a university, teaching a continuing professional education course, or engaging in research and scholarship, are performing *professional services*

and, therefore, are subject to the "Integrity and Objectivity Rule" [2.100.001].
[Prior reference: paragraph .06 of ET section 102]

2.170 Pressure to Breach the Rules

2.170.010 Pressure to Breach the Rules

.01 This interpretation addresses pressures that could result in a *member* taking actions that breach or cause others to breach the rules, particularly the "Integrity and Objectivity Rule" [2.100.001].

.02 A *member* may face pressure that could create *threats*, for example undue influence *threats*, to compliance with the "Integrity and Objectivity Rule" [2.100.001] when undertaking a *professional service*. Pressure may be explicit or implicit. Pressure may come from within the *employing organization*, for example, from a colleague or superior, from an external individual or organization such as a vendor, customer or lender, or from the need to meet internal or external targets and expectations.

.03 A *member* should not allow pressure from others to result in a breach of the "Integrity and Objectivity Rule" [2.100.001]. A *member* also should not place pressure on others that the *member* knows, or has reason to believe, would result in the other individuals breaching the rules of the AICPA Code of Professional Conduct.

.04 Examples of pressure that could result in a breach of the "Integrity and Objectivity Rule" [2.100.001] include the following:

- a. Pressure related to conflicts of interest, for example, pressure from a family member bidding to act as a vendor to the *member's employing organization* to select that vendor over another prospective vendor

Refer to the "Conflicts of Interest for Members in Business" interpretation [2.110.010] for additional guidance.

- b. Pressure to influence presentation of information:
 - i. Pressure to report misleading financial results to meet investor, analyst, or lender expectations.
 - ii. Pressure from elected officials on government accountants to misrepresent programs or projects to voters.
 - iii. Pressure from colleagues to misstate income, expenditure, or rates of return to bias decision-making on capital projects and acquisitions.
 - iv. Pressure from superiors to approve or process expenditures that are not legitimate business expenses.
 - v. Pressure to suppress internal audit reports containing adverse findings.

Refer to the "Knowing Misrepresentations in the Preparation and Presentation of Information" interpretation [2.130.010] for additional guidance.

- c. Pressure to act without sufficient competence or due care:
 - i. Pressure from superiors to inappropriately reduce the extent of work performed.
 - ii. Pressure from superiors to perform a task without sufficient skills or training or within unrealistic deadlines.

Refer to the "General Standards Rule" [2.300.001] for additional guidance.

- d. Pressure related to *financial interests*. For example, pressure to manipulate performance indicators from superiors, colleagues or others, such as those who may benefit from participation in compensation or incentive arrangements.
- e. Pressure related to gifts or entertainment:
 - i. Pressure from others, either internal or external to the *employing organization*, to offer gifts or entertainment to inappropriately influence the judgment or decision-making process of an individual or organization.
 - ii. Pressure from colleagues to accept inappropriate gifts or entertainment from potential vendors in a bidding process.

Refer to the "Offering or Accepting Gifts or Entertainment" interpretation [2.120.010] for additional guidance.

.05 In determining whether the pressure could result in a breach of the "Integrity and Objectivity Rule" [2.100.001], the *member* might consider factors including the following:

- a. The intent of the individual who is exerting the pressure and the nature and significance of the pressure.
- b. The application of relevant laws, regulations, and professional standards to the circumstances.
- c. The culture and leadership of the *employing organization* including the extent to which it emphasizes the importance of ethical behavior and the expectation that employees will act in an ethical manner. For example, a corporate culture that tolerates unethical behavior may increase the likelihood that the pressure would result in a breach of the rules.
- d. Policies and procedures, if any, that the *employing organization* has established, such as ethics or human resources policies that address pressure.

.06 In considering the factors in paragraph .05 along with other factors, and being alert to the requirements of the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070], the *member* may consult with the following:

- a. A colleague, superior, human resources personnel, internal compliance personnel, or another professional accountant.
- b. Relevant professional or regulatory bodies or industry associations.
- c. Legal counsel.

.07 If the *member* determines that the pressure would result in a breach of the "Integrity and Objectivity Rule" [2.100.001], the *member* might consider *safeguards*, including these:

- a. Discussing the matter with the individual who is exerting the pressure to seek to resolve it.
- b. Discussing the matter with the *member's* supervisor if the supervisor is not the individual exerting the pressure.
- c. Escalating the matter within the *employing organization*, for example, with higher levels of management, internal or external auditors, or *those charged with governance*, including independent

directors and, when appropriate, explaining any consequential risks to the organization.

- d. Requesting restructuring or segregating certain responsibilities and duties so that the *member* is no longer involved with the individual or entity exerting the pressure, when doing so would eliminate the pressure to breach the "Integrity and Objectivity Rule." For example, if a *member* is pressured in relation to a conflict of interest, the pressure to breach the rule may be eliminated if the *member* avoids being associated with the matter creating the conflict.
- e. Disclosing the matter in accordance with the *employing organization's* policies, including ethics and whistleblowing policies, using any established mechanism, such as a confidential ethics hotline.
- f. Consulting with legal counsel.

.08 In situations in which the *member* determines that the pressure to breach the "Integrity and Objectivity Rule" [2.100.001] has not been eliminated, the *member* should do the following:

- a. Decline to undertake or discontinue the professional activity that would result in a breach of the rule.
- b. Consider whether to continue a relationship with the *employing organization*.

.09 The *member* is also encouraged to document the facts, the communications, the courses of action considered, the parties with whom these matters were discussed, and how the matter was addressed.

Effective Date

.10 This interpretation is effective August 31, 2017.

2.180 Responding to Noncompliance With Laws and Regulations

2.180.010 Responding to Noncompliance With Laws and Regulations

Introduction

.01 When a *member in business* encounters or is made aware of noncompliance or suspected noncompliance with laws and regulations in the course of carrying out *professional services*, *threats* to compliance with the "Integrity and Objectivity Rule" [2.100.001] may exist. The purpose of this interpretation is to set out the *member's* responsibilities when encountering such noncompliance or suspected noncompliance and guide the *member* in evaluating the implications of the matter and the possible courses of action when responding to it. This interpretation applies regardless of the nature of the *employing organization*.

.02 Noncompliance with laws and regulations (noncompliance) comprises acts of omission or commission, intentional or unintentional, that are contrary to the prevailing laws or regulations and are committed by the *member's employing organization* or by *those charged with governance*, by management, or by other individuals working for or under the direction of the *employing organization*.

.03 When responding to noncompliance or suspected noncompliance in the course of carrying out *professional services*, the *member* should consider

the *member's* obligations under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070] of the "Acts Discreditable Rule" [2.400.001]. For example, a *member* should not disclose the noncompliance or suspected noncompliance to a third party without the employer's consent unless expressly permitted under the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070], such as when reporting the noncompliance or suspected noncompliance to a regulatory authority in order to comply with applicable laws and regulations, as discussed in paragraph .04.

.04 Some regulators, for example, the SEC or state boards of accountancy, may have regulatory provisions governing how a *member* should address noncompliance or suspected noncompliance which may differ from or go beyond this interpretation. In some circumstances, state and federal civil and criminal laws may also impose additional requirements. When encountering noncompliance or suspected noncompliance, a *member* has a responsibility to obtain an understanding of those legal or regulatory provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the relevant party prior to making any disclosure.

.05 A distinguishing mark of the accounting profession is its acceptance of the responsibility to act in the public interest. When responding to noncompliance or suspected noncompliance, the objectives of a *member* are as follows:

- a. To comply with the "Integrity and Objectivity Rule" [2.100.001]
- b. To alert management or, when appropriate, *those charged with governance* of the *employing organization*, to enable them to
 - i. rectify, remediate, or mitigate the consequences of the identified or suspected noncompliance or
 - ii. deter the commission of the noncompliance when it has not yet occurred
- c. To take such further action as appropriate in the public interest
- d. To comply with applicable laws, regulations, and the "Compliance With Standards Rule" [2.310.001]

Applicability

.06 This interpretation does not apply to the following:

- a. Personal misconduct unrelated to the business activities of the *employing organization*
- b. Noncompliance by parties other than
 - i. the *employing organization*,
 - ii. *those charged with governance*,
 - iii. management, or
 - iv. other individuals working for or under the direction of the *employing organization*.
- c. The provision of professional services by a *member in business* involving the following:
 - i. A litigation or investigation as defined in AICPA Statement on Standards for Forensic Services No. 1.
 - ii. A matter where the purpose is to identify, reach a conclusion regarding, or otherwise respond to a known or potential NOCLAR.

- iii. A matter pursuant to which the protections set forth in IRC Section 7525 or any comparable state or local statutes apply.
- iv. A matter where compliance with this interpretation would cause a violation of law or regulation.

A *member* may nevertheless find the guidance in this interpretation helpful in considering how to respond in these situations.

Scope

.07 This interpretation sets out the approach to be taken by a *member* who encounters or is made aware of noncompliance or suspected noncompliance with the following:

- a. Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the *employing organization's financial statements*
- b. Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the *employing organization's financial statements*, but compliance with which may be fundamental to the operating aspects of the *employing organization's* business, to its ability to continue its business, or to avoid material penalties

.08 Examples of laws and regulations which this interpretation addresses may include those that deal with the following:

- a. Fraud, corruption, and bribery
- b. Money laundering
- c. Securities markets and trading
- d. Banking and other financial products and services
- e. Data protection
- f. Tax and pension liabilities and payments
- g. Environmental protection
- h. Public health and safety

.09 Noncompliance may result in fines, litigation, or other consequences for the *employing organization* that may have a material effect on its *financial statements*. Importantly, such noncompliance may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees, or the general public. For the purposes of this interpretation, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or nonfinancial terms.

.10 A *member* who encounters or is made aware of matters that are clearly inconsequential is not required to comply with this interpretation with respect to such matters.

Responsibilities of the Employing Organization's Management and Those Charged With Governance

.11 It is the responsibility of the *employing organization's* management, with the oversight of *those charged with governance*, to ensure that the *employing organization's* business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and *those charged with governance* to identify and address any noncompliance by the *employing organization* or by an individual charged with governance of the entity, by a

member of management, or by other individuals working for or under the direction of the *employing organization*.

Responsibilities of Members in Business

.12 Many *employing organizations* have established protocols and procedures (for example, an ethics policy or internal whistleblowing mechanism) regarding how noncompliance or suspected noncompliance by the *employing organization* should be raised internally. Such protocols and procedures may allow for matters to be reported anonymously through designated channels. If these protocols and procedures exist within the *member's employing organization*, the *member* should consider them in determining how to respond to such noncompliance.

.13 When a *member* becomes aware of a matter to which this interpretation applies, the *member* should take timely steps to comply with this interpretation, taking into account the *member's* understanding of the nature of the matter and the potential harm to the interests of the *employing organization*, investors, creditors, employees, or the general public.

Responsibilities of Members Who Are Senior Professional Accountants in Business

.14 *Members* who are senior professional accountants in business are directors, officers, or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment, and control of the *employing organization's* human, financial, technological, physical, and intangible resources. Because of their roles, positions, and spheres of influence within the *employing organization*, there is a greater expectation for them to take whatever action is appropriate in the public interest to respond to noncompliance or suspected noncompliance than other professional accountants within the *employing organization*.

.15 *Obtaining an understanding of the matter.* If, in the course of carrying out *professional services*, a *member* who is a senior professional accountant becomes aware of credible information concerning an instance of noncompliance or suspected noncompliance, the *member* should obtain an understanding of the matter, including the following:

- a. The nature of the act and the circumstances in which it has occurred or is likely to occur
- b. The application of the relevant laws and regulations to the circumstances
- c. The potential consequences to the *employing organization*, investors, creditors, employees, or the wider public

.16 A *member* who is a senior professional accountant is expected to apply knowledge, professional judgment, and expertise but is not expected to have a level of understanding of laws and regulations beyond that required for the *member's* role within the *employing organization*. Whether an act constitutes noncompliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

.17 Depending on the nature and significance of the matter, the *member* may cause, or take appropriate steps to cause, the matter to be investigated internally.

.18 *Addressing the matter.* If the *member* who is a senior professional accountant identifies or suspects that noncompliance has occurred or may

occur, the *member* should, subject to paragraph .12, discuss the matter with the *member's* immediate superior, if any, to determine how the matter should be addressed. If the *member's* immediate superior appears to be involved in the matter, the *member* should discuss the matter with the next higher level of authority within the *employing organization*.

.19 The *member* who is a senior professional accountant should take the appropriate steps to

- a. have the matter communicated to *those charged with governance* to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities.
- b. comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of noncompliance or suspected noncompliance to an appropriate authority.
- c. have the consequences of the noncompliance or suspected noncompliance rectified, remediated, or mitigated.
- d. reduce the risk of reoccurrence.
- e. seek to deter the commission of the noncompliance if it has not yet occurred.

.20 In addition to responding to the matter in accordance with the provisions of this section, the *member* who is a senior professional accountant should disclose the matter to the *employing organization's* external auditor, if any, if the *member* determines such disclosure is necessary pursuant to the *member's* obligation to provide all information necessary to enable the auditor to perform the audit. See the "Obligation of a Member to His or Her Employer's External Accountant" interpretation [2.130.030] of the "Integrity and Objectivity Rule" [2.100.001] for additional guidance.

.21 *Determining whether further action is necessary.* The *member* who is a senior professional accountant should evaluate the appropriateness of the response of the *member's* superiors, if any, and *those charged with governance*.

.22 Relevant factors to consider in evaluating the appropriateness of the response of the *member's* superiors, where applicable, and *those charged with governance* may include whether

- a. the response is timely.
- b. they have taken or authorized appropriate action to seek to rectify, remediate, or mitigate the consequences of the noncompliance, or to avert the noncompliance if it has not yet occurred.
- c. the matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

.23 In light of the response of the *member's* superiors, if applicable, and *those charged with governance*, the *member* should determine if further action is necessary in the public interest. The determination of whether further action is necessary, and the nature and extent of it, may depend on various factors, including these:

- a. The legal and regulatory framework
- b. The urgency of the matter
- c. The pervasiveness of the matter throughout the *employing organization*

- d. Whether the *member* who is a senior professional accountant continues to have confidence in the integrity of the *member's* superiors and, if applicable, *those charged with governance*
- e. Whether the noncompliance or suspected noncompliance is likely to reoccur
- f. Whether there is credible evidence of actual or potential substantial harm to the interests of the *employing organization*, investors, creditors, employees, or the general public

.24 Examples of circumstances that may cause the *member* who is a senior professional accountant no longer to have confidence in the integrity of the *member's* superiors, if applicable, and *those charged with governance* include situations such as the following:

- a. The *member* suspects or has evidence of management's involvement or intended involvement in any noncompliance.
- b. Contrary to legal or regulatory requirements, management has not reported the matter, or authorized the matter to be reported, to an appropriate authority within a reasonable period.

.25 Further action by the *member* who is a senior professional accountant may include the following:

- a. Informing the management of the parent entity of the matter if the *employing organization* is a member of a group
- b. Resigning from the *employing organization*
- c. Reporting the noncompliance or suspected noncompliance to an appropriate authority unless prohibited by laws or regulations

.26 When the *member* who is a senior professional accountant determines that resigning from the *employing organization* would be appropriate, doing so would not be a substitute for taking other actions that may be necessary to achieve the member's objectives under this section.

.27 The determination of whether to disclose the matter to an appropriate authority may also depend on external factors such as the following:

- a. Whether there is an appropriate authority that is able to receive the information and cause the matter to be investigated and action to be taken. Identifying an appropriate authority will depend upon the nature of the matter. For example, an appropriate authority could be a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
- b. Whether there exists robust and credible protection from civil, criminal, or professional liability or retaliation afforded by legislation or regulation, such as under whistleblowing legislation or regulation.
- c. Whether there are actual or potential threats to the physical safety of the senior professional accountant or other individuals.

.28 As consideration of the matter may involve complex analysis and judgments, the *member* who is a senior professional accountant may want to consider consulting internally or externally, including obtaining legal or other advice to understand the *member's* options and the implications of taking any particular course of action.

.29 Documentation. In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the *member* who is a senior professional accountant is encouraged to have the following matters documented:

- a. The matter
- b. The results of discussions with the *member's* superiors, where applicable, and *those charged with governance* and other parties
- c. How the *member's* superiors, where applicable, and *those charged with governance* have responded to the matter
- d. The judgments made and the courses of action the *member* took
- e. How the *member* is satisfied that the *member* has fulfilled the responsibility set out in paragraph .23

Responsibilities of Members Other Than Those Who Are Senior Professional Accountants in Business

.30 If, in the course of carrying out *professional services*, a *member* becomes aware of information concerning an instance of noncompliance or suspected noncompliance, the *member* should seek to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.

.31 The *member* is expected to apply knowledge, professional judgment, and expertise but is not expected to have a level of understanding of laws and regulations beyond that required for the *member's* role within the *employing organization*. Whether an act constitutes noncompliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

.32 If the *member* identifies or suspects that noncompliance has occurred or may occur, the *member* should, subject to paragraph .12, inform an immediate superior to enable the superior to take appropriate action. If the *member's* immediate superior appears to be involved in the matter, the *member* should inform the next higher level of authority within the *employing organization*.

.33 In addition to responding to the matter in accordance with the provisions of this section, the *member* should disclose the matter to the *employing organization's* external auditor, if any, if the *member* determines such disclosure is necessary pursuant to the *member's* obligation to provide all information necessary to enable the auditor to perform the audit. See the "Obligation of a Member to His or Her Employer's External Accountant" interpretation [2.130.030] for additional guidance.

.34 Further action by the *member* may include reporting the noncompliance or suspected noncompliance to an appropriate authority unless prohibited by laws or regulations. In determining whether to disclose the matter to an appropriate authority, the *member* may consider the factors in paragraph .27.

.35 Documentation. In relation to an identified or suspected act of noncompliance that falls within the scope of this section, the *member* is encouraged to have the following matters documented:

- a. The matter
- b. The results of discussions with the *member's* superior; management and, where applicable, *those charged with governance*; and other parties
- c. How the *member's* superior has responded to the matter
- d. The judgments made and the courses of action the *member* took

Effective Date

.36 This interpretation is effective June 30, 2023. Early implementation is allowed.

2.300 General Standards**2.300.001 General Standards Rule**

.01 A *member* shall comply with the following standards and with any *interpretations* thereof by bodies designated by *Council*.

- a. *Professional Competence*. Undertake only those *professional services* that the *member* or the *member's firm* can reasonably expect to be completed with professional competence.
- b. *Due Professional Care*. Exercise due professional care in the performance of *professional services*.
- c. *Planning and Supervision*. Adequately plan and supervise the performance of *professional services*.
- d. *Sufficient Relevant Data*. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any *professional services* performed.

.02 See appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 201]

Interpretations Under the General Standards Rule**2.300.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts**

.01 In the absence of an *interpretation* of the "General Standards Rule" [2.300.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "General Standards Rule" [2.300.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional and legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

2.300.010 Competence

.01 Competence, in this context, means that the *member* or *member's* staff possesses the appropriate technical qualifications to perform *professional*

services and, as required, supervises and evaluates the quality of work performed. Competence encompasses knowledge of the profession's standards, the techniques and technical subject matter involved, and the ability to exercise sound judgment in applying such knowledge in the performance of *professional services*.

.02 A *member's* agreement to perform *professional services* implies that the *member* has the necessary competence to complete those services according to professional standards and to apply the *member's* knowledge and skill with reasonable care and diligence. However, the *member* does not assume a responsibility for infallibility of knowledge or judgment.

.03 The *member* may have the knowledge required to complete the services in accordance with professional standards prior to performance. A normal part of providing professional services involves performing additional research or consulting with others to gain sufficient competence.

.04 If a *member* is unable to gain sufficient competence, the *member* should suggest the involvement of a competent person to perform the needed *professional service*, either independently or as an associate. [Prior reference: paragraph .02 of ET section 201]

2.300.030 Submission of Financial Statements

.01 When a *member* is a stockholder, a *partner*, a director, an officer, or an employee of an entity and, in this capacity, prepares or submits the entity's *financial statements* to third parties, the *member* should clearly communicate, preferably in writing, the *member's* relationship to the entity and should not imply that the *member* is independent of the entity. In addition, if the communication states affirmatively that the *financial statements* are presented in conformity with the applicable financial reporting framework, the *member* should comply with the "Accounting Principles Rule" [2.320.001].

.02 Refer to the "Use of CPA Credential" interpretation [2.400.100] of the "Acts Discreditable Rule" [2.400.001] for additional guidance. [Prior reference: paragraphs .019–.020 of ET section 291]

2.310 Compliance With Standards

2.310.001 Compliance With Standards Rule

.01 A *member* who performs auditing, review, compilation, management consulting, tax, or other *professional services* shall comply with standards promulgated by bodies designated by *Council*.

.02 See appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 202]

A nonauthoritative question and answer regarding use of standards that have not been established by a body designated by AICPA Council is available in the FAQ at <https://us.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf>.

Interpretations Under the Compliance with Standards Rule

2.310.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Compliance With Standards Rule" [2.310.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010]

.02 A *member* would be considered in violation of the "Compliance With Standards Rule" [2.310.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015, and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

2.320 Accounting Principles

2.320.001 Accounting Principles Rule

.01 A *member* shall not (1) express an opinion or state affirmatively that the *financial statements* or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by *Council* to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the *member* can demonstrate that due to unusual circumstances the *financial statements* or data would otherwise have been misleading, the *member* can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

.02 See appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards." [Prior reference: paragraph .01 of ET section 203]

Interpretations Under the Accounting Principles Rule

2.320.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Accounting Principles Rule" [2.320.001] that addresses a particular relationship or circumstance, a

member should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "Accounting Principles Rule" [2.320.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to following an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed provided the member has implemented the revised code. Paragraph .03 is effective December 15, 2014.

2.320.010 Responsibility for Affirming That Financial Statements Are in Conformity With the Applicable Financial Reporting Framework

.01 A *member* shall not state affirmatively that an entity's *financial statements* or other financial data are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by *Council* to establish such principles. *Members* who affirm that *financial statements* or other financial data are presented in conformity with GAAP should comply with the "Accounting Principles Rule" [2.320.001]. A *member's* representation in a letter or other communication that an entity's *financial statements* are in conformity with GAAP may be considered an affirmative statement within the meaning of this rule with respect to the *member* who signed the letter or other communication (for example, the *member* signed a report to a regulatory authority, a creditor, or an auditor). [Prior reference: paragraph .05 ET section 203]

2.320.020 Status of Financial Accounting Standards Board, Governmental Accounting Standards Board, Federal Accounting Standards Advisory Board, and International Accounting Standards Board Interpretations

.01 The "Accounting Principles Rule" [2.320.001] authorizes *Council* to designate bodies to establish accounting principles. *Council* has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB *Accounting Standards Codification* (ASC) constitutes accounting principles as contemplated in the rule. *Council* designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities, pursuant to the "Accounting Principles Rule." *Council* designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities, pursuant to the "Accounting Principles Rule."

Council designated the International Accounting Standards Board (IASB) as an accounting body for purposes of establishing international financial accounting and reporting principles.

.02 Reference to GAAP in the "Accounting Principles Rule" [2.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in paragraph .01 and in appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards."

.03 The Professional Ethics Division will look to the codification or statements and any interpretations thereof issued by FASB, GASB, FASAB, or IASB in determining whether a *member* has departed from an accounting principle established by a designated accounting standard-setter in FASB ASC, a Statement of Governmental Accounting Standards, a Statement of Federal Accounting Standards, or International Financial Reporting Standards (IFRS). [Prior reference: paragraph .03 of ET section 203]

2.320.030 Departures From Generally Accepted Accounting Principles

.01 It is difficult to anticipate all the circumstances in which accounting principles may be applied. However, there is a strong presumption that adherence to GAAP would, in nearly all instances, result in *financial statements* that are not misleading. The "Accounting Principles Rule" [2.320.001] recognizes that, upon occasion, there may be unusual circumstances when the literal application of GAAP would have the effect of rendering *financial statements* misleading. In such cases, the proper accounting treatment to apply is that which will not render the *financial statements* misleading.

.02 The question of what constitutes unusual circumstances, as referred to in the "Accounting Principles Rule" [2.320.001], is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle within GAAP would be regarded generally by reasonable persons as producing misleading *financial statements*.

.03 Examples of circumstances that may justify a departure from GAAP include new legislation or evolution of a new form of business transaction. Examples of circumstances that would not justify departures from GAAP include an unusual degree of materiality or conflicting industry practices. [Prior reference: paragraph .02 of ET section 203]

.04 If the statements or data contain such departures, see the "Accounting Principles Rule" [2.320.001] for further guidance.

2.320.040 Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other Than GAAP

.01 Reference to GAAP in the "Accounting Principles Rule" [2.320.001] means those accounting principles promulgated by bodies designated by *Council*, which are listed in appendix A. The bodies designed by *Council* to promulgate accounting principles are

- a. FASAB,
- b. FASB,
- c. GASB, and
- d. IASB.

.02 *Financial statements* prepared pursuant to other accounting principles would be considered financial reporting frameworks other than GAAP within the context of the "Accounting Principles Rule" [2.320.001].

.03 However, the "Accounting Principles Rule" [2.320.001] does not preclude a *member* from preparing or reporting on *financial statements* that have been prepared pursuant to financial reporting frameworks other than GAAP, such as

- a. financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the entity's *financial statements* do not meet the requirements for full compliance with IFRS, as promulgated by the IASB;
- b. financial reporting frameworks prescribed by an agreement or a contract; or
- c. other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign governmental regulatory body to whose jurisdiction the entity is subject.

.04 In such circumstances, however, the *financial statements* or *member's* reports thereon should not purport that the *financial statements* are in accordance with GAAP and the *financial statements* or reports on those *financial statements*, or both, should clarify the financial reporting framework(s) used. [Prior reference: paragraph .06 of ET section 203]

2.400 Acts Discreditable

2.400.001 Acts Discreditable Rule

.01 A *member* shall not commit an act discreditable to the profession. [Prior reference: paragraph .01 of ET section 501]

Interpretations Under the Acts Discreditable Rule

2.400.005 Application of the Conceptual Framework for Members in Business and Ethical Conflicts

.01 In the absence of an *interpretation* of the "Acts Discreditable Rule" [2.400.001] that addresses a particular relationship or circumstance, a *member* should apply the "Conceptual Framework for Members in Business" [2.000.010].

.02 A *member* would be considered in violation of the "Acts Discreditable Rule" [2.400.001] if the *member* cannot demonstrate that *safeguards* were applied that eliminated or reduced significant *threats* to an *acceptable level*.

.03 A *member* should consider the guidance in "Ethical Conflicts" [2.000.020] when addressing ethical conflicts that may arise when the *member* encounters obstacles to follow an appropriate course of action. Such obstacles may be due to internal or external pressures or to conflicts in applying relevant professional standards or legal standards, or both. [No prior reference: new content]

Effective Date

.04 Paragraphs .01 and .02 are effective December 15, 2015 and early implementation is allowed. Paragraph .03 is effective December 15, 2014.

2.400.010 Discrimination and Harassment in Employment Practices

.01 A *member* would be presumed to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [2.400.001] if a final determination, no longer subject to appeal, is made by a court or an administrative agency of competent jurisdiction that a *member* has violated any antidiscrimination laws of the United States, state, or municipality, including those related to sexual and other forms of harassment. [Prior reference: paragraph .03 of ET section 501]

2.400.020 Solicitation or Disclosure of CPA Examination Questions and Answers

.01 A *member* who solicits or knowingly discloses the Uniform CPA Examination question(s) or answer(s), or both, without the AICPA's written authorization shall be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .07 of ET section 501]

2.400.030 Failure to File a Tax Return or Pay a Tax Liability

.01 A *member* who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the *member's* personal tax returns or tax returns for the *member's* employer that the *member* has the authority to timely file or (b) the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .08 of ET section 501]

2.400.040 Negligence in the Preparation of Financial Statements or Records

.01 A *member* shall be considered in violation of the "Acts Discreditable Rule" [2.400.001] if the *member*, by virtue of his or her negligence, does any of the following:

- a. Makes, or permits or directs another to make, materially false and misleading entries in the *financial statements* or records of an entity.
- b. Fails to correct an entity's *financial statements* that are materially false and misleading when the *member* has the authority to record an entry.
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .05 of ET section 501]

2.400.050 Governmental Bodies, Commissions, or Other Regulatory Agencies

.01 Many governmental bodies, commissions, or other regulatory agencies have established requirements, such as standards, guides, rules, and regulations, that *members* are required to follow in the preparation of *financial statements* or related information. For example, the SEC, the Federal Communications Commission, state insurance commissions, and other regulatory agencies have established such requirements.

.02 If a *member* prepares *financial statements* or related information (for example, management's discussion and analysis) for purposes of reporting to such bodies, commissions, or regulatory agencies, the *member* should follow the requirements of such organizations in addition to the applicable financial reporting framework.

.03 A *member's* material departure from such requirements would be considered a violation of the "Acts Discreditable Rule" [2.400.001] unless the *member* discloses in the *financial statements* or related information that such requirements were not followed and the applicable reasons. [Prior reference: paragraph .06 of ET section 501]

2.400.060 Indemnification and Limitation of Liability Provisions

.01 Certain governmental bodies, commissions, or other regulatory agencies (collectively, regulators) have established requirements through laws, regulations, or published interpretations that

- a. prohibit entities subject to their regulation (regulated entity) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators; or
- b. provide that the existence of such provisions disqualifies a *member* from rendering such services to these entities.

For example, federal banking regulators, state insurance commissions, and the SEC have established such requirements.

.02 If a *member* enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the *member* should not include, or knowingly permit or direct another individual to include, an indemnification or limitation of liability provision that would cause the regulated entity or a *member* to be in violation of such requirements or disqualify a *member* from providing such services to the regulated entity. A *member* who enters into, or directs or knowingly permits another individual to enter into, such an agreement for the performance of audit or other attest services would be considered in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .09 of ET section 501]

2.400.070 Confidential Information Obtained From Employment or Volunteer Activities

.01 A *member* should maintain the confidentiality of his or her employer's confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the *member* is working in a volunteer capacity).

.02 For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the *member* may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

.03 A *member* should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or *close relative* or *immediate family member*. The *member* should also take reasonable steps to ensure that staff

under his or her control or others within the *employing organization* and persons from whom advice and assistance are obtained are aware of the confidential nature of the information.

.04 When a *member* changes employment, a *member* should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer's confidential information continues even after the end of the relationship between a *member* and the employer. However, the *member* is entitled to use experience and expertise gained through prior employment relationships.

.05 A *member* would be considered in violation of the "Acts Discreditable Rule" [2.400.001] if the *member* discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the employer or organization for whom the *member* may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

.06 The following are examples of situations in which *members* are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
 - i. comply with a validly issued and enforceable subpoena or summons or
 - ii. inform the appropriate public authorities of violations of law that have been discovered.
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
 - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;
 - ii. protect the *member's* professional interests in legal proceedings;
 - iii. comply with professional standards and other ethics requirements; or
 - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the employer to
 - i. obtain financing with lenders;
 - ii. communicate with vendors, *clients*, and customers; or
 - iii. communicate with the employer's external accountant, attorneys, regulators, and other business professionals.

.07 In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated

conclusions, the member should use professional judgment in determining the type of disclosure to be made, if any.

- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

.08 A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

.09 Refer to the "Subordination of Judgment" interpretation [2.130.020] of the "Integrity and Objectivity Rule" [2.100.001] for additional guidance. [Prior reference: paragraph .10 of ET section 501]

2.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services

.01 A *member* would be in violation of the "Acts Discreditable Rule" [2.400.001] if the *member* promotes or markets the *member's* abilities to provide *professional services* or makes claims about the *member's* experience or qualifications in a manner that is false, misleading, or deceptive.

.02 Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body. [Prior reference: paragraph .11 of ET section 501]

2.400.100 Use of the CPA Credential

.01 A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [2.400.001]. [Prior reference: paragraph .12 of ET section 501].

ET Part 3***Other Members***

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3.000 Introduction

.01 Part 3 of the Code of Professional Conduct (the code) applies to *members* who are not in *public practice* and are not *members in business*. Accordingly, when the term *member* is used in part 3 of the code, the requirements apply only to such *members*. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

3.000.030 Applicability

.01 Part 3 of the code applies to *members* who are neither *members in public practice* nor *members in business*, for example *members* who are retired or not currently employed. These *members* are subject to the "Acts Discreditable Rule" [3.400.001]. [No prior reference: new content]

Effective Date

.02 Effective December 15, 2014.

3.400 Acts Discreditable

3.400.001 Acts Discreditable Rule

.01 A *member* shall not commit an act discreditable to the profession. [Prior reference: paragraph .01 of ET section 501]

Interpretations Under the Acts Discreditable Rule

3.400.010 Discrimination and Harassment in Employment Practices

.01 A *member* would be presumed to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [3.400.001] if a final determination, no longer subject to appeal, is made by a court or an administrative agency of competent jurisdiction that a *member* has violated any antidiscrimination laws of the United States, state, or municipality, including those related to sexual and other forms of harassment. [Prior reference: paragraph .03 of ET section 501]

3.400.020 Solicitation or Disclosure of CPA Examination Questions and Answers

.01 A *member* who solicits or knowingly discloses the Uniform CPA Examination question(s) or answer(s), or both, without the AICPA's written authorization shall be considered to have committed an act discreditable to the profession, in violation of the "Acts Discreditable Rule" [3.400.001]. [Prior reference: paragraph .07 of ET section 501]

3.400.030 Failure to File a Tax Return or Pay a Tax Liability

.01 A *member* who fails to comply with applicable federal, state, or local laws or regulations regarding (a) the timely filing of the *member's* personal tax returns or (b) the timely remittance of all payroll and other taxes collected on behalf of others may be considered to have committed an act discreditable to

the profession, in violation of the "Acts Discreditable Rule" [3.400.001]. [Prior reference: paragraph .08 of ET section 501]

3.400.070 Confidential Information Obtained From Former Employment or Previous Volunteer Activities

.01 A *member* should maintain the confidentiality of his or her former employer's confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer's vendors, customers, or lenders (for example, any confidential information pertaining to a previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the *member* worked in a volunteer capacity).

.02 For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the former employer or any organization for whom the *member* may have worked in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

.03 A *member* should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or *close relative* or *immediate family member*.

.04 A *member* should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer's confidential information continues even after the end of the relationship between a *member* and the employer. However, the *member* is entitled to use experience and expertise gained through prior employment relationships.

.05 A *member* would be considered in violation of the "Acts Discreditable Rule" [3.400.001] if the *member* discloses or uses any confidential employer information acquired as a result of former employment or volunteer relationships without the proper authority or specific consent of the former employer or organization for whom the *member* may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

.06 The following are examples of situations in which *members* are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the former employer.
- b. Disclosure is required by law, for example, to
 - i. comply with a validly issued and enforceable subpoena or summons or
 - ii. inform the appropriate public authorities of violations of law that have been discovered.
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
 - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;

- ii. protect the *member's* professional interests in legal proceedings;
 - iii. comply with professional standards and other ethics requirements; or
 - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the former employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the former employer to
- i. obtain financing with lenders;
 - ii. communicate with vendors, *clients*, and customers; or
 - iii. communicate with the former employer's external accountant, attorneys, regulators, and other business professionals.

.07 In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, the member should use professional judgment in determining the type of disclosure to be made, if any.
- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

.08 A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information. [Prior reference: paragraph .10 of ET section 501]

3.400.090 False, Misleading, or Deceptive Acts in Promoting or Marketing Services

.01 A *member* would be in violation of the "Acts Discreditable Rule" [3.400.001] if the *member* promotes or markets the *member's* abilities to provide services or makes claims about the *member's* experience or qualifications in a manner that is false, misleading, or deceptive.

.02 Promotional efforts would be false, misleading, or deceptive if they contain any claim or representation that would likely cause a reasonable person to be misled or deceived. This includes any representation about CPA licensure or any other professional certification or accreditation that is not in compliance with the requirements of the relevant licensing authority or designating body. [No prior reference: new content]

Effective Date

.03 Effective December 15, 2014.

3.400.100 Use of the CPA Credential

.01 A *member* should refer to applicable state accountancy laws and board of accountancy rules and regulations for guidance regarding the use of the

CPA credential. A *member* who fails to follow the accountancy laws, rules, and regulations on use of the CPA credential in any of the jurisdictions in which the CPA practices would be considered to have used the CPA credential in a manner that is false, misleading, or deceptive and in violation of the "Acts Discreditable Rule" [3.400.001]. [Prior reference: paragraph .12 of ET section 501]

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ET Appendix A

Council Resolution Designating Bodies to Promulgate Technical Standards

[As amended January 12, 1988; Revised April 1992, October 1999, May 2004, October 2007, May 2008, October 2012, May 2013, and May 20, 2018.]

Federal Accounting Standards Advisory Board

RESOLVED: That the Federal Accounting Standards Advisory Board, with respect to its statements of federal accounting standards and concepts adopted and issued in March of 1993 and subsequently, in accordance with its rules of procedure, the memorandum of understanding, and public notice designating FASAB's standards and concepts as having substantial authoritative support, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for federal governmental entities pursuant to the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code.¹

[Added by *Council* October 1999.]

Financial Accounting Standards Board

WHEREAS: In 1959 the *Council* designated the Accounting Principles Board to establish accounting principles, and

WHEREAS: The *Council* is advised that the Financial Accounting Standards Board (FASB) has become operational, it is

RESOLVED: That as of the date hereof the FASB, in respect of statements of financial accounting standards finally adopted by such board in accordance with its rules of procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this *Council* as the body to establish accounting principles pursuant to the "Accounting Principles Rule," (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) and standards on disclosure of financial information for such entities outside *financial statements* in published financial reports containing *financial statements* under the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct of the American Institute of Certified Public Accountants provided, however, any accounting research bulletins, or opinions of the accounting principles board issued or approved for exposure by the accounting principles board prior to April 1, 1973, and finally adopted by such board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by *Council* as contemplated in the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code unless and until such time as they are expressly superseded by action of the FASB.¹

¹ The changes to this appendix as of December 15, 2014, are administrative changes that were made to conform to the reformatted Code of Professional Conduct.

Governmental Accounting Standards Board

WHEREAS: The Governmental Accounting Standards Board (GASB) has been established by the board of trustees of the Financial Accounting Foundation (FAF) to issue standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities, and

WHEREAS: The American Institute of Certified Public Accountants is a signatory to the agreement creating the GASB as an arm of the FAF and has supported the GASB professionally and financially, it is

RESOLVED: That as of the date hereof, the GASB, with respect to statements of governmental accounting standards adopted and issued in July 1984 and subsequently, in accordance with its rules of procedure and the bylaws of the FAF, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for state and local governmental entities, pursuant to the "Accounting Principles Rule" (AICPA, *Professional Standards*, ET sec. 1.320.001 and 2.320.001) of the Code of Professional Conduct, and standards on disclosure of financial information for such entities outside *financial statements* in published financial reports containing *financial statements* under the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct.¹

Public Company Accounting Oversight Board

WHEREAS: The Public Company Accounting Oversight Board (PCAOB) has been established pursuant to the Sarbanes-Oxley Act of 2002 (the Act), and

WHEREAS: The PCAOB has authority under the Act to establish or adopt, or both, by PCAOB rule, auditing and related attestation standards, quality control, ethics, *independence* and other standards relating to the preparation and issuance of audit reports for issuers as defined in the Act.

RESOLVED: That the PCAOB be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act pursuant to the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct.¹

[Added by *Council* May 2004.]

International Accounting Standards Board

WHEREAS, At its Spring, 2008 meeting, the *Council* resolved that the International Accounting Standards Board (IASB) be designated as the body which is authorized to establish professional standards with regard to international accounting and reporting principles under the "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001 and 2.320.001) of the AICPA Code of Professional Conduct, with the proviso that Council would, three to five years after such designation, reassess whether continued recognition of the IASB for such purposes is appropriate, and readopted that resolution in May 2013, and

[Added by Council May 19, 2013, amended May 20, 2018.]

¹ The changes to this appendix as of December 15, 2014 are administrative changes that were made to conform to the reformatted Code of Professional Conduct.

WHEREAS, The Council supports the IASB and believes recognition of the IASB as the body authorized to establish professional standards with regard to international accounting and reporting principles under the "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001 and 2.320.001) of the AICPA Code of Professional Conduct should continue; and

[Added by Council May 19, 2013; readopted by Council, May 20, 2018.]

WHEREAS, The Council also believes it should again reassess such recognition three to five years after the effective date of this resolution; now

[Added by Council May 19, 2013; readopted by Council, May 20, 2018.]

BE IT RESOLVED, That the Council hereby readopts the resolutions related to the IASB set out in Appendix A to the Code of Professional Conduct as set out below.

[Added by Council May 19 2013; readopted by Council, May 20, 2018.]

RESOLVED: That the International Accounting Standards Board (IASB) is hereby designated as the body to establish professional standards with respect to international financial accounting and reporting principles pursuant to the "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001 and 2.320.001) of the Code of Professional Conduct; and

BE IT FURTHER RESOLVED: That the Council shall reassess, no sooner than three years but no later than five years after the effective date of this resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under the "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) and the "Accounting Principles Rule" (ET sec. 1.320.001 and 2.320.001) of the Code of Professional Conduct is appropriate.¹

[Added by Council May 18, 2008; readopted by Council, May 19, 2013 and May 20, 2018.]

AICPA COMMITTEES AND BOARDS

WHEREAS: The membership of the *Institute* has adopted the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) of the Code of Professional Conduct, which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is¹

Accounting and Review Services Committee

RESOLVED: That the AICPA accounting and review services committee is hereby designated to promulgate standards under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct with respect to unaudited *financial statements* or other unaudited financial information of an entity that is not required to file *financial statements* with a regulatory agency in connection with the sale or trading of its securities in a public market.¹

¹ See footnote 1 in this paragraph.

Auditing Standards Board

RESOLVED: That, with respect to standards relating to the preparation and issuance of audit reports not included within the resolution on the Public Company Accounting Oversight Board, the AICPA auditing standards board is hereby designated as the body authorized under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct to promulgate auditing, attestation, and quality control standards and procedures.

RESOLVED: That the auditing standards board shall establish under statements on auditing standards, the responsibilities of *members* with respect to standards for disclosure of financial information outside of the *financial statements* in published financial reports containing *financial statements*.¹

[Revised May 2004.]

Management Consulting Services Executive Committee

RESOLVED: That the AICPA management consulting services executive committee is hereby designated to promulgate standards under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct with respect to the offering of management consulting services, provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed.

AND FURTHER RESOLVED: That any *Institute* committee or board now or in the future authorized by the *Council* to issue enforceable standards under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct must observe an exposure process seeking comment from other affected committees and boards, as well as the general membership.¹

[Revised April 1992.]

Attestation Standards

RESOLVED: That the AICPA accounting and review services committee, auditing standards board, and management consulting services executive committee are hereby designated as bodies authorized under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001) of the Code of Professional Conduct to promulgate attestation standards in their respective areas of responsibility.¹

[Added by *Council*, May 1988; revised April 1992.]

Tax Executive Committee

RESOLVED: That the Tax Executive Committee is hereby designated as the body authorized under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001)

¹ The changes to this appendix as of December 15, 2014 are administrative changes that were made to conform to the reformatted Code of Professional Conduct.

of the Code of Professional Conduct to promulgate professional practice standards with respect to tax services.¹

[Added by *Council*, October 1999.]

Forensic and Valuation Services Executive Committee

RESOLVED: That the Forensic and Valuation Services Executive Committee is hereby designated as the body to promulgate professional standards with respect to forensic and valuation services under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.300.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct.¹

[Added by *Council*, October 2007.]

Personal Financial Planning Executive Committee

RESOLVED: That the Personal Financial Planning Executive Committee is hereby designated as the body to promulgate professional standards with respect to personal financial planning services under the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001 and 2.310.001) and the "Compliance With Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.310.001 and 2.310.001) of the Code of Professional Conduct.¹

[Added by *Council*, October 2012.]

ET Appendix B

Council Resolution Concerning the Form of Organization and Name Rule

[As adopted May 23, 1994; revised May 7, 1997, May 15, 2000, May 22, 2006 August 2011, and October 19, 2014.]

A. RESOLVED: That with respect to a *member* engaged in *public practice* in a *firm* or organization which performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards, (2) any review of a *financial statement* performed in accordance with the Statements on Standards for Accounting and Review Services, (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, (4) any engagement to be performed in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB), or (5) any examination, review, or agreed upon procedures engagement to be performed in accordance with the SSAE, other than an examination described in subsection (A) (3), or which holds itself out as a *firm* of certified public accountants or uses the term "certified public accountant(s)" or the designation "CPA" in connection with its name, the characteristics of such a *firm* or organization under the "Form of Organization and Name Rule" (AICPA, *Professional Standards*, ET sec. 1.800.001) of the Code of Professional Conduct are as set forth below:

1. A majority of the ownership of the *member's firm* in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the *firm* or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the *firm* or its affiliates is against the public interest and continues to be prohibited.
2. There must be a CPA who has ultimate responsibility for all the services described in A above, compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, and non-CPA owners could not assume ultimate responsibility for any such services or engagements.
3. Non-CPA owners would be permitted to use the title "principal," "owner," "officer," "member" or "shareholder" or any other title permitted by state law, but not hold themselves out to be CPAs.
4. A *member* shall not knowingly permit a person, whom the *member* has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the *member*, would place the *member* in violation of the rules. Further, a *member*

may be held responsible for the acts of all persons associated with him or her in the *public practice* whom the *member* has the authority or capacity to control.

5. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred, within a reasonable period of time, to the *firm* or to other qualified owners if the owner ceases to be actively engaged in the *firm* or its affiliates.
 6. Non-CPA owners would not be eligible for regular membership in the AICPA, unless they meet the requirements in BL section 2.2.1.
- B. RESOLVED: The characteristics of all other *firms* or organizations are deemed to be whatever is legally permissible under applicable law or regulation, except as otherwise provided in paragraph C below.
- C. RESOLVED: That with respect to a *member* engaged in *public practice* in a *firm* or organization which is not within the description of a *firm* or organization set forth in paragraph A above, but who performs compilations of *financial statements* performed in accordance with the Statements on Standards for Accounting and Review Services, the characteristics of such a *firm* or organization under the "Form of Organization and Name Rule" of the Code are as set forth below.
1. There must be a CPA who has ultimate responsibility for any *financial statement* compilation services provided by the *firm* and by each business unit performing such compilation services and non-CPA owners could not assume ultimate responsibility for any such services.
 2. Any compilation report must be signed individually by a CPA, and may not be signed in the name of the *firm* or organization.
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ET Appendix C

Revision History Table

Revisions made to the Code of Professional Conduct subsequent to June 1, 2014, appear below in the Revision History Table. In addition to identifying the numeric citation for the change, the effective date is identified and a link to the marked version of the content is provided when available. If the revision changes guidance that is already authoritative, the action taken (see "Action" column) will be identified as "revised." If the revision is new guidance, the action taken will be identified as "added."

The "New and Revised Interpretations and Other Guidance" [0.600.010] section and the "Pending Interpretations and Other Guidance" [0.600.020] section provide a listing of current activity.

<i>Appendix C Revision History</i>			
Citation	Action	Effective Date	Official Release
1.180.010 and 2.180.010	Added May 2022	June 30, 2023	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalnoclar.pdf
1.000.020 and 2.000.020	Revised	December 15, 2014	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalnoclar.pdf
1.295.113	Added May 2022	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/2021-September-accounting-standards-implementation.pdf
1.230.010	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalunpaidfees.pdf
0.400.06	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalloans.pdf

(continued)

Appendix C Revision History			
Citation	Action	Effective Date	Official Release
1.210.010	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalloans.pdf
1.224.010	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalloans.pdf
1.260.010	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalloans.pdf
1.260.020	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalloans.pdf
1.270.010	Revised	December 31, 2022	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/56175896-2022finalloans.pdf
0.600.030.03	Added December 2021	Effective November 16, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/2021novemberofficialreasetemporarypolicystatement.pdf
1.275.007	Added March 2021	November 30, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/2021-March-staff-augmentation-official.pdf
1.224.010	Revised	November 30, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/2021-March-staff-augmentation-official.pdf
1.297.020	Revised	November 30, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/2021-March-staff-augmentation-official.pdf
1.295.010	Revised	November 30, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2021/2021-March-staff-augmentation-official.pdf

Appendix C Revision History			
Citation	Action	Effective Date	Official Release
1.400.200	Revised	July 31, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/2021-March-records-requests-official.pdf
0.600.030	Added January 2021	Effective December 21, 2020	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2021/2021januaryofficialreleasetemporarypolicystatement.pdf
1.295.145	Revised	Effective January 1, 2023	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2019/2019-august-official-release-info-system-services.pdf
1.224	Revised	Effective January 1, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2019/2019-august-official-release-slg.pdf
1.224.020	Revised	Effective for years beginning after December 15, 2021	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2019/2019-august-official-release-slg.pdf
0.200.030	Retain Prior Code References and Appendix D	February 12, 2019	n/a
1.700.110	Added December 2018	Effective December 31, 2018	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2018/2018-december-official-release.pdf
1.260.040	Revised December 2018	Effective for fiscal years beginning after December 2020, early implementation allowed	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2018/2018-december-official-release.pdf
1.224.010.02e	Revised December 2018	Effective December 31, 2018	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2018/2018-december-official-release.pdf
1.295.143	Revised Effective Date	Effective July 1, 2019	The <i>Journal of Accountancy</i> posted an online news story on August 14, 2018.

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Appendix C Revision History			
Citation	Action	Effective Date	Official Release
0.400.12	Technical Correction, July 2018	Effective July 31, 2018	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2018-technical-correction-agreed-upon-procedure-engagements-performed-in-accordance-with-saas.pdf
1.297.020.05a	Technical Correction, July 2018	Effective July 31, 2018	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2018-technical-correction-agreed-upon-procedure-engagements-performed-in-accordance-with-saas.pdf
0.400.03	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
0.400.07	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
0.400.26	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
0.400.27	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
0.400.39	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
0.400.41	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.000	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.224.020	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf

Appendix C Revision History			
Citation	Action	Effective Date	Official Release
1.275.005	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.280.040	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.290.010	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.295.040	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.295.120	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.295.135	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.295.140	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.295.150	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.297.010	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.400.200	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.510.030	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionaethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf

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Appendix C Revision History			
Citation	Action	Effective Date	Official Release
1.510.040	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.510.050	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.520.030	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.520.040	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.520.050	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
1.700.030	Revised	Effective December 31, 2017	https://us.aicpa.org/content/dam/aicpa/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017-december-official-releases.pdf
2.130.010	Revised	Effective August 31, 2017	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017augustofficialrelease.pdf
2.170.010	Addition	Effective August 31, 2017	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017augustofficialrelease.pdf
1.295.143	Addition	Effective September 1, 2018	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2017/2017augustofficialrelease.pdf
1.110.010.04n, o, p	Technical Correction, August 2016	Effective Upon Revision	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2016octoberofficialrelease.pdf
1.700.050	Revised	October 31, 2016	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2016octoberofficialrelease.pdf
1.520.080	Addition	Effective for commission or referral fee arrangements entered into on or after January 31, 2017.	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2016octoberofficialrelease.pdf

Appendix C Revision History			
Citation	Action	Effective Date	Official Release
1.400.205	Addition	June 30, 2017. Early implementation allowed.	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2016octoberofficialrelease.pdf
1.240.020.01b	Technical Correction, June 2016	Effective Upon Revision	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2016/2016may26technicalcorrectionunsolicitedfinancialinterest.pdf
0.400.02 [1.224.010 conforming changes to items <i>b</i> , <i>c</i> , and <i>d</i> of paragraph .02]	Revised October 2015	October 31, 2015	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015octoberofficialreleases.pdf
1.220.040	Added October 2015	January 31, 2016	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015octoberofficialreleases.pdf
1.275.025 paragraphs .01–.06	Revised April 2015	April 30, 2015	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015aprilofficialreleases.pdf
1.224.010 paragraphs .05–.09	Revised April 2015	April 30, 2015	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015aprilofficialreleases.pdf
0.400.03	Revised April 2015	April 30, 2015	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015aprilofficialreleases.pdf
1.298.010	Added January 2015	March 31, 2016, early implementation allowed	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015marchofficialreleases.pdf
1.298	Added January 2015	March 31, 2016, early implementation allowed	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015marchofficialreleases.pdf
0.200.020.06–.07	Revised January 2015	March 31, 2016, early implementation allowed	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2015/2015marchofficialreleases.pdf
Appendix B	Revised October 2014	October 19, 2014	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2014/2014october19officialrelease.pdf

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Appendix C Revision History			
Citation	Action	Effective Date	Official Release
2.110.010	Revised June 2014	September 30, 2014	http://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2014/2014augustofficialreleases.pdf
1.110.010	Revised June 2014	September 30, 2014	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2014/2014augustofficialreleases.pdf
0.200.020	Revised June 2014	September 30, 2014	https://us.aicpa.org/interestareas/professionalethics/community/exposedrafts/downloadabledocuments/2014/2014augustofficialreleases.pdf

ET Appendix D

Mapping Document

[As of December 31, 2013]

On June 1, 2014, the AICPA issued a codification of the code's principles, rules, *interpretations* and rulings (revised code). To assist users in understanding where the content from the prior code appears in the revised code, this mapping document was created. The first two columns identify the citation and title where the content resided in the prior code and the second two columns identify the citation and title where the content now resides *in the revised code*. The "Prior Code Citations" box *has been left blank where* the content did not exist in the prior code and is new to the revised code. "New Titles" that appear in regular roman text are effective December 15, 2014, in bold italic December 15, 2015, and in italic have components that are effective both December 15, 2014, and December 15, 2015.

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
		0.100	Overview of the Code of Professional Conduct
Introduction	Composition, Applicability, and Compliance	0.100.010	Principles and Rules of Conduct
Introduction	Other Guidance	0.100.020	Interpretations and Other Guidance
		0.200.010	Structure of the AICPA Code
		0.200.020.01	Application of the AICPA Code
ET section 91	Applicability	0.200.020.02-.05	Application of the AICPA Code
		0.200.030	Citations
		0.200.040	Transition Provisions
		0.200.050	Drafting Conventions
ET section 51	Preamble	0.300.010	Preamble
ET section 52	Article I—Responsibilities	0.300.020	Responsibilities
ET section 53	Article II—The Public Interest	0.300.030	The Public Interest
ET section 54	Article III—Integrity	0.300.040	Integrity
ET section 55	Article IV—Objectivity and Independence	0.300.050	Objectivity and Independence

(continued)

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 56	Article V—Due Care	0.300.060	Due Care
ET section 57	Article VI—Scope and Nature of Services	0.300.070	Scope and Nature of Services
ET section 92	Definitions	0.400	Definitions
ET section 100-1	Conceptual Framework for AICPA Independence Standards—Introduction	0.400.01	Acceptable level
		0.400.01	Acceptable level
ET section 101.20	Application of the Independence Rules to Affiliates—Definitions	0.400.02	Affiliate
		0.400.03	Attest Client
ET section 92.01	Attest engagement	0.400.04	Attest Engagement
ET section 92.02	Attest engagement team	0.400.05	Attest Engagement Team
ET section 101.17	Financial Relationships—Definitions	0.400.06	Beneficially Owned
ET section 92.03	Client	0.400.07	Client
ET section 92.04	Close relative	0.400.08	Close Relative
ET section 92.05	Confidential Client Information	0.400.09	Confidential Client Information
Various locations		0.400.10	Control (s) (led)
ET section 92.06	Council	0.400.11	Council
ET section 92.07	Covered Member	0.400.12	Covered Member
ET section 101.17	Financial Relationships—Definitions	0.400.13	Direct financial interest
		0.400.14	Employing organization
ET section 101.17	Financial Relationships—Definitions	0.400.15	Financial interest
ET section 101.20	Application of the Independence Rules to Affiliates—Definitions	0.400.16	Financial statement attest client
ET section 92.10	Financial statements	0.400.17	Financial statements
ET section 92.11	Firm	0.400.18	Firm
ET section 92.13	Immediate family	0.400.19	Immediate family
ET section 100-1 paragraph .09	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.20	Impair(ed)(ing)

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 100-1 paragraphs .06–.08	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.21	Independence
ET section 101.17	Financial Relationships—Definitions	0.400.22	Indirect financial interest
ET section 92.14	Individual in a position to influence the attest engagement	0.400.23	Individual in a position to influence the attest engagement
ET section 92.15	Institute	0.400.24	Institute
ET section 92.16	Interpretation of a rules of conduct	0.400.25	Interpretation
ET section 92.17	Joint closely held investment	0.400.26	Joint Closely-Held Investments
ET section 92.18	Key position	0.400.27	Key position
ET section 92.09	Financial institution	0.400.28	Lending institution
ET section 92.19	Loan	0.400.29	Loan
ET section 92.20	Manager	0.400.30	Manager
ET section 92.21	Member	0.400.31	Member
ET section 92.22	Member in business	0.400.32	Member in business
ET section 92.23	Network	0.400.33	Network
ET section 92.24	Network Firm	0.400.34	Network Firm
ET section 92.25	Normal Lending Procedures, Terms, and Requirements	0.400.35	Normal lending procedures, terms, and requirements
ET section 92.26	Office	0.400.36	Office
ET section 92.27	Partner	0.400.37	Partner
ET section 92.28	Partner Equivalents	0.400.38	Partner Equivalents
ET section 92.29	Period of the professional engagement	0.400.39	Period of the professional engagement
ET section 92.31	Professional services	0.400.40	Professional Services
ET section 100-1 paragraph .20	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.41	Public interest entities
ET section 92.30	Practice of public accounting	0.400.42	Public Practice (also referred to as the practice of public accounting)
ET section 100-1 paragraph .20	Conceptual Framework for AICPA Independence Standards—Definitions	0.400.43	Safeguards

(continued)

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.02	Interpretation of Rule 101— Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated with a Client	0.400.44	Share-based compensation arrangements
ET section 92.32	Significant influence	0.400.45	Significant influence
ET section 101.05	Performance of nonattest services— Management Responsibilities	0.400.46	Source Documents
ET section 191.224–.225	Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services	0.400.47	Third-party service provider
ET section 291.023–.024	Applicability of General and Technical Standards When Using a Third-Party Service Provider	0.400.47	Third-party service provider
ET section 391.001–.002	Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member	0.400.47	Third-party service provider
ET section 92.33	Those Charged with Governance	0.400.48	Those Charged With Governance
		0.400.49	Threats
		0.500	Nonauthoritative Guidance
		0.600.010	New and Revised Interpretations and Other Guidance
		0.600.020	Pending Interpretations and Other Guidance
		0.700	Deleted Interpretations and Other Guidance
		1.000	Members in Public Practice— Introduction
		1.000.010	<i>Conceptual Framework for Members in Public Practice</i>

Prior Code Citations	Title in Prior Code	New Citation	New Title
		1.000.020	Members in Public Practice—Ethical Conflicts
ET section 102.01	Integrity and Objectivity	1.100.001	Integrity and Objectivity Rule
		1.100.005	<i>Integrity and Objectivity Rule—Application of the Conceptual Framework for Members in Public Practice and the Ethical Conflicts</i>
ET section 102.03	Conflicts of Interest	1.110.010	Conflicts of Interest
ET section 191.186–.187	Service on Board of Directors of Federated Fund-Raising Organization	1.110.010.01j	Conflicts of Interest
ET section 191.198–.199	Member Providing Services for Company Executives	1.110.010.01k	Conflicts of Interest
ET section 191.220–.221	Member is Connected With an Entity That has a Loan to or From a Client	1.110.010.01l	Conflicts of Interest
ET section 191.170–.171	Bank Director	1.110.020	Director Positions
ET section 191.226–.227	Acceptance or Offering of Gifts or Entertainment	1.120.010	Offering or Accepting Gifts or Entertainment
ET section 102.02	Knowing misrepresentations in the preparation of financial statements or records	1.130.010	Knowing Misrepresentations in the Preparation of Financial Statements or Records
ET section 102.05	Subordination of judgment by a member	1.130.020	Subordination of Judgment
ET section 102.07	Professional Services involving client advocacy	1.140.010	Client Advocacy
ET section 191.224–.225	Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services	1.150.040	Use of a Third-Party Service Provider
ET section 101.01	Rule 101—Independence	1.200.001	Independence Rule

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<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.02	Interpretation of Rule 101—Other Considerations	1.200.005.01–.02	Application of the Conceptual Framework for Independence and Ethical Conflicts Interpretation
		1.200.005.03	Application of the Conceptual Framework for Independence and Ethical Conflicts Interpretation
ET section 101.02	Interpretation of Rule 101—Other Considerations	1.210.010.01	Conceptual Framework for Independence
ET section 100-1	Conceptual Framework for AICPA Independence Standards—Introduction	1.210.010.02–.08	Conceptual Framework for Independence
ET section 101.02	Interpretation of Rule 101—Other Considerations	1.210.010.09	Conceptual Framework for Independence
ET section 100-1	Conceptual Framework for AICPA Independence Standards—Introduction	1.210.010.10–.21	Conceptual Framework for Independence
ET section 101.19	Network and network firms	1.220.010.01–.05	Network and Network Firms
ET section 101.19	Network and network firms—Characteristics of a Network	1.220.010.06–.19	Characteristics of a Network
ET section 101.16	The effect of alternative practice structures on the applicability of independence rules	1.220.020	Alternative Practice Structures
ET section 191.142–.143	Use of Nonindependent CPA Firm on an Engagement	1.220.030	Use of a Nonindependent CPA Firm on an Engagement
ET section 101.20	Application of the Independence Rules to Affiliates	1.224.010	Client Affiliates
ET section 101.12	The effect of independence of relationships with entities included in the governmental financial statements	1.224.020	Entities Included in State and Local Government Financial Statements
ET section 191.200–.201	Actions Permitted When Independence is Impaired	1.226.010	Consenting to the Use of a Previously Issued Report

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 191.188–.189	Indemnification Clause in Engagement Letters	1.228.010	Indemnification of a Covered Member
ET section 191.204–.205	Indemnification of a Client	1.228.020	Indemnification of an Attest Client
ET section 191.190–.191	Agreement with Attest Client to Use ADR Techniques	1.228.030.01–.02	Alternative Dispute Resolution
ET section 191.192–.193	Commencement of ADR Proceeding	1.228.030.03	Alternative Dispute Resolution
New		1.230.010.01	Unpaid Fees
ET section 191.103–.104	Unpaid Fees	1.230.010.02–.03	Unpaid Fees
New		1.230.020	Fees and Other Types of Remuneration
ET section 101.02(A)(1)	Interpretation of Rule 101-A1	1.240.010.01–.02	Overview of Financial Interests
ET section 101.17	Financial Relationships—Financial Interests	1.240.010.01–.02	Overview of Financial Interests
ET section 101.02(B)	Interpretation of Rule 101-B	1.240.010.03	Overview of Financial Interests
ET section 101.17	Financial Relationships—Unsolicited Financial Interest	1.240.020	Unsolicited Financial Interests
ET section 101.17	Financial Relationships—Mutual Funds	1.240.030	Mutual Funds
ET section 101.17	Financial Relationships—Retirement, Savings, Compensation, or Similar Plans	1.240.040	Retirement, Savings, Compensation, or Similar Plans
ET section 101.17	Financial Relationships—Partnerships	1.240.050	Partnerships
ET section 101.17	Financial Relationships—Limited Liability Companies	1.240.060	Limited Liability Companies
ET section 101.17	Financial Relationships—Section 529 Plans	1.240.070	Section 529 Plans
ET section 191.021–.022	Member Designated to Serve as Executor or Trustee	1.245.010.01	Trustee or Executor
ET section 101.02(A)(2)	Interpretation of Rule 101-A2	1.245.010.02	Trustee or Executor

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<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.17	Financial Relationships—Trust Investments	1.245.020	Trust Investments
ET section 191.214–.215	Participation in Employee Benefit Plan Sponsored by Client	1.250.010.01	Plan is an Attest Client or is Sponsored by an Attest Client
ET section 101.17	Financial Relationships—Retirement, Savings, Compensation, or Similar Plans	1.250.010.02	Plan is an Attest Client or is Sponsored by an Attest Client
ET section 101.04	Employment or Association with Attest Clients	1.250.020	Former Partners and Professional Employees Participation in a Firm-Sponsored Plan
ET section 191.140–.141	Member's Depository Relationship With Client Financial Institution	1.255.010	Depository Accounts
ET section 191.081–.082	Financial Services Company Client Has Custody of a Member's Assets	1.255.020	Brokerage and Other Accounts
ET section 101.17	Financial Relationships—Insurance Products	1.257.010	Insurance Policies with No Investment Option
ET section 101.17	Financial Relationships—Insurance Products	1.257.020	Insurance Policies with Investment Options
ET section 101.17	Financial Relationships—Insurance Products	1.257.030	Insurer Undergoes Demutualization
ET section 101.02(A)(4)	Interpretation of Rule 101-A4	1.260.010	Loans
ET section 101.07	Loans from financial institution clients and related terminology	1.260.020	Loans and Leases with Lending Institutions
ET section 191.150–.151	Membership in Client Credit Union	1.260.020	Loans and Leases with Lending Institutions
ET section 191.134–.135	Servicing of Loan	1.260.030	Servicing of a Loan
ET section 191.182–.183	Member Leasing Property to or From Client	1.260.040	Leases
ET section 191.220–.221	Member is Connected With an Entity That has a Loan to or From a Client	1.260.050	Association with an Entity that has a Loan To or From an Attest Client

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.14	Independence and cooperative arrangements with clients	1.265.010	Cooperative Arrangements with Attest Clients
ET section 101.02(A)(3)	Interpretation of Rule 101-A3	1.265.020.01	Joint Closely-Held Investments
ET section 191.184–.185	Joint Interest in Vacation Home	1.265.020.02	Joint Closely-Held Investments
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family	1.270.010	Immediate Family Members
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Permitted Employment	1.270.020.01–.03	Immediate Family Member is Employed by the Attest Client
ET section 101.02	Interpretation of Rule 101—Grandfathered Employment Relationships	1.270.020.04	Immediate Family Member is Employed by the Attest Client
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Employee Benefits Plans Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans	1.270.030	Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client (Other than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Employee Benefits Plans Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans	1.270.040	Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest Client

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<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Share-Based Compensation Arrangements Resulting in Beneficial Financial Interests in Attest Clients	1.270.050	Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest Clients
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client	1.270.060	Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest Client
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Share-Based Compensation Arrangements Based Upon Stock Appreciation	1.270.070	Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Covered Member's Immediate Family—Nonqualified Deferred Compensation Plans	1.270.080	Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to a Close Relatives	1.270.100.01–.03	Close Relatives

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.02	Interpretation of Rule 101—Grandfathered Employment Relationships	1.270.100.04	Close Relatives
ET section 101.02(C)	Interpretation of Rule 101-C	1.275.005.01–.02	Simultaneous Employment or Association with an Attest Client
ET section 101.21	Permitted Employment With Client Educational Institution	1.275.005.03	Simultaneous Employment or Association with an Attest Client
ET section 101.06	Honorary directorships and trusteeships of not-for-profit organization	1.275.010	Honorary Director or Trustee of a Not-for-Profit Organization
ET section 191.144–.145	Member on Advisory Board of Client	1.275.015	Member of Advisory Board
ET section 191.039–.040	Member Serving on Governmental Advisory Unit	1.275.020	Member of Governmental Advisory Committee
ET section 191.164–.165	Campaign Treasurer	1.275.025	Campaign Treasurer
ET section 191.027–.028	Member on Board of Federated Fund-Raising Organization	1.275.030	Member of Federated Fund-Raising Organization
ET section 191.128–.129	Member Serves on Board of Organization for Which Client Raises Funds	1.275.035	Member of Organization that Receives Funds From Fund-Raising Organization
ET section 101.02	Interpretation of Rule 101—Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated with a Client	1.277.010	Former Employment or Association with an Attest Client
ET section 101.04	Employment or Association with Attest Clients—Considering Employment or Association with the Client	1.279.010	Considering Employment or Association with an Attest Client

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<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.04	Employment or Association with Attest Clients	1.279.020	Subsequent Employment or Association with an Attest Client
ET section 191.033–.034	Member of Social Club	1.280.010	Member of a Social Club
ET section 191.003–.004	Association Membership	1.280.020	Member of a Trade Association
ET section 191.061–.062	Performance of Services for CIRAs, Including Cooperatives, Condominium Associations, Planned Unit Developments, Homeowners Associations, and Timeshare Developments	1.280.030	Member of a Common Interest Realty Association
ET section 191.150–.151	Membership in Client Credit Union	1.280.040	Member of a Credit Union
ET section 191.228–.229	Acceptance or Offering of Gifts and Entertainment to or From an Attest Client	1.285.010	Offering or Accepting Gifts or Entertainment
ET section 101.08	The effect of actual or threatened litigation on independence	1.290.010	Actual or Threatened Litigation
ET section 101.05	Performance of nonattest services— Introduction and Engagements Subject to Independence Rules of Certain Regulatory Bodies	1.295.010	Scope and Applicability of Nonattest Services
ET section 101.05	Cumulative Effect Providing Multiple Nonattest Services	1.295.020	Cumulative Effect on Independence When Providing Multiple Nonattest Services
ET section 101.05	Performance of nonattest services— Management Responsibilities	1.295.030	Management Responsibilities
ET section 101.05	Performance of nonattest services— General Requirements	1.295.040	General Requirements for Performing Nonattest Services
ET section 101.05	Performance of nonattest services— General Requirements	1.295.050	Documentation Requirements When Providing Nonattest Services

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.05	Performance of nonattest services— Management Responsibilities	1.295.105	Advisory Services
ET section 191.015–.016	Member Providing Advisory Services	1.295.105	Advisory Services
ET section 101.05	Performance of nonattest services— Appraisal, Valuation and Actuarial Services	1.295.110	Appraisal, Valuation, and Actuarial Services
ET section 101.05	Performance of nonattest services— Benefit Plan Administration	1.295.115	Benefit Plan Administration
ET section 101.05	Performance of nonattest services— Bookkeeping	1.295.120	Bookkeeping, Payroll, and Other Disbursements
ET section 101.05	Performance of nonattest services— Nontax Disbursements	1.295.120	Bookkeeping, Payroll, and Other Disbursements
ET section 101.05	Performance of nonattest services— Business Risk Consulting	1.295.125	Business Risk Consulting
ET section 101.05	Performance of nonattest services— Corporate Finance— Consulting or Advisory	1.295.130	Corporate Finance Consulting
ET section 101.05	Performance of nonattest services— Executive or employee search	1.295.135	Executive or Employee Recruiting
ET section 101.05	Performance of nonattest services— Forensic Accounting Services	1.295.140	Forensic Accounting
ET section 101.05	Performance of nonattest services— Information Systems—Design, Installation or integration	1.295.145	Information Systems Design, Implementation, or Integration
ET section 101.05	Performance of nonattest services— Internal Audit Assistance Services	1.295.150	Internal Audit
ET section 101.05	Performance of nonattest services— Investment— Advisory or Management	1.295.155	Investment Advisory or Management

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<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 101.05	Performance of nonattest services—Tax Compliance Services	1.295.160.01–.05, .07	Tax Services
		1.295.160.06	Tax Services—Power of Attorney
ET section 101.13	Modified Application of Rule 101 for Engagements Performed in Accordance with Statements on Standards for Attestations Engagements	1.297.010	Application of the Independence Rule to Engagements Performed in Accordance with Statements on Standards for Attestation Engagements
ET section 101.13	Modified Application of Rule 101 for Engagements Performed in Accordance with Statements on Standards for Attestations Engagements—AUP Engagements	1.297.020	Agreed-Upon Procedure Engagements Performed in Accordance with SSAEs
ET section 101.13	Modified Application of Rule 101 for Engagements Performed in Accordance with Statements on Standards for Attestations Engagements	1.297.030	Engagements, Other Than AUPs, Performed in Accordance with SSAEs
ET section 201.01	General Standards	1.300.001	General Standards Rule
New		1.300.005	<i>General Standards Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 201.02	Competence	1.300.010	Competence
ET section 291.017–.018	Supervision of Technical Specialist on Management Consulting Services Engagements	1.300.020	Supervision of a Specialist on Consulting Engagements
ET section 291.019–.020	Submission of Financial Statements by a Member in Public Practice	1.300.030	Submission of Financial Statements

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 291.015--016	Subcontractor Selection for Management Consulting Service Engagements	1.300.040	Use of a Third-Party Service Provider
ET section 291.023--024	Applicability of General and Technical Standards When Using a Third-Party Service Provider	1.300.040	Use of a Third-Party Service Provider
ET section 202.01	Compliance with Standards	1.310.001	Compliance with Standards Rule
		1.310.005	<i>Compliance with Standards Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 203.01	Accounting Principles	1.320.001	Accounting Principles Rule
		1.320.005	<i>Accounting Principles Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 203.05	Responsibility of employees for the preparation of financial statements in conformity with GAAP	1.320.010	Responsibility for Affirming that Financial Statements Are in Conformity With the Applicable Financial Reporting Framework
ET section 203.03	Status of FASB, GASB and FASAB interpretations	1.320.020	Status of Financial Accounting Standards Board, Governmental Accounting Standards Board, Federal Accounting Standards Advisory Board, and International Accounting Standards Board Interpretations
ET section 203.02	Departures from Generally Accepted Accounting Principles	1.320.030	Departures From Generally Accepted Accounting Principles

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<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 203.06	Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other than GAAP	1.320.040	Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other than GAAP
ET section 501.01	Acts Discreditable	1.400.001	Acts Discreditable Rule
		1.400.005	<i>Acts Discreditable Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 501.03	Discrimination and Harassment in Employment Practices	1.400.010	Discrimination and Harassment in Employment Practices
ET section 501.07	Solicitation or disclosure of CPA examination questions and answers	1.400.020	Solicitation or Disclosure of CPA Examination Questions and Answers
ET section 501.08	Failure to file tax returns or pay tax liability	1.400.030	Failure to File a Tax Return or Pay a Tax Liability
ET section 501.05	Negligence in the preparation of financial statements or records	1.400.040	Negligence in the Preparation of Financial Statements or Records
ET section 501.06	Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies	1.400.050	Governmental Bodies, Commissions, or Other Regulatory Agencies
ET section 501.04	Failure to follow standards and/or procedures or other requirements in governmental audits	1.400.055	Governmental Audits
ET section 501.09	Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability provisions in connection with audit and other attest services	1.400.060	Indemnification and Limitation of Liability Provisions

Prior Code Citations	Title in Prior Code	New Citation	New Title
ET section 501.10	Confidential Information Obtained From Employment or Volunteer Activities	1.400.070	Confidential Information Obtained from Employment or Volunteer Activities
		1.400.090	False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services
ET section 501.12	Use of CPA Credential	1.400.100	Use of the CPA Credential
ET section 501.02	Response to Requests by Clients and Former Clients for Records—Terminology	1.400.200.01–.05, .07–.10	Records Request
ET section 591.377–.378	Requests for Records Pursuant to Interpretation 501-1	1.400.200.06	Records Request
		1.400.200.11	Records Request
ET section 591.381–.382	Member Removing Client Files From an Accounting Firm	1.400.210.01	Removing Client Files or Proprietary Information From a Firm
		1.400.210.02	Removing Client Files or Proprietary Information From a Firm
ET section 391.027–.028	Use of Confidential Information on Management Consulting Service Engagements	1.400.240	Use of Confidential Information From Nonclient Sources
		1.400.240	Use of Confidential Information From Nonclient Sources
		1.500.008	Unpaid Fees
ET section 302.01	Contingent Fees	1.510.001	Contingent Fee Rule
		1.510.005	<i>Contingent Fee Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 302.02	Contingent Fees in tax matters	1.510.010	Tax Matters
ET section 391.033–.034	Definition of the Receipt of a Contingent Fee or a Commission	1.510.020	Receipt of Contingent Fee

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Prior Code Citations	Title in Prior Code	New Citation	New Title
ET section 391.037–.038	Receipt of Contingent Fees or Commissions by Member's Spouse	1.510.030	Services Performed by a Member's Spouse for a Contingent Fee
ET section 391.049–.050	Commission and Contingent Fee Arrangements with Nonattest Client	1.510.040	Contingent Fee Arrangements with an Investment Advisory Services Nonattest Client that is Related to a Client
ET section 391.047–.048	Investment Advisory Services	1.510.050	Investment Advisory Services
ET section 503.01	Commissions and Referral Fees	1.520.001	Commissions and Referral Fee Rule
		1.520.005	<i>Commissions and Referral Fee Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 591.367–.368	Definition of the Receipt of a Contingent Fee or a Commission	1.520.020	Receipt of Commission
ET section 591.373–.374	Receipt of Contingent Fees or Commissions by Member's Spouse	1.520.030	Services Performed by a Member's Spouse for a Commission
ET section 591.375–.376	Referral of Products of Others	1.520.040	Referral of Products of Others
ET section 591.383–.384	Commission and Contingent Fee Arrangements with Nonattest Client	1.520.050	Commission Arrangements with an Investment Advisory Services Nonattest Client that is Related to a Client
ET section 591.369–.370	Sale of Products to Clients	1.520.060	Sale of Products to Clients
ET section 591.371–.372	Billing for Subcontractor's Services	1.520.070	Billing for a Subcontractor's Services
ET section 502.01	Advertising and other forms of solicitation	1.600.001	Advertising and Other Forms of Solicitation Rule
		1.600.005	<i>Advertising and Other Forms of Solicitation Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 502.06	Engagements obtained through efforts of third parties	1.600.010.01	False, Misleading, or Deceptive Acts in Advertising or Solicitations
ET section 502.03	False, Misleading, or Deceptive Acts in Advertising or Solicitation	1.600.010.02	False, Misleading, or Deceptive Acts in Advertising or Solicitations
ET section 591.365–.366	Use of the AICPA Personal Financial Specialist Designation	1.600.030	Use of AICPA-Awarded Designation
ET section 502.07	Use of CPA Credential	1.600.100	Use of the CPA Credential
ET section 301.01	Confidential Client Information	1.700.001	Confidential Client Information Rule
		1.700.005	<i>Confidential Client Information Rule—Application of the Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 391.011–.012	Revealing Client Information to Competitors	1.700.010	Client Competitors
ET section 391.029–.030	Earlier Similar Management Consulting Service Study with Negative Outcome	1.700.020.01	Disclosing Information From Previous Engagements
ET section 391.005–.006	Information to Successor Accountant About Tax Return Irregularities	1.700.020.02–.03	Disclosing Information From Previous Engagements
ET section 391.031–.032	Disclosure of Confidential Client Information	1.700.030.01–.02	Disclosing Information to Persons or Entities Associated with Clients
ET section 391.041–.042	Member Providing Services for Company Executives	1.700.030.03	Disclosing Information to Persons or Entities Associated with Clients
ET section 391.001–.002	Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member	1.700.040	Disclosing Information to a Third-Party Service Provider

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Prior Code Citations	Title in Prior Code	New Citation	New Title
ET section 301.04	Confidential information and the purchase, sale, or merger of a practice	1.700.050	Disclosing Client Information in Connection with a Review of the Member's Practice
ET section 391.003--.004	Disclosure of Client Information to Trade Associations	1.700.060	Disclosure of Client Information to Third Parties
ET section 391.039--.040	Disclosure of Confidential Client Information to Professional Liability Insurance Carrier	1.700.070	Disclosing Client Information During Litigation
ET section 391.045--.046	Disclosure of Confidential Client Information in Legal or Alternative Dispute Resolution Proceedings	1.700.070	Disclosing Client Information During Litigation
ET section 391.035--.036	Bank Director	1.700.080	Disclosing Client Information in Director Positions
ET section 391.013--.014	Revealing Names of Clients	1.700.090	Disclosing Client Names
		1.700.100	Disclosing Confidential Client Information as a Result of a Subpoena or Summons
ET section 505.01	Form of Organization and Name	1.800.001	Form of Organization and Name Rule
		1.800.005	<i>Form of Organization and Name Rule—Application of Conceptual Framework for Members in Public Practice and Ethical Conflicts</i>
ET section 505.03	Application of rules of conduct to members who own a separate business	1.810.010.01--.03	Ownership of a Separate Business
ET section 591.275--.276	Partner Having Separate Proprietorship	1.810.010.04	Ownership of a Separate Business
ET section 591.273--.274	Nonproprietary Partners	1.810.020	Partner Designation
ET section 591.005--.006	Employment by Non-CPA Firm	1.810.030	A Member's Responsibility for Nonmember Practitioners

<i>Prior Code Citations</i>	<i>Title in Prior Code</i>	<i>New Citation</i>	<i>New Title</i>
ET section 591.281–.282	Responsibility for Non-CPA Partner	1.810.030	A Member's Responsibility for Nonmember Practitioners
ET section 591.271–.272	Audit with Former Partner	1.810.040	Attest Engagement Performed with a Former Partner
ET section 505.04	Application of rule 505 to alternative practice structures	1.810.050	Alternative Practice Structures
ET section 591.289–.290	Firm Name of Merged Partnerships	1.820.010	Use of a Retired Partner's Name
ET section 591.379–.380	Non-CPA Partner	1.820.020	A Practice with Non-CPA Partners
ET section 505.05	Misleading Firm Names	1.820.030	Misleading Firm Names
ET section 505.06	Common Network Brand in Firm Name	1.820.040	Use of a Common Brand Name in Firm Name
		2.000	Members in Business—Introduction
		2.000.010	<i>Conceptual Framework for Members in Business</i>
		2.000.020	Members in Business—Ethical Conflicts
ET section 102.01	Integrity and Objectivity	2.100.001	Integrity and Objectivity Rule
		2.100.005	<i>Integrity and Objectivity Rule—Application of the Conceptual Framework for Members in Business and Ethical Conflicts</i>
ET section 102.03	Conflicts of Interest	2.110.010	Conflicts of Interest
ET section 191.226–.227	Acceptance or Offering of Gifts or Entertainment	2.120.010	Offering or Accepting Gifts or Entertainment
ET section 102.02	Knowing misrepresentations in the preparation of financial statements or records	2.130.010	Knowing Misrepresentations in the Preparation of Financial Statements or Records
ET section 102.05	Subordination of judgment by a member	2.130.020	Subordination of Judgment
ET section 102.04	Obligations of a member to his or her employer's external accountant	2.130.030	Obligation of a Member to His or Her Employer's External Accountant

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ET section 201.01	General Standards	2.300.001	General Standards Rule
		2.300.005	<i>General Standards Rule—Application of the Conceptual Framework for Members in Business and Ethical Conflicts</i>
ET section 201.02	Competence	2.300.010	Competence
ET section 291.019–.020	Submission of Financial Statements by a Member in Public Practice	2.300.030	Submission of Financial Statements
ET section 202.01	Compliance with Standards	2.310.001	Compliance with Standards Rule
		2.310.005	<i>Compliance with Standards Rule—Application of the Conceptual Framework for Members in Business and Ethical Conflicts</i>
ET section 203.01	Accounting Principles	2.320.001	Accounting Principles Rule
		2.320.005	<i>Accounting Principles Rule—Application of the Conceptual Framework for Members in Business and Ethical Conflicts</i>
ET section 203.05	Responsibility of employees for the preparation of financial statements in conformity with GAAP	2.320.010	Responsibility for Affirming that Financial Statements Are in Conformity With the Applicable Financial Reporting Framework
ET section 203.03	Status of FASB, GASB and FASAB interpretations	2.320.020	Status of Financial Accounting Standards Board, Governmental Accounting Standards Board, Federal Accounting Standards Advisory Board, and International Accounting Standards Board Interpretations

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ET section 203.06	Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other than GAAP	2.320.040	Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other than GAAP
ET section 501.01	Acts Discreditable	2.400.001	Acts Discreditable Rule
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ET section 501.03	Discrimination and Harassment in Employment Practices	2.400.010	Discrimination and Harassment in Employment Practices
ET section 501.07	Solicitation or disclosure of CPA examination questions and answers	2.400.020	Solicitation or Disclosure of CPA Examination Questions and Answers
ET section 501.08	Failure to file tax returns or pay tax liability	2.400.030	Failure to File a Tax Return or Pay a Tax Liability
ET section 501.05	Negligence in the preparation of financial statements or records	2.400.040	Negligence in the Preparation of Financial Statements or Records
ET section 501.06	Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies	2.400.050	Governmental Bodies, Commissions, or Other Regulatory Agencies
ET section 501.09	Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability provisions in connection with audit and other attest services	2.400.060	Indemnification and Limitation of Liability Provisions

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ET section 501.11	False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services	2.400.090	False, Misleading, or Deceptive Acts in Promoting or Marketing Professional Services
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		3.000	Other Members—Introduction
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ET section 501.03	Discrimination and Harassment in Employment Practices	3.400.010	Discrimination and Harassment in Employment Practices
ET section 501.07	Solicitation or disclosure of CPA examination questions and answers	3.400.020	Solicitation or Disclosure of CPA Examination Questions and Answers
ET section 501.08	Failure to file tax returns or pay tax liability	3.400.030	Failure to File a Tax Return or Pay a Tax Liability
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Bylaws of the American Institute of Certified Public Accountants

As Amended October 28, 1997, unless otherwise indicated

DEFINITIONS

As used in these bylaws, implementing resolutions of Council thereunder, or the Code of Professional Conduct, masculine terms shall be understood to include the feminine; "state" shall be understood to include the District of Columbia, Puerto Rico, and the territories, or territorial possessions of the United States of America; "firm" shall be understood to mean any organization permitted by law or regulation; "owner" shall be understood to include partners, partner equivalents, shareholders, or other owners of a firm; "official records of the Institute" shall be understood to mean the records of the membership department; and "committee" shall be understood to include any board (except the AICPA Board of Directors), division, task force, or any subdivision thereof. "Association" shall be understood to mean the Association of International Certified Professional Accountants as it may be constituted after June 30, 2016. "President" shall be understood to mean the Chief Executive Officer of the Institute.

[As revised May 15, 2000; revised November 6, 2007; revised June 16, 2016.]

BL Section 100
1. NAME AND PURPOSE

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BL Section 101***Name and Purpose***

**As amended
January 12, 1988**

.01 The name of this organization shall be the American Institute of Certified Public Accountants. In keeping with the Institute's certificate of incorporation, its objectives shall be to unite certified public accountants in the United States; to promote and maintain high professional standards of practice; to assist in the maintenance of standards for entry to the profession; to promote the interests of CPAs; to develop and improve accounting education; and to encourage cordial relations between CPAs and professional accountants in other countries.

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BL Section 210

2.1 Members

**As amended
January 12, 1988**

.01 Members of the Institute shall be

2.1.1 Members of the Institute at the effective date of these bylaws,
and

2.1.2 Persons who shall qualify for admission as provided in section 2.2
of this article and who shall be admitted under procedures adopted by the
Board of Directors.

BL Section 220**2.2 Requirements for Admission to Membership**

**As amended
January 12, 1988,
unless otherwise indicated**

.01 Persons may qualify for admission as members of the Institute if they satisfy the criteria listed below:

2.2.1 They are in possession of a valid and unrevoked certified public accountant certificate issued by a legally constituted authority, or at any time possessed the certificate described herein and the certificate was not revoked as a result of a disciplinary action, or meet the education, examination, and experience requirements set out in the Uniform Accountancy Act and who are of good moral character and have never been granted a right to practice,

2.2.2 They have passed an examination in accounting and other related subjects satisfactory to the Board of Directors, and

2.2.3 With respect to those persons who are engaged in the practice of public accounting as an owner or as an employee who has been licensed as a CPA for more than two years, either they are practicing in a firm that is enrolled in an Institute-approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards, or if authorized by Council, are themselves enrolled in such a program.

[As amended October 28, 1997, May 15, 2000, and October 8, 2010.]

(See section 220R.)

2.2.4 With respect to persons who first become eligible to take the examination required by section 2.2.2 after the year 2012, they shall have obtained 150 semester hours of education at an accredited college or university including a bachelor's degree or its equivalent. After 2012, a person who does not meet the educational requirement set out in this section shall, nonetheless, be eligible for membership upon enactment (regardless of the effective date) of the education requirement set out in this section by the state which grants the certificate required under section 2.2.1.

[As revised May 15, 2000; revised November 6, 2007.]

BL Section 220R***Implementing Resolution Under Section 2.2
Requirements for Admission to Membership***

As amended
October 24, 1994,
unless otherwise indicated

**Under Sections 2.2.3 and 2.3.4 to Implement the
Practice-Monitoring Requirement*****Resolved:***

.01 That the Board of Directors is authorized to establish within the Institute a peer review division governed by an executive committee named the "peer review board" having senior status with authority to carry out the activities of the division. The primary activities of the division will be to establish and conduct, in cooperation with state CPA societies, practice-monitoring programs for AICPA and state society members engaged in the practice of public accounting. Such activities shall not conflict with the policies and standards of the AICPA and shall be subject to the oversight of the Board of Directors. The nominees to serve on the peer review board shall be selected by the AICPA nominations committee and elected by Council.

[As revised by Council May 15, 2000.]

Further Resolved:

.02 A firm within the description of subparagraph A of Council Resolution Concerning the Form of Organization and Name Rule shall be required to enroll in an Institute-approved practice-monitoring program. An individual engaged in the practice of public accounting in a firm not within the description of Subparagraph A of Council Resolution Concerning the Form of Organization and Name Rule, but who performs compilations of financial statements in accordance with the Statements on Standards for Accounting and Review Services shall be enrolled in an Institute-approved practice-monitoring program. A firm or individual enrolled in a practice-monitoring program established herein shall be deemed to be enrolled in an approved practice-monitoring program under sections 2.2.3 and 2.3.4 of the bylaws. A firm or individual which is dropped for disciplinary reasons from enrollment in a practice-monitoring program established herein is ineligible to enroll in another Institute-approved practice-monitoring program until the cause of the disciplinary action is removed.

[As amended by Council October 28, 1997; revised May 15, 2000; revised November 6, 2007.]

Further Resolved:

[.03] [Deleted May 15, 2000.]

BL Section 230***2.3 Requirements for Retention of Membership***

**As amended
January 8, 1990,
unless otherwise indicated**

.01 Members of the Institute shall

2.3.1 Pay dues as established by Council.

2.3.2 Conform with these bylaws and the Rules of the Code of Professional Conduct.

2.3.3 Complete continuing professional education requirements established by Council.

(See section 230R.)

2.3.4 Engage in the practice of public accounting with a firm that is enrolled in an Institute-approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards or, if authorized by Council, themselves enroll in such a program.

[As amended October 28, 1997; revised May 15, 2000.]

(See section 220R, as amended October 24, 1994.)

2.3.5

[Deleted November 6, 2007.]

BL Section 230R***Implementing Resolutions Under Section 2.3
Requirements for Retention of Membership***

As amended
January 12, 1988,
unless otherwise indicated

**Under Sections 2.2.3 and 2.3.4 to Implement the
Practice-Monitoring Requirement**

[.01–.03] [Deleted March 1995. See section 220R.]

**Under Section 2.3.3 Continuing Professional Education
for Members*****Resolved:***

.04 That pursuant to section 2.3.3 of the bylaws the continuing professional education requirement for membership in the American Institute of Certified Public Accountants shall be as follows:

From January 1, 2001, forward and for each three-year reporting period thereafter, all AICPA members shall complete 120 hours, or its equivalent, of continuing professional education. Compliance can be achieved either by a formal program of education or by any other means, however measured, that would be reasonably expected to maintain professional competencies in the member's area of practice or employment. Members shall report compliance with such requirement to the AICPA each year and shall keep appropriate records and submit copies of such on request of the Institute.

[As amended by Council September 23, 1989 and May 7, 1997.]

[.05–.06] [Deleted January 1, 2001.]

Further Resolved:

.07 That the Board of Directors, or a body designated or appointed by it, shall have the power and authority to

- a. Identify and accept methods of learning to meet and measure this continuing professional education requirement.
- b. Grant exceptions for reasons such as retirement, inactive dues status, health, military service, foreign residency, or any other reason it deems appropriate.

[As amended by Council May 7, 1997.]

Under Section 2.3.5, Definition of "SEC Client"

[.08] [Deleted November 6, 2007.]

BL Section 240***2.4 Certificate of Membership***

**As amended
January 12, 1988**

.01 Upon admission each member shall be entitled to a certificate setting forth that the person is a member of the Institute, but no certificate shall be issued until receipt of dues for the current year. Certificates of membership shall be returned upon the demand of the secretary of the Institute in the event of suspension or termination of membership.

BL Section 250***2.5 Right of Members to Describe
Themselves as Such***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 A member of the Institute shall be entitled to use the designation "Member of the American Institute of Certified Public Accountants." A firm shall be entitled to use the designation "Members of the American Institute of Certified Public Accountants" only if all of its CPA owners are members.

[As revised May 15, 2000.]

BL Section 260***2.6 International Associates***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 International associates shall include those who were international associates on or before January 12, 1988. Thereafter, citizens of other countries who shall satisfy such requirements as the Council may prescribe may be admitted as international associates. The Council shall adopt rules governing such association and indications thereof.

[As revised May 15, 2000.]

(See section 260R.)

BL Section 260R***Implementing Resolution Under Section 2.6
International Associates***

**As adopted
May 7, 1997,
unless otherwise indicated**

Resolved:

.01 That membership in the nonvoting international associate category created pursuant to bylaw section 2.6 shall be available to any individual who holds a valid non-U.S. accounting credential from a professional organization, governmental entity, or similar accountancy body with which the AICPA Board of Directors has approved a recognition agreement, and who is of good moral character and does not hold a CPA certificate issued by a U.S. jurisdiction and who meets either the CPE requirement for a CPA or its equivalent in the individual's home country or for an AICPA member. If reasonably practicable and appropriate, all member benefits will be made available to international associates, except for voting, eligibility for a seat on Council and as a nonpublic member of the Board of Directors.

[As revised by Council May 24, 2010.]

Further Resolved:

.02 That any individual who was an international associate as of May 25, 2010, shall be eligible to continue as a member of the international associate category.

[As adopted by Council May 24, 2010.]

BL Section 300**3. ORGANIZATION AND PROCEDURE**

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BL Section 310

3.1 *General*

**As amended
January 12, 1988,
unless otherwise indicated**

.01 The organization of the Institute shall include the members, the Council, the Board of Directors, officers, and committees.

.02 The Board of Directors may from time to time organize the committees and staff of the Institute into divisions and, subject to section 3.6, may adopt rules of procedure and operating policies for such divisions.

3.1.1 Communications With Members

Any communication, notification or other action required by these bylaws to be provided or undertaken by mail or in writing, to or from the members, may be provided or undertaken by any means including but not limited to electronic or telephonic means, as authorized by Council. Except for determining a member's residence for voting purposes under section 3.2.3, a member's mailing address for purposes of these bylaws may be an electronic or other form of address, in lieu of a postal address.

[As adopted May 15, 2000.]

BL Section 320

3.2 Membership

As amended
June 17, 1996,
unless otherwise indicated

.01 The rights and powers of the membership of the Institute shall be as defined herein.

3.2.1 Attendance at Meetings

Every member and international associate of the Institute shall be entitled to attend all meetings of the Institute.

3.2.2 Voting Rights

Every member, but no international associate, shall be entitled to vote in person, when in attendance, upon all questions brought before duly called meetings of the Institute, and by mail ballot for the election of Council members pursuant to sections 6.1 through 6.1.6, on proposed amendments to these bylaws or to the Code of Professional Conduct as provided in article 8, and upon proposed resolutions of the membership as provided in section 5.1.4.

3.2.3 Residence for Voting Purposes

The state from which a member may vote shall be that indicated by the member's mailing address as carried in the official records of the Institute, and may be either the state in which the member resides or that in which the member's office is located.

3.2.4 Resolutions of the Membership

As provided in section 5.1.4, the members by mail ballot may enact resolutions of the membership, not inconsistent with these bylaws, which shall be binding upon the membership, the Council, the Board of Directors, officers, committees, and staff.

3.2.5 Certain Positions to Be Held Only by Members

With the exceptions noted below, only members of the Institute, as defined in section 2.1, may serve as members of the Council, the Board of Directors, or any committee or board designated as "senior" by the Council (see section 3.6.1) or as "permanent" by these bylaws (see section 3.6.2). Exceptions to this rule are as follows:

1. Three representatives of the public, none of whom shall be members of the Institute, shall be members of the Board of Directors and Council.
2. Council may authorize the appointment of persons who are not Institute members to any senior or permanent committee or board provided the non-Institute members do not constitute more than twenty-five percent of its membership.

[As revised May 15, 2000.]

3.2.6 Dual Membership

Every member of the Institute shall have dual membership in the Institute and the Association, as long as such individual is a member of the

Institute. Every individual who belongs to any of the Institute's associate or affiliate categories shall also be in a similar membership category of the Association in a manner determined by the Association's Board of Directors, as long as such individual belongs to any Institute associate or affiliate category.

[As adopted June 16, 2016.]

BL Section 320R

Implementing Resolution Under Section 3.2 Membership

As adopted
May 15, 2000,
unless otherwise indicated

Under Section 3.2.5 Certain Positions to Be Held Only by Members

Resolved:

.01 That pursuant to bylaw section 3.2.5, persons who are not Institute members may be appointed to the following senior or permanent committees or boards:

- Board of Examiners
- Professional Ethics Executive Committee
- Auditing Standards Board
- Financial Reporting Executive Committee
- Center for Audit Quality Governing Board
- Peer Review Board
- Personal Financial Planning Executive Committee
- Information Management and Technology Assurance Executive Committee
- Forensic and Valuation Services Executive Committee
- National Accreditation Commission

[As revised by Council October 21, 2003; revised October 24, 2005; revised May 21, 2006; revised May 24, 2010; revised May 20, 2013.]

Further Resolved:

.02 That except as otherwise provided by Council, and except for committees of the Board of Directors, such as the Committee on Audit, no public member on a senior or permanent committee or board may serve as its chair.

BL Section 330

3.3 Council

As amended
January 12, 1988

- .01 The governing body of the Institute shall be the Council.

3.3.1 Composition

The Council shall be composed of

3.3.1.1 Members of the Institute directly elected by the membership in each state in accordance with sections 6.1.1 through 6.1.6;

3.3.1.2 Representatives of the recognized state societies of certified public accountants selected in accordance with section 6.2;

3.3.1.3 Twenty-one members-at-large selected in accordance with section 6.3;

3.3.1.4 All members of the Board of Directors of the Institute;

3.3.1.5 All past presidents of the American Institute of Certified Public Accountants who served prior to December 31, 1973, and are members of the Institute;

3.3.1.6 All past chairmen of the board of the American Institute of Certified Public Accountants who are members of the Institute.

3.3.2 Powers

The Council may exercise all powers requisite for the purposes of the Institute, not inconsistent with these bylaws or with duly enacted resolutions of the membership, including but not limited to the authority to prescribe the policies and procedures of the Institute and to enact resolutions binding upon the Board of Directors, the officers, committees, and staff.

3.3.3 Reports to Membership

The actions of the Council shall be reported to the membership at least annually.

BL Section 340

3.4 Board of Directors

**As amended
January 12, 1988**

.01 Between meetings of the Council, the activities of the Institute shall be directed by the Board of Directors, the composition of which shall be prescribed by the Council.

(See section 340R.)

3.4.1 Powers

The Board of Directors shall act as the executive committee of Council between meetings of Council, shall control and manage the property, business, and activities of the Institute, and shall take whatever action it deems desirable including the establishment of policies for the conduct of the affairs of the Institute consistent with the provisions of these bylaws, resolutions of the membership, or actions of the Council.

3.4.2 Reports to Council

The actions of the Board of Directors shall be reported to the Council at least semiannually.

BL Section 340R***Implementing Resolution Under Section 3.4
Board of Directors***

**As amended
May 23, 1994**

Resolved:

- .01** That the Institute's Board of Directors shall be composed of
- (a) The chairman, the vice chairman, and the immediate past chairman of the Board of Directors;
 - (b) The president of the Institute;
 - (c) Eleven present or former members of the Council elected pursuant to section 6.3 to serve for three years or until the election of their successors; and
 - (d) Three representatives of the public, who are not members of the Institute.

[As amended by Council June 16, 2016, and October 20, 2021.]

BL Section 350***3.5 Officers Elected by Council***

**As amended
June 17, 1996**

.01 The officers of the Institute elected by the Council shall be a chairman of the Board of Directors and a vice chairman of the board, who shall be the chairman of the board nominee, both of whom shall be members possessing valid and unrevoked certified public accountant certificates. The chairman and the vice chairman of the board shall have such terms of office, powers, and privileges as the Council may prescribe.

(See section 350R.)

3.5.1 Officers Authorized by the Board of Directors

The officers of the Institute authorized by the Board of Directors shall be a president, who shall be an employee and who shall be a member possessing a valid and unrevoked certified public accountant certificate, and a secretary, who shall be an employee, but need not be a member of the Institute. The president and the secretary shall have such terms of office, powers, and privileges as the Institute's Board of Directors may prescribe. The president of the Institute may also appoint senior staff who shall be neither members of the board nor of the Council and who shall perform such duties and have such titles as may be assigned to them by the president.

[As revised June 16, 2016.]

BL Section 350R***Implementing Resolution Under Section 3.5
Officers Elected by Council***

**As amended
January 14, 1992**

Resolved:**Term of Office**

.01 That the chairman and the vice chairman of the Board of Directors shall each be elected annually by the Council for a term of one year or until the election of that person's successor. Neither may succeed oneself in the same office after serving a full term of one year. The term of the president and the secretary shall be determined by the Board of Directors.

Chairman of the Board

.02 That the chairman of the Board of Directors shall preside at meetings of members of the Institute, the Council, and the Board of Directors. The chairman shall appoint committees and boards as provided in section 3.6 of the bylaws. The chairman shall act as a spokesperson for the Institute and appear on its behalf before other organizations.

Vice Chairman of the Board

.03 That the vice chairman shall be chairman-nominee of the Board of Directors and shall preside in the absence of the chairman at meetings of the Institute, the Council, and the Board of Directors. The vice chairman shall familiarize oneself with the duties of the office of chairman and shall perform such other related duties as may be assigned to the vice chairman by the chairman.

President

.04 That the president shall have full responsibility for the execution of the policies and programs of the Institute, act as a spokesperson for the Institute, and perform such other services as may be assigned to the president by the Council and the Board of Directors.

Secretary

.05 That the secretary of the Institute shall have the usual duties of a corporate secretary and shall perform such other related duties as may be assigned to the secretary by the president. An assistant secretary to serve in the secretary's absence, who need not be a member of the Institute, may be appointed by the Board of Directors.

BL Section 360

3.6 Committees

**As amended
June 17, 1996,
unless otherwise indicated**

.01 Except as otherwise provided by these bylaws or the Council (see section 3.6.1), the chairman of the Board of Directors, or the chairman's delegate, may appoint committees and boards with such duties, powers, responsibilities, and procedures as the chairman may prescribe. The chairman of the board and the president shall have the privilege of the floor at meetings of all committees.

(See section 360R.)

3.6.1 Senior Committees

The Council may designate any committee as a "senior" committee. The appointment by the chairman of the Board of Directors of members and any appointed pursuant to bylaw 3.2.5, to senior committees shall require the approval of the Board of Directors. The scope of responsibility of senior committees shall be as the Council may prescribe consistent with the specific provisions of these bylaws. The Board of Directors shall prescribe the duties, powers, and procedures of such committees.

[As revised November 6, 2007.]

(See section 360R.)

3.6.2 Permanent Committees, Boards, and Divisions

The following shall be permanent committees, boards, or divisions of the Institute: the nominations committee (see section 3.6.2.1); the professional ethics division (see section 3.6.2.2); the trial board (see section 3.6.2.3); and the board of examiners (see section 3.6.2.4).

(See section 360R.)

3.6.2.1 Nominations Committee

There shall be a nominations committee composed of eight persons, including any appointed pursuant to bylaw 3.2.5 and members of the Institute, elected by the Council in such manner as the Council shall prescribe. It shall be the responsibility of the committee to make nominations for the offices of chairman of the Institute's Board of Directors, vice chairman of the Institute's Board of Directors, the elected members of the Institute's Board of Directors, the joint trial board, the peer review board, and the Council, as elsewhere provided in these bylaws, and to apportion among the states directly elected Council seats pursuant to section 6.1.2.

[As revised June 16, 2016.]

(See section 360R.)

3.6.2.2 Professional Ethics Division

The executive committee of the professional ethics division, including any appointed pursuant to bylaw 3.2.5, shall serve as the ethics committee of the Institute, and there shall be such other committees within the division as the Board of Directors shall authorize. The executive committee shall (1) subject to amendment, suspension, or revocation by the Board of Directors, adopt rules governing procedures consistent with these bylaws or actions of Council to investigate potential disciplinary matters involving members, (2) arrange for presentation of a case before the trial board where the committee finds prima facie evidence of infraction of these bylaws or of the Code of Professional Conduct, (3) interpret the Code of Professional Conduct, (4) propose amendments thereto, and (5) perform such related services as the Council may prescribe.

(See section 360R.)

3.6.2.3 Joint Trial Board

There shall be a trial board that, in addition to any appointed pursuant to bylaw 3.2.5, shall consist of members possessing a valid and unrevoked certified public accountant certificate, each of whom shall have been a member for at least five consecutive years prior to that person's appointment to the joint trial board, to adjudicate disciplinary charges against members of the Institute pursuant to section 7.4. Members of the trial board shall be elected by the Council for such terms as the Council may prescribe.

The trial board is empowered to adopt rules, consistent with these bylaws or actions of the Council, governing procedure in cases heard by any hearing panel, and in connection with any application for review of a decision of a hearing panel.

Decisions of any hearing panel shall be subject to review only by the trial board.

(See section 360R.)

3.6.2.4 Board of Examiners

There shall be a board of examiners, that, in addition to any appointed pursuant to bylaw 3.2.5, shall consist of persons who have passed the Uniform CPA Examination and who possess valid and unrevoked certified public accountant certificates, appointed by the chairman of the Board of Directors subject to the approval of the Board of Directors. It shall supervise the preparation of a uniform examination which may be adopted by the legally constituted authorities of the states in examining candidates for the certified public accountant certificate and the conduct of the grading service offered by the Institute. The board of examiners shall formulate the necessary rules and regulations for the conduct of its work, but all such rules and regulations may be amended, suspended, or revoked by the Board of Directors. The board of examiners may delegate to members of the Institute's staff or other duly qualified persons the preparation of examination questions and the operation of the grading service conducted by the Institute.

BL Section 360R***Implementing Resolutions Under
Section 3.6 Committees***

**As amended
January 12, 1988,
unless otherwise indicated**

Resolved:

.01 (1) That the following be designated as senior committees and boards:*

- Accounting and review services committee*
- Assurance services executive committee*
- Auditing standards board*
- Board of examiners
- Center for audit quality governing board*
- Employee benefit plans audit quality center executive committee
- Financial reporting executive committee*
- Forensic and valuation services executive committee*
- Government audit quality center executive committee
- Management consulting services executive committee*
- National Accreditation Commission
- Peer review board*
- Personal financial planning executive committee*
- Private companies practice executive committee*
- Professional ethics executive committee*
- Tax executive committee*

[As amended by Council May 1988 and May 1991; revised April 1992; amended October 1994; revised June 1996; revised May 1997; revised October 21, 2003; revised October 24, 2005; revised October 2007; revised May 24, 2010; revised October 2012; revised May 17, 2022.]

[.02]

[As amended by Council May 1988 and May 1991; revised April 1992; amended October 24, 1994; revised May 1997; revised October 21, 2003; revised October 24, 2005; deleted October 2007.]

* Note: * Indicates a senior committee which is authorized to make statements, without clearance with the Council or the Board of Directors, in matters related to its area of practice.

Under Section 3.6.2.1 Nominations Committee

Resolved:

.03 That the nominations committee shall be chaired by the immediate past chairman of the Institute's Board and shall consist of seven additional members serving two-year terms. At the Council meeting held in conjunction with the annual meeting, the Institute's Board of Directors, after having considered at least seven candidates, shall recommend the candidates necessary to fill the projected vacancies for election to the nominations committee, each for a two-year term. At any one time, no more than two members, in addition to the chairman, shall be members of Council, and none shall be a member of the Institute's Board of Directors. Other nominations from the floor shall be permitted. Voting shall be by voice vote of the incoming Council, or, if requested by a majority of those present, by written ballot. A majority vote shall elect. With the exception of its chairman, no member, having served on the nominations committee, shall be eligible again to serve on the nominations committee until the passage of five years.

[As amended by Council May 1991; revised May 15, 2000; amended by Council June 16, 2016.]

Further Resolved:

.04 That the nominations committee shall not select any of its members for positions to be filled by the committee.

Under Section 3.6.2.2 Professional Ethics Division

Resolved:

.05 That in cases where the professional ethics executive committee concludes that a prima facie violation of the Code of Professional Conduct or by-laws is not of sufficient gravity to warrant further formal action, the committee may direct the member or members concerned to complete specified continuing professional education courses, or to take other remedial or corrective action, provided, however, that there will be no publication of such action in the Institute's principal membership periodical and the member concerned is notified of the member's right to reject such direction. In the case of such a rejection, the professional ethics executive committee shall determine whether to bring the matter to a hearing panel of the trial board for a hearing.

Further Resolved:

.06 That in cases where there is prima facie evidence of one or more actions by or with respect to a member as described in subparagraphs 7.4.1 through and including 7.4.6 of bylaw section 7.4, the professional ethics executive committee may decide to offer the member or members concerned the opportunity to avoid further investigation and a possible hearing before the trial board by entering into a settlement agreement under such terms and conditions as the committee deems appropriate including but not limited to agreement by the member or members (a) to resign from membership or (b) to complete specified continuing professional education courses and/or to submit to independent preissuance review of some or all financial statements and accountant's reports and/or submit to an accelerated practice-monitoring review, and/or to perform other remedial or corrective action as the committee may determine and/or (c) to submit to disciplinary action with publication by the Institute as provided in Council resolutions under bylaw section 7.6. The committee shall monitor compliance with the settlement agreement and may initiate an investigation where it finds there has been noncompliance.

[As revised by Council April 28, 2003; revised November 6, 2007.]

.07 A member's rejection of the terms and conditions of a proposed settlement agreement will not in any way affect the rights of a member under the bylaws and implementing resolutions in any subsequent investigation by the professional ethics executive committee in a hearing before the trial board.

[As adopted by Council May 26, 1993.]

Under Section 3.6.2.3 Joint Trial Board

Resolved:

.08 That the joint trial board shall consist of at least thirty-six members elected for a three-year term by Council on a staggered basis on nomination of the nominations committee. No member shall serve more than two full successive terms. The size of the trial board shall be determined by the Board of Directors. No member of the Institute's professional ethics division, of a state society ethics committee, or of a state board of accountancy shall be a member of the trial board.

[As revised by Council June 17, 1996.]

.09 The trial board shall elect from its membership a chairman and a vice chairman, the vice chairman to serve as chairman during any period of unavailability of the chairman. It shall also elect a secretary who need not be a member.

.10 The chairman or vice chairman, when acting as chairman, pursuant to the trial board rules of practice and procedure, may appoint from the members of the trial board a panel consisting of not less than three members, which may, but need not, include the chairman to sit as a hearing panel and hear and adjudicate charges against members, or an ad hoc committee consisting of not less than three members of the trial board to consider requests for nonapplication of sections 7.2 and 7.3. Decisions of hearing panels shall be reviewable by the trial board under the conditions and procedures as provided for in Council resolution under section 7.4 of the bylaws.

[As revised by Council May 15, 2000.]

Resolved:

.11 That the trial board is authorized to receive and act on petitions requesting review of a decision of the peer review board terminating a firm's or an individual's enrollment in the practice-monitoring program or of an AICPA peer review committee's decision terminating a firm's or an individual's enrollment in another Institute-approved practice-monitoring program. Following such review, the trial board may affirm, modify, or reverse all or any part of the peer review board's or an AICPA peer review committee's decision, but it may not increase the severity of the peer review board's or an AICPA peer review committee's sanction.

[As revised by Council June 17, 1996; revised October 24, 2005; revised November 6, 2007.]

Resolved:

.12 That the trial board is authorized to receive and act on petitions requesting review of a decision by the Center for Audit Quality Governing Board which imposed a sanction upon, or denied a reinstatement request by, a member or associate member of the Center for Audit Quality. Following such review, the trial board may affirm or reverse the Board's decision.

[As adopted by Council October 24, 2005.]

Resolved:

.13 That the trial board may hear and adjudicate charges involving alleged violations of a state CPA society's bylaws or code of professional conduct when there is in force a written agreement for such procedure between the Institute and the state CPA society concerned.

BL Section 400**4. FINANCIAL MANAGEMENT AND CONTROLS**

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BL Section 401***Financial Management and Controls***

**As amended
January 12, 1988**

.01 The Council shall delegate to the Institute's Board of Directors, and through it to the Association's Board of Directors, financial management and budgetary controls to ensure the effective governance, management and operations of the Institute and Association.

[As revised June 16, 2016.]

(See section 401R.)

BL Section 401R***Implementing Resolution Under Article 4
Financial Management and Controls***

**As amended
January 12, 1988,
unless otherwise indicated**

Resolved:

.01 That Council, at each regular meeting, shall be presented for review a report that contains information related to the Institute's and the Association's financial operations and material variations from the annual budget. The Institute's Board of Directors shall approve the Institute's annual budget for the succeeding fiscal year, which shall be incorporated into the consolidated Association budget and approved by the Association's Board of Directors.

[As revised by Council May 15, 2000, and June 16, 2016.]

BL Section 410

4.1 Audit

**As amended
January 12, 1988**

.01 The Council shall, for each fiscal year, appoint a certified public accountant or certified public accountants to express an opinion on the financial statements of the Institute and its affiliated organizations. The financial statements of the Institute and the report of the auditor or auditors for each fiscal year shall be published for the information of the membership.

BL Section 420***4.2 Committee on Audit***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 The chairman of the board shall appoint from among the members of the Board of Directors, other than the officers, a committee on audit to make arrangements with the auditor or auditors for their examination, to review the audit report, and to perform such other duties appropriate for such a committee as directed by the Board of Directors.

[As revised May 15, 2000.]

BL Section 430***4.3 Execution of Instruments on Behalf of the Institute***

**As amended
January 12, 1988**

.01 All checks, drafts, deeds, mortgages, bonds, contracts, reports, proxies, and other instruments may be executed on behalf of the Institute by such officers or employees as the Council or the Board of Directors may from time to time designate, either generally or in specific instances.

BL Section 440**4.4 Indemnification**

**As amended
January 12, 1988**

.01 The Institute shall indemnify to the full extent authorized by law for the good faith exercise of judgment in the performance of assigned duties any person made or threatened to be made a party to any action, suit, or proceeding, whether criminal, civil, administrative, or investigative, by reason of the fact that the person, the person's testator, or intestate is or was a member of Council, the Board of Directors, or any committee, trustee, officer, employee, or agent of the Institute or any affiliated entity or serves or served any other enterprise as a director, trustee, officer, employee, or agent at the request of the Institute.

.02 Without limiting the generality of the foregoing, the Institute may contract for insurance against all or a portion of any liabilities and expenses, if any, resulting from the indemnification of any of the foregoing persons pursuant to this section or otherwise as permitted by law, and may also contract for companion insurance directly insuring any or all of such persons against liabilities and expenses.

BL Section 450

4.5 Dues

As amended
January 14, 1992

.01 The Council shall determine the annual dues which shall be paid by each member and international associate in accordance with such classifications as it deems appropriate, and may require dues of a different amount for each class so created.

.02 Dues shall be payable on or before the first day of each fiscal year of the Institute or in such other manner as the Council shall prescribe. For new members or international associates, dues shall be apportioned to the end of the fiscal year.

.03 No dues shall be paid by members or international associates of the Institute while they are engaged in military service of the United States or its allies during war. Individual members or international associates may be excused from payment of dues for reasonable cause by the chairman of the Finance Committee.

BL Section 460

4.6 Fiscal Year

**As amended
January 12, 1988**

.01 The fiscal year of the Institute shall be as the Council shall prescribe.

(See section 460R.)

BL Section 460R

Implementing Resolution Under Section 4.6 Fiscal Year

**As amended
January 12, 1988**

Resolved:

.01 That the fiscal year of the Institute shall be the twelve months beginning January 1 and ending December 31.

[As amended by Council October 25, 2016.]

BL Section 500

**5. MEETINGS OF THE INSTITUTE AND
THE COUNCIL**

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BL Section 501

Meetings of the Institute and the Council

**As amended
January 12, 1988**

.01 This article shall govern meetings of the Institute and of the Council. The Board of Directors shall determine the dates of meetings of Council and the matters to be presented for action.

BL Section 510

5.1 Meetings of the Institute

As amended
January 12, 1988

.01 The membership shall meet pursuant to sections 5.1.1 through 5.1.3, conduct its business pursuant to section 5.1.3, and may adopt resolutions pursuant to section 5.1.4. Meetings of the membership shall be known as meetings of the Institute.

5.1.1 Regular Meetings of the Institute

There shall be a regular annual meeting of the Institute on a date to be fixed by the Institute's Board of Directors. This meeting shall also be known as the annual meeting of the Institute.

[As revised June 16, 2016.]

5.1.2 Special Meetings of the Institute

The chairman of the board shall call special meetings of the Institute when so requested by the Council or the Board of Directors, or upon the written request of at least 5 percent of the membership of the Institute or any thirty members of Council. Special meetings of the Institute shall be held at places designated by the Board of Directors. No business shall be transacted at a special meeting of the Institute other than that for which the meeting shall have been convened.

5.1.3 Notice of Meetings of the Institute

Notice of each meeting of the Institute, whether regular or special, shall be mailed to each member of the Institute, at the member's mailing address as shown on the official records of the Institute, at least thirty days prior to the date of such meeting.

5.1.4 Resolution of the Membership by Mail Ballot

A majority of the members of the Institute, assembled at any duly called corporate meeting of the Institute at which a quorum is present, may direct that the chairman of the board submit any question to the entire membership for a vote by mail. Any resolution enacted in such a mail ballot by two-thirds of the members voting shall be declared by the chairman of the board a resolution of the membership and shall be binding, if consistent with these bylaws, upon the Council, the Board of Directors, committees, officers, and staff. Mail ballots shall be valid and counted only if received within sixty days after the date of the mailing of ballot forms.

BL Section 520***5.2 Meetings of Council***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 Meetings of the Council shall be governed by sections 5.2.1 through 5.2.5, section 5.3, and section 6.6.

5.2.1 Regular Meetings of Council

A regular meeting of the Council shall be held in conjunction with the annual meeting of the Institute and on such other dates as the Council or the Board of Directors may designate.

[As revised May 15, 2000.]

5.2.2 Special Meetings of Council

The chairman of the board shall call special meetings of the Council when requested to do so by the Board of Directors or when requested in writing by at least thirty members of the Council. Special meetings of the Council shall be held at places designated by the Board of Directors.

5.2.3 Mail Ballot in Lieu of Special Meeting of Council

In lieu of a special meeting of the Council, the chairman of the board, with the approval of the Board of Directors, may submit any question to the Council for a vote by mail, and any action therein approved in writing by not less than two-thirds of those voting shall be declared by the chairman of the board an act of the Council and shall be recorded in the minutes of the Council provided, however, that at least a majority of the Council must have cast ballots on the question.

[As revised November 6, 2007.]

5.2.4 Notice

Notice of each meeting of the Council shall be sent to each member of the Council, at the member's mailing address as shown in the official records of the Institute, at least twenty-one days before such meeting. Such notice, as far as practicable, shall contain a statement of the business to be transacted.

5.2.5 Minutes

A copy of the minutes of each meeting of the Council shall be forwarded to each member of the Council within forty-five days after such meeting.

BL Section 530**5.3 General Provisions Governing Meetings**

**As amended
January 12, 1988**

.01 The following general provisions shall govern quorum and parliamentary procedure.

5.3.1 Meetings—Quorum

Five hundred members of the Institute shall constitute a quorum for the transaction of any business duly presented at any meeting of the Institute. Thirty members of Council shall constitute a quorum of the Council at any duly called meeting of the Council. A majority of the members of the Institute's Board of Directors shall constitute a quorum of the board.

[As revised June 16, 2016.]

5.3.2 Meetings—Rules of Parliamentary Procedure Applicable

The rules of parliamentary procedure contained in *Robert's Rules of Order Revised* shall govern all meetings of the Institute and of the Council.

BL Section 600**6. ELECTION OF COUNCIL, BOARD OF DIRECTORS, AND OFFICERS OF THE INSTITUTE**

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BL Section 601

Election of Council, Board of Directors, and Officers of the Institute

**As amended
January 12, 1988**

.01 Except for ex officio members of Council (see sections 3.3.1.4 through 3.3.1.6), the election of members of the Council, the Board of Directors, and officers of the Institute shall be in accordance with the provisions of this article.

BL Section 610***6.1 Members of Council Directly Elected by Members of the Institute***

**As amended
June 17, 1996,
unless otherwise indicated**

.01 Members of Council directly elected by the membership in the respective states (see section 3.3.1.1) shall be elected in accordance with sections 6.1.1 through 6.1.6 as supplemented by Council resolution.

6.1.1 At Least One Member of Council Directly Elected by Membership of Each State

There shall be at least one member of Council directly elected by the members of the Institute in each state having one or more persons enrolled upon the membership lists of the Institute.

6.1.2 Number and Allocation of Directly Elected Council Seats Among the States

The total number of directly elected members of Council, in addition to those provided for by section 6.1.1, shall be eighty-five except as modified by section 6.1.2.1. The number of seats, excluding those extended by section 6.1.2.1, shall be equitably allocated among the states in direct proportion to the number of Institute members enrolled from each state.

6.1.2.1 Unexpired Terms Unaffected by Reduced Allocation

No member of Council directly elected by the membership in any state shall lose the member's seat for the term the member then serves should the allocation of that state be diminished by virtue of section 6.1.2; but, no state's allocation of directly elected Council seats shall be extended by this section beyond the natural expiration of a seat's full term or its vacation by the member filling it, whichever first occurs.

6.1.2.2 Allocation to Be Made by Nominations Committee

The nominations committee shall make the allocation provided in section 6.1.2. It shall be made at five-year intervals, at least nine months prior to annual meetings to be held each calendar year which ends in one and in six, and shall govern the five annual elections immediately following. It shall be based upon the membership figures and addresses carried on the books of the Institute the last day of the fiscal year immediately preceding the date of such determination.

If a state gains an additional seat from such allocation, the state society may request the nominations committee to authorize election for an initial term of less than three years in order to promote orderly rotation of Council members from that state. Upon receipt of such request, the nominations committee may authorize such shortened term. Following the expiration of such shortened term, subsequent terms for the seat shall be for three years, as provided in section 6.1.3.

In the event that a state has three or more directly elected members whose terms are not evenly staggered over a three-year cycle, the state society may request the nominations committee, for the election following the year these bylaws are adopted and thereafter in calendar years ending in one and in six, to approve the election of a nominee to fill a vacancy for a term of less than three years in order to effect a more orderly rotation of the Council members from that state. The nominations committee may authorize such shortened term. Subsequent terms for such a seat shall be three years, as provided in section 6.1.3.

6.1.3 Term of Office

Except as specified by this section 6.1.3, the term of office of a directly elected member of the Council shall commence when the member's election is announced by the chairman of the Board of Directors at the meeting of the Council held in conjunction with the annual meeting of the Institute, as prescribed by section 6.6, and shall run until the announcement of the election of new directly elected members of the Council at the meeting of the Council held in conjunction with the annual meeting of the Institute three years after the member's election. If any such member of the Council shall not serve that member's full term, the vacancy so created may be filled pursuant to section 6.5. The term of office of any member directly elected by the members in that member's state to fill such vacancy shall be the remainder of the three-year term with respect to which the vacancy occurred.

No member having served for two consecutive full terms as a directly elected member of the Council shall be eligible to serve another such term until at least one year after the completion of the member's second consecutive full term.

6.1.4 Number of Council Seats to Be Filled by Election

The number of Council seats to be filled in a state's quota of directly elected members of the Council for any given year shall be the number of its allocation of directly elected Council seats less the number of members of the Council from that state filling such seats for terms running through that year.

6.1.5 Nominations

At least eight months prior to the annual meeting of the Institute, the nominations committee shall request, from the recognized society of certified public accountants in each state for which any vacancies (see section 6.1.4) will arise in the coming year, the names of suggested candidates from the state represented by such society to fill each such vacancy. The committee shall give due consideration to the names so submitted, but shall not be required to select its nominees from among such names. In the absence of a satisfactory response from any such state society, the nominations committee shall select the nominees from such state.

The nominations committee shall make its nominations for directly elected members of the Council at least six months prior to the annual meeting of the Institute. Notice of such nominations shall be published to the membership by the secretary at least five months prior to the annual meeting of the Institute. Five percent, but in no event less than twenty members of the Institute from any given state for which a vacancy shall arise, may submit to the secretary independent nominations for directly

elected members of the Council from that state provided that such nominations be filed with the secretary at least four months prior to the annual meeting of the Institute.

[As revised November 6, 2007.]

6.1.6 Election

The nominees of the nominations committee for directly elected seats on Council shall be declared elected by the secretary if no independent nominations are filed for such seats as required by section 6.1.5.

If independent nominations are received, the secretary shall mail to all members of the Institute in each state in which there is a contest for a directly elected seat on Council, at least ninety days prior to the annual meeting of the Institute, mail ballots containing the names and relevant background information of nominees from that state nominated by the nominations committee and the names and relevant background information of nominees independently nominated. Each ballot shall contain an announcement that votes will be counted only if received by the secretary at least forty-five days before the annual meeting of the Institute. Election to contested seats on Council shall be determined by a plurality of the votes received from each jurisdiction by that date. Mail ballots shall be counted by the secretary, who shall certify the results for publication to the membership. Newly elected members shall be notified promptly and advised to attend the meeting of Council held in conjunction with the annual meeting of the Institute. They shall take office as provided in section 6.6.

[As revised May 15, 2000; revised November 6, 2007]

(See section 610R.)

BL Section 610R***Implementing Resolution Under Section 6.1
Members of Council Directly Elected by
Members of the Institute***

As amended
January 12, 1988

Under Section 6.1.6 Election***Resolved:***

.01 That the withdrawal of a nomination for whatever reason after the balloting has commenced will not be acted upon until the certification of election has been completed. Vacancies then arising will be filled in accordance with section 6.5 of the bylaws, except that in states where the number of nominees exceeds the number of vacancies, the vacancy created by any withdrawal will be filled by that nominee having the highest number of votes after all other vacancies have been filled.

BL Section 620***6.2 Selection of Members of Council to Represent State Societies***

**As amended
June 17, 1996,
unless otherwise indicated**

.01 Each recognized state society of certified public accountants shall designate, in a manner it deems appropriate, an Institute member to represent it on the Council. The term of each member of the Council so designated shall commence at the meeting of Council held in conjunction with the annual meeting of the Institute after notification to the secretary by the society designating the member. The term shall run for one year or until the commencement of the successor's term, provided that no such member of the Council shall represent a state society for more than six consecutive years.

[As revised May 15, 2000.]

BL Section 630***6.3 Election of Members-at-Large of Council, Board of Directors, Chairman of the Board, and Vice Chairman of the Board***

**As amended
January 14, 1992,
unless otherwise indicated**

.01 At the meeting of the Council held in conjunction with the annual meeting of the Institute, following the completion of such other business as the Council may transact, seven Institute members, without regard to the states in which they reside, shall be elected annually by the Council as members-at-large of the Council. This election shall occur prior to the installation of the members of the Council newly elected under section 6.1. The at-large members shall serve for a term of three years or until the election of their successors. At the same meeting, but after all newly elected and designated Council members have been installed, the Council shall elect the chairman of the board, the vice chairman of the board, one-third (or as near to one-third as mathematically possible) of the elected members of the Board of Directors. The elected members of the Board of Directors shall serve for a term of three years or until election of their successors. The Council shall also elect one representative of the public, who is not a member of the Institute, to the Board of Directors for a term of three years, or until election of a successor. Nominations for all these positions on the Board of Directors shall be made by the nominations committee at least six months prior to the annual meeting of the Institute. Notice of those nominations shall be published to the membership of the Institute at least five months prior to such annual meeting. Independent nominations may be made by any twenty members of the Council if filed with the secretary at least four months prior to the annual meeting of the Institute. No nominations from the floor will be recognized. A majority of votes shall elect. Nominees may be invited to the meeting at which the election is to be held, and those elected shall take office as prescribed in section 6.6.

[As amended June 17, 1996; revised May 15, 2000.]

.02 No member having served for two consecutive full terms as a member-at-large of the Council shall be eligible to serve another such term until at least one year after the completion of the member's second consecutive full term.

6.3.1. Re-election to Board of Directors

No elected member of the Board of Directors who has served a full three-year term shall be eligible for re-election to such a term until the meeting of the Council one year after the completion of the member's full three-year term, provided, however, that a public member may be elected to serve a second three-year term.

BL Section 640***6.4 Forfeiture of Office for Nonattendance***

**As amended
January 12, 1988**

.01 Any directly elected member or member-at-large of Council who shall be absent from three consecutive meetings shall forfeit that member's seat.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

BL Section 650**6.5 Vacancies**

**As amended
June 17, 1996**

.01 Vacancies in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute elected by the Council, occurring between annual meetings of the Institute, may be filled by election of replacements by the Council, either at a meeting of Council or by mail ballot, under such conditions as the Council may prescribe. If the Council should so replace a directly elected member of the Council, such interim appointment will run only until the member's seat is filled by direct election of the membership of that member's state as provided in these bylaws.

.02 Pending action by the Council to fill a vacancy among any of the officers of the Institute who are elected by the Council, the Board of Directors may appoint a temporary successor to act in the capacity indicated.

(See section 650R.)

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

BL Section 650R***Implementing Resolution Under Section 6.5
Vacancies***

**As amended
June 17, 1996**

Resolved:

.01 That if a vacancy occurs in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute elected by the Council between annual meetings of the Institute, the Board of Directors shall recommend replacements for election by Council. Voting on such replacement may be conducted by mail ballot, in which case provision shall be made for write-in votes, or at the next meeting of Council, as may appear most desirable in the circumstances. If the voting takes place at a Council meeting, nominations from the floor shall be permitted; voting may be by voice vote, or, at the request of a majority of those present, by written ballot. A majority vote shall elect. In any event, persons elected to fill vacancies in the Board of Directors, in the Council, or in any of the offices of the Institute elected by the Council shall serve only for the remainder of the unexpired term of the previous incumbent or until a successor is elected.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

BL Section 660***6.6 Election Meeting of Council***

**As amended
June 17, 1996,
unless otherwise indicated**

.01 New members-at-large of Council elected pursuant to section 6.3 shall take office as soon as their election is completed, replacing those members-at-large whose terms shall have expired. Then the presiding officer shall announce the installation of members of the Council newly elected under section 6.1, at which time they shall take office, replacing those directly elected members of Council whose terms shall have expired. Election of officers who are elected by the Council, new members of the Board of Directors, and others shall then be held, and each officer or member of the Board of Directors so elected shall replace that person's predecessor upon such election, provided, however, that the retiring chairman of the board shall continue in office through the end of the annual meeting of the Institute.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996; as revised May 15, 2000.]

BL Section 670***6.7 Term Limit***

**As adopted
November 6, 2007**

.01 Regardless of whether a member has served as a designated, directly elected, or at-large member of Council, no Council member who has served in any, or all, of the foregoing categories may serve more than seven consecutive years. A member who has served seven consecutive years shall not be eligible to serve on Council as a designated, directly elected, or at-large member of the Council until at least one year after the seventh consecutive year the member last served on the Council. Notwithstanding anything to the contrary in any section of these bylaws, any period during which an individual served as an ex officio Council member, such as president or a member of the Board of Directors, shall not be included in any determination of eligibility under this section.

BL Section 700**7. TERMINATION OF MEMBERSHIP AND
DISCIPLINARY SANCTIONS****TABLE OF CONTENTS**

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BL Section 701***Termination of Membership and Disciplinary Sanctions***

**As amended
January 12, 1988**

.01 This article shall govern the termination or suspension of membership in the Institute, whether imposed as a matter of discipline or voluntarily sought, and the imposition of any other disciplinary sanction, or administrative reprimand, whether public or private, or imposition of conditions for retention of membership.

BL Section 710***7.1 Resignation of Membership***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 Resignations of members shall be in writing and may be offered at any time. Actions on such resignations and applications for reinstatement of resigned members shall be taken by the Board of Directors under such provisions as the Council may prescribe. Council may make separate provision for action on resignations of members not in good standing or against whom disciplinary proceedings or investigations are pending or as to whom or to whose firm a practice-monitoring review has begun but has not been completed, and the resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program, and on applications for reinstatement of persons whose resignation was accepted when in such classification.

[As revised November 6, 2007]

(See section 710R.)

BL Section 710R***Implementing Resolution Under Section 7.1
Resignation of Membership***

**As amended,
January 12, 1988,
unless otherwise indicated**

Resolved:

.01 That the Board of Directors shall act upon resignation of members, which shall become effective on the date of acceptance, but no action shall be taken on the resignation of a member with respect to whom charges are under investigation by the professional ethics division, or against whom a complaint is pending before the trial board, or as to whom or whose firm a practice-monitoring review has begun but has not been completed, and the resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program unless the division, the trial board, or the Peer Review Board or peer review committee, as the case may be, recommends that such resignation be accepted. If a person whose resignation was accepted when that person was under investigation or the object of a complaint or during the pendency of a practice-monitoring review when that resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program, should subsequently apply for reinstatement, the Board of Directors shall not reinstate such person without the consent of the division or the trial board, or the Peer Review Board or committee as the case may be.

[As revised November 6, 2007.]

BL Section 720***7.2 Termination of Membership for
Nonpayment of Financial Obligation
or for Failure to Comply With
Membership-Retention Requirements***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 The Board of Directors may, in its discretion, terminate the membership of a member who fails to pay dues or any other obligation to the Institute within five months after such debt has become due and terminate the membership of a member who fails to comply with the practice-monitoring or continuing education membership-retention requirements. The Council shall provide for consideration and disposition by the trial board, with or without hearing, of a timely written petition that membership should not be terminated pursuant to this section. Any membership so terminated may be reinstated by the Board of Directors, under such conditions and procedures as the Council may prescribe.

(See section 720R.)

7.2.1 Termination of Association of International Associate

The Board of Directors may terminate the affiliation of an international associate at its discretion.

[As revised May 15, 2000.]

BL Section 720R***Implementing Resolution Under
Section 7.2 Termination of Membership
for Nonpayment of Financial Obligation
or for Failure to Comply With
Membership-Retention Requirements***

**As amended
January 12, 1988**

Resolved:

.01 That if a person whose membership has terminated for nonpayment of dues or other financial obligation shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate the member, provided that all dues and other obligations owing to the Institute at the time membership was terminated shall have been paid.

Further Resolved:

.02 That if a person whose membership has terminated for failure to comply with membership-retention requirements relating to CPE or practice-monitoring shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate the person as a member provided the person shall have satisfactorily demonstrated that the failure to comply with the CPE or practice-monitoring requirements has been rectified.

Further Resolved:

.03 That no person shall be considered to have resigned in good standing if at the time of resignation the person was in debt to the Institute for dues or other obligations. A member submitting a resignation after the beginning of the fiscal year, but before expiration of the time limit for payment of dues or other obligations, may attain good standing by paying dues prorated according to the portion of the fiscal year which has elapsed, provided obligations other than dues shall have been paid in full.

.04 A member who has resigned or whose membership has terminated in any manner may not file a new application for admission but may apply for reinstatement under this resolution or applicable provisions of the bylaws.

BL Section 730**7.3 Disciplinary Action Without a Hearing**

As amended
January 12, 1988,
unless otherwise indicated

.01 Membership in the Institute shall be suspended or terminated without a hearing for disciplinary purposes, or a member may be subjected to other disciplinary actions, as provided in sections 7.3.1 and 7.3.2, under such conditions and by such procedure as shall be prescribed by the Council.

[As revised October 18, 2003.]

(See section 730R.)

7.3.1 Criminal Conviction of Member

Membership in the Institute shall be suspended without a hearing should there be filed with the secretary of the Institute a judgment of conviction imposed upon any member for

7.3.1.1 A crime punishable by imprisonment for more than one year;

7.3.1.2 The willful failure to file any income tax return which the member, as an individual taxpayer, is required by law to file;

7.3.1.3 The filing of a false or fraudulent income tax return on the member's or a client's behalf; or

7.3.1.4 The willful aiding in the preparation and presentation of a false and fraudulent income tax return of a client; and

shall be terminated in like manner upon the similar filing of a final judgment of conviction; however, the Council shall provide for the consideration and disposition by the trial board, with or without hearing, of a timely written petition of any member that the member's membership should not be suspended or terminated pursuant to section 7.3.1.1, herein.

7.3.2 Other Disciplinary Action

7.3.2.1 Membership in the Institute shall be suspended without a hearing should a member's certificate as a certified public accountant or license or permit to practice as such or to practice public accounting be suspended as a disciplinary measure; however, such suspension of membership shall terminate upon reinstatement of the certificate, license or permit. Membership in the Institute shall be terminated without a hearing should such certificate, license, or permit be revoked, withdrawn, surrendered, indefinitely suspended, or cancelled as a disciplinary measure or in connection therewith.

[As revised October 18, 2003.]

7.3.2.2 The professional ethics executive committee and the Board of Directors may jointly approve certain governmental agencies and other organizations whose disciplinary actions against a member will permit the Institute to take disciplinary action against that member without a hearing. To be eligible for approval, the governmental

agency must be one which has the authority to prohibit a member from either practicing before it or serving as a director, officer or trustee of an entity. To be eligible for approval, an organization other than a governmental agency must be one which has been granted the authority by statute or regulation to regulate accountants. If such approved governmental agency or organization temporarily suspends, prohibits or restricts a member from practicing before it or another governmental agency, or from serving as a director, officer or trustee of any entity, the member's membership in the Institute shall be suspended; however, such suspension of membership shall terminate upon such agency's or organization's termination of the suspension, prohibition or restriction. If such approved governmental agency or organization bars or permanently or indefinitely suspends, prohibits or restricts a member from practicing before it or another governmental agency, or from serving as a director, officer or trustee of any entity, the member's membership in the Institute shall be terminated.

[As adopted October 18, 2003.]

7.3.2.3 A member who has been subjected to any sanction as a disciplinary measure other than or in addition to those sanctions addressed above, by an authority covered in section 7.3.2.1 or section 7.3.2.2, may also be subjected to discipline by the Institute without a hearing pursuant to guidelines established by the professional ethics executive committee and approved by the Board of Directors.

[As adopted October 18, 2003.]

7.3.2.4 Council shall permit the trial board, with or without a hearing, to consider a timely written petition by the professional ethics executive committee or the member that the member should not be disciplined pursuant to this section 7.3.2.

[As revised October 18, 2003.]

7.3.3 Trial Board Disciplining Not Precluded

Application of the provisions of section 7.3.1 and section 7.3.2 shall not preclude the summoning of the member concerned to appear before a hearing panel of the trial board pursuant to section 7.4.

BL Section 730R***Implementing Resolution Under Section 7.3
Disciplinary Action Without a Hearing***

**As amended
January 12, 1988,
unless otherwise indicated**

Resolved:

.01 (1) That the membership of a member who is convicted by a court of any of the criminal offenses enumerated in section 7.3.1 of the bylaws shall become automatically suspended upon the mailing of a notice of such suspension, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a certified copy of a judgment of conviction of such criminal offense has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

.02 (2) That the membership of a member who has been convicted by a court of any of the offenses enumerated in section 7.3.1 of the bylaws, and which conviction has become final, shall become automatically terminated upon the mailing of a notice of such termination, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a certified copy of such conviction and evidence that it has become final has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

.03 (3) That the membership of a member (a) whose certificate, license or permit to practice public accounting or as a certified public accountant has been suspended as a disciplinary measure or (b) who is subject to a temporary suspension, prohibition or restriction by an approved governmental agency or organization covered in section 7.3.2 as a disciplinary measure shall, except as provided in paragraph (7) of this resolution, become automatically suspended upon the expiration of thirty days after the mailing of a notice of such suspension, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a statement by such authority showing the suspension, prohibition or restriction and specifying the cause and duration of such authority's action has been filed with the secretary of the Institute. Such automatic suspension shall cease upon the expiration of the period of suspension, prohibition or restriction so specified.

[As revised by Council October 18, 2003.]

.04 (4) That the membership of a member (a) whose certificate, license or permit to practice public accounting or as a certified public accountant has been revoked, withdrawn, indefinitely suspended, surrendered or cancelled as a disciplinary measure, or (b) who has been subjected to a bar, to a permanent or indefinite suspension, prohibition or restriction by an approved governmental agency or organization covered in section 7.3.2 shall, except as provided in paragraph (7) of this resolution, become automatically terminated upon the expiration of thirty days after the mailing of a notice of such termination, as provided in paragraph (6) of this resolution. Such notice shall be mailed within

a reasonable time after a statement by such authority showing the revocation, withdrawal, surrender, cancellation, bar, permanent or indefinite suspension, prohibition or restriction and specifying the cause of such authority's action, has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

.05 (5) That, if a member has been subjected to any sanction as a disciplinary measure, other than or in addition to those set out in paragraph (1), (2), (3) or (4), the member shall, except as provided in paragraph (7), have their membership suspended or terminated or be otherwise disciplined upon the expiration of thirty days after the mailing of a notice of such disciplinary action taken pursuant to guidelines developed by the professional ethics executive committee and approved by the Board of Directors, under section 7.3.2.

[As adopted by Council October 18, 2003.]

.06 (6) That notices of disciplinary action pursuant to paragraph (1), (2), (3), (4) or (5) of this resolution shall be signed by the secretary of the Institute and mailed by registered or certified mail, postage prepaid, addressed to the member concerned at the member's last known address according to the official records of the Institute, which are the records of the membership department.

[As revised by Council June 17, 1996; revised October 18, 2003.]

.07 (7) That the operation of paragraph (1), (2), (3), (4) or (5) of this resolution shall become postponed if, before the expiration of thirty days after mailing the notice of disciplinary action, the secretary of the Institute receives a written petition from either the member concerned or the professional ethics executive committee that the pertinent provision not become operative. The petition shall state briefly the facts and reasons relied upon. All such petitions shall be referred to the trial board for action thereon by a panel of the trial board consisting of at least three members appointed by the chairman of the trial board or vice chairman, when acting as chairman. If the petition is denied, the disciplinary action shall become effective upon such denial, and the party that made the petition shall be so notified in writing by the secretary of the Institute. No appeal shall be allowable with respect to a denial of such a petition. If the petition is granted, the disciplinary action shall not become effective. In such event, the secretary shall transmit the matter to the professional ethics division to take whatever action it considers proper in the circumstances. A determination that paragraph (1), (2), (3), (4) or (5) of this resolution shall not become operative shall be made only when it clearly appears that, because of exceptional or unusual circumstances, it would be inequitable to permit such automatic disciplinary action.

[As revised by Council May 15, 2000; revised October 18, 2003.]

BL Section 740***7.4 Disciplining of Member by Trial Board***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 Under such conditions and by such procedure as the Council may prescribe, a hearing panel of the trial board, by a two-thirds vote of the members present and voting, may expel a member (except as otherwise provided in section 7.4.3), or by a majority vote of the members present and voting, may suspend a member for a period not to exceed two years not counting any suspension imposed under sections 7.3.1 and 7.3.2, or may impose such lesser sanctions as the Council may prescribe on any member if the member

7.4.1 Infringes any of these bylaws or any rule of the Code of Professional Conduct;

7.4.2 Is declared by a court of competent jurisdiction to have committed any fraud;

7.4.3 Is held by a hearing panel of the trial board to have been guilty of an act discreditable to the profession, or to have been convicted of a criminal offense which tends to discredit the profession; provided that should a hearing panel of the trial board find by a majority vote that the member has been convicted by a criminal court of an offense involving moral turpitude, or any of the offenses enumerated in section 7.3.1, the penalty shall be expulsion;

7.4.4 Is declared by any competent court to be insane or otherwise incompetent;

7.4.5 Is subject to a disciplinary action by an authority covered in section 7.3.2 that could result in automatic discipline under section 7.3.2; or
[As revised October 18, 2003.]

7.4.6 Fails to cooperate with the professional ethics division in any disciplinary investigation of the member, owner or employee of the firm by not making a substantive response to interrogatories or a request for documents from a committee of the professional ethics division or by not complying with the educational and remedial or corrective action determined to be necessary by the professional ethics executive committee, within thirty days after the posting of notice of such interrogatories, or a request for documents, or directive to take CPE or corrective action by registered or certified mail, postage prepaid, to the member at the member's last known address shown in the official records of the Institute.

[As revised May 15, 2000.]

.02 With respect to a member residing in a state in which the state society has entered into an agreement approved by the Institute's Board of Directors

to deal with complaints against society members in cooperation with the professional ethics division, disciplinary hearings shall be conducted before a hearing panel of the joint trial board.

(See section 740R.)

BL Section 740R***Implementing Resolution Under Section 7.4
Disciplining of Member by Trial Board***

As amended
January 12, 1988,
unless otherwise indicated

Resolved:

.01 (1) Any complaint preferred against a member under section 7.4 of the bylaws shall be submitted to the professional ethics division, which in turn may refer the complaint for investigation and recommendation to an ethics committee (or its equivalent) of a state society of certified public accountants that has made an agreement with the Institute of the type authorized in section 7.4 of the bylaws. If, upon consideration of the complaint, investigation and/or recommendation thereon, it appears that a prima facie case is established showing a violation of any applicable bylaws or any rule of the Code of Professional Conduct of the Institute or any state society making an agreement with the Institute referred to above or showing any conduct discreditable to a certified public accountant, the professional ethics division or the ethics committee of such state society, except as provided in the implementing resolution under section 3.6.2.2 of the bylaws, shall report the matter to the secretary of the joint trial board who shall summon the member involved to respond to the charges preferred against the member, which response may include the entering of a plea of guilty without a hearing, in accordance with rules established by the trial board, provided, however, that with respect to a case in which the trial board has granted a petition that automatic discipline shall not become operative under the provisions of paragraph (7) in the implementing resolution under section 7.3.2 of the bylaws, the division or such state society ethics committee shall have discretion as to whether and when to report the matter to the secretary for such summoning.

[As revised by Council October 18, 2003.]

.02 (2)

- (a) If the professional ethics division or state society ethics committee dismisses any complaint preferred against a member or shall fail to initiate its inquiry within ninety days after such complaint is presented to it in writing, the member preferring the complaint may present the complaint in writing to the trial board, provided, however, that this provision shall not apply to a case falling within the scope of section 7.3.
- (b) The chairman of the trial board shall cause such investigation to be made of the matter as the chairman may deem necessary, and shall either dismiss the complaint or refer it to the secretary of the trial board who shall summon the member to answer the complaint in accordance with the provisions in paragraph (1) hereof.
- (c) Prior to causing the investigation referred to in paragraph (b), the chairman of the trial board shall designate six members of the trial

board who shall not be involved in such investigation in order that not less than three of them may be appointed to an independent hearing panel if necessary. The chairman shall report the names of such members to the secretary of the trial board prior to any action under paragraph (b).

[As revised by Council May 15, 2000.]

.03 (3) For the purpose of adjudicating charges against members of the Institute, as provided in the foregoing paragraphs of this resolution, the following must take place:

- (a) The secretary shall mail to the member concerned, at least thirty days prior to the proposed meeting of a panel appointed to hear the case, written notice of the charges to be adjudicated. Such notice, when mailed by registered or certified mail, postage prepaid, addressed to the member concerned at the member's last known address according to the official records of the Institute, which are the records of the membership department, shall be deemed properly served.
- (b) After considering the evidence presented by the professional ethics division or other complainant and by the defense, the panel hearing the case, a quorum present, by vote of the members present and voting, may, in a manner consistent with section 7.4 of the bylaws, admonish, suspend for a period of not more than two years, or expel the member against whom the complaint is made and take such other disciplinary, remedial or corrective action as the panel deems appropriate.
- (c) In a case decided by a panel, the member concerned may request a review by the trial board of the decision of the panel, provided such a request for review is filed with the secretary of the trial board within thirty days after the decision of the panel, and that such information as may be required by the rules of the trial board shall be filed with such request. Such a review shall not be a matter of right. Each such request for a review shall be considered by an ad hoc committee to be appointed by the chairman of the trial board, or its vice chairman in the event of the chairman's unavailability, and to consist of not less than three members of the trial board who did not participate in the prior proceedings in the case. The ad hoc committee shall have power to decide whether such request for review by the trial board shall be granted, and such committee's decision that such request shall not be granted shall be final and subject to no further review. A quorum of such ad hoc committee shall consist of a majority of the appointed. If such request for review is granted, the trial board shall review the decision of the panel in accordance with its rules of practice and procedure. On review of such decision, the trial board may affirm, modify, or reverse all or any part of such decision or make such other disposition of the case as it deems appropriate. The trial board may, by general rule, indicate the character of reasons that may be considered to be of sufficient importance to warrant an ad hoc committee granting a request for review of a decision of a panel.

[As revised by Council May 15, 2000.]

- (d) Any decision of the trial board, including any decision reviewing a decision of a panel, shall become effective when made, unless the trial board's decision indicates otherwise, in which latter event it shall become effective at the time determined by the trial board. Any decision of a panel shall become effective as follows:
 - (i) Upon the expiration of thirty days after it is made, if no request for review is properly filed within such thirty-day period.
 - (ii) Upon the denial of a request for review, if such request has been properly filed within such thirty-day period and is denied by an ad hoc committee.
 - (iii) Upon the date of a decision of a review panel affirming the decision of a hearing panel in cases where a review has been granted by an ad hoc committee.
- (e) A plea of guilty, if it conforms to the rules and procedures of the trial board, shall become effective upon acceptance by the trial board.

[As revised by Council June 17, 1996.]

.04 (4) In the case of a settlement agreement between a member and the professional ethics executive committee that provides for disciplinary action pursuant to the Council resolution implementing bylaw section 3.6.2.2, the matter shall be referred to a panel of the trial board which, upon finding that there has been a waiver of the member's rights under Article 7.4, shall recognize such settlement agreement and arrange for publication of such disciplinary action under section 7.6 of the bylaws.

[As revised by Council May 26, 1993; revised April 28, 2003.]

BL Section 750***7.5 Reinstatement***

**As amended
January 12, 1988**

.01 The Council may prescribe the conditions and procedures under which members suspended or terminated under sections 7.3 and 7.4 may be reinstated.

(See section 750R.)

BL Section 750R***Implementing Resolution Under
Section 7.5 Reinstatement***

**As amended
January 12, 1988,
unless otherwise indicated**

Resolved:

.01 (1) That at any time after the publication by the Institute of a statement of a case and decision, including cases in which a guilty plea was entered without a hearing, on application of the member concerned to the secretary of the trial board, the appropriate panel of the trial board that last heard the case and whose decision provided the basis for the publication or, where the original panel cannot be reappointed, or in the case of a guilty plea, a newly formed panel, may, by a two-thirds vote of the members present and voting, rescind or modify such decision. Any such action shall be published by the Institute. The denial of an application under this section shall not be published and shall not prevent the member concerned from applying for reinstatement under section (2) hereof.

[As revised by Council May 26, 1993; revised May 15, 2000.]

.02 (2) That

- (a) Should an order, judgment of conviction, decision or action on which the suspension or termination of membership was based under section 7.3 of the bylaws be reversed or otherwise set aside or invalidated, such suspension shall terminate or such member shall become reinstated when a certified copy of the order reversing or otherwise setting aside or invalidating such order, conviction, decision or action is filed with the secretary of the joint trial board, who shall refer the matter to the professional ethics division for whatever action it deems appropriate.

[As revised by Council October 18, 2003.]

- (b) A member who has been suspended or expelled by the trial board pursuant to section 7.4 of the bylaws may request that the suspension terminate or may request reinstatement if an order, judgment of conviction, decision or action on which the suspension or termination was based has been reversed or otherwise set aside or invalidated. Such request shall be referred to the trial board whereupon a hearing panel composed of five members designated by the chairman of the trial board may, after investigating all related circumstances, terminate the suspension or reinstate the member concerned by a majority vote of the members present and entitled to vote.

[As revised by Council October 18, 2003.]

- (c) Except as provided in subparagraphs (a) and (b) of this paragraph (2), a member whose membership has been automatically terminated

under section 7.3, or who has been expelled by or had the member's resignation accepted by a panel of the trial board may, at any time after three years from the effective date of such termination, expulsion, or acceptance of resignation, request reinstatement of their membership. Such request shall be referred to the trial board, whereupon the chairman shall designate five members of the board to a hearing panel which may, after investigation, reinstate such member on such terms and conditions as it shall determine to be appropriate. If an application for reinstatement under this subparagraph is denied, the member concerned may again apply for reinstatement at any time after two years from the date of such denial.

BL Section 760***7.6 Publication of Disciplinary Action***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 Notice of disciplinary action pursuant to section 7.3 or 7.4 or of termination of enrollment of a member or a member's firm in an Institute-approved practice-monitoring program, together with a statement of the reasons therefore, shall be published in such form and manner as the Council may prescribe. Council also may prescribe any additional disclosures regarding any matter within the jurisdiction of the professional ethics executive committee.

[As revised May 15, 2000; revised October 18, 2003; revised November 6, 2007.]

(See section 760R.)

BL Section 760R***Implementing Resolution Under Section 7.6
Publication of Disciplinary Action***

**As amended
May 26, 1993,
unless otherwise indicated**

Resolved:

.01 That notice of disciplinary action taken under section 7.3 or 7.4 of the bylaws or of termination of enrollment of a member or a member's firm in an Institute-approved practice monitoring program, and the basis therefore shall be published by the Institute and that the professional ethics division, the Peer Review Board or peer review committee as appropriate shall maintain a record of such information and disclose that information upon request. In the case of disciplinary action pursuant to section 7.3 of the bylaws, such notice shall be in a form approved by the chairman of the trial board and consistent with this Council resolution. In any action pursuant to section 7.4 of the bylaws in which the member is found guilty or has entered into a settlement agreement with the professional ethics executive committee, the trial board or panel hearing the case shall decide on the form of the notice of the case and the decision to be published. All notices shall disclose, at least, the name of the member involved and, when appropriate, the terms and conditions of any settlement agreement and the nature of the violation. The statement and decision, as released by the chairman, trial board, or hearing panel, shall be published by the Institute. No such publication shall be made until such decision has become effective. The professional ethics executive committee may inform the complainant of the outcome of its investigation without regard to whether the action taken results in publication under section 7.6 of the bylaws.

[As revised by Council May 15, 2000; revised October 18, 2003; revised November 6, 2007.]

BL Section 770***7.7 Disciplinary Sections Not to Be Applied Retroactively***

**As amended
January 12, 1988**

.01 Sections 7.3 and 7.4 shall not be applied to offenses of wrongful conduct occurring prior to their effective dates, but such offenses shall be subject to discipline under the bylaws of the Institute in effect at the time of their occurrence.

BL Section 800
8. AMENDMENTS

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BL Section 801***Amendments***

**As amended
January 12, 1988**

.01 Amendments to these bylaws and the Code of Professional Conduct shall be accomplished in a manner consistent with this article.

BL Section 810***8.1 Proposals to Amend the Bylaws***

**As amended
June 17, 1996**

.01 Proposals to amend the bylaws may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, or by petition of 5 percent of the membership as of the end of the prior fiscal year. Any such petition shall include the member's name (typed or printed), membership number and the date it is signed, and the signature of a member on such a petition shall be valid for one year from the date thereof. The changes to this provision will not apply to petitions, regardless of when they are signed, submitted pursuant to efforts to gather such petitions which were ongoing as of July 13, 1995.

BL Section 820***8.2 Proposals to Amend the Code of Professional Conduct***

**As amended
June 17, 1996**

.01 Proposals to amend the Code of Professional Conduct may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, by the professional ethics division, or by petition of 5 percent of the membership as of the end of the prior fiscal year. Any such petition shall include the member's name (typed or printed), membership number and the date it is signed, and the signature of a member on such a petition shall be valid for one year from the date thereof. The changes to this provision will not apply to petitions, regardless of when they are signed, submitted pursuant to efforts to gather such petitions which were ongoing as of July 13, 1995.

BL Section 830***8.3 Submission to Council via
Board of Directors***

**As amended
January 12, 1988**

.01 All such proposals to amend the bylaws or the Code of Professional Conduct, unless made at a meeting of the Council or the Board of Directors, shall be submitted in writing to the Board of Directors. The Board of Directors shall submit all such proposals, accompanied by its recommendation, to the Council for action.

8.3.1 Proposals Not Requiring Council Approval

Following discussion at a meeting of the Council, proposals sponsored by at least 5 percent of the membership shall be submitted to the membership of the Institute for vote by mail ballot pursuant to section 8.4.

BL Section 840***8.4 Submission to Membership by Mail Ballot***

**As amended
January 12, 1988,
unless otherwise indicated**

.01 Amendments proposed under section 8.3.1 and those authorized by the Council under section 8.3 shall be submitted to all of the members of the Institute for a vote by mail ballot no later than 180 days following discussion or authorization by the Council. If at least two-thirds of those voting approve such proposal, it shall become effective as an amendment to the bylaws or to the Code of Professional Conduct, as applicable. Mail ballots shall be considered valid and counted only if received as instructed by the Institute for the return of such votes within sixty days from the date of mailing the ballots to the members.

[As revised May 15, 2000; revised November 6, 2007.]

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BL Section 911

[Reserved.]

BL Section 921***A Description of the Professional Practice of Certified Public Accountants***

- .01** Certified public accountants practice in the broad field of accounting.
- .02** Accounting is a discipline which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organization.
- .03** The information which accounting provides is essential for (1) effective planning, control, and decision-making by management, and (2) discharging the accountability of organizations to investors, creditors, government agencies, taxing authorities, association members, contributors to welfare institutions, and others.
- .04** Accounting includes the development and analysis of data, the testing of their validity and relevance, and the interpretation and communication of the resulting information to intended users. The data may be expressed in monetary or other quantitative terms, or in symbolic or verbal forms.
- .05** Some of the data with which accounting is concerned are not precisely measurable, but necessarily involve assumptions and estimates as to the present effect of future events and other uncertainties. Accordingly, accounting requires not only technical knowledge and skill, but even more important, disciplined judgment, perception, and objectivity.
- .06** Within this broad field of accounting, certified public accountants are the identified professional accountants. They provide leadership in accounting research and education. In the practice of public accounting CPAs bring competence of professional quality, independence, and a strong concern for the usefulness of the information and advice they provide, but they do not make management decisions.
- .07** The professional quality of their services is based upon experience and the requirements for the CPA certificate—education and examination—and upon the ethical and technical standards established and enforced by their profession.
- .08** CPAs have a distinctive role in auditing financial statements submitted to investors, creditors, and other interested parties, and in expressing independent opinions on the fairness of such statements. This distinctive role has inevitably encouraged a demand for the opinions of CPAs on a wide variety of other representations, such as compliance with rules and regulations of government agencies, sales statistics under lease and royalty agreements, and adherence to covenants in indentures. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]
- .09** The audit of financial statements requires CPAs to review many aspects of an organization's activities and procedures. Consequently they can advise clients of needed improvements in internal control and make constructive suggestions on financial, tax, and other operating matters. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]

.10 In addition to furnishing advice in conjunction with their independent audits of financial statements, CPAs are engaged to provide objective advice and consultation on various management problems. Many of these involve information and control systems and techniques, such as budgeting, cost control, profit planning, internal reporting, automatic data processing, and quantitative analysis. CPAs also assist in the development and implementation of programs approved by management. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]

.11 Among the major management problems depending on the accounting function is compliance with tax requirements. An important part of the practice of CPAs includes tax planning and advice, preparation of tax returns, and representation of clients before government agencies.

.12 CPAs also participate in conferences with government agencies such as the Securities and Exchange Commission, and with other interested parties, such as bankers.

.13 Like other professionals, CPAs are often consulted on business, civic, and other problems on which their judgment, experience, and professional standards permit them to provide helpful advice and assistance.

.14 The complexities of an industrial society encourage a high degree of specialization in all professions. The accounting profession is no exception. Its scope is so wide and varied that many individual CPAs choose to specialize in particular types of service.

.15 Although their activities may be diverse, all CPAs have demonstrated basic competence of professional quality in the discipline of accounting. It is this which unites them as members of one profession, and provides a foundation for extension of their services into new areas.

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VS Section 100

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset

Source: Statement on Standards for Valuation Services No. 1

June 2007

Foreword

Why Issued

Valuations of businesses, business ownership interests, securities, or intangible assets (hereinafter collectively referred to in this Foreword as *business valuations*) may be performed for a wide variety of purposes including the following:

1. Transactions (or potential transactions), such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions
2. Litigation (or pending litigation) relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, and employment and intellectual property disputes
3. Compliance-oriented engagements, including (a) financial reporting and (b) tax matters such as corporate reorganizations; S corporation conversions; income, estate, and gift tax compliance; purchase price allocations; and charitable contributions
4. Planning oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning

In recent years, the need for business valuations has increased significantly. Performing an engagement to estimate value involves special knowledge and skill.

Given the increasing number of members of the AICPA who are performing business valuation engagements or some aspect thereof, the AICPA Consulting Services Executive Committee has written this standard to improve the consistency and quality of practice among AICPA members performing business valuations. AICPA members will be required to follow this standard when they perform engagements to estimate value that culminate in the expression of a conclusion of value or a calculated value.

The Consulting Services Executive Committee is a body designated by AICPA Council to promulgate professional standards under the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) and the "Compliance with Standards Rule" (ET sec. 1.310.001 and 2.310.001) of the AICPA Code of Professional Conduct (the code).

Introduction and Scope

.01 This statement establishes standards for AICPA members (hereinafter referred to in this statement as *members*) who are engaged to, or, as part of

another engagement, estimate the value of a **business**,¹ *business ownership interest, security, or intangible asset* (hereinafter collectively referred to in this statement as **subject interest**). For purposes of this statement, the definition of a business includes not-for-profit entities or activities.

.02 As described in this statement, the term **engagement to estimate value** refers to an engagement or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement) that involves estimating the value of a subject interest. An engagement to estimate value culminates in the expression of either a **conclusion of value** or a **calculated value** (see paragraph .21). A member who performs an engagement to estimate value is referred to, in this statement, as a **valuation analyst**.

.03 Valuation analysts should be aware of any governmental regulations and other professional standards applicable to the engagement, including the code and the Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* (CS sec. 100), and the extent to which they apply to engagements to estimate value. Compliance is the responsibility of the valuation analyst.

.04 In the process of estimating value as part of an engagement, the valuation analyst applies **valuation approaches** and **valuation methods**, as described in this statement, and uses professional judgment. The use of professional judgment is an essential component of estimating value.

Exceptions From This Statement

.05 This statement is not applicable to a member who participates in estimating the value of a subject interest as part of performing an attest engagement defined by the "Independence Rule" of the code (ET sec. 1.200.001) (for example, as part of an audit, review, or compilation engagement).

.06 This statement is not applicable when the value of a subject interest is provided to the member by the client or a third party, and the member does not apply valuation approaches and methods, as discussed in this statement.

.07 This statement is not applicable to internal use assignments from employers to employee members not in public practice, as that term is defined in the code (ET sec. 0.400.42). See also Valuation Interpretation No. 1, "Scope of Applicable Services" (VS sec. 9100), illustrations 24 and 25 (VS sec. 9100 par. .78–.81).

.08 This statement is not applicable to engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) unless those determinations include an engagement to estimate value. See also Interpretation No. 1, illustrations 1, 2, and 3 (VS sec. 9100 par. .06–.11).

.09 This statement is not applicable to mechanical computations that do not rise to the level of an engagement to estimate value; that is, when the member does not apply valuation approaches and methods and does not use professional judgment. See Interpretation No. 1, illustration 8 (VS sec. 9100 par. .20–.23).

¹ This statement includes two glossaries. Appendix B, "International Glossary of Business Valuation Terms" (par. .81), is a verbatim reproduction of the glossary jointly developed by the AICPA, the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and the Institute of Business Appraisers. Appendix C, "Glossary of Additional Terms" (par. .82), provides definitions for terms included in this statement but not defined in the jointly developed glossary. The terms defined in appendix B are in boldface type the first time they appear in this statement; the terms defined in appendix C are in italicized boldface type the first time they appear in this statement.

This statement is not applicable when it is not practical or not reasonable to obtain or use relevant information; as a result, the member is unable to apply valuation approaches and methods that are described in this statement.²

Jurisdictional Exception

.10 If any part of this statement differs from published governmental, judicial, or accounting authority, or such authority specifies valuation development procedures or valuation reporting procedures, then the valuation analyst should follow the applicable published authority or stated procedures with respect to that part applicable to the valuation in which the member is engaged. The other parts of this statement continue in full force and effect (Interpretation No. 1 [VS sec. 9100 par. .01–.89]).

Overall Engagement Considerations

Professional Competence

.11 The "General Standards Rule" of the code (ET sec. 1.300.001 and 2.300.001) states that a member shall "undertake only those *professional services* that the *member* or the *member's firm* can reasonably expect to be completed with professional competence." Performing a valuation engagement with professional competence involves special knowledge and skill. A valuation analyst should possess a level of knowledge of valuation principles and theory and a level of skill in the application of such principles that will enable him or her to identify, gather, and analyze data, consider and apply appropriate valuation approaches and methods, and use professional judgment in developing the estimate of value (whether a single amount or a range). An in-depth discussion of valuation theory and principles, and how and when to apply them, is not within the scope of this statement.

.12 In determining whether he or she can reasonably expect to complete the valuation engagement with professional competence, the valuation analyst should consider, at a minimum, the following:

- a. Subject entity and its industry
- b. Subject interest
- c. **Valuation date**
- d. Scope of the valuation engagement
 - i. Purpose of the valuation engagement
 - ii. **Assumptions and limiting conditions** expected to apply to the valuation engagement (see paragraph .18)
 - iii. Applicable **standard of value** (for example, ***fair value*** or ***fair market value***) and the applicable **premise of value** (for example, going concern)
 - iv. Type of valuation report to be issued (see paragraph .48), intended use and users of the report, and restrictions on the use of the report
- e. Governmental regulations or other professional standards that apply to the subject interest or to the valuation engagement

² Unless prohibited by statute or by rule, a member may use the client's estimates for compliance reporting to a third party if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member). See Interpretation No. 1, "Scope of Applicable Services" (VS sec. 9100 par. .01–.89), and Statement for Standards on Tax Services No. 4, *Use of Estimates* (TS sec. 400).

Nature and Risks of the Valuation Services and Expectations of the Client

.13 In understanding the nature and risks of the **valuation services** to be provided, and the expectations of the client, the valuation analyst should consider the matters in paragraph .12, and in addition, at a minimum, the following:

- a. The proposed terms of the valuation engagement
- b. The identity of the client
- c. The nature of the interest and ownership rights in the business, business interest, security, or intangible asset being valued, including **control** characteristics and the degree of **marketability** of the interest
- d. The procedural requirements of a valuation engagement and the extent, if any, to which procedures will be limited by either the client or circumstances beyond the client's or the valuation analyst's control
- e. The use of and limitations of the report, and the conclusion or calculated value
- f. Any obligation to update the valuation

Objectivity and Conflict of Interest

.14 The code requires objectivity in the performance of all professional services, including valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. Where a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent as required by the "Conflicts of Interest" interpretation (ET sec. 1.110.010 and 2.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001 and 2.100.001).

Independence and Valuation

.15 If valuation services are performed for a client for which the valuation analyst or valuation analyst's firm also performs an attest engagement (defined by the "Independence Rule" of the code), the valuation analyst should meet the requirements included in the interpretations of the "Nonattest Services" subtopic (ET sec. 1.295) under the "Independence Rule" (ET sec. 1.200.001) so as not to impair the member's independence with respect to the client.

Establishing an Understanding With the Client

.16 The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers. (If the engagement is being performed for an attest client, the "General Requirements for Performing Nonattest Services" interpretation [ET sec. 1.295.040] of the "Independence Rule" [ET sec. 1.200.001] requires the engagement understanding to be in writing.) Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she encounters circumstances during the engagement that make it appropriate to modify that understanding.

.17 The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. The understanding should include, at a minimum, the nature,

purpose, and objective of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities, the applicable assumptions and limiting conditions, the type of report to be issued, and the standard of value to be used.

Assumptions and Limiting Conditions

.18 Assumptions and limiting conditions are common to valuation engagements. Examples of typical assumptions and limiting conditions for a business valuation are provided in appendix A, "Illustrative List of Assumptions and Limiting Conditions for a Business Valuation" (par. .80). The assumptions and limiting conditions should be disclosed in the valuation report (see paragraphs .52*l*, .68*g*, and .71*m*).

Scope Restrictions or Limitations

.19 A restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis, may be present and known to the valuation analyst at the outset of the valuation engagement or may arise during the course of a valuation engagement. Such a restriction or limitation should be disclosed in the valuation report (see paragraphs .52*m*, .68*e*, and .71*n*).

Using the Work of Specialists in the Engagement to Estimate Value

.20 In performing an engagement to estimate value, the valuation analyst may rely on the work of a third party specialist (for example, a real estate or equipment appraiser). The valuation analyst should note in the assumptions and limiting conditions the level of responsibility, if any, being assumed by the valuation analyst for the work of the third party specialist. At the option of the valuation analyst, the written report of the third party specialist may be included in the valuation analyst's report.

Development

Types of Engagement

.21 There are two types of engagements to estimate value—a ***valuation engagement*** and a ***calculation engagement***. The valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client (see paragraphs .16 and .17):

- a. *Valuation engagement.* A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value (as outlined in paragraphs .23–.45) and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.
- b. *Calculation engagement.* A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the

process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement (see paragraph .46).

Hypothetical Conditions

.22 Hypothetical conditions affecting the subject interest may be required in some circumstances. When a valuation analyst uses hypothetical conditions during a valuation or calculation engagement, he or she should indicate the purpose for including the hypothetical conditions and disclose these conditions in the valuation or calculation report (see paragraphs .52*n*, .71*o*, and .74).

Valuation Engagement

.23 In performing a valuation engagement, the valuation analyst should do the following:

- Analyze the subject interest (paragraphs .25–.30)
- Consider and apply appropriate valuation approaches and methods (paragraphs .31–.42)
- Prepare and maintain appropriate documentation (paragraphs .44–.45)

.24 Even though the list in paragraph .23 and some requirements and guidance in this statement are presented in a manner that suggests a sequential valuation process, valuations involve an ongoing process of gathering, updating, and analyzing information. Accordingly, the sequence of the requirements and guidance in this statement may be implemented differently at the option of the valuation analyst.

Analysis of the Subject Interest

.25 The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable **premise of value**
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

.26 In analyzing the subject interest, the valuation analyst should consider financial and nonfinancial information. The type, availability, and significance of such information vary with the subject interest.

Nonfinancial Information

.27 The valuation analyst should, as available and applicable to the valuation engagement, obtain sufficient nonfinancial information to enable him or her to understand the subject entity, including the following:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of **equity** ownership interests and rights attached thereto
- Products or services, or both
- Economic environment
- Geographical markets
- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**
- Strategy and future plans
- Governmental or regulatory environment

Ownership Information

.28 The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to

- determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics.
- analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest.
- understand the classes of equity ownership interests and rights attached thereto.
- understand the rights included in, or excluded from, each intangible asset.
- understand other matters that may affect the value of the subject interest, such as the following:
 - *For a business, business ownership interest, or security:* Shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest.
 - *For an intangible asset:* Legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations.

Financial Information

.29 The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as the following:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding the following:
 - Advantageous or disadvantageous contracts
 - Contingent or off-balance-sheet assets or liabilities
 - Information on prior sales of company stock

.30 The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

Valuation Approaches and Methods

.31 In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (income-based) approach**
- **Asset (asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (market-based) approach**

.32 The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs .33–.41, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this statement.

.33 *Income Approach.* Two frequently used valuation methods under the income approach include the **capitalization of benefits method** (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows). When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

- a. *Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:
 - i. **Normalization** adjustments
 - ii. Nonrecurring revenue and expense items
 - iii. Taxes
 - iv. Capital structure and financing costs

- v. Appropriate capital investments
 - vi. Noncash items
 - vii. Qualitative judgments for risks used to compute discount and **capitalization rates**
 - viii. Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)
- b. *Discounted future benefits method (for example, earnings or cash flows).* In addition to the items in item a, the valuation analyst should consider the following:
- i. Forecast or projection assumptions
 - ii. Forecast or projected earnings or cash flows
 - iii. **Terminal value**
- c. For an intangible asset, the valuation analyst should also consider, when relevant, the following:
- i. Remaining useful life
 - ii. Current and anticipated future use of the intangible asset
 - iii. Rights attributable to the intangible asset
 - iv. Position of intangible asset in its life cycle
 - v. Appropriate discount rate for the intangible asset
 - vi. Appropriate **capital or contributory asset charge**, if any
 - vii. Research and development or marketing expense needed to support the intangible asset in its existing state
 - viii. Allocation of income (for example, **incremental income, residual income, or profit split income**) to intangible asset
 - ix. Whether any tax amortization benefit would be included in the analysis
 - x. Discounted multi-year excess earnings
 - xi. Market royalties
 - xii. Relief from royalty

Asset Approach and Cost Approach

.34 A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

.35 When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

Market Approach

.36 Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are as follows:

- **Guideline public company method**
- **Guideline company transactions method**
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are as follows:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)
- Comparable profit margin method (which is based on comparison of the profit margin earned by the subject entity that owns or operates the intangible asset to profit margins earned by guideline companies)
- **Relief from royalty method** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

.37 In applying the methods listed in paragraph .36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider the following:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

.38 The valuation analyst should set forth in the report the rationale and support for the valuation methods used (see paragraph .47).

.39 *Rules of Thumb*. Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as **rules of thumb**) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

Valuation Adjustments

.40 During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

.41 When valuing a controlling ownership interest under the income approach, the value of any **non-operating assets**, non-operating liabilities, or **excess or deficient operating assets** should be excluded from the computation of the value based on the operating assets and should be added to or deleted

from the value of the operating entity. When valuing a non-controlling ownership interest under the income approach, the value of any non-operating assets, non-operating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the non-controlling interest. In the asset-based or cost approach, it may not be necessary to separately consider non-operating assets, non-operating liabilities, or excess or deficient operating assets.

Conclusion of Value

- .42** In arriving at a conclusion of value, the valuation analyst should
- a.* correlate and reconcile the results obtained under the different approaches and methods used.
 - b.* assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
 - c.* determine, based on items *a* and *b*, whether the conclusion of value should reflect
 - i.* the results of one valuation approach and method, or
 - ii.* a combination of the results of more than one valuation approach and method.

Subsequent Events

.43 The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a **subsequent event**. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (see paragraphs .52p, .71r, and .74). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

Documentation

.44 Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include the following:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs .25–.30)

- Assumptions and limiting conditions (paragraph .18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph .19)
- Basis for using any **valuation assumption** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph .43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph .39)
- Other documentation considered relevant to the engagement by the valuation analyst

.45 The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

Calculation Engagement

.46 In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

- a. Identity of the client
- b. Identity of the subject interest
- c. Whether or not a business interest has ownership control characteristics and its degree of marketability
- d. Purpose and intended use of the calculated value
- e. Intended users of the report and the limitations on its use
- f. Valuation date
- g. Applicable premise of value
- h. Applicable standard of value
- i. Sources of information used in the calculation engagement
- j. Valuation approaches or valuation methods agreed upon with the client
- k. Subsequent events, if applicable (see paragraph .43)

In addition, the valuation analyst should comply with the documentation requirements listed in paragraphs .44 and .45. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

The Valuation Report

.47 A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. Reports issued for purposes of certain controversy proceedings are exempt from this reporting standard (see paragraph .50).

.48 The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are as follows:

either a detailed report or a summary report for a valuation engagement and a calculation report for a calculation engagement:

- a. *Valuation engagement—detailed report.* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .51).
- b. *Valuation engagement—summary report.* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .71). For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.
- c. *Calculation engagement—calculation report.* This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate the results of a valuation engagement (conclusion of value) (see paragraph .73).

.49 The valuation analyst should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or both) (paragraph .65d).

Reporting Exemption for Certain Controversy Proceedings

.50 A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this statement (see paragraphs .47–.49 and .51–.78). The developmental provisions of the statement (see paragraphs .21–.46) still apply whenever the valuation analyst expresses a conclusion of value or a calculated value (Interpretation No. 1 [VS sec. 9100 par. .01–.89]).

Detailed Report

.51 The *detailed report* is structured to provide sufficient information to permit intended users to understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement or financial information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments

- Non-operating assets, non-operating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendixes and exhibits

The report sections previously listed and the detailed information within the sections described in the following paragraphs .52–.77 may be positioned in the body of the report or elsewhere in the report at the discretion of the valuation analyst.

Introduction

.52 This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

- a.* Identity of the client
- b.* Purpose and intended use of the valuation
- c.* Intended users of the valuation
- d.* Identity of the subject entity
- e.* Description of the subject interest
- f.* Whether the business interest has ownership control characteristics and its degree of marketability
- g.* Valuation date
- h.* Report date
- i.* Type of report issued (namely, a detailed report) (paragraph .51)
- j.* Applicable premise of value
- k.* Applicable standard of value
- l.* Assumptions and limiting conditions (alternatively, these often appear in an appendix) (paragraph .18)
- m.* Any restrictions or limitations in the scope of work or data available for analysis (paragraph .19)
- n.* Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- o.* If the work of a specialist was used in the valuation engagement, a description of how the specialist's work was relied upon (paragraph .20)
- p.* Disclosure of subsequent events in certain circumstances (paragraph .43)
- q.* Any application of the jurisdictional exception (paragraph .10)
- r.* Any additional information the valuation analyst deems useful to enable the user(s) of the report to understand the work performed

If the items previously listed are not included in the introduction, they should be included elsewhere in the valuation report.

Sources of Information

.53 This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

- a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited
- b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected
- c. Names, positions, and titles of persons interviewed and their relationships to the subject interest
- d. Financial information (paragraphs .54 and .56)
- e. Tax information (paragraph .55)
- f. Industry data
- g. Market data
- h. Economic data
- i. Other empirical information
- j. Relevant documents and other sources of information provided by or related to the entity

.54 If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the Statements on Standards for Attestation Engagements [SSAEs] [AT sec. 20–701]) by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs (AT sec. 20–701) to the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

.55 The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information (see paragraph .53e), the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs (AT sec. 20–701) to any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.

.56 If the financial information used was derived from financial statements prepared by management that were not the subject of an audit, review, compilation, or attest engagement performed under the SSAEs, the valuation report should do the following:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest under the SSAEs (AT sec. 20–710) to the financial information and assumes no responsibility for that information

Analysis of the Subject Entity and Related Nonfinancial Information

.57 The valuation analyst should include a description of the relevant non-financial information listed and discussed in paragraph .27.

Financial Statement or Financial Information Analysis

.58 This section should include a description of the relevant information listed in paragraph .29. Such description may include the following:

- a. The rationale underlying any normalization or **control adjustments** to financial information
- b. Comparison of current performance with historical performance
- c. Comparison of performance with industry trends and norms, where available

Valuation Approaches and Methods Considered

.59 This section should state that the valuation analyst has considered the valuation approaches discussed in paragraph .31.

Valuation Approaches and Methods Used

.60 In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

.61 This section should also identify the following for each of the three approaches (if used):

- a. Income approach:
 - Composition of the representative benefit stream
 - Method(s) used, and a summary of the most relevant risk factors considered in selecting the appropriate **discount rate**, the capitalization rate, or both
 - Other factors as discussed in paragraph .33
- b. Asset-based approach or cost approach:
 - *Asset-based approach*. Any adjustments made by the valuation analyst to the relevant balance sheet data
 - *Cost approach*. The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated
- c. Market approach:
 - For the guideline public company method:
 - The selected guideline companies and the process used in their selection
 - The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
 - For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection; if the pricing multiples were adjusted, the rationale for such adjustments

- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions

.62 When a rule of thumb is used in combination with other methods, the valuation report should disclose the source(s) of data used and how the rule of thumb was applied (see paragraph .39).

Valuation Adjustments

.63 This section should (a) identify each valuation adjustment considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied (see paragraph .40).

Non-Operating Assets and Excess Operating Assets

.64 When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related non-operating assets, non-operating liabilities, or excess or deficient operating assets and their effect on the valuation (see paragraph .41).

Representation of the Valuation Analyst

.65 Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

- a. The analyses and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph .18), and they are the personal analyses and conclusion of value of the valuation analyst.
- b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.
- c. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties (see paragraph .49).
- e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation.
- f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.

- g. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.
- h. The valuation analyst and, if applicable, the person(s) assuming responsibility for the valuation should sign the representation in their own name(s). The names of those providing significant professional assistance should be identified.

Representations Regarding Information Provided to the Valuation Analyst

.66 It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of his or her performing the valuation engagement. The decision whether to obtain a representation letter is a matter of judgment for the valuation analyst.

Qualifications of the Valuation Analyst

.67 The report should contain information regarding the qualifications of the valuation analyst.

Conclusion of Value

.68 This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

- a. A valuation engagement was performed, including the subject interest and the valuation date.
- b. The analysis was performed solely for the purpose described in this report, and the resulting estimate of value should not be used for any other purpose.
- c. The valuation engagement was conducted in accordance with the Statement(s) on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- d. A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.
- e. The scope of work or data available for analysis is explained, including any restrictions or limitations (see paragraph .19).
- f. A statement describing the conclusion of value, either a single amount or a range.
- g. The conclusion of value is subject to the assumptions and limiting conditions (see paragraph .18) and to the valuation analyst's representation (see paragraph .65).
- h. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- i. The date of the valuation report is included.
- j. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

.69 The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a *valuation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of

Certified Public Accountants, of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date]. This valuation was performed solely to assist in the matter of [purpose of the valuation]; the resulting estimate of value should not be used for any other purpose or by any other party for any purpose. This valuation engagement was conducted in accordance with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

[If applicable] We were restricted or limited in the scope of our work or data available for analysis as follows: [describe restrictions or limitations].

Based on our analysis, as described in this valuation report, the estimate of value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [value, either a single amount or a range]. This conclusion is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Appendixes and Exhibits

.70 Appendixes or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the detailed report.

Summary Report

.71 A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. The business interest's ownership control characteristics, if any, and its degree of marketability
- g. Valuation date
- h. Valuation report date
- i. Type of report issued (namely, a summary report) (paragraph .48)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Sources of information used in the valuation engagement
- m. Assumptions and limiting conditions of the valuation engagement (paragraph .18)

- n. The scope of work or data available for analysis including any restrictions or limitations (paragraph .19)
- o. Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- p. If the work of a specialist was used in the valuation (paragraph .20), a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work
- q. The valuation approaches and methods used
- r. Disclosure of subsequent events in certain circumstances (paragraph .43)
- s. Any application of the jurisdictional exception (paragraph .10)
- t. Representation of the valuation analyst (paragraph .65)
- u. The report is signed in the name of the valuation analyst or the valuation analyst's firm
- v. A section summarizing the reconciliation of the estimates and the conclusion of value as discussed in paragraphs .68 and .69
- w. A statement that the valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the valuation report

.72 Appendixes or exhibits may be used for required information (see paragraph .70) or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendixes to the summary report.

Calculation Report

.73 As indicated in paragraph .48, a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in paragraph .65, but adapted for a calculation engagement.

.74 The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use (paragraph .22), any application of the jurisdictional exception (paragraph .10), and any assumptions and limiting conditions applicable to the engagement (paragraph .18). If the valuation analyst used the work of a specialist (paragraph .20), the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The calculation report may also include a disclosure of subsequent events in certain circumstances (paragraph .43).

.75 Appendixes or exhibits may be used for required information (paragraph .72) or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the calculation report.

.76 The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

- a. Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.

- b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
- c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
- d. The calculation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
- f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.
- g. A general description of a calculation engagement is given, including that
 - i. a calculation engagement does not include all of the procedures required for a valuation engagement, and
 - ii. had a valuation engagement been performed, the results may have been different.
- h. The calculated value, either a single amount or a range, is described.
- i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- j. The date of the valuation report is given.
- k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.

.77 The following is an example of report language that could be used, but is not required, in reporting a calculation engagement:

We have performed a *calculation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in paragraphs [reference to paragraph numbers] of our calculation report. The calculation procedures were performed solely to assist in the matter of [purpose of valuation procedures], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a *valuation engagement*, as that term is defined in the SSVS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as previously referred to, the resulting calculated value of [DEF Company, GHI business ownership interest of DEF Company,

GHI security of DEF Company, or GHI intangible asset of DEF Company] as of *[valuation date]* was *[calculated value, either a single amount or a range]*. This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in *[reference to applicable section of valuation report]* and to the Valuation Analyst's Representation found in *[reference to applicable section of valuation report]*. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Oral Report

.78 An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information the valuation analyst believes necessary to relate the scope, assumptions, limitations, and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the oral report. The member should document in the working papers the substance of the oral report communicated to the client.

Effective Date

.79 This statement applies to engagements to estimate value accepted on or after January 1, 2008. Earlier application is encouraged.

Appendix A

Illustrative List of Assumptions and Limiting Conditions for a Business Valuation

The valuation report or calculation report should include a list of assumptions and limiting conditions under which the engagement was performed. This appendix includes an illustrative list of assumptions and limiting conditions that may apply to a business valuation.

Illustrative List of Assumptions and Limiting Conditions

1. The conclusion of value (or the calculated value) arrived at herein is valid only for the stated purpose as of the date of the valuation.
2. Financial statements and other related information provided by [ABC Company] or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. [Valuation Firm] has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. We do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.
5. The conclusion of value (or the calculated value) arrived at herein is based on the assumption that the current level of management expertise and effectiveness would continue to be maintained, and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.
6. This report and the conclusion of value (or the calculated value) arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value (or the calculated value) are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The stated valuation represents the considered conclusion of value (or the calculated value) of [Valuation Firm], based on information furnished to them by [ABC Company] and other sources.
7. Neither all nor any part of the contents of this report (especially the conclusion of value [or the calculated value], the identity of any

valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without the prior written consent and approval of [Valuation Firm].

8. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of [Valuation Firm] unless previous arrangements have been made in writing.
9. [Valuation Firm] is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. [Valuation Firm] does not conduct or provide environmental assessments and has not performed one for the subject property.
10. [Valuation Firm] has not determined independently whether [ABC Company] is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. [Valuation Firm]'s valuation takes no such liabilities into account, except as they have been reported to [Valuation Firm] by [ABC Company] or by an environmental consultant working for [ABC Company], and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, [Valuation Firm] has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.
11. [Valuation Firm] has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
12. [Sample wording for use if the jurisdictional exception is invoked.] The conclusion of value (or the calculated value) in this report deviates from the Statement on Standards for Valuation Services as a result of published governmental, judicial, or accounting authority.
13. No change of any item in this report shall be made by anyone other than [Valuation Firm], and we shall have no responsibility for any such unauthorized change.
14. Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.
15. If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will

usually be differences between prospective financial information and actual results, and those differences may be material.

16. We have conducted interviews with the current management of [ABC Company] concerning the past, present, and prospective operating results of the company.
17. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.

Appendix B

International Glossary of Business Valuation Terms^{*}

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the subsequently identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

American Institute of Certified Public Accountants

American Society of Appraisers

Canadian Institute of Chartered Business Valuators

National Association of Certified Valuation Analysts

The Institute of Business Appraisers

Adjusted Book Value Method—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. {NOTE: In Canada on a going concern basis}

Adjusted Net Asset Method —see **Adjusted Book Value Method**.

Appraisal—see **Valuation**.

Appraisal Approach—see **Valuation Approach**.

Appraisal Date—see **Valuation Date**.

Appraisal Method—see **Valuation Method**.

Appraisal Procedure—see **Valuation Procedure**.

Arbitrage Pricing Theory—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

^{*} Reproduced verbatim from the International Glossary of Business Valuation Terms (the Glossary), which appears at www.aicpa.org/InterestAreas/ForensicAndValuation/Membership/DownloadableDocuments/Intl%20Glossary%20of%20BV%20Terms.pdf. Note that the phrase, "we discourage the use of this term," that appears herein is also reproduced verbatim.

Asset (Asset-Based) Approach—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount—an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Book Value—see **Net Book Value**.

Business—see **Business Enterprise**.

Business Enterprise—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk—the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

Business Valuation—the act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM)—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization—a conversion of a single period of economic benefits into value.

Capitalization Factor—any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Capitalization of Earnings Method—a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

Cash Flow—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control—the power to direct the management and policies of a business enterprise.

Control Premium—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise to reflect the power of control.

Cost Approach—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital—the expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free—*we discourage the use of this term.* See **Invested Capital**.

Discount for Lack of Control—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights—an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate—a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method—a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method—a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

Economic Benefits—inflows such as revenues, net income, net cash flows, etc.

Economic Life—the period of time over which property may generate economic benefits.

Effective Date—see **Valuation Date**.

Enterprise—see **Business Enterprise**.

Equity—the owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method—a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

Fair Market Value—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and

able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. [NOTE: In Canada, the term "*price*" should be replaced with the term "*highest price*."]]

Fairness Opinion—an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

Forced Liquidation Value—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow—*we discourage the use of this term*. See **Net Cash Flow**.

Going Concern—an ongoing operating business enterprise.

Going Concern Value—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

Goodwill—that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

Goodwill Value—the value attributable to goodwill.

Guideline Public Company Method—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Income (Income-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Internal Rate of Return—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

Invested Capital—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Invested Capital Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of

principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk—the degree of uncertainty as to the realization of expected returns.

Investment Value—the value to a particular investor based on individual investment requirements and expectations. (NOTE: in Canada, the term used is "*Value to the Owner.*")

Key Person Discount—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta—the beta reflecting a capital structure that includes debt.

Limited Appraisal—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

Liquidity—the ability to quickly convert property to cash or pay a liability.

Liquidation Value—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

Majority Control—the degree of control provided by a majority position.

Majority Interest—an ownership interest greater than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity—the share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital—the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple—the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability—the ability to quickly convert property to cash at minimal cost.

Marketability Discount—see **Discount for Lack of Marketability**.

Merger and Acquisition Method—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount—a discount for lack of control applicable to a minority interest.

Minority Interest—an ownership interest less than 50% of the voting interest in a business enterprise.

Multiple—the inverse of the capitalization rate.

Net Book Value—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows—when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

Net Present Value—the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net Tangible Asset Value—the value of the business enterprise's tangible assets (excluding excess assets and nonoperating assets) minus the value of its liabilities.

Nonoperating Assets—assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is "*Redundant Assets*."}

Normalized Earnings—economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements—financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value—liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

Premise of Value—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

Present Value—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount—an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple—the price of a share of stock divided by its earnings per share.

Rate of Return—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Redundant Assets—see **Nonoperating Assets**.

Report Date—the date conclusions are transmitted to the client.

Replacement Cost New—the current cost of a similar new property having the nearest equivalent utility to the property being valued.

Reproduction Cost New—the current cost of an identical new property.

Required Rate of Return—the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

Residual Value—the value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity—the amount, expressed as a percentage, earned on a company's common equity for a given period.

Return on Investment—See **Return on Invested Capital** and **Return on Equity**.

Return on Invested Capital—the amount, expressed as a percentage, earned on a company's total capital for a given period.

Risk-Free Rate—the rate of return available in the market on an investment free of default risk.

Risk Premium—a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb—a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

Special Interest Purchasers—acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

Standard of Value—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

Sustaining Capital Reinvestment—the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk—the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Tangible Assets—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value—See **Residual Value**.

Transaction Method—See **Merger and Acquisition Method**.

Unlevered Beta—the beta reflecting a capital structure without debt.

Unsystematic Risk—the risk specific to an individual security that can be avoided through diversification.

Valuation—the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

Valuation Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

Valuation Date—the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method—within approaches, a specific way to determine value.

Valuation Procedure—the act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio—a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Value to the Owner—see **Investment Value**.

Voting Control—*de jure* control of a business enterprise.

Weighted Average Cost of Capital (WACC)—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

Appendix C

Glossary of Additional Terms

assumptions and limiting conditions. Parameters and boundaries under which a valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

business ownership interest. A designated share in the ownership of a business (business enterprise).

calculated value. An estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values based on those procedures.

calculation engagement. An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

capital or contributory asset charge. A fair return on an entity's *contributory assets*, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

capitalization of benefits method. A method within the income approach whereby expected future benefits (for example, earnings or cash flow) for a representative single period are converted to value through division by a capitalization rate.

comparable profits method. A method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

comparable uncontrolled transaction method. A method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market place made between independent (uncontrolled) parties.

conclusion of value. An estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using

professional judgment as to the value or range of values based on those procedures.

control adjustment. A valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners' compensation that is in excess of market compensation.

engagement to estimate value. An engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.

excess operating assets. Operating assets in excess of those needed for the normal operation of a business.

fair value. In valuation applications, there are two commonly used definitions for fair value:

- (1) For financial reporting purposes only, the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Source:* Financial Accounting Standards Board *Accounting Standards Codification* glossary.
- (2) For state legal matters only, some states have laws that use the term *fair value* in shareholder and partner matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

guideline company transactions method. A method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

hypothetical condition. That which is or may be contrary to what exists, but is supposed for the purpose of analysis.

incremental income. Additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

normalization. See *Normalized Earnings* in appendix B, "International Glossary of Business Valuation Terms." (see paragraph .81).

pre-adjustment value. The value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

profit split income. With respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage) is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

relief from royalty method. A valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the

exemption from paying a royalty for its use. Application of this method usually involves estimating the fair market value of an intangible asset by quantifying the present value of the stream of market-derived royalty payments that the owner of the intangible asset is exempted from or "relieved" from paying.

residual income. For an entity that owns or operates an intangible asset being valued, the portion of the entity's income or cash flow remaining after subtracting a capital charge on all of the entity's tangible and other intangible assets. *Income or cash flows* can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

security. A certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

subject interest. A business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

subsequent event. An event that occurs subsequent to the valuation date.

valuation analyst. For purposes of this statement, an AICPA member who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

valuation assumptions. Statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

valuation engagement. An engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, as outlined in the AICPA Statement on Standards for Valuation Services, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range.

valuation service. See **engagement to estimate value.**

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC; Revised, January 2015, to reflect the revised Code of Professional Conduct.]

VS Section 9100

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100

1. Scope of Applicable Services

Background

.01 The Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* [VS section 100] establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the Statement. When originally proposed on March 30, 2005, the Exposure Draft contained a list of questions and answers (Appendix A of the March 30, 2005 Exposure Draft) that were intended to assist members in determining if an engagement, particularly with regard to litigation or tax engagements, fell within the scope of the Statement. Through the Exposure Draft process, it was determined that the questions and answers were an integral part of the Statement and should be made authoritative. This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in valuation practice, and its desire to provide guidance to members when providing valuation services. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards.

General Interpretation

.02 The SSVSs apply to an engagement to estimate value if, as all or as part of another engagement, a member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraphs 1 and 2 [VS section 100.01–.02]). In the process of estimating value, professional judgment is used to apply valuation approaches and valuation methods as described in the SSVS No. 1, paragraph 4 [VS section 100.04].

.03 In determining whether a particular service falls within the scope of the Statement, a member should consider those services that are specifically excluded:

- Audit, review, and compilation engagements (SSVS No. 1, paragraph 5 [VS section 100.05])
- Use of values provided by the client or a third party (SSVS No. 1, paragraph 6 [VS section 100.06])
- Internal use assignments from employers to employee members not in the *practice of public accounting* (SSVS No. 1, paragraph 7 [VS section 100.07])
- Engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) and that do not include an

engagement to estimate value (SSVS No. 1, paragraph 8 [VS section 100.08])

- Mechanical computations that do not rise to the level of an engagement to estimate value (SSVS No. 1, paragraph 9(a) [VS section 100.09a])
- Engagements where it is not practical or reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods described in this Statement. (SSVS No. 1, paragraph 9(b) [VS section 100.09b])
- Engagements meeting the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10])

.04 A member should be diligent in determining if an engagement falls within the scope of the Statement. Unless specifically excluded by the SSVS, if the engagement requires a member to apply valuation approaches and methods, and use professional judgment in applying those approaches and methods, the SSVS would apply. In determining the scope and requirements of the engagement, a member should consider the client's needs, or the requirements of a third party for which the valuation is intended, including governmental, judicial, and accounting authorities. In addition, a member should consider other professional standards that might apply.

Specific Illustrations

.05 The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in general facts, or to particular facts and circumstances, may lead to different conclusions. In each illustration, there is no authority other than that indicated.

Illustrations Relating to Litigation Engagements and Certain Controversy Proceedings

.06 *Illustration 1.* Do lost profits damage computations fall within the scope of the Statement?

.07 *Conclusion.* No, unless the computations are undertaken as part of an engagement to estimate value (SSVS No. 1, paragraphs 1, 2, and 8 [VS section 100.01, .02, and .08]).

.08 *Illustration 2.* Is an economic damages computation that incorporates a terminal value within the scope of the Statement?

.09 *Conclusion.* The use of a terminal value exclusively for the determination of lost profits is not within the scope of this statement unless that determination will be used as part of an engagement to estimate value (*Illustration 1*).

.10 *Illustration 3.* If a start-up business is destroyed, is the economic damages computation within the scope of the Statement?

.11 *Conclusion.* There are two common measures of damages: lost profits and loss of value. If a valuation analyst performs an engagement to estimate value to determine the loss of value of a business or intangible asset, the Statement applies. Otherwise, the Statement does not apply (*Illustration 1*). In order to determine whether the Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes an engagement to estimate value with respect to the business, business interest, security, or intangible asset or whether it constitutes a lost-profits computation.

.12 Illustration 4. Does the Statement include any exceptions relating to litigation or controversy proceedings?

.13 Conclusion. Yes, the Statement includes a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50]); however, there is no litigation or controversy proceeding exemption from the developmental provisions of the Statement (SSVS No. 1, paragraphs 21–46 [VS section 100.21–.46]) in circumstances in which an engagement to estimate value is performed (*Illustration 1*).

.14 Illustration 5. Is the Statements reporting exemption for litigation or controversy proceedings (see SSVS No. 1, paragraph 50 [VS section 100.50]) the same as the "litigation exemption" in the AICPA attestation standards?

.15 Conclusion. No, the so-called "litigation exemption" is provided for in the AICPA attestation standards and is further discussed in the attestation interpretations. The attestation standards do not apply to engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts. This is clarified in the attestation interpretation, which states, in part, that the attestation standards do not apply to litigation services engagements when (among other requirements) the practitioner "has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on the subject matter, or an assertion about the subject matter that is the responsibility of another party." (Interpretation No. 3, "Applicability of Attestation Standards to Litigation Services," of Chapter 1, "Attest Engagements," of Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, as revised [AT section 9101.34–.42]. However, unlike the AICPA attestation standards, which do not apply in any capacity to litigation or controversy proceeding situations, as discussed above, the Statements exemption for litigation or certain controversy proceedings is an exemption from the reporting provisions of the Statement (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]).

Illustrations Relating to Tax Engagements

.16 Illustration 6. When does the Statement apply to members who determine values related to tax reporting and planning engagements?

.17 Conclusion. The Statement applies when the member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). The application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

.18 Illustration 7. If the sole purpose of an engagement is reporting a value in a tax return and the Statement applies to this engagement, are any separate reports (specifically, valuation reports) required to be issued? To whom are those reports required to be provided? Is a report required to be attached to the tax return? Are any specific disclosures required?

.19 Conclusion. The Statement requires the preparation of a written or oral valuation report (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]) that is communicated to the client (SSVS No. 1, paragraph 47 [VS section 100.47]) but does not require that any report be attached to the tax return or mandate any other tax-specific disclosures. In limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (SSVS No. 1, paragraph 10 [VS section 100.10] and *Illustration 18*).

There is also a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50] and *Illustration 4*).

.20 *Illustration 8.* Are mechanical computations of value, for example, computations using actuarial tables, excluded from the Statement?

.21 *Conclusion.* Mechanical computations of value are excluded from the Statement if they do not rise to the level of an engagement to estimate value, that is, if the member does not apply valuation approaches and methods, and does not use professional judgment, as described in the Statement (SSVS No. 1, paragraph 9(a) [VS section 100.09a]).

.22 Examples of services that do **not** rise to the level of an engagement to estimate value include: (a) computations of a remainder interest under a grantor retained annuity trust (GRAT) using actuarial tables; (b) determining the value of relatively small blocks (relative to the total amount of corporate stock outstanding) of publicly traded stock whose per share price is readily ascertainable; (c) preparing a tax return using the valuation of a business that was provided by a third-party appraiser, or by the client (SSVS No. 1, paragraph 6, [VS section 100.06]); and (d) calculating cash "hold back" requirements for tax contingencies (SSVS No. 1, paragraphs 4 and 9(a) [VS section 100.01, .04, and .09a]).

.23 Examples of services that rise to the level of an engagement to estimate value include: (a) valuing a block of publicly traded stock, if the analysis includes consideration of a discount for blockage, lock-up, or other contractual or market restrictions such that valuation approaches and methods are applied, and professional judgment is used to determine the fair value, fair market value, or other applicable standard of value; (b) valuing stock that is not publicly traded; and (c) computing the fair market value of assets in a charitable remainder trust (CRT), if the engagement requires the application of valuation approaches and methods, and the use of professional judgment to estimate the fair market value.

.24 *Illustration 9.* Does the "jurisdictional exception" (SSVS No. 1, paragraph 10 [VS section 100.10]) provide that an engagement to estimate value is not subject to the Statement if a member determines and reports values using procedures mandated or allowed by the Internal Revenue Code (IRC), Internal Revenue Service (IRS) regulations, court cases, or other published guidance and other sources of federal, state, and local law solely for purposes of tax return preparation and other tax services using these methods?

.25 *Conclusion.* No, the "jurisdictional exception" would not exempt the engagement from this Statement, even if the engagements sole purpose was to value a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]) for tax reporting purposes. Only the portion of the Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of the Statement applies to the engagement.

.26 *Illustration 10.* Is an interest in a publicly traded partnership whose shares are frequently traded considered a "security" under the Statement? Is an interest in a family limited partnership (FLP), or in another nontraded partnership, considered a "security" under the Statement?

.27 *Conclusion.* Whether interest constitutes a "security" is a legal determination. However, where the value of a security is readily ascertainable, a valuation analyst does not need to apply valuation approaches and methods and use professional judgment. Accordingly, the valuation of such an interest would not be subject to the Statement (SSVS No. 1, paragraphs 1 and 9(a) [VS section 100.01 and .09a]). An interest in a nonpublicly traded partnership, such

as an FLP, whether considered a security or not, is a business ownership interest. The valuation of such nonpublicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (SSVS No. 1, paragraphs 1, 4, [VS section 100.01 and .04], and *Illustration 6*), unless the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b] applies (*Illustration 13e*). If the engagement requires the valuation analyst to consider and apply adjustments, for example, valuation discounts or premiums, then the engagement would be subject to the Statement.

.28 *Illustration 11.* A client engages a member to provide advice for planning purposes (such as estate planning, personal financial planning, or merger and acquisitions planning). The client holds an ownership interest in a family business being operated as a limited liability company, an interest in a private real estate limited partnership, publicly traded stock, a personal residence, and a retirement account (not an IRA). Is this a valuation engagement subject to the Statement?

.29 *Conclusion.* It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates a value to illustrate various planning options, he or she may fall under the Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the plan illustrations is a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the values for these assets, or the member does not use assumed or hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to the Statement with regard to these assets (SSVS No. 1, paragraph 1, [VS section 100.01] and *Illustration 6*). In this example, if the member applies valuation approaches and methods and uses professional judgment to determine the value of the ownership interest in the family business or the interest in the private real estate limited partnership in order to provide planning advice, the Statement would apply. In contrast, if the client or a third party provides the values for these assets, or the member uses assumed or hypothetical values, the Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. In addition, the exception under SSVS No. 1, paragraph 9(b), [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (see *Illustration 13e*). The computation of the "estimated estate tax" or other taxes once the values have been determined, assumed, or provided is not subject to the Statement, as the computation is a tax computation but would be subject to the Statements on Standards for Tax Services [TS sections 100–900] (*Illustration 10* at paragraph .27 of this Interpretation).

.30 *Illustration 12.* There are many instances where a tax engagement involves the need for a member to estimate value. The estimation of value may not be the primary purpose of the engagement, but rather a necessary task to perform or item to consider, when making a tax determination concerning the reporting of a transaction on a tax return. Consider the following practice situations:

.31 *Illustration 12a.* A member has been engaged to determine the deductibility of interest on a nonrecourse loan. Under applicable regulations, interest on a nonrecourse loan cannot be deducted if it is clear that the company will be unable to service the debt. For purposes of tax reporting, a conclusion must be reached concerning the ability of the company to service the debt. Is this considered a valuation engagement subject to the Statement?

.32 Conclusion. This is not a valuation engagement covered by the Statement because it is not the valuation of a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]). This example is a debt-service analysis.

.33 Illustration 12b. There are compliance filings that require an estimate of the value of a company. For example, the "market value" of "intangible personal property," as defined by a state's taxing authority may need to be reported annually on an intangible personal property tax return. A client has a subject interest that is considered intangible personal property for purposes of the return. The member has been engaged to prepare the tax return. Is this a valuation engagement subject to the Statement?

.34 Conclusion. It depends. If the state requires an estimation of the value of a subject interest, and the estimation of value requires the application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]), the Statement applies. If, however, the client or a third-party appraiser provides the value of the subject interest to the member, the Statement does not apply (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06]). In addition, the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (*Illustration 13e*). Alternatively, if the state follows more informal rules where the application of valuation approaches or valuation methods are not necessary, the Statement does not apply (SSVS No. 1, paragraph 4 [VS section 100.04]).

.35 Illustration 12c. There are times when a member must allocate value among various assets. For example, IRC sections 1060 and 338 require the allocation to assets, based on relative values, of consideration paid. In partnership taxation, there may be allocations under IRC sections 754, 743, and 734 and special tax basis adjustments for partnerships (sales or exchanges and transfers at or upon death) may require an allocation of value among various partnership assets. Are these types of allocations engagements to estimate value subject to the Statement?

.36 Conclusion. It depends. If one or more of the assets to which value is to be allocated is a subject interest (that is, a business, business ownership interest, security, or intangible asset), and the client or a third party did not provide the member with a value for those assets, then the member performing the allocation would be subject to the Statement, and the member is required to apply valuation approaches and methods, and use professional judgment to value those assets (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). For example, in an IRC section 1060 allocation, after the allocation of purchase price to cash, receivables, inventory, and depreciable tangible assets, there is a residual amount of value allocable to goodwill or going concern. The mechanical assignment of the residual amount to goodwill or going concern is not subject to the Statement. However, if the member allocates this residual amount to specific intangible assets (such as to various customer-based and supplier-based intangibles), such allocation is based on the assets relative values. Because the member applies valuation approaches and methods and uses professional judgment to value those specific intangible assets, the Statement applies.

.37 Illustration 12d. If the member does not apply any discount and simply computes the fair market value of an interest in a family limited partnership (FLP) for tax purposes, is this a valuation engagement subject to the Statement?

.38 Conclusion. Yes, the Statement applies if the member determines the value of the FLP or an interest in an FLP. The application of valuation

approaches and methods, and the use of professional judgment are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). The fact that the member does not apply a discount does not exempt the engagement from the Statement (SSVS No. 1, paragraphs 1–4 and 9(a) [VS section 100.01–.04 and .09a]).

.39 Illustration 12e. Would the Statement apply to the computation of the fair market value of assets in, or the computation of the required distribution of, a charitable remainder trust (CRT)?

.40 Conclusion. It depends on the underlying assets held by the CRT. The Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). To the extent that the CRT holds assets that, to be valued, require the application of valuation approaches and methods, and the use of professional judgment, such as an interest in a limited liability corporation (LLC), the Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, the Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

.41 Illustration 12f. In circumstances in which the value of assets contributed by partners to a partnership differ from their cost basis, each difference must be tracked for tax purposes under IRC section 704(c) so that amounts of gain or loss can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to the Statement?

.42 Conclusion. It depends. If one or more of the assets for which value is relevant under IRC section 704(c) is a subject interest that is, a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the valuation, and the member applies valuation approaches and methods and uses professional judgment to value these assets for IRC section 704(c) tax purposes, then the Statement applies (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06], and *Illustration 6*).

.43 Illustration 12g. A member has been engaged to perform a cost segregation study. The study involves an analysis of the costs of building a structure and the allocation of such costs to the real and personal property components of the structure so that depreciation of those components may be properly computed. Is this a valuation engagement subject to the Statement?

.44 Conclusion. No, none of the assets constitutes a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

.45 Illustration 12h. A member has been engaged to provide advice to a company regarding the tax planning for income from discharge of indebtedness under IRC section 108. The company has advised the member that the company will be able to negotiate a settlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to the Statement?

.46 Conclusion. It depends. Under IRC section 108(a), gross income of the company excludes income from discharge of indebtedness only under certain circumstances. One of those circumstances is the insolvency of the company. Under IRC section 108(d) (3), insolvency results from an excess of liabilities over the fair market value of assets. If (a) the company must rely on the insolvency provisions of IRC section 108; (b) one or more of the assets for which value is relevant under IRC section 108 is a subject interest (that is, a business, business ownership interest, security, or intangible asset); (c) the company or a third

party does not provide the valuation; and (d) the member applies valuation approaches and methods, and uses professional judgment to value the subject interest(s) for purposes of the IRC section 108(d)(3) insolvency determination, the Statement applies.

.47 Illustration 13. An executor has engaged a member to prepare an estate tax return, which requires determining values for the following estate assets: (a) shares in a publicly traded company, "TI Corporation," whose shares are infrequently traded; (b) a large block of stock in "LB Corporation," a publicly traded company; (c) a brokerage account consisting of shares in various publicly traded companies; (d) "CHB Corporation," a closely held business owned by the decedent and the decedent's family; and (e) a 5 percent interest in "RP," a privately held rental real estate partnership. Does the Statement apply to any of the following assets owned by the estate? (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

.48 Illustration 13a. Does the Statement apply to shares in a publicly traded company, "TI Corporation," whose shares are traded infrequently?

.49 Conclusion. It depends; although the price of a share of publicly traded stock is ascertainable from published sources, there are no definitive criteria that would indicate when the Statement applies to shares that are infrequently traded. A key consideration is the average daily trading volume of TI Corporation stock on or around the valuation date. The concept of fair market value incorporates the notions that (1) cash could have been received for the stock at the valuation date, and (2) the share price of an infrequently traded stock could decrease if a relatively large block of the stock were to be put on the market on that date. If the subject shares held by the estate do not represent a significant percentage of the daily trading volume of TI stock on or around the valuation date, and the price of a share of the stock is readily ascertainable on the valuation date, then the resulting value (the quoted share price times the number of shares owned) represents a cash price that could have been received at the valuation date for the block, and the Statement does not apply because the calculation of value is mechanical (SSVS No. 1, paragraph 9(a) [VS section 100.09a]). If, however, the subject shares held by the estate represent a large percentage of the average daily trading volume of the stock, the quoted market price for a share may not be adequate for purposes of determining the fair market value of the block of shares on the valuation date. In that case, the Statement applies because valuation approaches and methods need to be applied, and professional judgment needs to be used in determining the value of the block (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]) (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

.50 Illustration 13b. Does the Statement apply to a large block of stock in "LB Corporation," a publicly traded company?

.51 Conclusion. The answer depends on the amount of shares to be valued in relation to the average daily trading volume in LB Corporation on or around the valuation date. There are no definitive criteria that would indicate when the Statement applies to the valuation of a large block of publicly traded stock. The concept of fair market value incorporates the notion that cash could have been received from a sale of the block on the valuation date. A large block could decrease the share price if sold on the valuation date. The Statement would typically not apply to the valuation of a large block (for example, 200,000 shares) of a large and actively-traded public company. Even though the value of the estate's stock may be large in absolute terms, the daily trading volume in such stock on the valuation date may be sufficiently high that a sale of the block on the valuation date would not affect the market price of a company's

shares. In such a case, the quoted market price of a share times the number of shares held by the estate may be considered to reflect the fair market value of the subject block of stock, and because it would not be the case that valuation approaches and methods would need to be applied and professional judgment used, the Statement would not apply. If, however, the large block of publicly traded shares represents a significant percentage of the daily trading volume, the Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

.52 *Illustration 13c.* Does the Statement apply to a brokerage account consisting of shares in various publicly traded companies?

.53 *Conclusion.* The Statement would not apply to the determination of the value of a brokerage account consisting of publicly traded securities, except as discussed in paragraphs .49 and .51 of this Interpretation. Absent certain scenarios involving infrequently traded securities or large blocks of stock, the application of valuation approaches and methods and the use of professional judgment are not necessary in that determination (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

.54 *Illustration 13d.* Does the Statement apply to "CHB Corporation," a closely held business owned by the decedent and the decedent's family?

.55 *Conclusion.* The Statement would apply to the determination of value of CHB Corporation because valuation approaches and methods need to be applied, and professional judgment needs to be used to determine the fair market value of the ownership interest in CHB (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

.56 *Illustration 13e.* Does the Statement apply to a 5 percent interest in a privately held rental real estate partnership (RP)?

.57 *Conclusion.* The Statement would apply to the determination of value of the 5 percent interest in rental real estate partnership (RP) because valuation approaches and methods need to be applied and professional judgment needs to be used to determine the fair market value of the ownership of a fractional interest in a privately held partnership (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, where it is not practical or not reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods, the Statement would not apply. For example, the member has requested from RP's general partner financial information the member needs in order to apply valuation approaches and methods. The general partner is not responsive to the member's requests, and the due date for filing the estate tax return is near. Given the small ownership interest, and given that RP is likely a relatively small percent of the total estate, unless prohibited by statute or by rule, the member may then use the taxpayer's estimates if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member) (SSVS No. 1, paragraph 9(b) [VS section 100.09b]).

.58 *Illustration 14.* Would the answers to *Illustration 13* change if the values were provided by the client or a client-engaged third party?

.59 *Conclusion.* The Statement would not apply if the values were provided by the client or by a client-engaged third party because the member is not applying valuation approaches and methods and using professional judgment to determine value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300],

in providing appropriate due diligence with respect to the values provided to the member. It is also recommended that the understanding between member and client in these circumstances include documentation of the fact that the member is not determining but rather is being provided with the value of the subject interest.

.60 Illustration 15. Would the answers to *Illustration 13* change if the values were provided by an outside third-party specialist hired by the member?

.61 Conclusion. If the member engages an outside third-party specialist to assist with the member's work, and it is the member expressing a conclusion or calculated value, the member will be applying valuation approaches and methods and using professional judgment; thus, the Statement would apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]; SSVS No. 1, paragraph 20, "Using the Work of Specialists in the Valuation Engagement," [VS section 100.20]). If, however, the third-party specialist is determining the value in his or her own name and providing that value to the client, and the member will not be applying valuation approaches and methods or using professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), the Statement would not apply, but the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300] in providing appropriate due diligence with respect to the values provided.

.62 Illustration 16. The client and the member agree that the member will value a partnership interest and then apply an "average" discount that the member is to determine (based on the results of various studies and case law). Does the Statement apply? If so, is this a valuation engagement or a calculation engagement?

.63 Conclusion. Yes, the Statement applies because the member determined the value of the partnership interest by applying valuation approaches and valuation methods and using professional judgment. This would be considered a calculation engagement because the member and the client have agreed on the specific valuation approaches or valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform (SSVS No. 1, paragraph 21(b) [VS section 100.21b] and *Illustration 6*).

.64 Illustration 17. Would the Statement apply if a member has an informal conversation or communicates in writing with a client regarding the alternative tax consequences of gifting versus selling a business using a presumption of a specific value of the business?

.65 Conclusion. No, the Statement would not apply. The member is providing tax advice using an assumed or hypothetical value of a business and is not determining value, applying valuation approaches and methods, and using professional judgment to value a business (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

.66 Illustration 18. Would the Statement apply to a transfer pricing study (IRC section 482) that involves the use of specific methodologies, data, terminology, and documentation requirements that are provided in the IRS regulations and procedures, and whose methodologies and documentation requirements differ from those contained in the Statement?

.67 Conclusion. No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, the Statement would not apply (see SSVS No. 1, paragraph 1 [VS section 100.01] and *Illustration 6*). To the extent that the transfer pricing study applies to the valuation of intangible assets, the Statement would normally apply. However, because the

IRS regulations require that the taxpayer reasonably calculate an arm's-length price according to the best method that is determined using third-party comparable data under explicit IRS rules and documentation procedures, and to the extent these IRS rules and procedures differ from the Statement, the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10]) would exempt the valuation of the intangible assets from the developmental provisions of the Statement (SSVS No. 1, paragraphs 25–48 [VS section 100.25–.48]). In addition, to the extent that the IRS regulations (such as IRS regulation section 1.6662-6(d) (2) (iii)) and procedures provide specific documentation requirements for avoiding potential penalties, and if a transfer pricing report is provided to a client according to such IRS documentation requirements, the jurisdictional exception would apply to the reporting provisions of the Statement (SSVS No. 1, paragraphs 50–78 [VS section 100.50–.78]) and thus a valuation report would not be necessary.

.68 Illustration 19. In a situation where the Statement applies to members who determine value as part of tax engagements, would the member also be required to be in compliance with the Statements on Standards for Tax Services (SSTSs) [TS sections 100–900]?

.69 Conclusion. Yes, the Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTSs would apply to all aspects of the engagement. For example, even though the Statement would govern the determination of value of an applicable asset reported on a tax return, the member would also have to be in compliance with SSTS No. 1, *Tax Return Positions*, [TS section 100], for that valuation.

.70 Illustration 21. Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under the Statement?

.71 Conclusion. No, settlements or negotiations of value in offers-in-compromise or tax disputes are part of a tax process. However, if a member prepares a valuation in preparation for a settlement or negotiation of value, and the valuation involves the application of valuation approaches and methods and the use of professional judgment, the valuation would fall under the developmental aspects of the Statement. The settlement or negotiation process itself is not a valuation and would not fall under the Statement. In addition, the Statement's reporting exemption for certain controversy proceedings would apply as the valuation was performed specifically for the administrative matter (SSVS No. 1, paragraph 50 [VS section 100.50]).

Illustrations Relating to Other Engagements

.72 Illustration 20. Does determining the value of accounts receivable fall under the Statement?

.73 Conclusion. No, accounts receivable constitute **tangible assets** under the Statement (SSVS No. 1, Appendix B [VS section 100.81], and do not constitute a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

.74 Illustration 22. In the course of performing a valuation under the Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]?

.75 Conclusion. No, Chapter 1, "Attest Engagements," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, as amended [AT section 101.01] states that the attestation standards apply when a practitioner is "engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter..., that is the responsibility of another party." If the valuation analyst has not been engaged to examine, compile, assemble, review, or apply agreed-upon procedures to prospective financial information, and does not issue an examination, compilation, assembly, or agreed-upon report on prospective financial information, the SSAEs [AT sections 20–701] do not apply (SSARS 14 [AR section 120]).

.76 Illustration 23. Under a valuation engagement, a valuation analyst is free to select any and all valuation approaches and methods the valuation analyst deems appropriate in the circumstances. Under a calculation engagement, the valuation analyst and the client agree to the specific approaches or methods the valuation analyst will use or the extent of calculation procedures the valuation analyst will perform. (SSVS No. 1, paragraph 21 [VS section 100.21]) Under SSVS No. 1, paragraph 18 [VS section 100.18], a restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis may be present and known to the valuation analyst at the outset of the engagement, or may arise during the course of an engagement (and such restriction or limitation should be disclosed in the report). Is it possible to have a restriction or limitation that is of such a degree that a valuation analyst engaged to perform a valuation engagement should propose altering the engagement to be a calculation engagement?

.77 Conclusion. Although the two engagements represent two different types of service performed by valuation analysts, the possibility exists. If, in the course of a valuation engagement, restrictions, or limitations on the scope of the valuation analyst's work or the data available for analysis are so significant that the valuation analyst believes that he or she cannot, even with disclosure in the valuation report of the restrictions or limitations, adequately perform a valuation engagement leading to a conclusion of value, the valuation analyst should determine whether he or she has the ability to adequately complete the engagement as a calculation engagement or should consider resigning from the engagement.

.78 Illustration 24. If a member employed in industry, government, or education "moonlights" doing engagements to estimate value, do the Standards apply?

.79 Conclusion. Yes, the Standard applies. By moonlighting, the member is holding him or herself out as a certified public accountant and as being in public practice. The Standard would apply just as it would to any other member in public practice unless one of the exceptions applies.

.80 Illustration 25. Does the Statement apply to an assignment from an employer to an employee member not in public practice to prepare a valuation for internal financial reporting purposes?

.81 Conclusion. No, SSVS No. 1, paragraph 7 [VS section 100.07] exempts internal use assignments from an employer to an employee member not in the practice of public accounting. However, if the valuation is to be used for financial reporting purposes, the employer and the employee may wish to consider whether the work will be accepted by the employer's outside auditors if the statement is not followed.

Illustrations for PFP-Specific Engagements

These illustrations assume the member has not been engaged to perform a business valuation.

.82 Illustration 26. When does the Statement apply to members who determine values related to personal financial planning engagements?

.83 Conclusion. The Statement applies to personal financial planning engagements when the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]) and in the process of determining the value applies valuation approaches and methods and uses professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

.84 Illustration 27. If a member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest, does the Statement apply?

.85 Conclusion. No. The Statement does not apply because estimate of future sales proceeds does not in itself constitute a valuation engagement (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

.86 Illustration 28. A member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest. As part of that engagement, the member shares general industry knowledge to assist the client in estimating the current value of the business interest. Does the Statement apply?

.87 Conclusion:

(a) If, in the process of determining the current value from which the member estimates future sales proceeds, the member applies valuation approaches and methods and uses professional judgment, the Statement applies to the determination of the current value (SSVS No. 1, paragraph 4 [VS section 100.04]). However, the Statement does not apply when the member shares general industry knowledge with the client instead of applying professional judgment.

(b) If the client or another party provides the current value, and the member does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

(c) If the member uses a hypothetical or assumed value as the starting point for the calculation of future sales proceeds and does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). The Statement does not apply to a general discussion with the client of valuation concepts or industry price multiples based on the member's industry knowledge, which assists the client in determining a hypothetical or assumed value (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

.88 Illustration 29. The client has asked the member to prepare a personal financial plan that includes an estimate of future proceeds from a sale of the business interest at retirement. The member estimates the future proceeds based on an estimate of the business' current value by applying a rule of thumb for the business' industry, but the member does not consider the risk factors of the subject interest or exercise other professional judgment in applying the multiple. Does the Statement apply?

.89 Conclusion. No, the Statement does not apply because the member did not use professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]). If the member considers specific risk factors of the business interest in applying the price multiple, the Statement applies.

This Statement titled Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset was unanimously adopted by the assenting votes of the AICPA Consulting Services Executive Committee.

FS Section

STATEMENT ON STANDARDS FOR
FORENSIC SERVICES

Statements on Standards for Forensic Services (SSFSSs) are issued by the Forensic and Valuation Services Executive Committee (FVS Executive Committee). The FVS Executive Committee provides guidance and establishes enforceable standards for members performing certain forensic and valuation services. The AICPA Council has designated the FVS Executive Committee as a body to establish professional standards under the "Compliance With Standards Rule," found in ET sections 1.310.001 and 2.310.001 of the AICPA Code of Professional Conduct. Members should be prepared to justify departures from this section (ET sec. 0.100.010).

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FS Section 100

Statement on Standards for Forensic Services No. 1

Source: Statement on Standards for Forensic Services No. 1

Effective for engagements accepted on or after January 1, 2020.

June 2019

Why Issued

The term *forensic* is defined as "used in, or suitable to, courts of law or public debate."¹ Forensic accounting services² generally involve the application of specialized knowledge and investigative skills by a member³ to collect, analyze, and evaluate certain evidential matter and to interpret and communicate findings (forensic services).

The FVS Executive Committee has issued this standard to protect the public interest by preserving and enhancing the quality of practice of a member performing forensic services. Practice aids and other guidance issued at the direction of the FVS Executive Committee continue to serve as nonauthoritative guidance on the application of professional standards.⁴ Authoritative standards and nonauthoritative guidance are not a substitute for the use of professional judgment.

Introduction and Scope — Forensic Services

.01 This section establishes standards for a member providing services to a client⁵ as part of the following engagements:

- *Litigation*. An actual or potential legal or regulatory proceeding before a trier of fact or a regulatory body as an expert witness, consultant, neutral, mediator, or arbitrator in connection with the resolution of disputes between parties. The term *litigation* as used herein is not limited to formal litigation but is inclusive of disputes and all forms of alternative dispute resolution.
- *Investigation*. A matter conducted in response to specific concerns of wrongdoing in which the member is engaged to perform procedures to collect, analyze, evaluate, or interpret certain evidential matter to assist the stakeholders (for example, client, board of directors, independent auditor, or regulator) in reaching a conclusion on the merits of the concerns.

¹ Bryan A. Garner, ed. *Black's Law Dictionary*, 10 ed., St. Paul, MN: Thomson West Publishing Co., 2014.

² ET section 1.295.140.01.

³ ET section 0.400.31.

⁴ Professionals should be aware of any governmental regulations and other professional standards applicable to the engagement.

⁵ See ET section 0.400.07 for the definition of *client*, which indicates there may be multiple clients for one engagement.

.02 For purposes of this section, forensic services consist of either litigation or investigation engagements. When an engagement meets the definition of *forensic services*, CS section 100, *Consulting Services: Definitions and Standards*, does not apply. This section applies when services provided under VS section 100, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*, are provided as part of a litigation or investigation engagement.

Except as provided hereunder, this section does not apply to a member who performs forensic services as part of an attest engagement (for example, as part of an audit, review, or compilation) or under TS section 100, *Tax Return Positions*.

When a member is engaged as an expert witness by one party in a litigation engagement to provide expert opinions, the member may not perform the work under AT-C section 215, *Agreed-Upon Procedures Engagements* (AUP standard). When performing services under the AUP standard, "the member does not perform an examination or a review and does not provide an opinion or conclusion." However, results may be reported under the AUP standard in an engagement in which a member is engaged by the trier of fact or both sides of the dispute jointly, or both. In each scenario, this section and the AUP standard applies.

.03 The key consideration of this section's applicability is the purpose for which the member was engaged (for example, litigation or investigation) as opposed to the skill set employed or services provided. As an example, a member may provide data analysis services in a client engagement that does not constitute a litigation or investigation engagement. Conversely, similar data analysis services may also be performed in a client engagement, which constitutes a litigation or investigation engagement. This section would apply under the second scenario and would not apply under the first scenario.

.04 This section applies when a member, who may have been engaged originally to perform services under another set of standards, discovers that the original scope of the engagement has been modified or amended and has become a litigation or investigation engagement. The member should modify his or her understanding with the client if such an engagement converts to a forensic services engagement.

.05 This section is not applicable to internal use assignments from employers to employee members not in public practice. *Public practice* is defined as the performance of professional services for a client by a member or member's firm (ET sec. 0.400.42). The definition of a *client* specifically excludes a member's employer (ET sec. 0.400.07).

Standards for Forensic Services

.06 The general standards of the profession are contained in the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) and apply to all services performed by a member, including forensic services. They are as follows:

- *Professional competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
- *Due professional care.* Exercise due professional care in the performance of professional services.

- *Planning and supervision.* Adequately plan and supervise the performance of professional services.
- *Sufficient relevant data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

.07 A member must serve his or her client with integrity and objectivity, as required by the AICPA Code of Professional Conduct. A member performing forensic services should not subordinate his or her opinion to that of any other party.

.08 A member performing forensic services must follow additional general standards, which are promulgated to address the distinctive nature of such services. These standards are established under the "Compliance With Standards Rule" (ET sec. 1.300.001 and 2.300.001):

- *Client interest.* Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.
 - *Integrity.* Integrity is described as follows: "Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle." (ET sec. 0.300.040)
 - *Objectivity.* Objectivity is described as follows: "Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest." (ET sec. 0.300.050)
- *Understanding with client.* Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed and modify the understanding if circumstances require a significant change during the engagement.
- *Communication with client.* Inform the client of (a) conflicts of interest that may occur pursuant to the "Integrity and Objectivity Rule" (ET sec. 1.100.001 and 2.100.001), (b) significant reservations concerning the scope or benefits of the engagement, and (c) significant engagement findings or events.

The "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) under the "Integrity and Objectivity Rule" provides guidance about the identification, evaluation, disclosures, and consent related to conflict of interest. This section states, in part, the following:

- In determining whether a professional service, relationship, or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who

is aware of the relevant information would conclude that a conflict of interest exists.

.09 A member engaged as an expert witness in a litigation engagement may not provide opinions pursuant to a contingent fee arrangement, unless explicitly allowed otherwise under the "Contingent Fees Rule" (ET sec. 1.510.001).

.10 The ultimate decision regarding the occurrence of fraud is determined by a trier of fact; therefore, a member performing forensic services is prohibited from opining regarding the ultimate conclusion of fraud. This does not apply when the member is the trier of fact. A member may provide expert opinions relating to whether evidence is consistent with certain elements of fraud or other laws based on objective evaluation.

Effective Date

.11 This section is effective for new engagements accepted on or after January 1, 2020. Early application of the provisions of this section is permissible.

CS Section
CONSULTING SERVICES

**STATEMENT ON
STANDARDS FOR CONSULTING SERVICES**

Statements on Standards for Consulting Services are issued by the AICPA Management Consulting Services Executive Committee, the senior technical committee of the Institute designated to issue pronouncements in connection with consulting services. Council has designated the AICPA Management Consulting Services Executive Committee as a body to establish professional standards under the "Compliance with Standards Rule" (ET sec. 1.310.001) of the Institute's Code of Professional Conduct (code). Members should be prepared to justify departures from this statement.

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CS Section 100

Consulting Services: Definitions and Standards

Source: Statement on Standards for Consulting Services No. 1

Effective for engagements accepted on or after January 1, 1992, unless otherwise indicated.

Introduction

.01 Consulting services that CPAs provided to their clients have evolved from advice on accounting-related matters to a wide range of services involving diverse technical disciplines, industry knowledge, and consulting skills. Most practitioners, including those who provide audit and tax services, also provide business and management consulting services to their clients.

.02 Consulting services differ fundamentally from the CPA's function of attesting to the assertions of other parties. In an attest service, the practitioner expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, the assertor. In a consulting service, the practitioner develops the findings, conclusions, and recommendations presented. The nature and scope of work is determined solely by the agreement between the practitioner and the client. Generally, the work is performed only for the use and benefit of the client.

.03 Historically, CPA consulting services have been commonly referred to as management consulting services, management advisory services, business advisory services, or management services. A series of Statements on Standards for Management Advisory Services (SSMASs) previously issued by the AICPA contained guidance on certain types of consulting services provided by members. This Statement on Standards for Consulting Services (SSCS) supersedes the SSMASs and provides standards of practice for a broader range of professional services, as described in paragraph .05.

.04 This SSCS and any subsequent SSCSs apply to any AICPA member holding out as a CPA while providing consulting services as defined herein.

Definitions

.05 Terms established for the purpose of SSCSs are as follows:

Consulting services practitioner. Any AICPA member holding out as a CPA while engaged in the performance of a Consulting Service for a client, or any other individual who is carrying out a Consulting Service for a client on behalf of any Institute member or member's firm holding out as a CPA.

Consulting process. The analytical approach and process applied in a Consulting Service. It typically involves some combination of activities relating to determination of client objective, fact-finding, definition of the problems or opportunities, evaluation of alternatives, formulation of proposed action, communication of results, implementation, and follow-up.

Consulting services. Professional services that employ the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process.¹ Consulting services may include one or more of the following:

- a. *Consultations*, in which the practitioner's function is to provide counsel in a short time frame, based mostly, if not entirely, on existing personal knowledge about the client, the circumstances, the technical matters involved, client representations, and the mutual intent of the parties. Examples of consultations are reviewing and commenting on a client-prepared business plan and suggesting computer software for further client investigation.
- b. *Advisory services*, in which the practitioner's function is to develop findings, conclusions, and recommendations for client consideration and decision making. Examples of advisory services are an operational review and improvement study, analysis of an accounting system, assistance with strategic planning, and definition of requirements for an information system.
- c. *Implementation services*, in which the practitioner's function is to put an action plan into effect. Client personnel and resources may be pooled with the practitioner's to accomplish the implementation objectives. The practitioner is responsible to the client for the conduct and management of engagement activities. Examples of implementation services are providing computer system installation and support, executing steps to improve productivity, and assisting with the merger of organizations.
- d. *Transaction services*, in which the practitioner's function is to provide services related to a specific client transaction, generally with a third party. Examples of transaction services are insolvency services, valuation services, preparation of information for obtaining financing, analysis of a potential merger or acquisition, and litigation services.
- e. *Staff and other support services*, in which the practitioner's function is to provide appropriate staff and possibly other support to perform tasks specified by the client. The staff provided will be directed by the client as circumstances require. Examples of staff and other support services are data processing facilities management, computer programming, bankruptcy trusteeship, and controllership activities.
- f. *Product services*, in which the practitioner's function is to provide the client with a product and associated professional services in support of the installation, use, or maintenance of the product.

¹ The definition of consulting services excludes the following:

- a. Services subject to other AICPA professional standards such as Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), or Statements on Standards for Accounting and Review Services (SSARSs). (These excluded services may be performed in conjunction with consulting services, but only the consulting services are subject to the Statement on Standards for Consulting Services [SSCS].)
- b. Engagements specifically to perform tax return preparation, tax planning or advice, tax representation, personal financial planning or bookkeeping services, or situations involving the preparation of written reports or the provision of oral advice on the application of accounting principles to specified transactions or events, either completed or proposed, and the reporting thereof.
- c. Recommendations and comments prepared during the same engagement as a direct result of observations made while performing the excluded services.

Examples of product services are the sale and delivery of packaged training programs, the sale and implementation of computer software, and the sale and installation of systems development methodologies.

Standards for Consulting Services

.06 The general standards of the profession are contained in the "General Standards Rule" of the code (ET sec. 1.300.001 and 2.300.001) and apply to all services performed by members. They are as follows:

- *Professional competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
- *Due professional care.* Exercise due professional care in the performance of professional services.
- *Planning and supervision.* Adequately plan and supervise the performance of professional services.
- *Sufficient relevant data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

.07 The following additional general standards for all consulting services are promulgated to address the distinctive nature of consulting services in which the understanding with the client may establish valid limitations on the practitioner's performance of services. These standards are established under the "Compliance with Standards Rule" of the code (ET sec. 1.310.001 and 2.310.001):

- *Client interest.* Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.²
- *Understanding with client.* Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed, and modify the understanding if circumstances require a significant change during the engagement.
- *Communication with client.* Inform the client of (a) conflicts of interest that may occur pursuant to the "Integrity and Objectivity Rule" of the code (ET sec. 1.100.001 and 2.100.001),³ (b) significant

² In "Integrity" (ET sec. 0.300.040), *integrity* is described as follows: "Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle."

In "Objectivity and Independence" (ET sec. 0.300.050), *objectivity* and *independence* are differentiated as follows: "Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. *Independence* precludes relationships that may appear to *impair a member's* objectivity in rendering attestation services."

³ The "Conflict of Interest Rule" (ET sec. 1.110.010) states, in part, the following:

A conflict of interest may occur if a *member* or the *member's firm* has a relationship with another person, entity, product, or service that, in the member's professional judgment, the client or other appropriate parties may view as impairing the *member's* objectivity...

A *member* may perform the *professional service* if he or she determines that the service can be performed with objectivity because the *threats* are not significant or can be reduced to an *acceptable level* through the application of *safeguards*...

reservations concerning the scope or benefits of the engagement, and (c) significant engagement findings or events.

.08 Professional judgment must be used in applying Statements on Standards for Consulting Services in a specific instance because the oral or written understanding with the client may establish constraints within which services are to be provided. For example, the understanding with the client may limit the practitioner's effort with regard to gathering relevant data. The practitioner is not required to decline or withdraw from a consulting engagement when the agreed-upon scope of services includes such limitations.

Consulting Services for Attest Clients

.09 The performance of consulting services for an attest client does not impair independence.⁴ However, members and their firms performing attest services for a client should comply with applicable independence standards, rules and regulations issued by AICPA, the state boards of accountancy, state CPA societies, and other regulatory agencies.

Effective Date

.10 This section is effective for engagements accepted on or after January 1, 1992. Early application of the provisions of this section is permissible.

[Revised, January 2015, to reflect the revised Code of Professional Conduct.]

⁴ AICPA independence standards relate only to the performance of attestation services; objectivity standards apply to all services. See footnote 2.

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QM Section

QUALITY MANAGEMENT

STATEMENTS ON QUALITY MANAGEMENT STANDARDS

Statements on Quality Management Standards (previously titled Statements on Quality Control Standards) are issued by the Auditing Standards Board, the senior technical body of the AICPA designated to issue pronouncements on auditing, attestation, and quality control matters. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires compliance with these standards when firms perform auditing and accounting services for a nonissuer.

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QM Section 10

A Firm's System of Quality Management

(Supersedes SQCS No. 8.)

Source: SQMS No. 1.

Systems of quality management in compliance with this section are required to be designed and implemented by December 15, 2025, and the evaluation of the system of quality management required by paragraphs .54-.55 is required to be performed within one year following December 15, 2025.

Introduction

Scope of This Section

.01 This section deals with a firm's responsibilities to design, implement, and operate a system of quality management for its accounting and auditing practice.

.02 Engagement quality reviews form part of the firm's system of quality management and

- a. this section addresses the firm's responsibility to establish policies or procedures addressing engagements that are required to be subject to engagement quality reviews.
- b. section 20, *Engagement Quality Reviews*, deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.

.03 Other professional standards include requirements for engagement partners and other engagement team members regarding quality management at the engagement level. For example, Statement on Auditing Standards (SAS) No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C sec. 220), deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. Other professional standards, including AT-C section 105, *Concepts Common to All Attestation Engagements*, and AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*, also establish requirements for the engagement partner for the management of quality at the engagement level.

.04 This section is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. Law, regulation, or relevant ethical requirements may establish responsibilities for the firm's management of quality beyond those described in this section. (Ref: par. A1)

.05 This section applies to audit and attestation engagements performed by a firm in accordance with *Government Auditing Standards*. This section does not apply to government audit organizations. Instead, those government audit

organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*.

.06 This section applies to all firms that perform any engagement included in a firm's accounting and auditing practice. The system of quality management that is established in accordance with the requirements of this section enables the consistent performance by the firm of all such engagements.

The Firm's System of Quality Management

.07 A system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements. It does not operate in a linear manner. However, for the purposes of this section, a system of quality management addresses the following eight components: (Ref: par. .A2)

- a. The firm's risk assessment process
- b. Governance and leadership
- c. Relevant ethical requirements
- d. Acceptance and continuance of client relationships and specific engagements
- e. Engagement performance
- f. Resources
- g. Information and communication
- h. The monitoring and remediation process

.08 This section requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management in an interconnected and coordinated manner such that the firm proactively manages the quality of engagements performed by the firm. (Ref: par. .A3)

.09 The risk-based approach is embedded in the requirements of this section through the following:

- a. *Establishing quality objectives.* The quality objectives established by the firm consist of objectives in relation to the components of the system of quality management that are to be achieved by the firm. The firm is required to establish the quality objectives specified by this section and any additional quality objectives considered necessary by the firm to achieve the objectives of the system of quality management.
- b. *Identifying and assessing risks to the achievement of the quality objectives* (referred to in this section as *quality risks*). The firm is required to identify and assess quality risks to provide a basis for the design and implementation of responses.
- c. *Designing and implementing responses to address the quality risks.* The nature, timing, and extent of the firm's responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks.

.10 This section requires that, at least annually, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluate the system of quality management and conclude whether the system of quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph .15a–b, are being achieved. (Ref: par. .A4)

Scalability

.11 In applying a risk-based approach, the firm is required to take into account

- a. the nature and circumstances of the firm, and
- b. the nature and circumstances of the engagements performed by the firm.

Accordingly, the design of the firm's system of quality management — in particular, the complexity and formality of the system — will vary. For example, a firm that performs different types of engagements for a wide variety of entities, such as audits of specialized industries or group audits for multinational entities, will likely need to have a more complex and formalized system of quality management and supporting documentation than a firm that performs only reviews of financial statements or compilation engagements.

Networks and Service Providers

.12 This section addresses the firm's responsibilities when the firm

- a. belongs to a network, and the firm complies with network requirements or uses network services in the system of quality management or in performing engagements, or
- b. uses resources from a service provider in the system of quality management or in performing engagements.

Even when the firm complies with network requirements or uses network services or resources from a service provider, the firm is responsible for its system of quality management.

Authority of This Section

.13 Paragraph .15 contains the objective of the firm in following this section. This section contains the following: (Ref: par. .A5)

- a. Requirements designed to enable the firm to meet the objective in paragraph .15 (Ref: par. .A6)
- b. Related guidance in the form of application and other explanatory material (Ref: par. .A7)
- c. Introductory material that provides context relevant to a proper understanding of this section
- d. Definitions (Ref: par. .A8)

Effective Date

.14 Systems of quality management in compliance with this section are required to be designed and implemented by December 15, 2025, and the evaluation of the system of quality management required by paragraphs .54–.55 is required to be performed within one year following December 15, 2025.

Objective

.15 The objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and
- b. engagement reports issued by the firm are appropriate in the circumstances.

.16 The public interest is served by the consistent performance of quality engagements. The design, implementation, and operation of the system of quality management enables the consistent performance of quality engagements by providing the firm with reasonable assurance that the objectives of the system of quality management, stated in paragraph .15a–b, are achieved. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, maintaining professional skepticism.

Definitions

.17 For purposes of the QM sections, the following terms have the meanings attributed as follows:

Accounting and auditing practice. A practice that performs engagements covered by this section, which are audit, attestation, review, compilation, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA code. (Ref: par. .A9)

Deficiency in the firm's system of quality management (referred to as *deficiency* in this section). This exists when (Ref: par. .A10 and .A174–.A175)

- a quality objective required to achieve the objective of the system of quality management is not established;
- a quality risk, or combination of quality risks, is not identified or properly assessed; (Ref: par. .A11)
- a response, or combination of responses, does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the responses are not properly designed, implemented, or operating effectively; or
- another aspect of the system of quality management is absent, or not properly designed, implemented, or operating effectively, such that a requirement of this section has not been addressed. (Ref: par. .A12–.A13)

Engagement documentation. The record of work performed, results obtained, and conclusions the practitioner reached (terms such as *working papers* or *work papers* are sometimes used).

Engagement partner. The partner or other individual appointed by the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, when

required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon performed by the engagement quality reviewer and completed on or before the date of the engagement report.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Engagement team. All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, excluding an external specialist¹ and internal auditors who provide direct assistance on an engagement. (Ref: par. .A14)

External inspections. Inspections or investigations, undertaken by an external oversight authority, related to the firm's system of quality management or engagements performed by the firm. (Ref: par. .A15)

Findings (in relation to a system of quality management). Information about the design, implementation, and operation of the system of quality management that has been accumulated from the performance of monitoring activities, external inspections, and other relevant sources, which indicates that one or more deficiencies may exist. (Ref: par. .A16–.A18)

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice. (Ref: par. .A19)

Inspection. Inspection is an evaluation of the adequacy of aspects of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.

Network. As defined in "Definitions" (ET sec. 0.400) in the AICPA code, an association of entities that includes one or more firms. (Ref: par. .A20)

Network firm. As defined in "Definitions" in the AICPA code, a firm or other entity that belongs to a network. References to a *network firm* are to be read hereafter as "another firm or entity that belongs to the same network as the firm."

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

Personnel. Partners and staff in the firm. (Ref: par. .A21–.A22)

Professional judgment. The application of relevant training, knowledge, and experience, within the context of professional standards, in making informed decisions about the courses of action that are

¹ Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

appropriate in the design, implementation, and operation of the firm's system of quality management.

Professional standards. Standards promulgated by the ASB or ARSC under the "General Standards Rule" or the "Compliance With Standards Rule" of the AICPA code or other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Quality objectives. The desired outcomes in relation to the components of the system of quality management to be achieved by the firm.

Quality risk. A risk that has a reasonable possibility of

- occurring, and
- individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

Reasonable assurance. In the context of the QM sections, a high, but not absolute, level of assurance.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the firm, engagement team, engagement quality reviewer, and other firm personnel are subject when undertaking engagements in the firm's accounting and auditing practice that consist of the AICPA code together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive. (Ref: par. .A23–.A24 and .A64)

Response (in relation to a system of quality management). Policies or procedures designed and implemented by the firm to address one or more quality risks. (Ref: par. .A25–.A27 and .A52)

- *Policies* are statements of what should, or should not, be done to address quality risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- *Procedures* are actions to implement policies.

Service provider (in the context of this section). An individual or organization external to the firm that provides a resource that is used in the system of quality management or in performing engagements. Service providers exclude the firm's network, other network firms, or other structures or organizations in the network. (Ref: par. .A28 and .A110)

Staff. Professionals, other than partners, including any specialists the firm employs.

System of quality management. A system designed, implemented, and operated by a firm to provide the firm with reasonable assurance that

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
- b. engagement reports issued by the firm are appropriate in the circumstances.

Requirements

Applying and Complying With Relevant Requirements

.18 The firm should comply with each requirement of this section unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: par. .A29)

.19 The individual or individuals assigned ultimate responsibility and accountability for the firm's system of quality management, and the individual or individuals assigned operational responsibility for the firm's system of quality management, should have an understanding of this section, including the application and other explanatory material, to understand the objective of this section and to apply its requirements properly.

System of Quality Management

.20 The firm should design, implement, and operate a system of quality management. In doing so, the firm should exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements. The governance and leadership component of the system of quality management establishes the environment that supports the design, implementation, and operation of the system of quality management. (Ref: par. .A30–.A31)

Responsibilities

.21 The firm should assign (Ref: par. .A32–.A36)

- a. ultimate responsibility and accountability for the system of quality management to the firm's CEO or the firm's managing partner (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent);
- b. operational responsibility for the system of quality management; and
- c. operational responsibility for specific aspects of the system of quality management, including
 - i. compliance with independence requirements, and (Ref: par. .A37)
 - ii. the monitoring and remediation process.

.22 In assigning the roles in paragraph .21, the firm should determine that the individual or individuals (Ref: par. .A38)

- a. have the appropriate experience, knowledge, influence, and authority within the firm and sufficient time to fulfill their assigned responsibility, and (Ref: par. .A39)
- b. understand their assigned roles and that they are accountable for fulfilling them.

.23 The firm should determine that the individual or individuals assigned operational responsibility for the system of quality management, compliance with independence requirements, and the monitoring and remediation process have a direct line of communication to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management.

The Firm's Risk Assessment Process

.24 The firm should design and implement a risk assessment process to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks. (Ref: par. .A40–.A42)

.25 The firm should establish the quality objectives specified by this section and any additional quality objectives considered necessary by the firm to achieve the objectives of the system of quality management. (Ref: par. .A43–.A45)

.26 The firm should identify and assess quality risks to provide a basis for the design and implementation of responses. In doing so, the firm should do the following:

- a. Obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, including the following: (Ref: par. .A46–.A48)
 - i. With respect to the nature and circumstances of the firm, those relating to
 - (1) the complexity and operating characteristics of the firm;
 - (2) the strategic and operational decisions and actions, business processes, and business model of the firm;
 - (3) the characteristics and management style of leadership;
 - (4) the resources of the firm, including the resources provided by service providers;
 - (5) law, regulation, professional standards, and the environment in which the firm operates; and
 - (6) in the case of a firm that belongs to a network, the nature and extent of the network requirements and network services, if any
 - ii. With respect to the nature and circumstances of the engagements performed by the firm, those relating to
 - (1) the types of engagements performed by the firm and the reports to be issued, and
 - (2) the types of entities for which such engagements are undertaken
- b. Take into account how, and the degree to which, the conditions, events, circumstances, actions, or inactions in (a) may adversely affect the achievement of the quality objectives. (Ref: par. .A49–.A50)

.27 The firm should design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks. The firm's responses should include the responses specified in paragraph .35. However, the responses specified in paragraph .35 alone are not sufficient to achieve the objectives of the system of quality management. (Ref: par. .A51–.A53)

.28 The firm should establish policies or procedures that are designed to identify information that indicates additional quality objectives, or additional or modified quality risks or responses, are needed due to changes in the nature

and circumstances of the firm or its engagements. If such information is identified, the firm should consider the information and, when appropriate, (Ref: par. .A54–.A55)

- a. establish additional quality objectives or modify additional quality objectives previously established by the firm; (Ref: par. .A56)
- b. identify and assess additional quality risks, modify the quality risks, or reassess the quality risks; or
- c. design and implement additional responses or modify the responses.

Governance and Leadership

.29 The firm should establish the following quality objectives that address the firm's governance and leadership, which establishes the environment that supports the system of quality management:

- a. The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following: (Ref: par. .A57–.A58)
 - i. The firm's role in serving the public interest by consistently performing quality engagements
 - ii. The importance of professional ethics, values, and attitudes
 - iii. The responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management and their expected behavior
 - iv. The importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities
- b. Leadership is responsible and accountable for quality. (Ref: par. .A59)
- c. Leadership demonstrates a commitment to quality through its actions and behaviors. (Ref: par. .A60)
- d. The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm's system of quality management. (Ref: par. .A32–.A35 and .A61)
- e. Resource needs, including financial resources, are planned for, and resources are obtained, allocated, or assigned in a manner that is consistent with the firm's commitment to quality. (Ref: par. .A62–.A63)

Relevant Ethical Requirements

.30 The firm should establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence: (Ref: par. .A64–.A66 and .A68)

- a. The firm and its personnel
 - i. understand the relevant ethical requirements to which the firm and the firm's engagements are subject, and (Ref: par. .A23)

- ii. fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject.
- b. Others, including the network, network firms, individuals in the network or network firms, or service providers, who are subject to the relevant ethical requirements to which the firm and the firm's engagements are subject
 - i. understand the relevant ethical requirements that apply to them, and (Ref: par. .A23 and .A67)
 - ii. fulfill their responsibilities in relation to the relevant ethical requirements that apply to them. (Ref: par. .A68)

Acceptance and Continuance of Client Relationships and Specific Engagements

.31 The firm should establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements:

- a. Judgments by the firm about whether to accept or continue a client relationship or specific engagement are appropriate based on the following:
 - i. Information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management and, when appropriate, those charged with governance) that is sufficient to support such judgments (Ref: par. .A69–.A74)
 - ii. The firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements (Ref: par. .A75–.A76)
- b. The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: par. .A77–.A78)

Engagement Performance

.32 The firm should establish the following quality objectives that address the performance of quality engagements:

- a. Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement. (Ref: par. .A79)
- b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams; the work performed by less experienced engagement team members is directed, supervised, and reviewed by suitably experienced engagement team members. (Ref: par. .A80–.A81)

- c. Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, maintain professional skepticism. (Ref: par. .A82)
- d. Consultation on difficult or contentious matters is undertaken, and the conclusions agreed to are implemented. (Ref: par. .A83–.A85)
- e. Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, are brought to the attention of the firm and resolved. (Ref: par. .A86)
- f. Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, and professional standards. (Ref: par. .A87–.A89)

Resources

.33 The firm should establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating, and assigning resources in a timely manner to enable the design, implementation, and operation of the system of quality management: (Ref: par. .A90–.A91)

Human Resources

- a. Personnel are hired, developed, and retained and have the competence and capabilities to (Ref: par. .A92–.A94)
 - i. consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or
 - ii. perform activities or carry out responsibilities in relation to the operation of the firm's system of quality management.
- b. Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives. (Ref: par. .A95–.A97)
- c. Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of firm's system of quality management or performance of engagements. (Ref: par. .A98)
- d. Engagement team members, including an engagement partner, who have appropriate competence and capabilities to consistently perform quality engagements, including being given sufficient time, are assigned to each engagement. (Ref: par. .A92–.A93 and .A99–.A101)
- e. Individuals who have appropriate competence and capabilities, including sufficient time, to perform such activities are assigned to perform activities within the system of quality management.

Technological Resources

- f. Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the performance of engagements. (Ref: par. .A102–.A106 and .A109)

Intellectual Resources

- g. Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm's system of quality management and the consistent performance of quality engagements, and such intellectual resources are consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: par. .A107–.A109)

Service Providers

- h. Human, technological, or intellectual resources from service providers are appropriate for use in the firm's system of quality management and in performing engagements, taking into account the quality objectives in (d–g). (Ref: par. .A110–.A115)

Information and Communication

.34 The firm should establish the following quality objectives that address obtaining, generating, or using information regarding the system of quality management and communicating information within the firm and to external parties on a timely basis to enable the design, implementation, and operation of the system of quality management: (Ref: par. .A116)

- a. The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources. (Ref: par. .A117–.A119)
- b. The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another. (Ref: par. .A120)
- c. Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following: (Ref: par. .A120)
 - i. Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the system of quality management or engagements.
 - ii. Personnel and engagement teams communicate information to the firm when performing activities within the system of quality management or engagements.
- d. Relevant and reliable information is communicated to external parties, including the following:
 - i. Information is communicated by the firm to or within the firm's network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities

relating to the network requirements or network services or resources provided by them. (Ref: par. .A121)

- ii. Information is communicated externally when required by law, regulation, or professional standards or to support external parties' understanding of the system of quality management. (Ref: par. .A122–.A123)

Specified Responses

.35 In designing and implementing responses in accordance with paragraph .27, the firm should include the following responses: (Ref: par. .A124)

- a. The firm establishes policies or procedures for
 - i. identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements. (Ref: par. .A125)
 - ii. identifying, communicating, evaluating, and reporting of any breaches of the relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner. (Ref: par. .A126–.A127)
- b. The firm obtains, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.
- c. The firm establishes policies or procedures for receiving, investigating, and resolving complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm's policies or procedures established in accordance with this section. (Ref: par. .A128–.A129)
- d. The firm establishes policies or procedures that address the following circumstances:
 - i. The firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement. (Ref: par. .A130–.A131)
 - ii. The firm is obligated by law or regulation to accept a client relationship or specific engagement. (Ref: par. .A132–.A133)
- e. The firm establishes policies or procedures that (Ref: par. .A134–.A137)
 - i. address when it is appropriate to communicate with external parties about the firm's system of quality management, and (Ref: par. .A138–.A140)
 - ii. address the information to be provided when communicating externally about the firm's system of quality management, including the nature, timing, and extent and appropriate form of communication. (Ref: par. .A141–.A142)
- f. The firm establishes policies or procedures that address engagement quality reviews in accordance with section 20 and requires an engagement quality review for the following:

- i. Audits or other engagements for which an engagement quality review is required by law or regulation (Ref: par. .A143)
- ii. Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risks (Ref: par. .A144–.A147)

Monitoring and Remediation Process

.36 The firm should establish a monitoring and remediation process to (Ref: par. .A148)

- a. provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
- b. take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

Designing and Performing Monitoring Activities

.37 The firm should design and perform monitoring activities to provide a basis for the identification of deficiencies.

.38 In determining the nature, timing, and extent of the monitoring activities, the firm should take the following into account: (Ref: par. .A149–.A152)

- a. The reasons for the assessments given to the quality risks
- b. The design of the responses
- c. The design of the firm's risk assessment process and monitoring and remediation process (Ref: par. .A153–.A155)
- d. Changes in the system of quality management (Ref: par. .A156)
- e. The results of previous monitoring activities, whether previous monitoring activities continue to be relevant in evaluating the firm's system of quality management and whether remedial actions to address previously identified deficiencies were effective (Ref: par. .A157–.A158)
- f. Other relevant information, including complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm's policies or procedures established in accordance with this section, information from external inspections, and information from service providers (Ref: par. .A159–.A161)

.39 The firm should include the inspection of completed engagements in its monitoring activities and should determine which engagements and engagement partners to select. In doing so, the firm should (Ref: par. .A150 and .A162–.A166)

- a. take into account the matters in paragraph .38;
- b. consider the nature, timing, and extent of other monitoring activities undertaken by the firm and the engagements and engagement partners subject to such monitoring activities; (Ref: par. .A167–.A168) and
- c. select at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.

.40 The firm should establish policies or procedures that

- a. require the individuals performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively; and
- b. address the objectivity of the individuals performing the monitoring activities, based on the premise that objectivity is enhanced when the engagement team members or the engagement quality reviewer of an engagement are not involved in performing any monitoring activities related to that engagement. (Ref: par. .A169–.A173)

Evaluating Findings and Identifying Deficiencies

.41 The firm should evaluate findings to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: par. .A174–.A178)

Evaluating Identified Deficiencies

.42 The firm should evaluate the severity and pervasiveness of identified deficiencies by (Ref: par. .A177 and .A179–.A180)

- a. investigating the root causes of the identified deficiencies. In determining the nature, timing, and extent of the procedures to investigate the root causes, the firm should take into account the nature of the identified deficiencies and their possible severity. (Ref: par. .A181–.A185)
- b. evaluating the effect of the identified deficiencies, individually and in aggregate, on the system of quality management.

Responding to Identified Deficiencies

.43 The firm should design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. (Ref: par. .A186–.A188)

.44 The individual or individuals assigned operational responsibility for the monitoring and remediation process should evaluate whether the remedial actions

- a. are appropriately designed to address the identified deficiencies and their related root causes and determine that they have been implemented.
- b. implemented to address previously identified deficiencies are effective.

.45 If the evaluation indicates that the remedial actions are not appropriately designed and implemented or are not effective, the individual or individuals assigned operational responsibility for the monitoring and remediation process should take appropriate action to determine that the remedial actions are appropriately modified such that they are effective.

Findings About a Particular Engagement

.46 The firm should respond to circumstances in which findings indicate that there is an engagement for which required procedures were omitted during the performance of the engagement, or that the report issued may be inappropriate. The firm's response should include the following: (Ref: par. .A190)

- a. Taking appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements

- b. When the report is considered to be inappropriate, considering the implications and taking appropriate action, including considering whether to obtain legal advice

Ongoing Communication Related to Monitoring and Remediation

.47 The individual or individuals assigned operational responsibility for the monitoring and remediation process should communicate the following on a timely basis to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management and the individual or individuals assigned operational responsibility for the system of quality management: (Ref: par. .A190)

- a. A description of the monitoring activities performed
- b. The identified deficiencies, including the severity and pervasiveness of such deficiencies
- c. The remedial actions to address the identified deficiencies

.48 The firm should communicate the matters described in paragraph .47 to engagement teams and other individuals assigned activities within the system of quality management to enable them to take prompt and appropriate action in accordance with their responsibilities.

Network Requirements or Network Services

.49 When the firm belongs to a network, the firm should understand the following, when applicable: (Ref: par. .A20 and .A191–.A193)

- a. The requirements established by the network regarding the firm's system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (that is, network requirements)
- b. Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation, or operation of the firm's system of quality management (that is, network services)
- c. The firm's responsibilities for any actions that are necessary to implement the network requirements or use network services (Ref: par. .A194)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation, and operation of the system of quality management. The firm should not allow compliance with the network requirements or use of network services to contravene the requirements of this section. (Ref: par. .A20 and par. .A195)

.50 Based on the understanding obtained in accordance with paragraph .49, the firm should

- a. determine how the network requirements or network services are relevant to, and are taken into account in, the firm's system of quality management, including how they are to be implemented. (Ref: par. .A196)
- b. evaluate whether and, if so, how the network requirements or network services need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management. (Ref: par. .A197–.A199)

Monitoring Activities Undertaken by the Network on the Firm's System of Quality Management

.51 For circumstances in which the network performs monitoring activities relating to the firm's system of quality management, the firm should

- a. determine the effect of the monitoring activities performed by the network on the nature, timing, and extent of the firm's monitoring activities performed in accordance with paragraphs .37–.39;
- b. determine the firm's responsibilities in relation to the monitoring activities, including any related actions by the firm; and
- c. as part of evaluating findings and identifying deficiencies in paragraph .41, obtain the results of the monitoring activities from the network in a timely manner. (Ref: par. .A200)

Monitoring Activities Undertaken by the Network Across the Network Firms

.52 The firm should

- a. understand the overall scope of the monitoring activities undertaken by the network across the network firms, including monitoring activities to determine that network requirements have been appropriately implemented across the network firms, and how the network will communicate the results of its monitoring activities to the firm.
- b. at least annually, obtain information from the network about the overall results of the network's monitoring activities across the network firms, if applicable, and (Ref: par. .A201–.A203)
 - i. communicate the information to engagement teams and other individuals assigned activities within the system of quality management, as appropriate, to enable them to take prompt and appropriate action in accordance with their responsibilities, and
 - ii. consider the effect of the information on the firm's system of quality management.

Deficiencies in Network Requirements or Network Services Identified by the Firm

.53 If the firm identifies a deficiency in the network requirements or network services, the firm should (Ref: par. .A204)

- a. communicate to the network relevant information about the identified deficiency, and
- b. in accordance with paragraph .43, design and implement remedial actions to address the effect of the identified deficiency in the network requirements or network services. (Ref: par. .A205)

Evaluating the System of Quality Management

.54 The individual or individuals assigned ultimate responsibility and accountability for the system of quality management should evaluate, on behalf of the firm, the system of quality management. The evaluation should be undertaken as of a point in time and performed at least annually. (Ref: par. .A206–.A209)

.55 Based on the evaluation, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management

should conclude, on behalf of the firm, one of the following: (Ref: par. .A210 and .A217)

- a. The system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. .A211)
- b. Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. .A212)
- c. The system of quality management does not provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. .A212–.A216)

.56 If the individual or individuals assigned ultimate responsibility and accountability for the system of quality management reaches the conclusion described in paragraph .55*b* or .55*c*, the firm should do the following: (Ref: par. .A218)

- a. Take prompt and appropriate action.
- b. Communicate to
 - i. engagement teams and other individuals assigned activities within the system of quality management to the extent that it is relevant to their responsibilities, and (Ref: par. .A219)
 - ii. external parties in accordance with the firm's policies or procedures required by paragraph .35*e*. (Ref: par. .A220)

.57 The firm should undertake periodic performance evaluations of the individual or individuals assigned ultimate responsibility and accountability for the system of quality management and the individual or individuals assigned operational responsibility for the system of quality management. In doing so, the firm should take into account the evaluation of the system of quality management. (Ref: par. .A221–.A223)

Documentation

.58 The firm should prepare documentation of its system of quality management that is sufficient to (Ref: par. .A224–.A226)

- a. support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the system of quality management and performing engagements.
- b. support the consistent implementation and operation of the responses.
- c. provide evidence of the design, implementation, and operation of the responses to support the evaluation of the system of quality management by the individual or individuals assigned ultimate responsibility and accountability for the system of quality management.

.59 In preparing documentation, the firm should include the following:

- a. Identification of the individual or individuals assigned ultimate responsibility and accountability for the system of quality management and operational responsibility for the system of quality management
- b. The firm's quality objectives and quality risks (Ref: par. .A227)
- c. A description of the responses and how the firm's responses address the quality risks
- d. Regarding the monitoring and remediation process,
 - i. evidence of the monitoring activities performed;
 - ii. the evaluation of findings, and identified deficiencies and their related root causes; and
 - iii. remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions
 - iv. communications about monitoring and remediation
- e. The conclusion reached pursuant to paragraph .55 and the basis for that conclusion

.60 The firm should document the matters in paragraph .59 as they relate to network requirements or network services and the evaluation of the network requirements or network services in accordance with paragraph .50b. (Ref: par. .A228)

.61 The firm should establish a period of time for the retention of documentation for the system of quality management that is sufficient to enable the firm and its peer reviewer to monitor the design, implementation, and operation of the firm's system of quality management or for a longer period if required by law or regulation.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .03–.04)

.A1 The AICPA code establishes the fundamental principles of professional ethics, which include the obligation to act in a way that serves the public interest.² As indicated in paragraph .16, in the context of engagement performance as described in this section, the consistent performance of quality engagements forms part of the obligation to act in the public interest.

The Firm's System of Quality Management (Ref: par. .07–.10)

.A2 The firm may use different terminology or frameworks to describe the components of its system of quality management.

.A3 Examples of the interconnected nature of the components include the following:

- The firm's risk assessment process sets out the process the firm is required to follow in implementing a risk-based approach across the system of quality management.

² Paragraph .01 of ET section 0.300.030.

- The governance and leadership component establishes the environment that supports the system of quality management.
- The resources and information and communication components enable the design, implementation, and operation of the system of quality management.
- The monitoring and remediation process is designed to monitor the entire system of quality management. The results of the monitoring and remediation process provide information that is relevant to the firm's risk assessment process.
- There may be relationships between specific matters; for example, certain aspects of relevant ethical requirements are relevant to accepting and continuing client relationships and specific engagements.

.A4 Reasonable assurance is obtained when the system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph .15a–b are not achieved. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of a system of quality management. Such limitations include the fact that human judgment in decision making can be faulty and that breakdowns in a firm's system of quality management may occur, for example, due to human error or behavior or failures in IT applications.

Authority of This Section (Ref: par. .13)

.A5 The objective of this section provides the context in which the requirements of this section are set, establishes the desired outcome of this section, and is intended to assist the firm in understanding what needs to be accomplished and, when necessary, the appropriate means of doing so.

.A6 The requirements of this section are expressed using the word *should*.

.A7 When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover, and
- include examples that illustrate how the requirements might be applied.

Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this section. These additional considerations assist in the application of the requirements in this section. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this section.

.A8 This section includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of this section. These definitions are provided to assist in the consistent application and interpretation of this section and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise.

Definitions

Accounting and Auditing Practice (Ref: par. .17)

.A9 Standards promulgated by the ASB and ARSC that apply to engagements covered by this section comprise the following:

- Statements on Auditing Standards (SASs)
- Statements on Standards for Attestation Engagements (SSAEs)
- Statements on Standards for Accounting and Review Services (SSARSs)

Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

Deficiency (Ref: par. .17)

.A10 The firm identifies deficiencies by evaluating findings. A deficiency may arise from a finding or a combination of findings.

.A11 When a deficiency is identified as a result of a quality risk, or combination of quality risks, not being identified or properly assessed, the responses to address such quality risks may also be absent or not appropriately designed or implemented.

.A12 The other aspects of the system of quality management consist of the requirements in this section addressing the following:

- Assigning responsibilities (paragraphs .21–.22)
- The firm's risk assessment process
- The monitoring and remediation process
- The evaluation of the system of quality management

.A13 Examples of deficiencies related to other aspects of the system of quality management include the following:

- The firm's risk assessment process fails to identify information that indicates changes in the nature and circumstances of the firm and its engagements and the need to establish additional quality objectives or modify the quality risks or responses.
- The firm's monitoring and remediation process is not designed or implemented in a manner that
 - provides relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
 - enables the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.
- The individual or individuals assigned ultimate responsibility and accountability for the system of quality management do not undertake the annual evaluation of the system of quality management.

Engagement Team (Ref: par. .17)

.A14 SAS No. 146³ provides guidance in applying the definition of *engagement team* in the context of an audit of financial statements. AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, expands on how SAS No. 146 is to be applied in relation to an audit of group financial statements. The quality risks and responses to those risks relevant to group audit engagements may be different for engagement team members who are firm personnel than for engagement team members who are external to the firm (for example, engagement team members who are from network firms or are service providers, such as component auditors from firms not within the firm's network).

External Inspections (Ref: par. .17)

.A15 In some circumstances, an external oversight authority, such as the U.S. Department of Labor, may undertake other types of inspections, for example, reviews that focus on, for a selection of firms, particular aspects of audit engagements or firm-wide practices.

Findings (Ref: par. .17)

.A16 As part of accumulating findings from monitoring activities, external inspections, and other relevant sources, the firm may identify other observations about the firm's system of quality management, such as positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management. Paragraph .A168 explains how other observations may be used by the firm in the system of quality management.

.A17 Paragraph .A157 provides examples of information from other relevant sources.

.A18 Monitoring activities include monitoring at the engagement level, such as inspection of engagements. Furthermore, external inspections and other relevant sources may include information that relates to specific engagements. As a result, information about the design, implementation, and operation of the system of quality management includes engagement-level findings that may be indicative of findings in relation to the system of quality management.

Firm (Ref: par. .17)

.A19 The definition of *firm* in relevant ethical requirements may differ from the definition set out in this section.

Network (Ref: par. .17 and .49)

.A20 Networks and the firms within the network may be structured in a variety of ways. For example, in the context of a firm's system of quality management,

- the network may establish requirements for the firm related to its system of quality management or provide services that are used by the firm in its system of quality management or in performing engagements.
- other firms within the network may provide services (for example, resources) that are used by the firm in its system of quality management or in performing engagements.

³ Paragraphs A15–A21 of Statement on Auditing Standards (SAS) No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- other structures or organizations within the network may establish requirements for the firm related to its system of quality management or provide services.

For the purposes of this section, any network requirements or network services that are obtained from the network, another firm within the network, or another structure or organization in the network are considered "network requirements or network services."

Personnel (Ref: par. .17)

.A21 In addition to personnel (that is, individuals in the firm), the firm may use individuals external to the firm in performing activities in the system of quality management or in performing engagements. For example, individuals external to the firm may include individuals from other network firms (for example, individuals in a service delivery center of a network firm) or individuals employed by a service provider (for example, a component auditor from another firm not within the firm's network).

.A22 Personnel also includes partners and staff in other structures of the firm, such as a service delivery center in the firm.

Relevant Ethical Requirements (Ref: par. .17 and .30)

.A23 The relevant ethical requirements that are applicable in the context of a system of quality management may vary, depending on the nature and circumstances of the firm and its engagements. The AICPA code acknowledges that federal, state, or local statutes, rules, or regulations may be more restrictive than the AICPA code.

.A24 Various provisions of the relevant ethical requirements may apply only to individuals in the context of the performance of engagements and not the firm itself. For example, the "Integrity and Objectivity Rule" (ET sec. 1.100.001) of the AICPA code prohibits individuals from knowingly misrepresenting facts or subordinating their judgment when performing professional services for a client or for an employer. Compliance with such relevant ethical requirements by individuals may need to be addressed by the firm's system of quality management.

Response (Ref: par. .17)

.A25 Policies are implemented through the actions of personnel and other individuals whose actions are subject to the policies (including engagement teams) or through their restraint from taking actions that would conflict with the firm's policies.

.A26 Procedures may be mandated, through formal documentation or other communications, or may result from behaviors that are not mandated but, rather, are conditioned by the firm's culture. Procedures may be enforced through the actions permitted by IT applications or other aspects of the firm's IT environment.

.A27 If the firm uses individuals external to the firm in the system of quality management or in performing engagements, different policies or procedures may need to be designed by the firm to address the actions of the individuals. SAS No. 146⁴ provides guidance when different policies or procedures may need to be designed by the firm to address the actions of individuals external to the firm in the context of an audit of financial statements.

⁴ Paragraphs A23–A25 of SAS No. 146.

Service Provider (Ref: par. .17)

.A28 Service providers include component auditors from other firms not within the firm's network.

Applying, and Complying With, Relevant Requirements (Ref: par. .18)

.A29 Examples of when a requirement of this section may not be relevant to the firm include the following:

- The firm is a sole practitioner. For example, the requirements addressing the organizational structure and assigning roles, responsibilities, and authority within the firm; direction, supervision, and review; and addressing differences of opinion may not be relevant.
- The firm only performs engagements that are preparation of financial statements engagements in accordance with AR-C section 70, *Preparation of Financial Statements*. For example, because the firm is not required to maintain independence for preparation of financial statements engagements, the requirement to obtain a documented confirmation of compliance with independence requirements from all personnel would not be relevant.

System of Quality Management**Design, Implement, and Operate a System of Quality Management (Ref: par. .20)**

.A30 Quality management is not a separate function of the firm; it is the integration of a culture that demonstrates a commitment to quality with the firm's strategy, operational activities, and business processes. As a result, designing the system of quality management and the firm's operational activities and business processes in an integrated manner may promote a harmonious approach to managing the firm and enhance the effectiveness of quality management.

.A31 The quality of professional judgments exercised by the firm is likely to be enhanced when individuals making such judgments demonstrate an attitude that includes an inquiring mind, which involves

- considering the source, relevance, and sufficiency of information obtained about the system of quality management, including information related to the nature and circumstances of the firm and its engagements, and
- being open and alert to a need for further investigation or other action.

Responsibilities (Ref: par. .21–.22 and .29d)

.A32 The governance and leadership component includes a quality objective that the firm has an organizational structure and assignment of roles, responsibilities, and authority that is appropriate to enable the design, implementation, and operation of the firm's system of quality management.

.A33 Notwithstanding the assignment of responsibilities related to the system of quality management in accordance with paragraph .21, the firm

remains ultimately responsible for the system of quality management and holding individuals responsible and accountable for their assigned roles. For example, in accordance with paragraphs .54–.55, although the firm assigns the evaluation of the system of quality management and conclusion thereon to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management, the firm is responsible for the evaluation and conclusion.

.A34 Individuals who have the appropriate influence and authority within the firm, as required by paragraph .22, to be assigned responsibility for the matters in paragraph .21 are typically partners of the firm. However, based on the legal structure of the firm, there may be circumstances in which an individual may not be a partner of the firm, but the individual has the appropriate influence and authority within the firm to perform the assigned role because of formal arrangements made by the firm or the firm's network.

.A35 How the firm assigns roles, responsibilities, and authority within the firm may vary, and law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities. An individual assigned responsibility for a matter in paragraph .21 may further assign roles, procedures, tasks, or actions to other individuals to assist the individual in fulfilling the responsibilities. However, an individual assigned responsibility for a matter in paragraph .22 remains responsible and accountable for the responsibilities assigned to the individual.

.A36 An example of scalability to demonstrate how assigning roles and responsibilities may be undertaken in firms of different complexity is as follows:

- In a less complex firm, ultimate responsibility and accountability for the system of quality management may be assigned to a single managing partner with sole responsibility for the oversight of the firm. This individual may also assume responsibility for all aspects of the system of quality management, including operational responsibility for the system of quality management, compliance with independence requirements, and the monitoring and remediation process.
- In a more complex firm, the organizational structure of the firm may include multiple levels of leadership, and the firm may have an independent governing body that has nonexecutive oversight of the firm, which may comprise external individuals. Furthermore, the firm may assign operational responsibility for specific aspects of the system of quality management beyond those specified in paragraph .21c, such as operational responsibility for compliance with ethical requirements or operational responsibility for managing a service line.

.A37 Compliance with independence requirements is essential to the performance of engagements in a firm's accounting and auditing practice and is an expectation of stakeholders relying on the firm's reports. The individual or individuals assigned operational responsibility for compliance with independence requirements are ordinarily responsible for the oversight of all matters related to independence so that a robust and consistent approach is designed and implemented by the firm to deal with independence requirements.

.A38 Law, regulation, or professional standards may establish additional requirements for an individual assigned responsibility for a matter in paragraph .21, such as requirements for professional licensing, professional education, or continuing professional development.

.A39 The appropriate experience and knowledge for the individual or individuals assigned operational responsibility for the system of quality management ordinarily includes an understanding of the firm's strategic decisions and actions and experience with the firm's business operations.

The Firm's Risk Assessment Process (Ref: par. .24)

.A40 How the firm designs the firm's risk assessment process may be affected by the nature and circumstances of the firm, including how the firm is structured and organized.

Examples of scalability to demonstrate how the firm's risk assessment process may differ from that of other firms include the following:

- In a less complex firm, the individual or individuals assigned operational responsibility for the system of quality management may have a sufficient understanding of the firm and its engagements to undertake the risk assessment process. Furthermore, the documentation of the quality objectives, quality risks, and responses may be less extensive than for a more complex firm (for example, it may be documented in a single document).
- In a more complex firm, there may be a formal risk assessment process involving multiple individuals and numerous activities. The process may be centralized (for example, the quality objectives, quality risks, and responses are established centrally for all business units, functions, and service lines) or decentralized (for example, the quality objectives, quality risks, and responses are established at a business unit, function, or service line level, with the outputs combined at the firm level). The firm's network may also provide the firm with quality objectives, quality risks, and responses to be included in the firm's system of quality management.

.A41 The process of establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses is iterative, and the requirements of this section are not intended to be addressed in a linear manner. Examples of the iterative and nonlinear nature of the firm's risk assessment process include the following:

- In identifying and assessing quality risks, the firm might determine that an additional quality objective needs to be established.
- When designing and implementing responses, the firm might determine that a quality risk was not identified and assessed.

.A42 Information sources that enable the firm to establish quality objectives, identify and assess quality risks, and design and implement responses are part of the firm's information and communication component and include the following:

- The results of the firm's monitoring and remediation process (see paragraphs .43 and .A169)
- Information from the network or service providers, including
 - information about network requirements or network services (see paragraph .49)
 - other information from the network, including information about the results of monitoring activities undertaken by

the network across the network firms (see paragraphs .51–.52)

Other information, whether internal or external, may also be relevant to the firm's risk assessment process, such as the following:

- Information regarding complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm's policies or procedures established in accordance with this section
- The results of external inspections
- Information from regulators about the entities for whom the firm performs engagements that is made available to the firm, such as information from a securities regulator about an entity for whom the firm performs engagements (for example, irregularities in the entity's financial statements or noncompliance with securities regulations)
- Changes in the system of quality management that affect other aspects of the system; for example, changes in the firm's resources
- Other external sources, such as regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider

Establish Quality Objectives (Ref: par. .25)

.A43 Law, regulation, or professional standards may establish requirements that give rise to additional quality objectives. For example, if a firm is required by law or regulation to appoint nonexecutive individuals to the firm's governance structure, the firm may consider it necessary to establish additional quality objectives to address the requirements.

.A44 While the nature and circumstances of the firm and its engagements are specific to the firm, the quality objectives are sufficiently comprehensive such that it is unlikely that the firm would find it necessary to establish additional quality objectives.

.A45 The firm may establish sub-objectives to enhance the firm's identification and assessment of quality risks and design and implementation of responses.

Identify and Assess Quality Risks (Ref: par. .26)

.A46 There may be other conditions, events, circumstances, actions, or inactions not described in paragraph .26a that may adversely affect the achievement of a quality objective.

.A47 A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. Not all risks meet the definition of a *quality risk*. Professional judgment assists the firm in determining whether a risk is a quality risk, which is based on the firm's consideration of whether there is a reasonable possibility of the risk occurring and, individually or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

.A48 Examples of the firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and the related quality risks are as follows:

<i>Examples of the firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives</i>	<i>Examples of quality risks that may arise</i>
The strategic and operational decisions and actions, business processes, and business model of the firm: The firm's overall financial goals are overly dependent on the extent of services provided by the firm not within the scope of this section.	In the context of governance and leadership, this may give rise to a number of quality risks such as the following: • Resources are allocated or assigned in a manner that prioritizes the services not within the scope of this section and may negatively affect the quality of engagements within the scope of this section. • Decisions about financial and operational priorities do not fully or adequately consider the importance of quality in performing engagements within the scope of this section.
The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.	In the context of governance and leadership, this may give rise to a number of quality risks such as the following: • Leadership's responsibilities and accountability for quality are not clearly defined and assigned. • The actions and behaviors of leadership that do not promote quality are not questioned.
The complexity and operating characteristics of the firm: The firm has recently completed a merger with another firm.	In the context of resources, this may give rise to a number of quality risks, including the following: • Technological resources used by the two merged firms may be incompatible. • Engagement teams may use intellectual resources developed by a firm prior to the merger, which are no longer consistent with the new methodology being used by the new merged firm.

.A49 Given the evolving nature of the system of quality management, the responses designed and implemented by the firm may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks. For example, the firm may implement a resource (for example, a technological resource) to address a quality risk, and quality risks may arise from the use of such resource.

.A50 The degree to which a risk, individually or in combination with other risks, may adversely affect the achievement of a quality objective may vary based on the conditions, events, circumstances, actions, or inactions giving rise to the risk, taking matters such as the following into account:

- How the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective
- How frequently the condition, event, circumstance, action, or inaction is expected to occur
- How long it would take after the condition, event, circumstance, action, or inaction occurred for it to have an effect, and whether in that time the firm would have an opportunity to respond to mitigate the effect of the condition, event, circumstance, action, or inaction
- How long the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective once it has occurred

The assessment of quality risks need not comprise formal ratings or scores, although firms are not precluded from using them.

Design and Implement Responses to Address the Quality Risks **(Ref: par. .17 and .27)**

.A51 The nature, timing, and extent of the responses are based on the reasons for the assessment given to the quality risks.

.A52 The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level. An example of a response designed and implemented by the firm that operates at both the firm and engagement level is as follows:

The firm establishes policies or procedures for consultation, which include with whom consultation should be undertaken by engagement teams and the specific matters for which consultation is required. The firm appoints suitably qualified and experienced individuals to provide the consultations. The engagement team is responsible for identifying when matters for consultation occur, initiating consultation, and implementing the conclusions from consultation.⁵

.A53 The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.

Changes in the Nature and Circumstances of the Firm or Its Engagements **(Ref: par. .28)**

.A54 Examples of scalability to demonstrate how policies or procedures for identifying information about changes in the nature and circumstances of the firm and its engagements may vary from other firms include the following:

⁵ Paragraph 35 of SAS No. 146.

- In a less complex firm, the firm may have informal policies or procedures to identify information about changes in the nature and circumstances of the firm or its engagements, particularly when the individual or individuals responsible for establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses are able to identify such information in the normal course of their activities.
- In a more complex firm, the firm may need to establish more formal policies or procedures to identify and consider information about changes in the nature and circumstances of the firm or its engagements. This may include, for example, a periodic review of information relating to the nature and circumstances of the firm and its engagements, including ongoing tracking of trends and occurrences in the firm's internal and external environment.

.A55 Additional quality objectives may need to be established, or quality risks and responses added to or modified, as part of the remedial actions undertaken by the firm to address an identified deficiency in accordance with paragraph .43.

.A56 The firm may have established quality objectives in addition to those specified by this section. The firm may also identify information that indicates that additional quality objectives previously established by the firm are no longer needed or need to be modified.

Governance and Leadership

Commitment to Quality (Ref: par. .29a)

.A57 The firm's culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics and are further addressed in the "Relevant Ethical Requirements" section. Professional values and attitudes may include the following:

- Professional manner; for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability
- A commitment to teamwork
- Maintaining an open mind to new ideas or different perspectives in the professional environment
- Pursuit of excellence
- A commitment to continual improvement (for example, setting expectations beyond the minimum requirements and placing a focus on continual learning)
- Social responsibility

.A58 The firm's strategic decision-making process, including the establishment of a business strategy, may include matters such as the firm's decisions about financial and operational matters, the firm's financial goals, how financial resources are managed, growth of the firm's market share, industry specialization, or new service offerings. The firm's financial and operational priorities may directly or indirectly affect the firm's commitment to quality; for example, the firm may have incentives focused on financial and operational priorities that may discourage behaviors that demonstrate a commitment to quality.

Leadership (Ref: par. .29b–c)

.A59 The responses designed and implemented by the firm to hold leadership responsible and accountable for quality include the performance evaluations required by paragraph .57.

.A60 Although leadership establishes the tone at the top through its actions and behaviors, clear, consistent, and frequent actions and communications at all levels within the firm collectively contribute to the firm's culture and demonstrate a commitment to quality.

Organizational Structure (Ref: par. .29d)

.A61 The organizational structure of the firm may include operating units, operational processes, divisions, or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, and engagement teams may include personnel from the firm's service delivery center who perform specific tasks that are repetitive or specialized in nature.

Resources (Ref: par. .29e)

.A62 The individual or individuals assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are, in most cases, able to influence the nature and extent of resources that the firm obtains, develops, uses, and maintains and how those resources are allocated or assigned, including the timing of when they are used.

.A63 Because resource needs may change over time, it may not be practicable to anticipate all resource needs. The firm's resource planning may involve determining the resources currently required, forecasting the firm's future resource needs, and establishing processes to deal with unanticipated resource needs when they arise.

Relevant Ethical Requirements (Ref: par. .17 and .30)

.A64 The AICPA code sets out the fundamental principles of ethics that provide the framework for the rules that govern the performance of professional responsibilities. The fundamental principles are responsibilities, the public interest, integrity, objectivity and independence, due care, and scope and nature of services. Independence requirements are set forth in the "Independence Rule" (ET sec. 1.200.001) and related interpretations of the AICPA code and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the AICPA code are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010).

.A65 In some cases, the matters addressed by the firm in its system of quality management may be more specific than, or additional to, the provisions of relevant ethical requirements. Examples of matters that a firm may include in its system of quality management that are more specific than, or additional to, the provisions of relevant ethical requirements include the following:

- The firm prohibits the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- The firm sets rotation periods for all engagement partners, including those performing attestation, review, and compilation engagements.

.A66 Other components may affect or relate to the relevant ethical requirements component. Examples of relationships between the relevant ethical requirements component and other components include the following:

- The information and communication component may address the communication of various matters related to relevant ethical requirements, including
 - the firm communicating the independence requirements to all personnel and others subject to independence requirements.
 - personnel and engagement teams communicating relevant information to the firm without fear of reprisals, such as situations that may create threats to independence or breaches of relevant ethical requirements.
- As part of the resources component, the firm may
 - assign individuals to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.
 - use IT applications to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

.A67 The relevant ethical requirements that apply to others depend on the provisions of the relevant ethical requirements and how the firm uses others in its system of quality management or in performing engagements. Examples of relevant ethical requirements that apply to others include the following:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms; for example, the AICPA code includes independence requirements that apply to network firms.
- Relevant ethical requirements may include a definition of *engagement team* or other similar concept, and the definition may include any individual who performs assurance procedures on the engagement (for example, a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team as defined in the relevant ethical requirements, or other similar concept, may also be relevant to such individuals.
- The principle of confidentiality may apply to the firm's network, other network firms, or service providers when they have access to client information obtained by the firm.

.A68 AU-C section 600⁶ states that when the component auditor is not subject to the AICPA code, compliance with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants (IESBA) *International Code of Ethics for Professional Accountants* is sufficient to fulfill the component auditor's ethical responsibilities in the group

⁶ Paragraph .A46 of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

audit.⁷ The firm may use, for example, confirmations, letters of representation, or other affirmations from network firms, employees of network firms, or service providers regarding the fulfillment of ethical requirements that are relevant to the firm.

Acceptance and Continuance of Client Relationships and Specific Engagements

The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client (Ref: par. .31a(i))

.A69 The information obtained about the nature and circumstances of the engagement may include the following:

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors
- The nature of the entity; for example, its operations, organizational structure, ownership and governance, its business model, and how it is financed
- The nature of the underlying subject matter and the applicable criteria; for example, in the case of sustainability reporting,
 - the underlying subject matter may include social, environmental, or health and safety information.
 - the applicable criteria may be performance measures established by a recognized body of specialists.

.A70 The information obtained to support the firm's judgments about the integrity and ethical values of the client may include the identity and business reputation of the client's principal owners, key management, and those charged with its governance.

.A71 Examples of factors that may affect the nature and extent of information obtained about the integrity and ethical values of the client include the following:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure
- The nature of the client's operations, including its business practices
- Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and the internal control environment
- Whether the client is aggressively concerned with keeping the firm's fees as low as possible

⁷ The section, "Application of the AICPA Code" (ET sec. 0.200.020), of the AICPA Code of Professional Conduct (AICPA code) explains that an AICPA member who is the group engagement partner will not be considered in violation of the AICPA code if a component auditor practicing outside the United States departs from the AICPA code with respect to the audit or review of group financial statements, as long as the component auditor's conduct, at a minimum, is in accordance with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants International Code of Ethics for Professional Accountants.

- Indications of a client-imposed limitation in the scope of work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm
- The identity and business reputation of related parties

.A72 The firm may obtain the information from a variety of internal and external sources, including the following:

- In the case of an existing client, information from current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.
- In the case of a new client, inquiry of existing or previous providers of auditing services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel, and industry peers.
- Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

.A73 Information that is obtained during the firm's acceptance and continuance process also may often be relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, SAS No. 146⁸ requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement.

.A74 Professional standards or applicable legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an engagement. For example, when there has been a change of auditors, AU-C section 210, *Terms of Engagement*,⁹ requires the auditor, prior to starting an initial audit, to request management to authorize the predecessor auditor to respond fully to the auditor's inquiries regarding matters that will assist the auditor in determining whether to accept the engagement. The "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) of the AICPA code also addresses consideration of conflicts of interest in accepting or continuing a client relationship or specific engagement.

The Firm's Ability to Perform Engagements (Ref: par. .31a(ii))

.A75 The firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements may be affected by the following:

- The availability of appropriate resources to perform the engagement

⁸ Paragraph 23 of SAS No. 146.

⁹ Paragraph .11 of AU-C section 210, *Terms of Engagement*.

- Having access to information to perform the engagement or to the persons who provide such information
- Whether the firm and the engagement team are able to fulfill their responsibilities in relation to the relevant ethical requirements

.A76 Examples of factors the firm may consider in determining whether appropriate resources are available to perform the engagement include the following:

- The circumstances of the engagement and the reporting deadline.
- The availability of individuals with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes having
 - individuals to take overall responsibility for directing and supervising the engagement,
 - individuals with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements, and
 - individuals to perform audit procedures on the financial information of a component for purposes of an audit of group financial statements.
- The availability of specialists, if needed.
- If an engagement quality review is needed, whether there is an individual available who meets the eligibility requirements in section 20.
- The need for technological resources; for example, IT applications that enable the engagement team to perform procedures on the entity's data.
- The need for intellectual resources; for example, a methodology, industry or subject-matter-specific guides, or access to information sources.

The Firm's Financial and Operational Priorities (Ref: par. .31b)

.A77 Financial priorities may focus on the profitability of the firm, and fees obtained for performing engagements have an effect on the firm's financial resources. Operational priorities may include strategic focus areas, such as growth of the firm's market share, industry specialization, or new service offerings. There may be circumstances in which the firm is satisfied with the fee quoted for an engagement, but it is not appropriate for the firm to accept or continue the engagement or client relationship (for example, when the client lacks integrity and ethical values).

.A78 There may be other circumstances in which the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The "Fees and Other Types of Remuneration" rule (ET sec. 1.500) of the AICPA code addresses fees and other types of remuneration.

Engagement Performance

Responsibilities of the Engagement Team and Direction, Supervision, and Review (Ref: par. .32a–b)

.A79 Professional standards or applicable legal and regulatory requirements may include specific provisions regarding the overall responsibility of the engagement partner. For example, SAS No. 146 deals with the overall responsibility of the engagement partner for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement, including taking responsibility for appropriate direction and supervision of the engagement team and review of its work.

.A80 Examples of direction, supervision, and review include the following:

- Direction and supervision of the engagement team may include
 - tracking the progress of the engagement,
 - considering the following with respect to members of the engagement team:
 - Whether they understand their instructions
 - Whether the work is being carried out in accordance with the planned approach to the engagement
 - addressing matters arising during the engagement, considering their significance, and modifying the planned approach appropriately, and
 - identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
- A review of work performed may include considering whether
 - the work has been performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements;
 - significant matters have been raised for further consideration;
 - appropriate consultations have been undertaken, and the resulting conclusions have been documented and implemented;
 - there is a need to revise the nature, timing, and extent of planned work;
 - the work performed supports the conclusions reached and is appropriately documented;
 - the evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
 - the objectives of the engagement procedures have been achieved.

.A81 In some circumstances, the firm may use personnel from a service delivery center in the firm or individuals from a service delivery center in another network firm to perform procedures on the engagement (that is, the personnel

or other individuals are included in the engagement team). In such circumstances, the firm's policies or procedures may specifically address the direction and supervision of the individuals and review of their work, such as

- what aspects of the engagement may be assigned to individuals in the service delivery center;
- how the engagement partner, or their designee, is expected to direct, supervise, and review the work undertaken by individuals in the service delivery center; and
- the protocols for communication between the engagement team and individuals in the service delivery center.

Professional Judgment and Professional Skepticism (Ref: par. .32c)

.A82 Professional skepticism supports the quality of judgments made on an assurance engagement and, through these judgments, the overall effectiveness of the engagement team in performing the assurance engagement. Other professional standards may address the exercise of professional judgment or maintenance of professional skepticism at the engagement level. For example, SAS No. 146¹⁰ provides examples of impediments to the maintenance of professional skepticism at the engagement level, unconscious auditor biases that may impede the maintenance of professional skepticism, and possible actions that the engagement team may take to mitigate such impediments.

Consultation (Ref: par. .32d)

.A83 Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise on difficult or contentious matters. An environment that reinforces the importance and benefit of consultation and encourages engagement teams to consult may contribute to supporting a culture that demonstrates a commitment to quality.

.A84 Difficult or contentious matters on which consultation is needed may either be specified by the firm, or the engagement team may identify matters that require consultation. The firm may also specify how conclusions should be agreed upon and implemented.

.A85 SAS No. 146¹¹ includes requirements for the engagement partner related to consultation.

Differences of Opinion (Ref: par. .32e)

.A86 The firm may encourage identifying differences of opinion at an early stage and may specify the steps to be taken in raising and dealing with them, including how the matter is to be resolved and how the related conclusions should be implemented and documented. In some circumstances, resolving differences of opinion may be achieved through consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Documentation (Ref: par. .32f)

.A87 Law, regulation, or professional standards may prescribe the time limits by which the assembly of final engagement files for specific types of engagements are to be completed. When no such time limits are prescribed, the

¹⁰ Paragraphs A34–A36 of SAS No. 146.

¹¹ Paragraph 35 of SAS No. 146.

time limit may be determined by the firm. For example, in the case of engagements conducted in accordance with the SSAEs or SSARSSs, an appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the engagement report.

.A88 The retention and maintenance of engagement documentation may include managing the safe custody, integrity, accessibility, or retrievability of the underlying data and the related technology. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation may be compromised if it is altered, supplemented, or deleted without authorization to do so, or if it is permanently lost or damaged.

.A89 Law, regulation, or professional standards may prescribe the retention periods for engagement documentation. If the retention periods are not prescribed, the firm may consider the nature of the engagements performed by the firm and the firm's circumstances, including whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of engagements conducted under generally accepted auditing standards or the SSAEs, the retention period is ordinarily no shorter than five years from the date of the engagement report or, if later, the date of the auditor's report on the group financial statements, when applicable.

Resources (Ref: par. .33)

.A90 Resources for the purposes of the resources component include the following:

- Human resources
- Technological resources; for example, IT applications
- Intellectual resources; for example, written policies or procedures, a methodology, or guides

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing, and maintaining the firm's human resources, technological resources, and intellectual resources. Given that the management and allocation of financial resources is strongly influenced by leadership, the quality objectives in governance and leadership, such as those that address financial and operational priorities, address financial resources.

.A91 Resources may be internal to the firm or may be obtained externally from the firm's network, another network firm, or service provider. Resources may be used in performing activities within the firm's system of quality management or in performing engagements as part of operating the system of quality management. In circumstances in which a resource is obtained from the firm's network or another network firm, paragraphs .49–.53 form part of the responses designed and implemented by the firm in achieving the objectives in this component.

Human Resources

Hiring, Developing, and Retaining Personnel and Personnel Competence and Capabilities (Ref: par. .33a and .33d)

.A92 *Competence* is the ability of the individual to perform a role and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values, and attitudes. Competence can be developed

through a variety of methods, including professional education, continuing professional development, training, work experience, or coaching of less experienced engagement team members by more experienced engagement team members.

.A93 Law, regulation, or professional standards may establish requirements addressing competence and capabilities. For example, law or regulation may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.

.A94 The policies or procedures designed and implemented by the firm relating to hiring, developing, and retaining personnel may address, for example, the following:

- Recruiting individuals who have, or are able to develop, appropriate competence
- Training programs focused on developing the competence of personnel and continuing professional development
- Evaluation mechanisms that are undertaken at appropriate intervals and include competency areas and other performance measures
- Compensation, promotion, and other incentives, for all personnel, including engagement partners and individuals assigned roles and responsibilities related to the firm's system of quality management

Personnel's Commitment to Quality and Accountability and Recognition for Commitment to Quality (Ref: par. .33b)

.A95 Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, such as in the case of firms with fewer personnel.

.A96 Positive actions or behaviors demonstrated by personnel may be recognized through various means, such as through compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

.A97 The manner in which the firm holds personnel accountable for actions or behaviors that negatively affect quality, such as failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role, or implement the firm's responses as designed, may depend on the nature of the action or behavior, including its severity and frequency of occurrence. The following are some actions the firm may take when personnel demonstrate actions or behaviors that negatively affect quality:

- Training or other professional development
- Considering the effect of the matter on the evaluation, compensation, promotion, or other incentives of those involved
- Disciplinary action, if appropriate

Individuals obtained from external sources (Ref: par. .33c).

.A98 Professional standards may include responsibilities for the engagement partner regarding the appropriateness of resources. For example, SAS

No. 146¹² addresses the responsibility of the engagement partner for determining that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner in accordance with the firm's policies or procedures.

Engagement Team Members Assigned to Each Engagement (Ref: par. .33d)

.A99 Engagement team members may be assigned to engagements by

- the firm, including assigning personnel from a service delivery center in the firm.
- the firm's network or another network firm when the firm uses individuals from the firm's network or another network firm to perform procedures on the engagement (for example, a component auditor or a service delivery center of the network or another network firm).
- a service provider when the firm uses individuals from a service provider to perform procedures on the engagement (for example, a component auditor from a firm not within the firm's network).

.A100 SAS No. 146¹³ addresses the responsibility of the engagement partner to determine that members of the engagement team, and any auditor's external specialists and internal auditors who provide direct assistance (who are not part of the engagement team), collectively have the appropriate competence and capabilities, including sufficient time, to perform the engagement. The responses designed and implemented by the firm to address the competence and capabilities of engagement team members assigned to the engagement may include policies or procedures that address the following:

- Information that may be obtained by the engagement partner and factors to consider in determining that the engagement team members assigned to the engagement, including those assigned by the firm's network, another network firm, or service provider, have the competence and capabilities to perform the engagement
- How concerns about the competence and capabilities of engagement team members, in particular those assigned by the firm's network, another network firm, or service provider, may be resolved

.A101 The requirements in paragraphs .49–.53 are also applicable when using individuals from the firm's network or another network firm on an engagement, including component auditors (see, for example, paragraph .A190).

Technological Resources (Ref: par. .33f)

.A102 Technological resources, which are typically IT applications, form part of the firm's IT environment. The firm's IT environment also includes the supporting IT infrastructure and the IT processes and human resources involved in those processes:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure comprises the IT network, operating systems, and databases and their related hardware and software.

¹² Paragraph 25 of SAS No. 146.

¹³ Paragraph 26 of SAS No. 146.

- The IT processes are the firm's processes to manage access to the IT environment, program changes or changes to the IT environment, and IT operations, which includes monitoring the IT environment.

.A103 A technological resource may serve multiple purposes within the firm, and some of the purposes may be unrelated to the system of quality management. Technological resources that are relevant for the purposes of this section are as follows:

- Technological resources that are directly used in designing, implementing, or operating the firm's system of quality management
- Technological resources that are used directly by engagement teams in performing engagements
- Technological resources that are essential to enabling the effective operation of the preceding, such as, in relation to an IT application, the IT infrastructure and IT processes supporting the IT application

.A104 Examples of scalability to demonstrate how the technological resources that are relevant for the purposes of this section may differ in firms of different complexity include the following:

- In a less complex firm, the technological resources may comprise a commercial IT application used by engagement teams that has been purchased from a service provider. The IT processes that support the operation of the IT application may also be relevant, although they may be simple (for example, processes for authorizing access to the IT application and processing updates to the IT application).
- In a more complex firm, the technological resources may be more complex and may comprise the following:
 - Multiple IT applications, including custom-developed applications or applications developed by the firm's network, such as
 - IT applications used by engagement teams (for example, engagement software and automated audit tools) and
 - IT applications developed and used by the firm to manage aspects of the system of quality management (for example, IT applications to monitor independence or assign personnel to engagements)
 - The IT processes that support the operation of these IT applications, including the individuals responsible for managing the IT infrastructure and processes and the firm's processes for managing program changes to IT applications

.A105 The firm may consider the following matters in obtaining, developing, implementing, and maintaining an IT application:

- The data inputs are complete and appropriate.
- Confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.

- The outputs of the IT application achieve the purpose for which they will be used.
- The general IT controls necessary to support the IT application's continued operation as designed are appropriate.
- The need for specialized skills to use the IT application effectively, including the training of individuals who will use the IT application.
- The need to develop procedures that set out how the IT application operates.

.A106 The firm may specifically prohibit the use of IT applications or features of IT applications until such time that it has been determined that they operate appropriately and have been approved for use by the firm. Alternatively, the firm may establish policies or procedures to address circumstances in which the engagement team uses an IT application that is not approved by the firm. Such policies or procedures may require the engagement team to determine that the IT application is appropriate for use prior to using it on the engagement, through considering the matters in paragraph .A102. SAS No. 146¹⁴ addresses the engagement partner's responsibilities for engagement resources.

Intellectual Resources (Ref: par. .33g)

.A107 Intellectual resources include the information and materials the firm uses to enable the operation of the system of quality management and promote consistency in performing engagements. Examples of intellectual resources include written policies or procedures, a methodology, industry or subject-matter-specific guides, accounting guides, standardized documentation, or access to information sources (for example, subscriptions to websites that provide in-depth information about entities or other information that is typically used in performing engagements).

.A108 Intellectual resources may be made available through technological resources; for example, the firm's methodology may be embedded in the IT application that facilitates the planning and performance of the engagement.

Use of Technological and Intellectual Resources (Ref: par. .33f–g)

.A109 The firm may establish policies or procedures regarding the use of the firm's technological and intellectual resources. Examples of such policies or procedures include the following:

- Requiring the use of certain IT applications or intellectual resources in performing engagements, or relating to other aspects of the engagement, such as in archiving the engagement file
- Specifying the qualifications or experience that individuals need to use the resource, including the need for a specialist or training; for example, the firm may specify the qualifications or expertise needed to use an IT application that analyzes data, given that specialized skills may be needed to interpret the results
- Specifying the responsibilities of the engagement partner regarding the use of technological and intellectual resources
- Setting out how the technological or intellectual resources are to be used, including how individuals should interact with an IT application or how the intellectual resource should be applied, and

¹⁴ Paragraphs 25–28 of SAS No. 146.

the availability of support or assistance in using the technological or intellectual resource

Service Providers (Ref: par. .17 and .33h)

.A110 In some circumstances, the firm may use resources that are provided by a service provider, particularly in circumstances in which the firm does not have access to the appropriate resources internally. Notwithstanding that a firm may use resources from a service provider, the firm remains responsible for its system of quality management.

.A111 Examples of resources from a service provider include the following:

- Individuals engaged to perform the firm's monitoring activities or engagement quality reviews, or to provide consultation on technical matters
- A commercial IT application used to perform audit engagements
- Individuals performing procedures on the firm's engagements; for example, component auditors from firms not within the firm's network or individuals engaged to attend a physical inventory count at a remote location
- An auditor's external specialist used by the firm to assist the engagement team in obtaining audit evidence

.A112 In identifying and assessing quality risks, the firm is required to obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, which includes conditions, events, circumstances, actions, or inactions relating to service providers. In doing so, the firm may consider the nature of the resources provided by service providers, how and the extent to which they will be used by the firm, and the general characteristics of the service providers used by the firm (for example, the varying types of other professional services firms that are used) to identify and assess quality risks related to the use of such resources.

.A113 In determining whether a resource from a service provider is appropriate for use in the firm's system of quality management or performing engagements, the firm may obtain information about the service provider and the resource it provides from a number of sources. The following are matters the firm may consider:

- The related quality objective and quality risks. For example, in the case of a methodology from a service provider, there may be quality risks related to the quality objective in paragraph .33g, such as a quality risk that the service provider does not update the methodology to reflect changes in professional standards and applicable legal and regulatory requirements.
- The nature and scope of the resources and the conditions of the service (for example, in relation to an IT application, how often updates will be provided, limitations on the use of the IT application, and how the service provider addresses confidentiality of data).
- The extent to which the resource is used across the firm, how the resource will be used by the firm, and whether it is suitable for that purpose.
- The extent of customization of the resource for the firm.
- The firm's previous use of the service provider.

- The service provider's experience in the industry and reputation in the market.
- The results of attestation engagements performed by independent third parties on the resource (for example, assurance engagements on quality control materials or reports on service organization controls).

.A114 The firm may have a responsibility to take further actions in using the resource from a service provider so that the resource functions effectively. For example, the firm may need to communicate information to the service provider in order for the resource to function effectively or, in relation to an IT application, the firm may need to have supporting IT infrastructure and IT processes in place.

.A115 The evaluation of a service provider from a firm not within the firm's network that is used as a component auditor may be different than that of a service provider engaged directly by the firm. For example, in understanding the competency of the component auditor to perform the engagement, it may not be necessary or practicable for the firm to obtain an understanding of how the component auditor updates its methodology to reflect changes in professional standards. Rather, the firm could perform procedures such as review of results of regulatory inspections, transparency or audit quality information published by the component auditor's firm, or evaluation of the reputation of the component auditor.

Information and Communication (Ref: par. .34)

.A116 Obtaining, generating, or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication are pervasive to all components of the system of quality management.

The Firm's Information System (Ref: par. .34a)

.A117 Reliable and relevant information includes information that is accurate, complete, timely, and valid to enable the proper functioning of the firm's system of quality management and to support decisions regarding the system of quality management.

.A118 The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained, and communicated. The procedures to identify, capture, process, maintain, and communicate information may be enforced through IT applications and in some cases may be embedded within the firm's responses for other components. In addition, digital records may replace or supplement physical records.

.A119 An example of scalability is that less complex firms with fewer personnel and direct involvement of leadership may not need rigorous policies and procedures that specify how information should be identified, captured, processed, and maintained.

Communication Within the Firm (Ref: par. .34b–c)

.A120 The firm may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the firm and one another by establishing communication channels to facilitate communication across

the firm. Examples of communication among the firm, engagement teams, and other individuals include the following:

- The firm communicates the responsibility for implementing the firm's responses to personnel and engagement teams.
- The firm communicates changes to the system of quality management to personnel and engagement teams to the extent that the changes are relevant to their responsibilities and enables personnel and engagement teams to take prompt and appropriate action in accordance with their responsibilities.
- The firm communicates information that is obtained during the firm's acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.
- Engagement teams communicate the following information to the firm:
 - Information about the client that is obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement
 - Information about the operation of the firm's responses (for example, concerns about the firm's processes for assigning personnel to engagements) which, in some cases, may indicate a deficiency in the firm's system of quality management
- Engagement teams communicate information to the engagement quality reviewer or individuals providing consultation.
- Group engagement teams communicate matters to component auditors in accordance with the firm's policies or procedures, including matters related to quality management at the engagement level.
- The individual or individuals assigned operational responsibility for compliance with independence requirements communicate to relevant personnel and engagement teams changes in the independence requirements and the firm's policies or procedures to address such changes.

Communication With External Parties

Communication to or Within the Firm's Network and to Service Providers (Ref: par. .34d(i))

.A121 In addition to the firm communicating information to or within the firm's network or to a service provider, the firm may need to obtain information from the network, a network firm, or a service provider that supports the firm in the design, implementation, and operation of its system of quality management. For example, the firm may obtain information from the network or other network firms about clients of other network firms when there are independence requirements that affect the firm.

Communication With Others External to the Firm (Ref: par. .34d(ii))

.A122 Examples of when law, regulation, or professional standards may require the firm to communicate information to external parties include the following:

- The firm becomes aware of noncompliance with laws and regulations by a client, and relevant ethical requirements require the firm to report the noncompliance with laws and regulations to an appropriate authority outside the client entity or to consider whether such reporting is an appropriate action in the circumstances.
- Law or regulation requires the firm to publish a transparency report and specifies the nature of the information that is required to be included in the transparency report.
- Securities law or regulation requires the firm to communicate certain matters to those charged with governance.

Paragraphs .A131–.A135 address communications to support external parties' understanding of the system of quality management beyond those required by law, regulation, or professional standards.

.A123 In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. Examples of when the firm may be precluded from communicating information externally include the following:

- Confidentiality law or regulation prohibits disclosure of certain information
- Law, regulation, or relevant ethical requirements include provisions addressing the duty of confidentiality

Specified Responses (Ref: par. .35)

.A124 The specified responses may address multiple quality risks related to more than one quality objective across different components. For example, policies or procedures for complaints and allegations may address quality risks related to quality objectives in resources (for example, personnel's commitment to quality), relevant ethical requirements, and governance and leadership.

Relevant Ethical Requirements (Ref: par. .35a–b)

.A125 Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the AICPA code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third-party test.

.A126 Relevant ethical requirements may specify how the firm is required to respond to a breach. For example, the "Breach of an Independence" interpretation (ET sec. 1.298.010) of the "Independence Rule" (ET sec. 1.200.001) contains guidance addressing a breach of an independence interpretation of the AICPA code, which also contains guidance addressing a breach of any other provision of the AICPA code.

.A127 Matters the firm may address relating to breaches of the relevant ethical requirements include the following:

- The communication of breaches of the relevant ethical requirements to appropriate personnel

- The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements
- The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable
- Determining whether to report a breach to external parties, such as those charged with governance of the entity to which the breach relates or an external oversight authority
- Determining the appropriate actions to be taken in relation to the individual or individuals responsible for the breach

Complaints and Allegations (Ref: par. .35c)

.A128 Establishing policies or procedures for dealing with complaints and allegations may assist the firm in preventing engagement reports from being issued that are inappropriate. It also may assist the firm in

- identifying and dealing with individuals, including leadership, who do not act or behave in a manner that demonstrates a commitment to quality and supports the firm's commitment to quality, or
- identifying deficiencies in the system of quality management.

.A129 Complaints and allegations may be made by personnel or others external to the firm (for example, clients, component auditors, or individuals within the firm's network).

Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement (Ref: par. .35d)

.A130 Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may

- have existed at the time of the firm's decision to accept or continue the client relationship or specific engagement, and the firm was not aware of such information, or
- relate to new information that has arisen since the decision to accept or continue the client relationship or specific engagement.

.A131 Examples of matters addressed in the firm's policies or procedures for circumstances in which information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm's decision to accept or continue a client relationship or specific engagement include the following:

- Undertaking consultation within the firm or with legal counsel
- Considering whether there is a professional, legal, or regulatory requirement for the firm to continue the engagement
- Discussing with the appropriate level of the client's management and with those charged with governance or the engaging party the action that the firm might take based on the relevant facts and circumstances
- When it is determined that withdrawal is an appropriate action:
 - Informing the client's management and those charged with governance or the engaging party of this decision and the reasons for the withdrawal

- Considering whether there is a professional, legal, or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities

.A132 In some circumstances, law or regulation may impose an obligation on the firm to accept or continue a client engagement.

.A133 Examples of matters addressed in the firm's policies or procedures in circumstances in which the firm is obligated to accept or continue an engagement, or the firm is unable to withdraw from an engagement, and the firm is aware of information that would have caused the firm to decline or discontinue the engagement, include the following:

- The firm considers the effect of the information on the performance of the engagement.
- The firm communicates the information to the engagement partner and requests the engagement partner to increase the extent and frequency of the direction and supervision of the engagement team members and review of their work.
- The firm assigns more experienced personnel to the engagement.
- The firm determines that an engagement quality review should be performed.

Communication With External Parties (Ref: par. .35e)

.A134 The firm's ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through relevant, reliable, and transparent communication by the firm about the activities that it has undertaken to address quality and the effectiveness of those activities.

.A135 External parties who may use information about the firm's system of quality management, and the extent of their interest in the firm's system of quality management, may vary based on the nature and circumstances of the firm and its engagements.

.A136 Examples of external parties who may use information about the firm's system of quality management include the following:

- Management or those charged with governance of the firm's clients may use the information to determine whether to appoint the firm to perform an engagement.
- External oversight authorities may have indicated a desire for the information to support their responsibilities in monitoring the quality of engagements across a jurisdiction and in understanding the work of firms.
- Other firms who use the work of the firm in performing engagements (for example, in relation to a group audit) may have requested such information.
- Other users of the firm's engagement reports, such as investors who use engagement reports in their decision making, may have indicated a desire for the information.

.A137 The information about the system of quality management provided to external parties, including information communicated to those charged with governance about how the system of quality management supports the

consistent performance of quality engagements, may address such matters as the following:

- The nature and circumstances of the firm, such as the organizational structure, business model, strategy, and operating environment
- The firm's governance and leadership, such as
 - its culture;
 - how it demonstrates a commitment to quality; and
 - how roles, responsibilities, and authority with respect to the system of quality management are assigned
- How the firm fulfills its responsibilities in accordance with relevant ethical requirements, including those related to independence
- Factors that contribute to quality engagements; for example, such information may be presented in the form of engagement quality indicators with narrative to explain the indicators
- The results of the firm's monitoring activities and external inspections and how the firm has remediated identified deficiencies or is otherwise responding to them
- The evaluation undertaken in accordance with paragraphs .54–.55 of whether the system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved and the conclusion thereon, including the basis for the judgments made in evaluating and concluding
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes
- The relationship between the firm and the network, the overall structure of the network, a description of network requirements and network services, the responsibilities of the firm and the network (including that the firm is ultimately responsible for the system of quality management), and information about the overall scope and results of network monitoring activities across the network firms

Determining When It Is Appropriate to Communicate With External Parties (Ref: par. .35e(i))

.A138 The firm's determination of when it is appropriate to communicate with external parties about the firm's system of quality management is a matter of professional judgment and may be influenced by matters such as the following:

- The types of engagements performed by the firm
- The types of entities for which such engagements are undertaken; for example, entities that may have public interest or public accountability characteristics, such as
 - entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders, including financial institutions, such as certain banks, insurance companies, and pension funds;

- entities with a high public profile or whose management or owners have a high public profile; and
 - entities with a large number and wide range of stakeholders.
- The nature and circumstances of the firm
 - The nature of the firm's operating environment, such as customary business practice in the firm's jurisdiction and the characteristics of the financial markets in which the firm operates
 - The extent to which the firm has already communicated with external parties in accordance with law or regulation (that is, whether further communication is needed and, if so, the matters to be communicated)
 - The expectations of stakeholders in the firm's jurisdiction, including the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm's processes in performing the engagements
 - Jurisdictional trends
 - The information that is already available to external parties
 - How external parties may use the information, and their general understanding of matters related to firms' systems of quality management and engagements performed by the firm in its accounting and auditing practice
 - The public interest benefits of external communication and whether it would reasonably be expected to outweigh the costs (monetary or otherwise) of such communication

The preceding matters may also affect the information provided by the firm in the communication and the nature, timing, and extent and appropriate form of communication.

.A139 AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements and addresses the auditor's determination of the appropriate person or persons within the entity's governance structure with whom to communicate¹⁵ and the communication process.¹⁶ In some circumstances, it may be appropriate to include information about the firm's system of quality management in those communications with those charged with governance (or when performing other engagements, for example, review or examination engagements). How the communication with those charged with governance is undertaken (that is, by the firm or the engagement team) may depend on the firm's policies or procedures and the circumstances of the engagement.

Considerations for Engagements for Governmental Organizations

.A140 The firm may determine it is appropriate to communicate to those charged with governance of a governmental organization about how the firm's system of quality management supports the consistent performance of quality engagements, taking into account the size and complexity of the governmental

¹⁵ Paragraphs .07–.09 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*.

¹⁶ Paragraphs .15–.20 of AU-C section 260.

organization, the range of its stakeholders, the nature of the services it provides, and the roles and responsibilities of those charged with governance.

Nature, Timing, and Extent and Appropriate Form of Communication With External Parties (Ref: par. .35e(ii))

.A141 The firm may consider the following attributes in preparing information that is communicated to external parties:

- The information is specific to the circumstances of the firm. Relating the matters in the firm's communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time.
- The information is presented in a clear and understandable manner, and the manner of presentation is neither misleading nor would inappropriately influence the users of the communication (for example, the information is presented in a manner that is appropriately balanced toward positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources (for example, the firm's website).

.A142 The firm uses professional judgment in determining, in the circumstances, the appropriate form of communication with the external party, including communication with those charged with governance when performing an audit of financial statements of listed entities, which may be made orally or in writing. Accordingly, the form of communication may vary.

Examples of forms of communication to external parties include the following:

- A publication such as a transparency report or audit quality report
- Targeted written communication to specific stakeholders (for example, information about the results of the firm's monitoring and remediation process)
- Direct conversations and interactions with the external party (for example, discussions between the engagement team and those charged with governance)
- A web page
- Other forms of digital media, such as social media, or interviews or presentations via webcast or video

Engagements Subject to an Engagement Quality Review

Engagement Quality Review Required by Law or Regulation (Ref: par. .35f(i))

.A143 Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that

- are *public interest entities* as defined in a particular jurisdiction,
- are governmental organizations or recipients of government funding, or entities with public accountability,

- operate in certain industries (for example, financial institutions such as banks, insurance companies, and pension funds),
- meet a specified asset threshold, or
- are under the management of a court or judicial process (for example, liquidation).

Engagement Quality Review as a Response to Address One or More Quality Risks(Ref: par. .35f(ii))

.A144 The firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives as required by paragraph .26a(ii) relates to the nature and circumstances of the engagements performed by the firm. In designing and implementing responses to address one or more quality risks, the firm may determine that an engagement quality review is an appropriate response based on the reasons for the assessments given to the quality risks.

.A145 Criteria established by the firm to determine whether an engagement quality review is an appropriate response for one or more quality risks may relate to the types of engagements performed by the firm and reports to be issued, and the types of entities for which engagements are undertaken. Examples of conditions, events, circumstances, actions, or inactions giving rise to such quality risks include the following:

Those relating to the types of engagements performed by the firm and reports to be issued:

- Engagements that involve a high level of complexity or judgment, such as the following:
 - Audits of financial statements for entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (for example, certain large financial institutions or mining entities) or for entities for which uncertainties exist related to events or conditions that may cast significant doubt on their ability to continue as a going concern
 - Assurance engagements that require specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (for example, a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein)
- Engagements on which issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremediated significant deficiencies in internal control, or a material restatement of comparative information in the financial statements
- Engagements for which unusual circumstances have been identified during the firm's acceptance and continuance process (for example, a new client that had a disagreement with its previous auditor or assurance practitioner)
- Engagements that involve reporting on financial or nonfinancial information that is expected to be included in a regulatory filing and that may involve a higher degree of judgment, such as pro forma financial information to be included in a prospectus

Those relating to the types of entities for which engagements are undertaken:

- Entities in emerging industries or for which the firm has no previous experience
- Entities for which concerns were expressed in communications from regulators
- Entities that may have public interest or public accountability characteristics, such as the following:
 - Entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders, including financial institutions such as certain banks, insurance companies, and pension funds for which an engagement quality review is not otherwise required by law or regulation
 - Entities with a high public profile or whose management or owners have a high public profile
 - Entities with a large number and wide range of stakeholders
 - Governmental organizations
 - Due to their size and complexity, the range of their stakeholders or the nature of the services they provide
 - Due to the complexity, and importance to users, of additional reporting requirements established by law or regulation (for example, a separate report on instances of noncompliance with law or regulation to the legislature or other governing body or communicating such instances in the auditor's report on the financial statements)

.A146 The firm's responses to address quality risks may include other forms of engagement reviews that are not an engagement quality review. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures relating to significant risks, or reviews of certain significant judgments, by personnel who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

.A147 In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review or another form of engagement review is an appropriate response to address the quality risks.

Monitoring and Remediation Process (Ref: par. .36–.48)

.A148 In addition to enabling the evaluation of the system of quality management, the monitoring and remediation process facilitates the proactive and continual improvement of engagement quality and the system of quality management. Examples follow:

- Given the inherent limitations of a system of quality management, the firm's identification of deficiencies is not unusual, and it is an important aspect of the system of quality management because prompt identification of deficiencies enables the firm to remediate them in a timely and effective manner and contributes to a culture of continual improvement.

- The monitoring activities may provide information that enables the firm to prevent a deficiency through responding to a finding that could, over a period of time, lead to a deficiency.

Designing and Performing Monitoring Activities (Ref: par. .38–.39)

.A149 The firm's monitoring activities may comprise a combination of on-going monitoring activities and periodic monitoring activities. Ongoing monitoring activities are generally routine activities built into the firm's processes and performed on a real-time basis. Periodic monitoring activities are conducted at certain intervals by the firm. In most cases, ongoing monitoring activities provide information about the system of quality management in a timelier manner.

.A150 Monitoring activities may include the inspection of in-process engagements. Inspections of engagements are designed to monitor whether an aspect of the system of quality management is designed, implemented, and operating in the manner intended. In some circumstances, the system of quality management may include responses that are designed to review engagements while they are in the process of being performed that appear similar in nature to an inspection of in-process engagements (for example, reviews that are designed to detect failures or shortcomings in the system of quality management so that they can prevent a quality risk from occurring). The purpose of the activity drives its design and implementation and where it fits within the system of quality management (that is, whether it is an inspection of an in-process engagement that is a monitoring activity or a review of an engagement that is a response to address a quality risk).

.A151 The nature, timing, and extent of the monitoring activities may also be affected by other matters, including

- the size, structure, and organization of the firm,
- the involvement of the firm's network in monitoring activities, and
- the resources that the firm intends to use to enable monitoring activities, such as the use of IT applications.

.A152 When performing monitoring activities, the firm may determine that changes to the nature, timing, and extent of the monitoring activities are needed, such as when findings indicate the need for more extensive monitoring activities.

The Design of the Firm's Risk Assessment Process and Monitoring and Remediation Process (Ref: par. .38c)

.A153 How the firm's risk assessment process is designed (for example, a centralized or decentralized process, or the frequency of review) may affect the nature, timing, and extent of the monitoring activities, including monitoring activities over the firm's risk assessment process.

.A154 How the firm's monitoring and remediation process is designed (that is, the nature, timing, and extent of the monitoring and remediation activities, taking into account the nature and circumstances of the firm) may affect the monitoring activities undertaken by the firm to determine whether the monitoring and remediation process is achieving the intended purpose as described in paragraph .36.

.A155 An example of scalability to demonstrate how the monitoring activities for the monitoring and remediation process may differ in firms of different complexity is as follows:

- In a less complex firm, the monitoring activities may be simple because information about the monitoring and remediation process may be readily available in the form of leadership's knowledge, based on their frequent interaction with the system of quality management, of the nature, timing, and extent of the monitoring activities undertaken, the results of the monitoring activities, and the firm's actions to address the results.
- In a more complex firm, the monitoring activities for the monitoring and remediation process may be specifically designed to determine that the monitoring and remediation process is providing relevant, reliable, and timely information about the system of quality management, and responding appropriately to identified deficiencies.

Changes in the System of Quality Management (Ref: par. .38d)

.A156 Changes in the system of quality management may include

- changes to address an identified deficiency in the system of quality management, and
- changes to the quality objectives, quality risks, or responses as a result of changes in the nature and circumstances of the firm and its engagements.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm's monitoring activities may include monitoring of those areas of change.

Previous Monitoring Activities (Ref: par. .38e and .44b)

.A157 The results of the firm's previous monitoring activities may indicate areas of the system where a deficiency may arise, particularly areas where there is a history of identified deficiencies.

.A158 Previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system, including on areas of the system of quality management that have not changed, particularly when time has elapsed since the monitoring activities were undertaken.

Other Relevant Information (Ref: par. .38f)

.A159 In addition to the sources of information indicated in paragraph .38f, other relevant information may include the following:

- Information communicated by the firm's network in accordance with paragraphs .51c and .52b about the firm's system of quality management, including the network requirements or network services that the firm has included in its system of quality management
- Information communicated by a service provider about the resources the firm uses in its system of quality management
- Information from regulators about the entities for whom the firm performs engagements that is made available to the firm, such as information from a securities regulator about an entity for whom the firm performs engagements (for example, irregularities in the entity's financial statements)

.A160 The results of external inspections or other relevant information, both internal and external, may indicate that previous monitoring activities undertaken by the firm failed to identify a deficiency in the system of quality management. This information may affect the firm's consideration of the nature, timing, and extent of the monitoring activities.

.A161 External inspections are not a substitute for the firm's internal monitoring activities. Nevertheless, the results of external inspections inform the nature, timing, and extent of the monitoring activities.

Engagement Inspections (Ref: par. .39)

.A162 Examples of matters in paragraph .38 that may be considered by the firm in selecting completed engagements for inspection include the following:

- In relation to the conditions, events, circumstances, actions, or in-actions giving rise to the quality risks:
 - The types of engagements performed by the firm, and the extent of the firm's experience in performing the type of engagement
 - The types of entities for which engagements are undertaken, such as the following:
 - Entities operating in emerging industries
 - Entities operating in industries associated with a high level of complexity or judgment
 - Entities operating in an industry that is new to the firm
 - The tenure and experience of engagement partners
- The results of previous inspections of completed engagements, including for each engagement partner
- In relation to other relevant information:
 - Complaints or allegations about an engagement partner
 - The results of external inspections, including for each engagement partner
 - The results of the firm's evaluation of each engagement partner's commitment to quality

.A163 The firm may undertake multiple monitoring activities, other than inspection of completed engagements, that focus on determining whether engagements have complied with policies or procedures. These monitoring activities may be undertaken on certain engagements or engagement partners. The nature and extent of these monitoring activities, and the results, may be used by the firm in determining the following:

- How often to select completed engagements for inspection, and which completed engagements to select, based on the factors described in paragraph .A159
- Which engagement partners to select for inspection, and how frequently to select an engagement partner for inspection, based on factors such as how long it has been since the engagement partner was subject to inspection, the results of previous inspections of the engagement partner, or the engagement partner's experience with performing engagements at different levels of service, in new industries, or with complex financial reporting matters

- Which aspects of the engagement to consider when performing the inspection of completed engagements

For example, if the firm has undertaken inspections of in-process engagements,

- the firm may determine it appropriate to reduce the extent of selection of completed engagements for inspection;
- the results of the inspections of in-process engagements may indicate areas of risk that may affect which completed engagements are selected for inspection; or
- the results of the inspections of in-process engagements may identify negative quality issues that prompt the firm to shorten the inspection cycle or expand the extent of completed engagement inspections.

.A164 The inspection of completed engagements for engagement partners on a cyclical basis may assist the firm in monitoring whether engagement partners have fulfilled their overall responsibility for managing and achieving quality on the engagements to which they are assigned.

.A165 Examples of policies and procedures that a firm may establish to apply a cyclical basis for the inspection of completed engagements for each engagement partner include the following policies or procedures that

- set forth the standard period of the inspection cycle, such as the inspection of a completed engagement for each engagement partner performing audits of financial statements once every, for example, three years, and for all other engagement partners, once every, for example, five years.
- set out the criteria for selecting completed engagements, including that for an engagement partner performing audits of financial statements, the engagements selected include an audit engagement.
- address the selection of engagement partners in a manner that is unpredictable.
- address when it is necessary or appropriate to select engagement partners more, or less, frequently than the standard period set out in the policy. Examples follow:
 - The firm may select engagement partners more frequently than the standard period set out in the firm's policy when the following apply:
 - Multiple deficiencies have been identified by the firm that have been evaluated as severe, and the firm determines that a more frequent cyclical inspection is needed across all engagement partners.
 - The engagement partner performs engagements for entities operating in a certain industry in which there are high levels of complexity or judgment.
 - An engagement performed by the engagement partner has been subject to other monitoring activities, and the results of the other monitoring activities were unsatisfactory.

- The engagement partner has performed an engagement for an entity operating in an industry in which the engagement partner has limited experience.
 - The engagement partner has limited experience in performing that level of service engagements.
 - The engagement partner is a newly appointed engagement partner or has recently joined the firm from another firm or another jurisdiction.
- The firm may defer the selection of the engagement partner (for example, deferring for a year beyond the standard period set out in the firm's policy) when
- engagements performed by the engagement partner have been subject to other monitoring activities during the standard period set out in the firm's policy, and
 - the results of the other monitoring activities provide sufficient information about the engagement partner; that is, performing the inspection of completed engagements would unlikely provide the firm with further information about the engagement partner.

.A166 The matters considered in an inspection of an engagement depend on how the inspection will be used to monitor the system of quality management. Ordinarily, the inspection of an engagement includes determining that responses that are implemented at the engagement level (for example, the firm's policies and procedures in respect of engagement performance) have been implemented as designed and are operating effectively.

The Relationship of Peer Review to Monitoring

.A167 A peer review is not a substitute for all monitoring activities. However, because the objective of a peer review is similar to that of an inspection, the firm's quality management policies or procedures may provide that a peer review conducted under standards established by the AICPA may be a substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

.A168 A peer review may result in findings or deficiencies. However, the definitions of *findings* and *deficiencies* in this section are different from the definitions of those terms in *AICPA Standards for Performing and Reporting on Peer Reviews*.¹⁷ Accordingly, findings and deficiencies may be evaluated differently for peer review purposes than for purposes of this section. Findings or deficiencies identified in a firm's system of quality management may not necessarily result in a peer review finding or deficiency; similarly, peer review findings or deficiencies may not necessarily equate to findings or deficiencies in a firm's system of quality management. As with other items identified in the firm's monitoring activities, the firm would need to assess any peer review findings or deficiencies to determine the impact on the firm's evaluation of its system of quality management.

¹⁷ Paragraph .11 of PR-C section 100, *Concepts Common to All Peer Reviews*.

Individuals Performing the Monitoring Activities (Ref: par. .40)

.A169 It is important that individuals performing the monitoring activities have the competence, capabilities, including sufficient time, and objectivity to perform the monitoring activities. Each of these attributes is equally essential. In some circumstances, there may not be personnel who have the competence, capabilities, including sufficient time, and objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities.

.A170 The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs an inspection of an engagement was an engagement team member or the engagement quality reviewer of that engagement. A self-review threat may also arise when an individual involved in operating the response to a quality risk is performing the monitoring of that response. For example, a self-review threat may arise if an individual responsible for accepting client engagements is also responsible for monitoring compliance with the firm's client acceptance policies and procedures.

.A171 This section does not preclude an individual from performing monitoring activities, including inspections, of their own compliance with a quality management system. However, such self-inspections may be less effective than compliance inspections by another qualified individual. When an individual inspects their own compliance with the firm's policies and procedures, the firm has a higher risk that noncompliance with policies and procedures will not be detected or reported. To effectively monitor one's own compliance, it is necessary that an individual be able to critically review their own performance, assess their own strengths and weaknesses, and maintain an attitude of continual improvement.

.A172 Responses that may provide safeguards against the self-review threat and lessen the likelihood of deficiencies in the system of quality management include the following actions:

- Fostering a commitment to continuing professional education and providing effective training programs so that personnel stay current on accounting, auditing, and quality management standards
- Providing training on how to perform monitoring inspections and requiring the use of peer review or other inspection checklists
- Requiring the passage of time after the completion of an engagement before self-inspections are performed

.A173 The firm may have responses in place to address quality risks other than the self-review threat that may be particularly helpful when self-inspections are performed, such as the following actions:

- Establishing strong client acceptance and engagement continuance policies that address the risk of the firm accepting or continuing engagements it doesn't have the competency and resources to perform
- Establishing consultation policies that require engagement teams to consult when they encounter technical accounting and auditing difficulties
- Taking corrective action in response to the results identified by the firm's internal monitoring, engagement quality reviews, peer

review results or other external inspections; for example, inspections by the U.S. Department of Labor

- Requiring the use of an external service provider to perform engagement quality reviews or monitoring activities when
 - deficiencies identified by the firm's monitoring activities, peer reviewers, or other external inspections indicate that self-inspection is not effective, or
 - changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) occur.

Evaluating Findings and Identifying Deficiencies (Ref: par. .17 and .41–.42)

.A174 The firm accumulates findings from the performance of monitoring activities, external inspections, and other relevant sources. Information accumulated by the firm from the monitoring activities, external inspections, and other relevant sources may reveal other observations about the firm's system of quality management, such as

- actions, behaviors, or conditions that have given rise to positive outcomes in the context of quality or the effectiveness of the system of quality management, or
- similar circumstances in which no findings were noted (for example, engagements in which no findings were noted, and the engagements have a similar nature to the engagements in which findings were noted).

Other observations may be useful to the firm because they may assist the firm in investigating the root causes of identified deficiencies, indicate practices that the firm can support or apply more extensively (for example, across all engagements), or highlight opportunities for the firm to enhance the system of quality management.

.A175 The firm exercises professional judgment in determining whether findings, individually or in combination with other findings, give rise to a deficiency in the system of quality management. In making the judgment, the firm may need to take into account the relative importance of the findings in the context of the quality objectives, quality risks, responses, or other aspects of the system of quality management to which they relate. The firm's judgments may be affected by quantitative and qualitative factors relevant to the findings. In some circumstances, the firm may determine it appropriate to obtain more information about the findings in order to determine whether a deficiency exists. Not all findings, including engagement findings, will be a deficiency.

.A176 Examples of quantitative and qualitative factors that a firm may consider in determining whether findings give rise to a deficiency include the following:

Quality risks and responses

- If the findings relate to a response, factors such as the following:
 - How the response is designed; for example, the nature of the response, the frequency of its occurrence (if applicable), and the relative importance of the response to addressing the quality risks and achieving the quality objectives to which it relates

- The nature of the quality risk to which the response relates and the extent to which the findings indicate that the quality risk has not been addressed
- Whether there are other responses that address the same quality risk and whether there are findings for those responses

Nature of the findings and their pervasiveness

- The nature of the findings; for example, findings related to leadership actions and behaviors may be qualitatively significant, given the pervasive effect this could have on the system of quality management as a whole
- Whether the findings, in combination with other findings, indicate a trend or systemic issue; for example, similar engagement findings that appear on multiple engagements may indicate a systemic issue

Extent of Monitoring Activity and Extent of Findings

- The extent of the monitoring activity from which the findings arose, including the number or size of the selections.
- The extent of the findings in relation to the selection covered by the monitoring activity and in relation to the expected deviation rate; for example, in the case of inspection of engagements, the number of engagements selected in which the findings were identified relative to the total number of engagements selected, and the expected deviation rate set by the firm

.A177 Evaluating findings and identifying deficiencies and evaluating the severity and pervasiveness of an identified deficiency, including investigating the root causes of an identified deficiency, are part of an iterative and nonlinear process. Examples follow:

- In investigating the root causes of an identified deficiency, the firm may identify a circumstance that has similarities to other circumstances in which there were findings that were not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and classifies them as deficiencies.
- In evaluating the severity and pervasiveness of an identified deficiency, the firm may identify a trend or systemic issue that correlates with other findings that are not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and also classifies them as deficiencies.

.A178 The results of monitoring activities, results of external inspections, and other relevant information (for example, network monitoring activities or complaints and allegations) may reveal information about the effectiveness of the monitoring and remediation process. For example, the results of external inspections may provide information about the system of quality management that has not been identified by the firm's monitoring and remediation process, which may highlight a deficiency in that process.

Evaluating Identified Deficiencies (Ref: par. .42)

.A179 Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include the following:

- The nature of the identified deficiency, including the aspect of the firm's system of quality management to which the deficiency relates, and whether the deficiency is in the design, implementation, or operation of the system of quality management
- In the case of identified deficiencies related to responses, whether there are compensating responses to address the quality risk to which the response relates
- The root causes of the identified deficiency
- The frequency with which the matter giving rise to the identified deficiency occurred
- The magnitude of the identified deficiency, how quickly it occurred, and the duration of time that it existed and had an effect on the system of quality management

.A180 The severity and pervasiveness of identified deficiencies affects the evaluation of the system of quality management that is undertaken by the individual or individuals assigned ultimate responsibility and accountability for the system of quality management.

Root Cause of the Identified Deficiencies (Ref: par. .42a)

.A181 The objective of investigating the root causes of identified deficiencies is to understand the underlying circumstances that caused the deficiencies to enable the firm to

- evaluate the severity and pervasiveness of the identified deficiency and
- appropriately remediate the identified deficiency.

Performing a root cause analysis involves the exercise of professional judgment based on the evidence available by those performing the assessment.

.A182 The nature, timing, and extent of the procedures undertaken to understand the root causes of an identified deficiency may also be affected by the nature and circumstances of the firm, such as the following:

- The complexity and operating characteristics of the firm.
- The size of the firm.
- The geographical dispersion of the firm.
- How the firm is structured or the extent to which the firm concentrates or centralizes its processes or activities. For example, in the case of a less complex firm with a single location, the firm's procedures to understand the root causes of a deficiency may be simple because the information to inform the understanding may be readily available and concentrated, and the root causes may be more apparent. In the case of a more complex firm with multiple locations, the procedures to understand the root causes of a deficiency may include using individuals specifically trained on investigating the root causes of identified deficiencies and developing a methodology with more formalized procedures for identifying root causes.
- The nature of the identified deficiency. For example, the firm's procedures to understand the root causes of an identified deficiency may be more rigorous in circumstances when an engagement report related to an audit of financial statements was issued that

was inappropriate, or the identified deficiency relates to leadership's actions and behaviors regarding quality.

- The possible severity of the identified deficiency. For example, the firm's procedures to understand the root causes of an identified deficiency may be more rigorous in circumstances in which the deficiency has been identified across multiple engagements, or there is an indication that policies or procedures have high rates of non-compliance.

.A183 In investigating the root causes of identified deficiencies, the firm may consider why deficiencies did not arise in other circumstances that are of a similar nature to the matter to which the identified deficiency relates. Such information may also be useful in determining how to remediate an identified deficiency. For example, the firm may determine that a deficiency exists because similar findings have occurred across multiple engagements. However, the findings have not occurred in several other engagements within the same population being tested. By contrasting the engagements, the firm concludes that the root cause of the identified deficiency is a lack of appropriate involvement by the engagement partners at key stages of the engagements.

.A184 Identifying root causes that are appropriately specific may support the firm's process for remediating identified deficiencies. For example, the firm may identify that engagement teams performing audits of financial statements are failing to obtain sufficient appropriate audit evidence on accounting estimates when management's assumptions have a high degree of subjectivity. Although the firm notes that these engagement teams are not maintaining appropriate professional skepticism, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to question individuals with greater authority or insufficient direction, supervision, and review of the work performed on the engagements.

.A185 In addition to investigating the root causes of identified deficiencies, the firm may also investigate the root causes of positive outcomes because doing so may reveal opportunities for the firm to improve, or further enhance, the system of quality management.

Responding to Identified Deficiencies (Ref: par. .43)

.A186 The nature, timing, and extent of remedial actions may depend on a variety of other factors, including the following:

- The root causes
- The severity and pervasiveness of the identified deficiency and, therefore, the urgency with which it needs to be addressed
- The effectiveness of the remedial actions in addressing the root causes, such as whether the firm needs to implement more than one remedial action in order to effectively address the root causes, or needs to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions

.A187 In some circumstances, the remedial action may include establishing additional quality objectives, or quality risks or responses may be added or modified, because it is determined that they are not appropriate.

.A188 In circumstances in which the firm determines that the root cause of an identified deficiency relates to a resource provided by a service provider, the firm may also

- consider whether to continue using the resource provided by the service provider, or
- communicate the matter to the service provider/

The firm is responsible for addressing the effect of the identified deficiency related to a resource provided by a service provider on the system of quality management and taking action to prevent the deficiency from recurring with respect to the firm's system of quality management. However, the firm is not ordinarily responsible for remediating the identified deficiency on behalf of the service provider or further investigating the root cause of the identified deficiency at the service provider.

Findings About a Particular Engagement (Ref: par. .46)

.A189 AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date*, addresses the auditor's responsibilities in circumstances in which procedures were omitted, or the report issued is inappropriate. In such circumstances relating to other assurance and attest engagements, the action taken by the firm may include the following:

- Consulting with appropriate individuals regarding the appropriate action
- Discussing the matter with management of the entity or those charged with governance
- Performing the omitted procedures

The actions taken by the firm do not relieve the firm of the responsibility to take further actions relating to the finding in the context of the system of quality management, including evaluating the findings to identify deficiencies and, when a deficiency exists, investigating the root causes of the identified deficiency.

Ongoing Communication Related to the Monitoring and Remediation (Ref: par. .47)

.A190 The information communicated about the monitoring and remediation to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may be communicated on an ongoing basis or periodically. The individual or individuals may use the information in multiple ways. Examples follow:

- As a basis for further communications to personnel about the importance of quality
- To hold individuals accountable for their roles assigned to them
- To identify key concerns about the system of quality management in a timely manner

The information also provides a basis for the evaluation of the system of quality management, and conclusion thereon, as required by paragraphs .54–.56.

Network Requirements or Network Services (Ref: par. .49)

.A191 In some circumstances, the firm may belong to a network. Networks may establish requirements regarding the firm's system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation, and operation of its system of quality management. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that belong to the network. The extent to which the network will provide the firm

with quality objectives, quality risks, and responses that are common across the network will depend on the firm's arrangements with the network.

.A192 Examples of network requirements include the following:

- Requirements for the firm to include additional quality objectives or quality risks in the firm's system of quality management that are common across the network firms.
- Requirements for the firm to include responses in the firm's system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, or resources, such as network-developed methodologies for performing engagements or IT applications.
- Requirements that the firm be subject to the network's monitoring activities. These monitoring activities may relate to network requirements (for example, monitoring that the firm has implemented the network's methodology appropriately) or to the firm's system of quality management in general.

.A193 Examples of network services include services or resources that are optional for the firm to use in its system of quality management or in performing engagements, such as voluntary training programs, use of component auditors or specialists from within the network, or use of a service delivery center established at the network level, or by another network firm or group of network firms.

.A194 The network may establish responsibilities for the firm in implementing the network requirements or network services. Examples follow:

- The firm is required to have certain IT infrastructure and IT processes in place to support an IT application provided by the network that the firm uses in the system of quality management.
- The firm is required to provide firm-wide training on the methodology provided by the network, including when updates are made to the methodology.

.A195 The firm's understanding of the network requirements or network services and the firm's responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as the following:

- The network's governance and leadership
- The procedures undertaken by the network in designing, implementing, and, if applicable, operating, the network requirements or network services
- How the network identifies and responds to changes that affect the network requirements or network services or other information, such as changes in the professional standards or information that indicates a deficiency in the network requirements or network services
- How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms' monitoring activities, and the network's processes for remediating identified deficiencies

Network Requirements or Network Services in the Firm’s System of Quality Management (Ref: par. .50)

.A196 The characteristics of the network requirements or network services are a condition, event, circumstance, action, or inaction in identifying and assessing quality risks. An example of a network requirement or network service that gives rise to a quality risk is as follows.

The network may require the firm to use an IT application for the acceptance and continuance of client relationships and specific engagements that is standardized across the network. This may give rise to a quality risk that the IT application does not address matters in local law or regulation that need to be considered by the firm in accepting and continuing client relationships and specific engagements.

.A197 The purpose of the network requirements may include the promotion of consistent performance of quality engagements across the network firms. The firm may be expected by the network to implement the network requirements; however, the firm may need to adapt or supplement the network requirements such that they are appropriate for the nature and circumstances of the firm and its engagements.

.A198 Examples of how the network requirements or network services may need to be adapted or supplemented include the following:

<i>Network requirement or network service</i>	<i>How the firm adapts or supplements the network requirement or network service</i>
The network requires the firm to include certain quality risks in the system of quality management so that all firms in the network address the quality risks. The network does not provide an assessment of the quality risks.	As part of identifying and assessing quality risks, the firm assesses the quality risks that are required by the network. The firm also designs and implements responses to address the assessed quality risks that are required by the network.
The network requires that the firm design and implement certain responses.	As part of designing and implementing responses, the firm determines • which assessed quality risks the responses address. • how the responses required by the network will be incorporated into the firm's system of quality management, given the nature and circumstances of the firm. This may include tailoring the response to reflect the nature and circumstances of the firm and the engagements performed by the firm (for example, tailoring a methodology to include matters related to law or regulation).

<i>Network requirement or network service</i>	<i>How the firm adapts or supplements the network requirement or network service</i>
The firm uses individuals from other network firms as component auditors. Network requirements are in place that drive a high degree of commonality across the network firms' systems of quality management. The network requirements include specific criteria that apply to individuals assigned to work on a component for a group audit.	The firm establishes policies or procedures that require the engagement team to confirm with the component auditor (that is, the other network firm) that the individuals assigned to the component meet the specific criteria set out in the network requirements.

.A199 In some circumstances, in adapting or supplementing the network requirements or network services, the firm may identify possible improvements to the network requirements or network services and may communicate these improvements to the network.

Monitoring Activities Undertaken by the Network on the Firm's System of Quality Management (Ref: par. .51c)

.A200 The results of the network's monitoring activities of the firm's system of quality management may include information such as the following:

- A description of the monitoring activities, including their nature, timing, and extent
- Findings, identified deficiencies, and other observations about the firm's system of quality management (for example, positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management)
- The network's evaluation of the root causes of the identified deficiencies, the assessed effect of the identified deficiencies, and recommended remedial actions

Monitoring Activities Undertaken by the Network Across the Network Firms (Ref: par. .52b)

.A201 The information from the network about the overall results of the network's monitoring activities undertaken across the network firms' systems of quality management may be an aggregation or summary of the information described in paragraph .A193, including trends and common areas of identified deficiencies across the network, or positive outcomes that may be replicated across the network. Such information may

- be used by the firm
 - in identifying and assessing quality risks, and
 - as part of other relevant information considered by the firm in determining whether deficiencies exist in the network requirements or network services used by the firm in its system of quality management.
- be communicated to group engagement partners, in the context of considering the competence and capabilities of component auditors from a network firm who are subject to common network

requirements (for example, common quality objectives, quality risks, and responses).

.A202 In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm's system of quality management that affects the firm. The network may also gather information from network firms regarding the results of external inspections over network firms' systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other network firms or may restrict the specificity of such information.

.A203 In circumstances in which the network does not provide the information about the overall results of the network's monitoring activities across the network firms, the firm may take further actions, such as

- discussing the matter with the network, and
- determining the effect on the firm's engagements and communicating the effect to engagement teams.

Deficiencies in Network Requirements or Network Services Identified by the Firm (Ref: par. .53)

.A204 As network requirements or network services used by the firm form part of the firm's system of quality management, they are also subject to the requirements of this section regarding monitoring and remediation. The network requirements or network services may be monitored by the network, the firm, or a combination of both; for example, a network may undertake monitoring activities at a network level for a common methodology. The firm may also monitor the application of the methodology by engagement team members through performing engagement inspections.

.A205 In designing and implementing the remedial actions to address the effect of the identified deficiency in the network requirements or network services, the firm may

- understand the planned remedial actions by the network, including whether the firm has any responsibilities for implementing the remedial actions, and
- consider whether supplementary remedial actions need to be taken by the firm to address the identified deficiency and the related root causes, such as when
 - the network has not taken appropriate remedial actions, or
 - the network's remedial actions will take time to effectively address the identified deficiency.

Evaluating the System of Quality Management (Ref: par. .54)

.A206 The individual or individuals assigned ultimate responsibility and accountability for the system of quality management may be assisted by other individuals in performing the evaluation. Nevertheless, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management remain responsible and accountable for the evaluation.

.A207 The point in time at which the evaluation is undertaken may depend on the circumstances of the firm and may coincide with the fiscal year-end of the firm or the completion of an annual monitoring cycle.

.A208 The information that provides the basis for the evaluation of the system of quality management includes the information communicated to the individuals assigned ultimate responsibility and accountability for the system of quality management in accordance with paragraph .47.

.A209 An example of scalability to demonstrate how the information that provides the basis for the evaluation of the system of quality management may be obtained in firms of different complexity is as follows:

- In a less complex firm, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and, therefore, will be aware of the information that supports the evaluation of the system of quality management.
- In a more complex firm, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may need to establish processes to collate, summarize, and communicate the information needed to evaluate the system of quality management.

Concluding on the System of Quality Management (Ref: par. .55)

.A210 In the context of this section, it is intended that the operation of the system as a whole provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. In concluding on the system of quality management, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may, in using the results of the monitoring and remediation process, consider the following:

- The severity and pervasiveness of identified deficiencies and the effect on the achievement of the objectives of the system of quality management
- Whether remedial actions have been designed and implemented by the firm and whether the remedial actions taken up to the time of the evaluation are effective
- Whether the effect of identified deficiencies on the system of quality management have been appropriately corrected, such as whether further actions have been taken in accordance with paragraph .46

.A211 There may be circumstances in which identified deficiencies that are severe (including identified deficiencies that are severe and pervasive) have been appropriately remediated and the effect of them corrected at the point in time of the evaluation. In such cases, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved.

.A212 An identified deficiency may have a pervasive effect on the design, implementation, and operation of the system of quality management when, for example, the deficiency

- affects several components or aspects of the system of quality management.

- is confined to a specific component or aspect of the system of quality management but is fundamental to the system of quality management.
- affects several business units or geographical locations of the firm.
- is confined to a business unit or geographical location, but the business unit or location affected is fundamental to the firm overall.
- affects a substantial portion of engagements that are of a certain type or nature.

.A213 An example of an identified deficiency that may be considered severe but not pervasive is as follows:

The firm identifies a deficiency in one of its smaller regional offices. The identified deficiency relates to noncompliance with many firm policies or procedures. The firm determines that the culture in the regional office, particularly the actions and behavior of leadership in the regional office, which were overly focused on financial priorities, has contributed to the root cause of the identified deficiency. The firm determines that the effect of the identified deficiency is as follows:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures
- Not pervasive, because it is limited to the smaller regional office

.A214 The individual or individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that the system of quality management does not provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved in circumstances in which identified deficiencies are severe and pervasive, actions taken to remediate the identified deficiencies are not appropriate, and the effect of the identified deficiencies have not been appropriately corrected.

.A215 An example of an identified deficiency that may be considered severe and pervasive is as follows:

The firm identifies a deficiency in a regional office, which is the firm's largest office and provides financial, operational, and technical support for the entire region. The identified deficiency relates to noncompliance with many firm policies or procedures. The firm determines that the culture in the regional office, particularly the actions and behavior of leadership in the regional office, which were overly focused on financial priorities, has contributed to the root cause of the identified deficiency. The firm determines that the effect of the identified deficiency is as follows:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures
- Pervasive, because the regional office is the largest office and provides support to many other offices, and the noncompliance with firm policies or procedures may have had a broader effect on the other offices

.A216 It may take time for the firm to remediate identified deficiencies that are severe and pervasive. As the firm continues to take action to remediate the identified deficiencies, the pervasiveness of the identified deficiencies may be diminished, and it may be determined that the identified deficiencies are still severe but no longer severe and pervasive. In such cases, the individual or individuals assigned ultimate responsibility and accountability for the

system of quality management may conclude that, except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved.

.A217 This section does not require the firm to obtain an independent evaluation (for example, a peer review report or report on service organization controls) on its system of quality management annually or preclude the firm from doing so.

Taking Prompt and Appropriate Action and Further Communication (Ref: par. .56)

.A218 In circumstances in which the individual or individuals assigned ultimate responsibility and accountability for the system of quality management reach the conclusion described in paragraph .55b or 55c, the prompt and appropriate action taken by the firm may include the following:

- Taking measures to support performing engagements through assigning more resources or developing more guidance and to confirm that reports issued by the firm are appropriate in the circumstances, until such time as the identified deficiencies are remediated, and communicating such measures to engagement teams
- Obtaining legal advice

.A219 In some circumstances, the firm may have an independent governing body that has nonexecutive oversight of the firm. In such circumstances, communications may include informing the independent governing body.

.A220 Examples of circumstances in which it may be appropriate for the firm to communicate to external parties about the evaluation of the system of quality management include the following:

- When the firm belongs to a network
- When other network firms use the work performed by the firm, for example, in the case of a group audit
- When a report issued by the firm is determined by the firm to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed
- When law or regulation requires the firm to communicate to an oversight authority or a regulatory body

Performance Evaluations (Ref: par. .57)

.A221 Periodic performance evaluations promote accountability. In considering the performance of an individual, the firm may take the following into account:

- The results of the firm's monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. In some circumstances, the firm may set targets for the individual and measure the results of the firm's monitoring activities against those targets.

- The actions taken by the individual in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.

.A222 An example of scalability to demonstrate how firms of different complexity may undertake the performance evaluations is as follows:

- In a less complex firm, the firm may engage a service provider to perform the evaluation, or the results of the firm's monitoring activities may provide an indication of the performance of the individual.
- In a more complex firm, the performance evaluations may be undertaken by an independent nonexecutive member of the firm's governing body or a special committee overseen by the firm's governing body.

.A223 A positive performance evaluation may be rewarded through compensation, promotion, and other incentives that focus on the individual's commitment to quality and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm's achievement of its quality objectives.

Documentation (Ref: par. .58–.60)

.A224 Documentation provides evidence that the firm complies with this section, as well as law, regulation, or relevant ethical requirements. It may also be useful for training personnel and engagement teams, ensuring the retention of organizational knowledge, and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment made, about its system of quality management. Furthermore, compliance with this section may be evidenced by the firm through its information and communication component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

.A225 Documentation may be formal (for example, written manuals, checklists, and forms), informal (for example, email communication or postings on websites), or held in IT applications or other digital forms (for example, in databases). Factors that may affect the firm's judgments about the form, content, and extent of documentation, including how often documentation is updated, may include the following:

- The complexity of the firm and the number of offices
- The nature and complexity of the firm's practice and organization
- The nature of engagements the firm performs and the nature of the entities for whom engagements are performed
- The nature and complexity of the matter being documented, such as whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk, and the complexity of the judgments relating to the matter
- The frequency and extent of changes in the system of quality management

In a less complex firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may

be effective. Nevertheless, a less complex firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

.A226 In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation; for example, the AICPA code requires documentation of particular matters, including certain situations related to conflicts of interest, noncompliance with laws and regulations, and independence.

.A227 The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction for each quality objective or each risk that may give rise to a quality risk. However, in documenting the quality risks and how the firm's responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (that is, the considered occurrence and effect on the achievement of one or more quality objectives) to support the consistent implementation and operation of the responses.

.A228 The documentation may be provided by the network, other network firms, or other structures or organizations within the network.

QM Section 10A*

A Firm's System of Quality Control

(Supersedes SQCS No. 7.)

Source: SQCS No. 8; SAS No. 122; SAS No. 128.

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

Introduction

Scope of This Section

.01 This section addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This section is to be read in conjunction with the AICPA Code of Professional Conduct and other relevant ethical requirements.

.02 This section, although applicable to audit and attestation engagements performed by CPA firms in accordance with *Government Auditing Standards*, does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*, which are similar to those of this section.

.03 Other professional standards set out additional requirements and guidance on the responsibilities of firm personnel regarding quality control procedures for specific types of engagements. AU-C section 220A, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for example, addresses quality control procedures for engagements conducted in accordance with generally accepted auditing standards. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.04 A system of quality control consists of policies designed to achieve the objective set out in paragraph .12 and the procedures necessary to implement and monitor compliance with those policies.

Authority of the SQCSs

.05 This section applies to all CPA firms with respect to engagements in their accounting and auditing practice. The nature and extent of the policies and procedures developed by an individual firm to comply with this section will depend on various factors, such as the size and operating characteristics of the firm and whether it is part of a network.

.06 Statements on Quality Control Standards (SQCSs) contain the objective of the firm in following the SQCSs and requirements designed to enable the

* Prior to the release of Statement on Quality Management Standards (SQMS) Nos. 1-2, this section used a "QC" identifier. Upon the issuance of SQMS Nos. 1-2, which supersede this content, the title "Quality Control" was changed to "Quality Management," and the section identifiers were changed to "QM."

firm to meet that stated objective. In addition, SQCSs contain related guidance in the form of application and other explanatory material, as discussed further in paragraph .09, and introductory material that provides context relevant to a proper understanding of the SQCSs and definitions.

.07 The objective provides the context in which the requirements of SQCSs are set and is intended to assist the firm in the following:

- Understanding what needs to be accomplished
- Deciding whether more needs to be done to achieve the objective

.08 SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:

- *Unconditional requirements.* The firm is required to comply with an unconditional requirement in all cases in which such a requirement is relevant. SQCSs use the word *must* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The firm is also required to comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement, provided that the firm documents the justification for the departure and how the alternative policies established, or procedures performed, in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

.09 When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover.
- include examples of policies and procedures that may be appropriate in the circumstances.

The words *may*, *might*, and *could*, among others, are used to describe these actions and procedures. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in SQCSs. When appropriate, additional considerations specific to governmental entities or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in SQCSs. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in SQCSs.

.10 SQCSs include, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the SQCSs. These are provided to assist in the consistent application and interpretation of SQCSs and

are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. The AU-C glossary contains a complete listing of terms defined in this section. It also includes descriptions of other terms found in this section to assist in common and consistent interpretation. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Effective Date

.11 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

Objective

.12 The objective of the firm is to establish and maintain a system of quality control to provide it with reasonable assurance that

- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
- b. reports issued by the firm are appropriate in the circumstances.

Definitions

.13 For purposes of SQCSs, the following terms have the meanings attributed as follows:

Accounting and auditing practice. A practice that performs engagements covered by this section, which are audit, attestation, compilation, review, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee (ARSC) under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

Engagement documentation. The record of the work performed, results obtained, and conclusions that the practitioner reached (also known as *working papers* or *workpapers*).

Engagement partner. The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement quality control review. A process designed to provide an objective evaluation, before the report is released, of the significant judgments the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is only for those engagements, if any, for which the firm has determined that an engagement quality control review is required, in accordance with its policies and procedures.

Engagement quality control reviewer. A partner, other person in the firm, suitably qualified external person, or team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the

significant judgments that the engagement team made and the conclusions it reached in formulating the report.

Engagement team. All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external specialists engaged by the firm or a network firm.¹

The term *engagement team* also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of section 610, *Using the Work of Internal Auditors*.

Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice.

Inspection. A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them. Inspection includes a review of completed engagements.

Monitoring. A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is designed appropriately and operating effectively.

Network. An association of entities, as defined in ET section 0.400, *Definitions*.

Network firm. A firm or other entity that belongs to a network, as defined in ET section 0.400.

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Personnel. Partners and staff.

Professional standards. Standards promulgated by the ASB or ARSC under the "General Standards Rule" or the "Compliance With Standards Rule" of the AICPA Code of Professional Conduct, or other standards-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

Reasonable assurance. In the context of this section, a high, but not absolute, level of assurance.

Relevant ethical requirements. Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

Staff. Professionals, other than partners, including any specialists that the firm employs.

¹ Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Suitably qualified external person. An individual outside the firm with the competence and capabilities to act as an engagement partner (for example, a partner of another firm).

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Requirements

Applying and Complying With Relevant Requirements

.14 Personnel within the firm responsible for establishing and maintaining the firm's system of quality control should have an understanding of the entire text of this section, including its application and other explanatory material, to understand its objective and apply its requirements properly.

.15 The firm should comply with each requirement of this section unless, in the circumstances of the firm, the requirement is not relevant to the services provided by a firm's accounting and auditing practice. (Ref: par. .A1)

.16 The requirements are designed to enable the firm to achieve the objective stated in this section. The proper application of the requirements is, therefore, expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the firm should consider whether there are particular matters or circumstances that require the firm to establish policies and procedures in addition to those required by this section to meet the stated objective.

Elements of a System of Quality Control

.17 The firm must establish and maintain a system of quality control. The system of quality control should include policies and procedures addressing each of the following elements:

- a. Leadership responsibilities for quality within the firm (the tone at the top)
- b. Relevant ethical requirements
- c. Acceptance and continuance of client relationships and specific engagements
- d. Human resources
- e. Engagement performance
- f. Monitoring

Policies and procedures established by the firm related to each element are designed to achieve reasonable assurance with respect to the purpose of that element. Deficiencies in policies and procedures for an element may result in not achieving reasonable assurance with respect to the purpose of that element; however, the system of quality control as a whole may still be effective in achieving the objective described in paragraph .12.

.18 The firm should document its policies and procedures and communicate them to the firm's personnel. (Ref: par. .A2–.A3)

Leadership Responsibilities for Quality Within the Firm

.19 The firm should establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Such policies and procedures should require the firm's leadership (managing partner or board of managing partners, CEO, or equivalent) to assume ultimate responsibility for the firm's system of quality control. (Ref: par. .A4–.A5)

.20 The firm should establish policies and procedures designed to provide it with reasonable assurance that any person or persons assigned operational responsibility for the firm's system of quality control by the firm's leadership has sufficient and appropriate experience and ability, and the necessary authority, to assume that responsibility. (Ref: par. .A6)

Relevant Ethical Requirements

.21 The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (Ref: par. .A7–.A9)

Independence

.22 The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm; its personnel; and, when applicable, others subject to independence requirements (including network firm personnel) maintain independence when required by relevant ethical requirements. Such policies and procedures should enable the firm to

- a. communicate its independence requirements to its personnel and, when applicable, others subject to them and
- b. identify and evaluate circumstances and relationships that create threats to independence and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if considered appropriate, to withdraw from the engagement when withdrawal is possible under applicable law or regulation.

.23 Such policies and procedures should require

- a. engagement partners to provide the firm with relevant information about client engagements, including the scope of services, to enable the firm to evaluate the overall effect, if any, on independence requirements;
- b. personnel to promptly notify the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken; and
- c. the accumulation and communication of relevant information to appropriate personnel so that
 - i. the firm and its personnel can readily determine whether they satisfy independence requirements,
 - ii. the firm can maintain and update information relating to independence, and
 - iii. the firm can take appropriate action regarding identified threats to independence that are not at an acceptable level.

.24 The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence

requirements and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for

- a. personnel to promptly notify the firm of independence breaches of which they become aware;
- b. the firm to promptly communicate identified breaches of these policies and procedures to
 - i. the engagement partner who, with the firm, needs to address the breach and
 - ii. other relevant personnel in the firm and, when appropriate, the network and those subject to the independence requirements who need to take appropriate action; and
- c. prompt communication to the firm, if necessary, by the engagement partner and the other individuals referred to in subparagraph (b)(ii) of the actions taken to resolve the matter so that the firm can determine whether it should take further action.

.25 At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in the "Independence Rule" (ET sec. 1.200.001) and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. (Ref: par. .A10) [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.26 The firm should establish policies and procedures for all audit or attestation engagements for which regulatory or other authorities require the rotation of personnel after a specified period, in compliance with such requirements.

Acceptance and Continuance of Client Relationships and Specific Engagements

.27 The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only when the firm

- a. is competent to perform the engagement and has the capabilities, including time and resources, to do so; (Ref: par. .A11)
- b. can comply with legal and relevant ethical requirements; and
- c. has considered the integrity of the client and does not have information that would lead it to conclude that the client lacks integrity. (Ref: par. .A12–.A13)

.28 Such policies and procedures should

- a. require the firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. (Ref: par. .A14)
- b. require the firm to determine whether it is appropriate to accept the engagement if a potential conflict of interest is identified in accepting an engagement from a new or an existing client.

- c. if issues have been identified and the firm decides to accept or continue the client relationship or a specific engagement, require the firm to
 - i. consider whether ethical requirements that exist under the "Conflicts of Interest" interpretation (ET sec. 1.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001) apply, and
 - ii. document how the issues were resolved.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.29 To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, the firm should establish policies and procedures that provide for obtaining an understanding with the client regarding those services. (Ref: par. .A15)

.30 The firm should establish policies and procedures on continuing an engagement and the client relationship that address the circumstances when the firm obtains information that would have caused it to decline the engagement had that information been available earlier. Such policies and procedures should include consideration of the following:

- a. The professional and legal responsibilities that apply to the circumstances, including whether there is a requirement for the firm to report to regulatory authorities
- b. The possibility of withdrawing from the engagement or from both the engagement and the client relationship (Ref: par. .A16)

Human Resources

.31 The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the competence, capabilities, and commitment to ethical principles necessary to

- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A17–.A24)

.32 The firm's policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities that they will be called on to assume.

Assignment of Engagement Teams

.33 The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that

- a. the identity and role of the engagement partner are communicated to management and those charged with governance;
- b. the engagement partner has the appropriate competence, capabilities, and authority to perform the role; and (Ref: par. .A25–.A30)
- c. the responsibilities of the engagement partner are clearly defined and communicated to that individual.

.34 The firm should establish policies and procedures to assign appropriate personnel with the necessary competence and capabilities to

- a. perform engagements in accordance with professional standards and applicable legal and regulatory requirements and
- b. enable the firm to issue reports that are appropriate in the circumstances. (Ref: par. .A31)

Engagement Performance

.35 The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements and that the firm issues reports that are appropriate in the circumstances. Such policies and procedures should include the following:

- a. Matters relevant to promoting consistency in the quality of engagement performance (Ref: par. .A32–.A33)
- b. Supervision responsibilities (Ref: par. .A34)
- c. Review responsibilities (Ref: par. .A35)

.36 The firm's review responsibility policies and procedures should be determined on the basis that suitably experienced engagement team members, which may include the engagement partner, review work performed by other engagement team members.

Consultation

.37 The firm should establish policies and procedures designed to provide it with reasonable assurance that

- a. appropriate consultation takes place on difficult or contentious issues;
- b. sufficient resources are available to enable appropriate consultation to take place;
- c. the nature and scope of such consultations are documented and are agreed upon by both the individual seeking consultation and the individual consulted; and
- d. the conclusions resulting from consultations are documented, understood by both the individual seeking consultation and the individual consulted, and implemented. (Ref: par. .A36–.A40)

Engagement Quality Control Review

.38 The firm should establish criteria against which all engagements covered by this section should be evaluated to determine whether an engagement quality control review should be performed. (Ref: par. .A41)

.39 The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review should be performed for that engagement.

.40 The firm should establish policies and procedures setting out the nature, timing, and extent of an engagement quality control review. Such policies and procedures should require that the engagement quality control review be completed before the report is released. (Ref: par. .A42–.A44)

.41 The firm should establish policies and procedures to require the engagement quality control review to include

- a. discussion of significant findings and issues with the engagement partner;

- b. reading the financial statements or other subject matter information and the proposed report;
- c. review of selected engagement documentation relating to significant judgments that the engagement team made and the related conclusions it reached; and
- d. evaluation of the conclusions reached in formulating the report and consideration of whether the proposed report is appropriate. (Ref: par. .A45–.A47)

Criteria for the Eligibility of Engagement Quality Control Reviewers

.42 The firm should establish policies and procedures to address the appointment of engagement quality control reviewers and to establish their eligibility through

- a. the technical qualifications required to perform the role, including the necessary experience and authority, and (Ref: par. .A48)
- b. the degree to which an engagement quality control reviewer can be consulted on the engagement without compromising the reviewer's objectivity. (Ref: par. .A49)

.43 The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed. Accordingly, such policies and procedures should provide that the engagement quality control reviewer

- a. when practicable, is not selected by the engagement partner.
- b. does not otherwise participate in the performance of the engagement during the period of review.
- c. does not make decisions for the engagement team.
- d. is not subject to other considerations that would threaten the reviewer's objectivity.

.44 The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review is likely to have been impaired. (Ref: par. .A50)

Documentation of the Engagement Quality Control Review

.45 The firm should establish policies and procedures on documentation of the engagement quality control review, which require documentation that

- a. the procedures required by the firm's policies on engagement quality control review have been performed;
- b. the engagement quality control review has been completed before the report is released; and
- c. the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments that the engagement team made and the conclusions it reached were not appropriate.

Differences of Opinion

.46 The firm should establish policies and procedures for addressing and resolving differences of opinion within the engagement team; with those consulted; and, when applicable, between the engagement partner and the engagement quality control reviewer. (Ref: par. .A51–.A52)

.47 Such policies and procedures should enable a member of the engagement team to document that member's disagreement with the conclusions reached after appropriate consultation.

.48 Such policies and procedures should require the following:

- a. Conclusions reached be documented and implemented
- b. The report not be released until the matter is resolved

Engagement Documentation

Completion of the Assembly of Final Engagement Files

.49 The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports have been released. (Ref: par. .A53–.A54)

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation

.50 The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation. (Ref: par. .A55–.A58)

Retention of Engagement Documentation

.51 The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations. (Ref: par. .A59–.A62)

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures

.52 The firm should establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. This process should

- a. include an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements;
- b. require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility; and
- c. assign the performance of monitoring the firm's system of quality control to qualified individuals. (Ref: par. .A63–.A73)

Evaluating, Communicating, and Remedying Identified Deficiencies

.53 Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this section do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards.

.54 The firm should evaluate the effect of deficiencies noted as a result of the monitoring process and determine whether they are either

- a. instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and applicable legal and regulatory requirements and that the reports issued by the firm are appropriate in the circumstances or
- b. systemic, repetitive, or other significant deficiencies that require prompt corrective action.

.55 The firm should communicate to relevant engagement partners, and other appropriate personnel, deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action. (Ref: par. .A74)

.56 Recommendations for appropriate remedial actions for deficiencies noted should include one or more of the following:

- a. Taking appropriate remedial action in relation to an individual engagement or member of personnel
- b. The communication of the findings to those responsible for training and professional development
- c. Changes to the quality control policies and procedures
- d. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly

.57 The firm should establish policies and procedures to address cases when the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement. Such policies and procedures should require the firm to

- a. determine what further action is appropriate to comply with relevant professional standards and legal and regulatory requirements and
- b. consider whether to obtain legal advice.

.58 The firm should communicate, at least annually, the results of the monitoring of its system of quality control to engagement partners and other appropriate individuals within the firm, including the firm's leadership. This communication should be sufficient to enable the firm and these individuals to take prompt and appropriate action, when necessary, in accordance with their defined roles and responsibilities to provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:

- a. A description of the monitoring procedures performed
- b. The conclusions drawn from the monitoring procedures
- c. When relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies

.59 Some firms operate as part of a network and, for consistency, may implement some of their monitoring procedures on a network basis. When firms within a network operate under common monitoring policies and procedures designed to comply with this section, and these firms place reliance on such a monitoring system, the firm's policies and procedures should require that

- a. at least annually, the network communicate the overall scope, extent, and results of the monitoring process to appropriate individuals within the network firms and

- b. the network communicate promptly any identified deficiencies in the quality control system to appropriate individuals within the relevant network firm or firms so that the necessary action can be taken in order that engagement partners in the network firms can rely on the results of the monitoring process implemented within the network, unless the firms or the network advise otherwise.

Complaints and Allegations

.60 The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with

- a. complaints and allegations that the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and
- b. allegations of noncompliance with the firm's system of quality control.

As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals. (Ref: par. .A75)

.61 If, during the investigations into complaints and allegations, deficiencies in the design or operation of the firm's quality control policies and procedures, or instances of noncompliance with the firm's system of quality control by an individual or individuals are identified, the firm should take appropriate actions, as set out in paragraph .56. (Ref: par. .A76–.A77)

Documentation of the System of Quality Control

.62 The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control. (Ref: par. .A78–.A80)

.63 The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review of the firm to evaluate the firm's compliance with its system of quality control or for a longer period if required by law or regulation.²

.64 The firm should establish policies and procedures requiring documentation of complaints and allegations described in paragraph .60 and the responses to them.

Application and Other Explanatory Material

Applying and Complying With Relevant Requirements

Considerations Specific to Smaller Firms (Ref: par. .15)

.A1 This section does not call for compliance with requirements that are not relevant (for example, in the circumstances of a sole practitioner with no staff). Requirements in this section, such as those for policies and procedures for the assignment of appropriate personnel to the engagement team (see paragraph .34), for review responsibilities (see paragraph .36), and for the annual

² PR section 100, *Standards for Performing and Reporting on Peer Reviews*, is applicable to firms enrolled in the AICPA Peer Review Program.

communication of the results of monitoring to engagement partners within the firm (see paragraph .58) are not relevant in the absence of staff.

Elements of a System of Quality Control (Ref: par. .18)

.A2 In general, communication of quality control policies and procedures to firm personnel includes a description of the quality control policies and procedures and the objectives they are designed to achieve and the message that each individual has a personal responsibility for quality and is expected to comply with these policies and procedures. By encouraging firm personnel to communicate their views or concerns on quality control matters, the firm recognizes the importance of obtaining feedback on the firm's system of quality control. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing.

Considerations Specific to Smaller Firms

.A3 Documentation and communication of policies and procedures for smaller firms may be less formal and extensive than for larger firms.

Leadership Responsibilities for Quality Within the Firm

Promoting an Internal Culture of Quality (Ref: par. .19)

.A4 The firm's leadership, and the examples it sets, significantly influences the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures and the requirement to

- a. perform work that complies with professional standards and applicable legal and regulatory requirements.
- b. issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in partner and staff appraisal procedures and the firm's internal documentation and training materials, such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

.A5 Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Promoting such an internal culture includes the following:

- a. Establishment of policies and procedures that address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel in order to demonstrate the firm's overarching commitment to quality
- b. Assignment of management responsibilities so that commercial considerations do not override the quality of the work performed
- c. Provision of sufficient and appropriate resources for the development, documentation, and support of its quality control policies and procedures

Assigning Operational Responsibility for the Firm's System of Quality Control (Ref: par. .20)

.A6 Sufficient and appropriate experience and ability enables the person or persons responsible for the firm's system of quality control to identify and understand quality control issues and to develop appropriate policies and procedures. Necessary authority enables the person or persons to implement those policies and procedures.

Relevant Ethical Requirements***Compliance With Relevant Ethical Requirements (Ref: par. .21)***

.A7 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

.A8 Independence requirements are set forth in the "Independence Rule" and related interpretations of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010). [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A9 The fundamental principles are reinforced, in particular, by the following:

- The leadership of the firm
- Education and training
- Monitoring
- A process for dealing with noncompliance

Written Confirmation (Ref: par. .25)

.A10 Written confirmation may be in paper or electronic form. By obtaining confirmation and taking appropriate action on information indicating non-compliance, the firm demonstrates the importance that it attaches to independence and keeps the issue current for, and visible to, its personnel.

Acceptance and Continuance of Client Relationships and Specific Engagements***Competence, Capabilities, and Resources (Ref: par. .27a)***

.A11 Consideration of whether the firm has the competence, capabilities, and resources to undertake a new engagement from a new or an existing client involves reviewing the specific requirements of the engagement and the existing partner and staff profiles at all relevant levels, including whether

- firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;
- firm personnel have experience with relevant regulatory or reporting requirements or the ability to effectively gain the necessary competencies;
- the firm has sufficient personnel with the necessary competence and capabilities;
- specialists are available, if needed;
- individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, when applicable; and
- the firm is able to complete the engagement within the reporting deadline.

Integrity of a Client (Ref: par. .27c)

.A12 Matters to consider regarding the integrity of a client include, for example, the following:

- The identity and business reputation of the client's principal owners, key management, and those charged with governance
- The nature of the client's operations, including its business practices
- Information concerning the attitude of the client's principal owners, key management, and those charged with governance toward such matters as internal control or aggressive interpretation of accounting standards
- Indications of an inappropriate limitation in the scope of the work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm

The extent of knowledge that a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

.A13 Sources of information on such matters obtained by the firm may include the following:

- Communications with existing or previous providers of professional accountancy services to the client, in accordance with relevant ethical requirements, and discussions with other third parties
- Inquiry of other firm personnel or third parties, such as bankers, legal counsel, and industry peers
- Background searches of relevant databases

Continuance of a Client Relationship (Ref: par. .28a)

.A14 Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements and their implications for continuing the relationship. For example, a client may have started to expand its business operations into an area where the firm does not possess, and cannot obtain, the necessary expertise.

Obtaining an Understanding With the Client (Ref: par. .29)

.A15 Professional standards applicable to the engagement may contain requirements for obtaining a written understanding with the client.

Withdrawal (Ref: par. .30)

.A16 Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship may address issues that include the following:

- Discussing with the appropriate level of the client's management and those charged with governance the appropriate action that the firm might take based on the relevant facts and circumstances
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with governance withdrawal from the engagement or from both the engagement and the client relationship and the reasons for the withdrawal
- Considering whether there is a professional, legal, or regulatory requirement for the firm to remain in place or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities
- Documenting significant matters, consultations, conclusions, and the basis for the conclusions

Human Resources (Ref: par. .31)

.A17 Personnel issues relevant to the firm's policies and procedures related to human resources include, for example, the following:

- Recruitment and hiring, if applicable
- Performance evaluation, compensation, and advancement
- Determining competencies and capabilities, including time to perform assignments
- Professional development
- The estimation of personnel needs

Effective recruitment processes and procedures help the firm select individuals of integrity who have the capacity to develop the competence and capabilities necessary to perform the firm's work and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

.A18 *Competencies and capabilities* are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this section. Competencies and capabilities are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

.A19 Competence can be developed through a variety of methods; these methods include, for example, the following:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff, such as other members of the engagement team
- Independence education for personnel who are required to be independent

.A20 The continuing competence of the firm's personnel depends, to a significant extent, on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education (CPE) and other professional development activities that enable them to fulfill responsibilities assigned and to satisfy applicable CPE requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required competence and capabilities.

.A21 The firm may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.

.A22 Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps that a firm may take in developing and maintaining competence and commitment to ethical principles include the following:

- Making personnel aware of the firm's expectations regarding performance and ethical principles
- Providing personnel with an evaluation of, and counseling on, performance, progress, and career development
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles and that failure to comply with the firm's policies and procedures may result in disciplinary action.

Considerations Specific to Smaller Firms

.A23 The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control

.A24 CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern public practice. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute, including related administrative rules, designed by the AICPA and the National Association of State Boards

of Accountancy to provide a uniform approach to the regulation of the accounting profession. The UAA provides that "[a]ny individual licensee ... who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm, shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this section is intended to enable a practitioner who performs accounting and auditing services on the firm's behalf to meet the competency requirement referred to in the UAA. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

Assignment of Engagement Teams

Engagement Partners (Ref: par. .33)

.A25 In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this section. In some cases, however, an engagement partner may have obtained the necessary competencies through disciplines other than public practice, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by CPE and consultation. The following are examples:

- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
- An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.
- A person in academia might obtain the necessary competencies to perform engagements covered by this section by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (b) performing a rigorous self-study program or by engaging a consultant to assist on such engagements.

[Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.A26 The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner. For example

- the competencies expected of an engagement partner to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
- supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.
- the engagement partner for an attestation engagement to examine the effectiveness of an entity's internal control over financial

reporting that is integrated with an audit of financial statements would be expected to have technical proficiency in understanding and evaluating the effectiveness of controls, whereas an engagement partner of an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

.A27 In practice, the competencies necessary for the engagement partner are broad and varied in both their nature and number. Competencies include the following, as well as other competencies as necessary in the circumstances:

- *Understanding of the role of a system of quality control and the Code of Professional Conduct.* An understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.
- *Understanding of the service to be performed.* An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.
- *Technical proficiency.* An understanding of the applicable professional standards, including those standards directly related to the industry in which a client operates, and the kinds of transactions in which a client engages.
- *Familiarity with the industry.* An understanding of the industry in which a client operates to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.
- *Professional judgment.* Skills that indicate sound professional judgment. In performing engagements covered by this section, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration, including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.
- *Understanding the organization's IT systems.* A sufficient understanding of how the organization is dependent on, or enabled by, information technologies and the manner in which the information systems are used to record and maintain financial information to determine when involvement of an IT professional is necessary for an audit engagement.

Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control

.A28 The competencies previously listed are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

.A29 In establishing policies and procedures related to the nature of competencies needed by the engagement partner of an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.

.A30 Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

Engagement Teams (Ref: par. .34)

.A31 The firm's assignment of engagement teams and the determination of the level of supervision required include, for example, consideration of the engagement team's

- understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation;
- understanding of professional standards and legal and regulatory requirements;
- technical knowledge and expertise, including knowledge of relevant IT;
- knowledge of relevant industries in which the clients operate;
- ability to apply professional judgment; and
- understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

Engagement Performance

Consistency in the Quality of Engagement Performance (Ref: par. .35a)

.A32 The firm promotes consistency in the quality of engagement performance through its policies and procedures. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed may include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work
- Processes for complying with applicable engagement standards
- Processes of engagement supervision, staff training, and mentoring
- Methods of reviewing the work performed, the significant judgments made, and the type of report being issued
- Appropriate documentation of the work performed and of the timing and extent of the review
- Processes to keep all policies and procedures current

.A33 Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

Supervision (Ref: par. .35b)

.A34 Engagement supervision includes the following:

- Tracking the progress of the engagement
- Considering the competence and capabilities of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement
- Addressing significant findings and issues arising during the engagement, considering their significance, and modifying the planned approach appropriately
- Identifying matters for consultation or consideration by more experienced engagement team members during the engagement

Review (Ref: par. .35c)

.A35 A review consists of consideration of whether

- the work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- significant findings and issues have been raised for further consideration;
- appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- the nature, timing, and extent of the work performed is appropriate and without need for revision;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to support the report; and
- the objectives of the engagement procedures have been achieved.

Consultation (Ref: par. .37)

.A36 Consultation includes discussion at the appropriate professional level with individuals within or outside the firm who have relevant specialized expertise.

.A37 Consultation uses appropriate research resources, as well as the collective experience and technical expertise of the firm. Consultation helps promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps promote a culture in which consultation is recognized as a strength and personnel are encouraged to consult on difficult or contentious issues.

.A38 Effective consultation on significant technical, ethical, and other matters within the firm or, when applicable, outside the firm can be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, authority, and experience

and when conclusions resulting from consultations are appropriately documented and implemented.

.A39 Documentation that is sufficiently complete and detailed of consultations with other professionals that involve difficult or contentious matters contributes to an understanding of

- the issue on which consultation was sought and
- the results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

Considerations Specific to Smaller Firms

.A40 A firm needing to consult externally may take advantage of advisory services provided by the following:

- Other firms
- Professional and regulatory bodies
- Commercial organizations that provide relevant quality control services

Before contracting for such services, consideration of the competence and capabilities of the external provider helps the firm determine whether the external provider is suitably qualified for that purpose.

Engagement Quality Control Review

Criteria for an Engagement Quality Control Review (Ref: par. .38)

.A41 The structure and nature of the firm's practice are important considerations in establishing criteria for determining which engagements are to be subject to an engagement quality control review. Such criteria may include, for example, the following:

- The nature of the engagement, including the extent to which it involves a matter of public interest
- The identification of unusual circumstances or risks in an engagement or class of engagements
- Whether laws or regulations require an engagement quality control review

Nature, Timing, and Extent of the Engagement Quality Control Review (Ref: par. .40-.41)

.A42 An engagement quality control review may include consideration of the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations
- Whether documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached

.A43 If the engagement quality control review is completed after the report is dated and identifies instances where additional procedures are needed or additional evidence is required, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional

evidence has been obtained, in accordance with the professional standards applicable to the engagement.

.A44 Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant issues to be promptly resolved to the engagement quality control reviewer's satisfaction before the report is released.

.A45 The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner.

.A46 Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review for audits, as well as reviews of financial statements and other assurance and related services engagements, include the following:

- Significant risks identified during the engagement and the responses to those risks
- Judgments made, particularly with respect to materiality and significant risks
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The matters to be communicated to management and those charged with governance and, when applicable, other parties, such as regulatory bodies

.A47 When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply.

Criteria for the Eligibility of Engagement Quality Control Reviewers

Sufficient and Appropriate Technical Expertise, Experience, and Authority (Ref: par. .42a)

.A48 What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

Consultation With the Engagement Quality Control Reviewer (Ref: par. .42b)

.A49 The engagement partner may consult the engagement quality control reviewer at any stage during the engagement (for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer). Such consultation avoids identification of differences of opinion at a late stage of the engagement and does not necessarily impair the engagement quality control reviewer's eligibility to perform the role. When the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity. When this is not possible, another individual within the firm or a suitably qualified external person may be appointed to take on the role of either the engagement quality control reviewer or the person to be consulted on the engagement.

*Objectivity of the Engagement Quality Control Reviewer (Ref: par. .43–.44)**Considerations Specific to Smaller Firms*

.A50 Suitably qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews and no person in the firm meets the eligibility requirements for an engagement quality control reviewer. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts suitably qualified external persons or other firms, the requirements in paragraphs .43–.44 and the guidance in paragraph .A49 apply.

Differences of Opinion (Ref: par. .46)

.A51 Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

.A52 Procedures to resolve such differences may include consulting with another practitioner or firm or a professional or regulatory body.

*Engagement Documentation**Completion of the Assembly of Final Engagement Files (Ref: par. .49)*

.A53 Professional standards, law, or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed. When no such time limits are prescribed, paragraph .49 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis.

.A54 When two or more different reports are issued regarding the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on financial information prepared in accordance with generally accepted accounting principles and, at a subsequent date, an auditor's report on the same financial information prepared in accordance with a special purpose framework for regulatory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation (Ref: par. .50)

.A55 Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or a legal or professional duty exists to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly when data of a personal nature are concerned.

.A56 Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, or retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that

- enable the determination of when and by whom engagement documentation was prepared or reviewed;

- protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
- prevent unauthorized changes to the engagement documentation; and
- allow access to the engagement documentation by the engagement team and other authorized parties, as necessary, to properly discharge their responsibilities.

.A57 Controls that the firm designs and implements to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include the following:

- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hard copy engagement documentation

.A58 For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In such cases, the firm's procedures designed to maintain the integrity, accessibility, and retrievability of the documentation may include requiring the engagement teams to

- generate scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references, and annotations.
- integrate the scanned copies into the engagement files, including indexing and signing off on the scanned copies as necessary.
- enable the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons for a firm to retain original paper documentation.

Retention of Engagement Documentation (Ref: par. .51)

.A59 The needs of the firm for retention of engagement documentation and the period of such retention will vary with the nature of the engagement and the firm's circumstances (for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements). The retention period may also depend on other factors, such as whether professional standards, law, or regulation prescribe specific retention periods for certain types of engagements or whether generally accepted retention periods exist in the absence of specific legal or regulatory requirements.

.A60 In the specific case of audit engagements, the retention period would be no shorter than five years from the report release date.³

.A61 Procedures that the firm may adopt for retention of engagement documentation include those that enable the requirements of paragraph .51 to be met during the retention period, such as, for example, procedures to

- enable the retrieval of, and access to, the engagement documentation during the retention period, particularly in the case of electronic documentation because the underlying technology may be upgraded or changed over time.
- provide, when necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
- enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

Ownership of Engagement Documentation

.A62 Unless otherwise specified by law or regulation, engagement documentation is the property of the firm. The firm may, at its discretion, make portions of, or extracts from, engagement documentation available to clients, provided that such disclosure does not undermine the validity of the work performed or, in the case of assurance engagements, the independence of the firm or its personnel.

Monitoring

Monitoring the Firm's Quality Control Policies and Procedures (Ref: par. .52)

.A63 The purpose of monitoring compliance with quality control policies and procedures is to assess, for the system of quality control as a whole, whether the firm is achieving the objective described in paragraph .12 through an evaluation of the following:

- Adherence to professional standards and applicable legal and regulatory requirements
- Whether the system of quality control has been appropriately designed and effectively implemented
- Whether the firm's quality control policies and procedures have been operating effectively so that reports that are issued by the firm are appropriate in the circumstances

The evaluation may identify circumstances that necessitate changes to, or improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

.A64 Ongoing consideration and evaluation of the system of quality control may include matters such as the following:

- Review of selected administrative and personnel records pertaining to the quality control elements
- Review of engagement documentation, reports, and clients' financial statements
- Discussions with the firm's personnel

³ Paragraph .17 of AU-C section 230, *Audit Documentation*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

- Determination of corrective actions to be taken and improvements to be made in the system, including providing feedback into the firm's policies and procedures relating to education and training
- Communication to appropriate firm personnel of weaknesses identified in the system, in the level of understanding of the system, or compliance with the system
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures

.A65 Monitoring procedures also may include an assessment of the following:

- The appropriateness of the firm's guidance materials and any practice aids
- New developments in professional standards and legal and regulatory requirements and how they are reflected in the firm's policies and procedures, when appropriate
- Written confirmation of compliance with policies and procedures on independence
- The effectiveness of continuing professional development, including training
- Decisions related to acceptance and continuance of client relationships and specific engagements
- Firm personnel's understanding of the firm's quality control policies and procedures and implementation thereof

.A66 Some of the monitoring procedures discussed previously may be accomplished through the performance of the following:

- Engagement quality control review
- Review of engagement documentation, reports, and clients' financial statements for selected engagements after the report release date
- Inspection procedures

Reviews of the work or report when performed by engagement team members prior to the date of the report are not monitoring procedures.

.A67 The need for, and extent of, inspection procedures depends, in part, on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

.A68 The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, such as the following:

- The size of the firm
- The number and geographical location of offices
- The results of previous monitoring procedures

- The degree of authority of both personnel and office (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them)
- The nature and complexity of the firm's practice and organization
- The risks associated with the firm's clients and specific engagements

.A69 Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

.A70 The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections.

The Relationship of Peer Review to Monitoring

.A71 A peer review does not substitute for all monitoring procedures. However, because the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

Considerations Specific to Smaller Firms

.A72 In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes review of engagement working papers, reports, and clients' financial statements by the engagement partner or other qualified personnel after the report release date. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

.A73 Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a suitably qualified external person or another firm to perform engagement inspections and other monitoring procedures.

Communicating Deficiencies (Ref: par. .55)

.A74 The reporting of identified deficiencies to individuals other than the relevant engagement partners need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper

discharge of the responsibilities of the individuals other than the engagement partners.

Complaints and Allegations

Source of Complaints and Allegations (Ref: par. .60)

.A75 Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

Investigation Policies and Procedures (Ref: par. .61)

.A76 Policies and procedures established for the investigation of complaints and allegations may include, for example, that the partner supervising the investigation

- has sufficient and appropriate experience,
- has authority within the firm, and
- is otherwise not involved in the engagement.

The partner supervising the investigation may involve legal counsel as necessary.

Considerations Specific to Smaller Firms

.A77 In the case of firms with few partners, it may not be practicable for the partner supervising the investigation not to be involved in the engagement. These small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation into complaints and allegations.

Documentation of the System of Quality Control (Ref: par. .62)

.A78 The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including the following:

- The size of the firm and the number of offices
- The nature and complexity of the firm's practice and organization

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations, and the results of monitoring inspections.

.A79 Appropriate documentation relating to monitoring includes, for example, the following:

- Monitoring procedures, including the procedure for selecting completed engagements to be inspected
- A record of the evaluation of the following:
 - Adherence to professional standards and applicable legal and regulatory requirements
 - Whether the system of quality control has been appropriately designed and effectively implemented
 - Whether the firm's quality control policies and procedures have been appropriately applied so that the reports that

are issued by the firm are appropriate in the circumstances

- Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary

Considerations Specific to Smaller Firms

.A80 Smaller firms may use more informal methods in the documentation of their systems of quality control, such as manual notes, checklists, and forms.

.A81

Exhibit—Comparison of Section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between section 10, *A Firm's System of Quality Control*, and International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and the rationale therefore. This analysis is not authoritative and is prepared for informational purposes only. It has not been acted on or reviewed by the Auditing Standards Board (ASB).

Differences in Language

The ASB has made various changes to the language throughout section 10, as compared with ISQC 1. Such changes have been made to use terms applicable in the United States and to make section 10 easier to read and apply. The ASB believes that such changes will not create differences between the application of ISQC 1 and the application of section 10.

Requirements in Section 10 Not in ISQC 1

Section 10 requires firms to establish policies and procedures providing

- in paragraph .30, for obtaining an understanding with the client regarding the nature, scope, and limitations of the services to be performed.
- in paragraph .33, that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.
- in paragraph .44, that although the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.
- in paragraph .48, that when differences of opinion exist, a member of the engagement team be able to document that member's disagreement with the conclusions reached, after appropriate consultation.

ISQC 1 does not have equivalent requirements.

Requirements in ISQC 1 Not in Section 10

Paragraph 25 of ISQC 1 requires the firm to establish policies and procedures setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time. The ASB believes that the familiarity threat should not be singled out among other threats to independence.

Paragraph 48(a) of ISQC 1 requires including, on a cyclical basis, inspection of at least one completed engagement for each engagement partner as a monitoring procedure. The ASB believes that this requirement is overly prescriptive and that a risk-based approach to inspections is more appropriate.

Requirements in ISQC 1 Revised in Section 10

Paragraph .41 of section 10 requires that when an engagement quality control review is performed, the engagement quality control review be completed before the report is released. Paragraph 36 of ISQC 1 requires that the quality control review be completed before the report is dated. The ASB believes that an engagement quality control review is an independent review of the engagement team's significant judgments, including the date selected by the engagement team to date the report. As noted in the application material to section 10, when the engagement quality control review results in additional procedures having to be performed, the date of the report would be changed.

Paragraph 48(c) of ISQC 1 requires that those performing the engagement or the engagement quality control review are not involved in inspecting the engagements. Paragraph .53c of section 10, consistent with the requirement in paragraph 100 of Statement on Quality Control Standards No. 7, *A Firm's System of Quality Control*, requires that performance of monitoring of the firm's system of quality control be assigned to qualified individuals. Paragraph .A72 of section 10 notes that in small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. The ASB concluded that it was not necessary to change existing practice because in the United States, the peer review process provides a safeguard and provides evidence that the monitoring procedures are effective.

Paragraph A49 of ISQC 1 references the requirement in paragraph 40 of ISQC 1 to establish policies and procedures to maintain the objectivity of the engagement quality control reviewer and states, "Accordingly, such policies and procedures provide...." The ASB believes that notwithstanding its placement as application material, the language is indicative of a requirement and, accordingly, has included a requirement for the provision of these specific policies and procedures in paragraph .44 of section 10. The ASB believes this will not create a difference in the application of ISQC 1 and the application of section 10.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

QM Section 20

Engagement Quality Reviews

Source: SQMS No. 2.

Effective for audits or reviews of financial statements for periods beginning on or after December 15, 2025, and other engagements in the firm's accounting and auditing practice beginning on or after December 15, 2025.

Introduction

Scope of This Statement on Quality Management Standards

.01 This section addresses the following:

- a.* The appointment and eligibility of the engagement quality reviewer
- b.* The engagement quality reviewer's responsibilities relating to the performance and documentation of an engagement quality review

.02 This section applies to all engagements for which an engagement quality review is required to be performed in accordance with Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management* (QM sec. 10), including when the firm has determined that an engagement quality review is an appropriate response to assessed quality risks.¹ This section is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements.

.03 An engagement quality review performed in accordance with this section is a specified response that is designed and implemented by the firm in accordance with SQMS No. 1.² The performance of an engagement quality review is undertaken at the engagement level by the engagement quality reviewer on behalf of the firm.

Scalability

.04 The nature, timing, and extent of the engagement quality reviewer's procedures required by this section vary depending on the nature and circumstances of the engagement or the entity. For example, for engagements involving fewer significant judgments made by the engagement team, the engagement quality reviewer's procedures would likely be less extensive.

The Firm's System of Quality Management and Role of Engagement Quality Reviews

.05 SQMS No. 1 establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to address the quality risks in a manner that is based on, and responsive to,

¹ Paragraph 35f of Statement on Quality Management Standards (SQMS) (previously Statement on Quality Control Standards) No. 1, *A Firm's System of Quality Management* (QM sec. 10).

² See footnote 1.

the reasons for the assessments given to the quality risks.³ The specified responses in SQMS No. 1⁴ include establishing policies or procedures addressing engagement quality reviews in accordance with this section.

.06 The firm is responsible for designing, implementing, and operating the system of quality management. Under SQMS No. 1, the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice⁵ that provides the firm with reasonable assurance that

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
- b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.⁶

.07 As explained in SQMS No. 1, the public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, maintaining professional skepticism.

.08 An engagement quality review is an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon. The engagement quality reviewer's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements. However, an engagement quality review is not intended to be an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements or with the firm's policies or procedures.

.09 The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not change the responsibilities of the engagement partner for managing and achieving quality on the engagement or for the direction and supervision of the members of the engagement team and the review of their work. The engagement quality reviewer is not required to obtain evidence to support the opinion or conclusion on the engagement, but the engagement team may obtain further evidence in responding to matters raised during the engagement quality review.

Authority of This SQMS

.10 This section contains the objective for the firm in following this section and requirements designed to enable the firm and the engagement quality reviewer to meet that stated objective. In addition, it contains related guidance in the form of application and other explanatory material and introductory material that provides context relevant to a proper understanding of this section

³ Paragraph 25 of SQMS No. 1.

⁴ Paragraph 35f of SQMS No. 1.

⁵ The term *auditing and accounting practice* is defined in paragraph 17 of SQMS No. 1.

⁶ Paragraph 15 of SQMS No. 1.

and definitions. SQMS No. 1⁷ explains the terms *objective*, *requirements*, *application material* and *other explanatory material*, *introductory material*, and *definitions*.

Effective Date

.11 This section is effective for

- a. audits or reviews of financial statements for periods beginning on or after December 15, 2025, and
- b. other engagements in the firm's accounting and auditing practice beginning on or after December 15, 2025.

Objective

.12 The objective of the firm, through appointing an eligible engagement quality reviewer, is to perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon.

Definitions

.13 For purposes of the SQMSs, the following terms have the meanings attributed as follows:

Engagement quality review. An objective evaluation of the significant judgments made by the engagement team, and the conclusions reached thereon, performed by the engagement quality reviewer and completed before the engagement report is released.

Engagement quality reviewer. A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

Relevant ethical requirements. Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer, when undertaking an engagement quality review, are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive. (Ref: par. .A11–.A14)

Requirements

Applying, and Complying With, Relevant Requirements

.14 The firm and the engagement quality reviewer should have an understanding of this section, including the application and other explanatory material, to understand the objective of this section and to properly apply the requirements relevant to them.

.15 The firm or the engagement quality reviewer, as applicable, should comply with each requirement of this section, unless the requirement is not relevant in the circumstances of the engagement.

⁷ Paragraphs 12 and A6–A9 of SQMS No. 1.

.16 The proper application of the requirements is expected to provide a sufficient basis for the achievement of the objective of this standard. However, if the firm or the engagement quality reviewer determines that the application of the relevant requirements does not provide a sufficient basis for the achievement of the objective of this standard, the firm or the engagement quality reviewer, as applicable, should take further actions to achieve the objective.

Appointment and Eligibility of Engagement Quality Reviewers

.17 The firm should establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual or individuals with the competence, capabilities, and appropriate authority within the firm to fulfill the responsibility. Those policies or procedures should require such individual or individuals to appoint the engagement quality reviewer. (Ref: par. .A1–.A3)

.18 The firm should establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer. Those policies or procedures should require that the engagement quality reviewer (Ref: par. .A4)

- a. not be a member of the engagement team;
- b. have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review; (Ref: par. .A5–.A10)
- c. comply with relevant ethical requirements, including those addressing threats to the objectivity and independence of the engagement quality reviewer; and (Ref: par. .A11–.A13)
- d. comply with provisions of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: par. .A14)

.19 The firm's policies or procedures established in accordance with paragraph .18c should also address threats to objectivity created by an individual being appointed as the engagement quality reviewer after previously serving as the engagement partner. (Ref: par. .A15–.A17)

.20 The firm should establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer. Those policies or procedures should require that such individuals

- a. not be members of the engagement team;
- b. have the competence and capabilities, including sufficient time, to perform the duties assigned to them; and (Ref: par. .A18)
- c. comply with relevant ethical requirements, including addressing threats to their objectivity and independence and, if applicable, the provisions of law and regulation. (Ref: par. .A19–.A20)

.21 The firm should establish policies or procedures that

- a. require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review and
- b. address the engagement quality reviewer's responsibility for determining the nature, timing, and extent of the direction and supervision of individuals assisting in the engagement quality review and the review of their work. (Ref: par. .A21)

Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review

.22 The firm should establish policies or procedures that address circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances. (Ref: par. .A22)

.23 When the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer's eligibility, the engagement quality reviewer should notify the appropriate individual or individuals in the firm and, (Ref: par. .A23)

- a. if the engagement quality review has not commenced, decline the appointment to perform the engagement quality review, or
- b. if the engagement quality review has commenced, discontinue the performance of the engagement quality review.

Performance of the Engagement Quality Review

.24 The firm should establish policies or procedures regarding the performance of the engagement quality review that address the following:

- a. The engagement quality reviewer's responsibilities to perform procedures in accordance with paragraphs .25–.26 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon
- b. The responsibilities of the engagement partner in relation to the engagement quality review, including that the engagement partner is precluded from releasing the engagement report until notification has been received from the engagement quality reviewer, in accordance with paragraph .27, that the engagement quality review is complete (Ref: par. .A24–.A26)
- c. Circumstances in which the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer and appropriate actions to take in these circumstances (Ref: par. .A27)

.25 In performing the engagement quality review, the engagement quality reviewer should do the following: (Ref: par. .A28–.A33)

- a. Read, and obtain an understanding about, information communicated by (Ref: par. .A34)
 - i. the engagement team regarding the nature and circumstances of the engagement and the entity and
 - ii. the firm related to the firm's monitoring and remediation process, in particular, identified deficiencies that may relate to, or affect, the areas involving significant judgments made by the engagement team.
- b. Discuss with the engagement partner and, if applicable, other members of the engagement team, significant matters and significant judgments made in planning, performing, and reporting on the engagement. (Ref: par. .A35–.A38)

- c. Based on the information obtained in (a) and (b), review selected engagement documentation relating to significant judgments made by the engagement team and evaluate the following: (Ref: par. .A39–.A43)
 - i. The basis for making those significant judgments, including, when applicable to the type of engagement, the maintenance of professional skepticism by the engagement team
 - ii. Whether the engagement documentation supports the conclusions reached
 - iii. Whether the conclusions reached are appropriate
- d. Evaluate the basis for the engagement partner's determination that relevant ethical requirements relating to independence, when applicable, have been fulfilled. (Ref: par. .A44)
- e. Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations. (Ref: par. .A45)
- f. For engagements conducted in accordance with generally accepted auditing standards, evaluate the basis for the engagement partner's determination that the engagement partner's involvement has been sufficient and appropriate throughout the engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. (Ref: par. .A46–.A47)
- g. Review,
 - i. for audits of financial statements, the financial statements and the auditor's report thereon, including, if applicable, the description of the key audit matters; (Ref: par. .A48)
 - ii. for reviews of financial statements or financial information, the financial statements or financial information and the review report thereon; or (Ref: par. .A48)
 - iii. for other engagements, the engagement report, and when applicable, the subject matter information. (Ref: par. .A49)

.26 The engagement quality reviewer should notify the engagement partner if the engagement quality reviewer has concerns that the significant judgments made by the engagement team, including the appropriate maintenance of professional skepticism by the engagement team when applicable to the type of engagement, or the conclusions reached thereon, are not appropriate. If such concerns are not resolved to the engagement quality reviewer's satisfaction, the engagement quality reviewer should notify the appropriate individual or individuals in the firm that the engagement quality review cannot be completed. (Ref: par. .A50)

Completion of the Engagement Quality Review

.27 The engagement quality reviewer should determine whether the requirements in this section with respect to the performance of the engagement quality review have been fulfilled and whether the engagement quality review is complete. If so, the engagement quality reviewer should notify the engagement partner that the engagement quality review is complete.

Documentation

.28 The firm should establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review. (Ref: par. .A51)

.29 The firm should establish policies or procedures that require documentation of the engagement quality review in accordance with paragraph .30 and require that such documentation be included with the engagement documentation.

.30 The engagement quality reviewer should determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing, and extent of the procedures performed by the engagement quality reviewer and, when applicable, individuals who assisted the reviewer and to understand the conclusions reached in performing the review. In doing so, the engagement quality reviewer should determine that the documentation of the engagement quality review includes the following: (Ref: par. .A52–.A54)

- a. The names of the engagement quality reviewer and any individuals who assisted with the engagement quality review
- b. An identification of the engagement documentation reviewed
- c. The basis for the engagement quality reviewer's determination in accordance with paragraph .27
- d. The notifications required in accordance with paragraphs .26–.27
- e. The date of completion of the engagement quality review

Application and Other Explanatory Material

Appointment and Eligibility of Engagement Quality Reviewers

Assignment of Responsibility for the Appointment of Engagement Quality Reviewers (Ref: par. .17)

.A1 Competence and capabilities that are relevant to an individual's ability to fulfill responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about the following:

- The responsibilities of an engagement quality reviewer
- The criteria in paragraphs .18–.19 regarding the eligibility of engagement quality reviewers
- The nature and circumstances of the engagement or the entity subject to an engagement quality review, including the composition of the engagement team

.A2 The firm's policies or procedures may specify that the individual responsible for the appointment of engagement quality reviewers not be a member of the engagement team for which an engagement quality review is to be performed. However, in certain circumstances (for example, in the case of a smaller firm or a sole practitioner), it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer.

.A3 The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm's policies or procedures may specify a different process for appointing engagement quality reviewers for audits of financial statements than for attestation examination engagements or other engagements, with different individuals responsible for each process.

Eligibility of the Engagement Quality Reviewer (Ref: par. .18)

.A4 In some circumstances, for example, in the case of a smaller firm or a sole practitioner, there may not be a partner or other individual in the firm who is eligible to perform the engagement quality review. In these circumstances, the firm may contract with, or obtain the services of, individuals external to the firm to perform the engagement quality review. An individual external to the firm may be a partner or an employee of a network firm, a structure or organization within the firm's network, or a service provider. When using such an individual, the provisions in SQMS No. 1 addressing network requirements or network services or service providers apply.

Eligibility Criteria for the Engagement Quality Reviewer

Competence and Capabilities, Including Sufficient Time (Ref: par. .18a)

.A5 SQMS No. 1 describes characteristics related to competence, including the integration and application of technical competence, professional skills, and professional ethics, values, and attitudes.⁸ Characteristics that the firm may consider in determining that an individual has the necessary competence to perform an engagement quality review include, for example, the following:

- An understanding of professional standards and applicable legal and regulatory requirements and the firm's policies or procedures relevant to the engagement
- Knowledge of the entity's industry
- An understanding of, and experience relevant to, engagements of a similar nature and complexity
- An understanding of the responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review, which may be attained or enhanced by receiving relevant training from the firm

.A6 The conditions, events, circumstances, actions, or inactions considered by the firm in determining that an engagement quality review is an appropriate response to address one or more quality risks⁹ may be important to the firm's determination of the competence and capabilities required to perform the engagement quality review for that engagement. Other considerations that the firm may take into account in determining whether the engagement quality reviewer has the competence and capabilities, including sufficient time, needed to evaluate the significant judgments made by the engagement team and the conclusions reached thereon include, for example, the following:

- The nature of the entity
- The specialization and complexity of the industry or regulatory environment in which the entity operates

⁸ Paragraph A92 of SQMS No. 1.

⁹ See footnote 8.

- The extent to which the engagement relates to matters requiring specialized expertise (for example, with respect to IT or specialized areas of accounting or auditing), or scientific and engineering expertise, which may be needed for certain assurance engagements (Also see paragraph .A19.)

.A7 In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (for example, findings from the inspection of engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.

.A8 A lack of appropriate competence or capabilities affects the ability of the engagement quality reviewer to exercise appropriate professional judgment in performing the review. For example, an engagement quality reviewer who lacks relevant industry experience may not possess the ability or confidence necessary to evaluate and, when appropriate, challenge significant judgments made and the maintenance of professional skepticism by the engagement team on a complex, industry-specific accounting or auditing matter.

Appropriate Authority (Ref: par. .18a)

.A9 Actions at the firm level help to establish the authority of the engagement quality reviewer. For example, when the firm has created a culture of respect for the role of the engagement quality reviewer, the engagement quality reviewer is less likely to experience pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In some cases, the engagement quality reviewer's authority may be enhanced by the firm's policies or procedures to address differences of opinion, which may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.

.A10 The authority of the engagement quality reviewer may be diminished when

- the culture within the firm promotes respect for authority only for personnel at a higher level of hierarchy within the firm.
- the engagement quality reviewer has a reporting line to the engagement partner, for example, when the engagement partner holds a leadership position in the firm or is responsible for determining the compensation of the engagement quality reviewer.

Relevant Ethical Requirements (Ref: par. .13 and .18c)

.A11 The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of the engagement or the entity. Various provisions of relevant ethical requirements may apply to an individual, such as an engagement quality reviewer, and not the firm itself. For example, if a firm uses an external provider to perform an engagement quality review, that individual may be subject to independence requirements; however, the independence requirements imposed on that individual as a result of performing the engagement quality review may not extend to the entire firm for which that individual works.

Threats to the Objectivity of the Engagement Quality Reviewer

.A12 Threats to the engagement quality reviewer's objectivity may be created by a broad range of facts and circumstances. Examples follow:

- A self-review threat may be created when the engagement quality reviewer previously was involved with significant judgments made by the engagement team, in particular, as the engagement partner or another engagement team member.
- A familiarity or self-interest threat may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team.
- An intimidation threat may be created when actual or perceived pressure is exerted on the engagement quality reviewer (for example, when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner).

.A13 Relevant ethical requirements may include requirements and guidance to identify, evaluate, and address threats to objectivity. They may also include provisions that address threats to independence created by long association with an audit or assurance client.

Law or Regulation Relevant to the Eligibility of the Engagement Quality Reviewer (Ref: par. .18d)

.A14 Law or regulation may prescribe additional requirements regarding the eligibility of the engagement quality reviewer. For example, the audit requirements of the FDIC regulations¹⁰ for certain financial institutions require the auditor (which includes the engagement quality reviewer) to be in compliance with the AICPA's Code of Professional Conduct and also meet the independence requirements and interpretations of the SEC and its staff.

Considerations Related to Assigning the Previous Engagement Partner as Engagement Quality Reviewer (Ref: par. .19)

.A15 In recurring engagements, the matters on which significant judgments are made often do not vary. Therefore, significant judgments made in prior periods may continue to affect judgments of the engagement team in subsequent periods. Therefore, the ability of an engagement quality reviewer to perform an objective evaluation of significant judgments is affected when the individual was previously involved with those judgments as the engagement partner. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity, in particular, the self-review threat, to an acceptable level. The following factors may be taken into consideration when designing policies or procedures to maintain the objectivity of an engagement quality reviewer who served as the engagement partner on the previous year's engagement:

- The extent of changes in the matters on which significant judgments are made and the facts and circumstances around those significant judgments compared to the period or periods in which the individual was the engagement partner. For example, if a business combination with a material effect on the financial statements has occurred, the significant judgments made in the current period may vary from those of the prior period to such an extent that an objective evaluation of those judgments could be made by the individual who served as the engagement partner in the previous period.

¹⁰ See Title 12, Chapter III, Subchapter B, Part 363.3(f) of the U.S. *Code of Federal Regulations*.

- The incentives and disincentives within the firm that may affect the objectivity of the engagement quality reviewer.

.A16 A firm may establish policies or procedures that limit the eligibility to be appointed as engagement quality reviewers of individuals who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends on the facts and circumstances of the engagement.

.A17 The firm's policies or procedures may also address whether a cooling-off period is appropriate for an individual other than the engagement partner before becoming eligible to be appointed as the engagement quality reviewer on that engagement. In this regard, the firm may consider the nature of that individual's role and previous involvement with the significant judgments made on the engagement. For example, the firm may determine that an engagement partner responsible for the performance of audit procedures on the financial information of a component in a group audit engagement may not be eligible to be appointed as the group engagement quality reviewer because of that audit partner's involvement in the significant judgments affecting the group audit engagement.

Circumstances in Which the Engagement Quality Reviewer Uses Assistants (Ref: par. .20–.21)

.A18 In certain circumstances, it may be appropriate for the engagement quality reviewer to be assisted by an individual or team of individuals. For example, assistance from individuals with highly specialized knowledge, skills, or expertise may be useful for understanding certain transactions undertaken by the entity to help the engagement quality reviewer evaluate the significant judgments made by the engagement team related to those transactions.

.A19 The guidance in paragraph .A14 may be helpful to the firm when establishing policies or procedures that address threats to objectivity of individuals who assist the engagement quality reviewer.

.A20 When the engagement quality reviewer is assisted by an individual external to the firm, the assistant's responsibilities, including those related to compliance with relevant ethical requirements, may be set out in the contract or other agreement between the firm and the assistant.

.A21 The firm's policies or procedures may include responsibilities of the engagement quality reviewer to

- consider whether assistants understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement quality review and
- address matters raised by assistants, considering their significance and modifying the planned approach appropriately.

Impairment of the Engagement Quality Reviewer's Eligibility to Perform the Engagement Quality Review (Ref: par. .22–.23)

.A22 Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review is impaired include the following:

- Whether changes in the circumstances of the engagement result in the engagement quality reviewer no longer having the appropriate competence and capabilities to perform the review

- Whether changes in the other responsibilities of the engagement quality reviewer indicate that the individual no longer has sufficient time to perform the review
- Notification from the engagement quality reviewer in accordance with paragraph .23

.A23 In circumstances in which the engagement quality reviewer's eligibility to perform the engagement quality review becomes impaired, the firm's policies or procedures may set out a process by which alternative eligible individuals are identified. The firm's policies or procedures may also address the responsibility of the individual appointed to replace the engagement quality reviewer to perform procedures sufficient to fulfill the requirements of this section with respect to the performance of the engagement quality review. Such policies or procedures may further address the need for consultation in such circumstances and may include, for example, the following:

- Evaluation of whether procedures performed by the previous engagement quality reviewer could be relied on by the newly assigned engagement quality reviewer or whether all work would need to be reperformed
- Consideration of the effect of an engagement quality review assistant on the transition, when such assistant has been involved in the engagement quality review prior to transition
- Procedures undertaken by the engagement team to inform the newly assigned engagement quality reviewer about planning meeting discussions that have already occurred and other matters in which the previous engagement quality reviewer had been involved
- Documentation of the circumstances necessitating the change

Performance of the Engagement Quality Review (Ref: par. .24–.27)

Engagement Partner Responsibilities in Relation to the Engagement Quality Review (Ref: par. .24b)

.A24 Statement on Auditing Standards (SAS) No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, (AU-C sec. 220)¹¹ establishes the requirements for the engagement partner in audit engagements for which an engagement quality review is required, including the following:

- Determining that an engagement quality reviewer has been appointed
- Cooperating with the engagement quality reviewer and informing other members of the engagement team of their responsibility to do so
- Discussing significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer

¹¹ Paragraph .36 of Statement on Auditing Standards (SAS) No. 146, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (AU-C sec. 220).

- Not releasing the auditor's report until the completion of the engagement quality review

.A25 Professional standards include requirements that address the engagement report date. When the engagement quality review is completed after the report date, there may be instances in which the date of the report is required to be changed because additional procedures are needed or additional evidence is required. In such instances, the report date is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with the professional standards applicable to the engagement. The need to change a report date may be indicative of a deficiency or deficiencies in the firm's system of quality management.

.A26 AT-C section 105, *Concepts Common to All Attestation Engagements*,¹² also establishes requirements for the engagement partner in relation to the engagement quality review.

Discussions Between the Engagement Quality Reviewer and the Engagement Team (Ref: par. .24c)

.A27 Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may assist in facilitating an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created depending on the timing and extent of the discussions with the engagement team about a significant judgment. The firm's policies or procedures may set out the actions to be taken by the engagement quality reviewer or the engagement team to avoid situations in which the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team. For example, in these circumstances, the firm may require consultation about such significant judgments with other relevant personnel in accordance with the firm's consultation policies or procedures.

Procedures Performed by the Engagement Quality Reviewer (Ref: par. .25-.27)

.A28 The firm's policies or procedures may specify the nature, timing, and extent of the procedures performed by the engagement quality reviewer and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.

.A29 The timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement or the entity, including the nature of the matters subject to the review. Timely review of the engagement documentation by the engagement quality reviewer throughout all stages of the engagement (for example, planning, performing, and reporting) allows matters to be promptly resolved to the engagement quality reviewer's satisfaction before the release of the engagement report. For example, the engagement quality reviewer may perform procedures in relation to the overall strategy and plan for the engagement at the completion of the planning phase. Timely performance of the engagement quality review may also reinforce the exercise of professional judgment and, when applicable to the type of engagement, maintenance of professional skepticism by the engagement team in planning and performing the engagement.

¹² Paragraph .45 of AT-C section 105, *Concepts Common to All Engagements*.

.A30 The nature and extent of the engagement quality reviewer's procedures for a specific engagement may depend on the following, among other factors:

- The reasons for the assessments given to quality risks,¹³ for example, engagements performed for entities in emerging industries or with complex transactions.
- Identified deficiencies, and the remedial actions to address the identified deficiencies, related to the firm's monitoring and remediation process and any related guidance issued by the firm, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer.
- The complexity of the engagement.
- The nature and size of the entity, including whether the entity is a listed entity.
- Findings relevant to the engagement, such as the results of inspections undertaken by an external oversight authority in a prior period, or other concerns raised about the quality of the work of the engagement team.
- Information obtained from the firm's acceptance and continuance of client relationships and specific engagements.
- For assurance engagements, the engagement team's identification and assessment of, and responses to, risks of material misstatement in the engagement.
- Whether members of the engagement team have cooperated with the engagement quality reviewer. The firm's policies or procedures may address the actions the engagement quality reviewer takes in circumstances in which the engagement team has not cooperated with the engagement quality reviewer, for example, informing an appropriate individual in the firm so appropriate action can be taken to resolve the issue.

.A31 The nature, timing, and extent of the engagement quality reviewer's procedures may need to change based on circumstances encountered in performing the engagement quality review.

Group Audit Considerations

.A32 The performance of an engagement quality review for an audit of group financial statements may involve additional considerations for the individual appointed as the engagement quality reviewer for the group audit, depending on the size and complexity of the group. Paragraph .21a requires the firm's policies or procedures to require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review. In doing so, for larger and more complex group audits, the group engagement quality reviewer may need to discuss significant matters and significant judgments with key members of the engagement team other than the group engagement team (for example, those responsible for performing audit procedures on the financial information of a component). In these circumstances, the engagement quality reviewer may be assisted by individuals in accordance with paragraph .20. The guidance in paragraph .A22 may be helpful when the engagement quality reviewer for the group audit is using assistants.

¹³ Paragraph A49 of SQMS No. 1.

.A33 In some cases, an engagement quality reviewer may be appointed for an audit of an entity or business unit that is part of a group, for example, when such an audit is required by law, regulation, or for other reasons. In these circumstances, communication between the engagement quality reviewer for the group audit and the engagement quality reviewer for the audit of that entity or business unit may help the group engagement quality reviewer in fulfilling the responsibilities in accordance with paragraph .21a. For example, this may be the case when the entity or business unit has been identified as a component for purposes of the group audit and significant judgments related to the group audit have been made at the component level.

Information Communicated by the Engagement Team and the Firm (Ref: par. .25a)

.A34 Obtaining an understanding of information communicated by the engagement team and the firm in accordance with paragraph .25a may assist the engagement quality reviewer in understanding the significant judgments that may be expected for the engagement. Such an understanding may also provide the engagement quality reviewer with a basis for discussions with the engagement team about the significant matters and significant judgments made in planning, performing, and reporting on the engagement. For example, a deficiency identified by the firm may relate to significant judgments made by other engagement teams for certain accounting estimates for a particular industry. When this is the case, such information may be relevant to the significant judgments made on the engagement with respect to those accounting estimates and, therefore, may provide the engagement quality reviewer with a basis for discussions with the engagement team in accordance with paragraph .25b.

Significant Matters and Significant Judgments (Ref: par. .25b–c)

.A35 For audits of financial statements, SAS No. 146¹⁴ requires the engagement partner to review audit documentation relating to significant matters¹⁵ and significant judgments, including those relating to difficult or contentious matters identified during the engagement, and the conclusions reached.

.A36 For audits of financial statements, SAS No. 146¹⁶ provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team.

.A37 For engagements other than audits of financial statements, the significant judgments made by the engagement team may depend on the nature and circumstances of the engagement or the entity. For example, in an attestation engagement performed in accordance with Statements on Standards for Attestation Engagements, the engagement team's determination of whether the criteria to be applied in the preparation of the subject matter information are suitable for the engagement may involve or require significant judgment.

.A38 In performing the engagement quality review, the engagement quality reviewer may become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team's procedures performed or the basis for conclusions reached. In those circumstances, discussions with

¹⁴ Paragraph .31 of SAS No. 146.

¹⁵ Paragraph .08c of AU-C section 230, *Audit Documentation*.

¹⁶ Paragraph .A93 of SAS No. 146.

the engagement quality reviewer may result in the engagement team concluding that additional procedures need to be performed.

.A39 The information obtained in accordance with paragraphs .25a–b, and the review of selected documentation, assists the engagement quality reviewer in evaluating the engagement team's basis for making the significant judgments. Other considerations that may be relevant to the engagement quality reviewer's evaluation include, for example, the following:

- Remaining alert to changes in the nature and circumstances of the engagement or the entity that may result in changes in the significant judgments made by the engagement team
- Applying an unbiased view in evaluating responses from the engagement team
- Following up on inconsistencies identified in reviewing engagement documentation or inconsistent responses by the engagement team to questions relating to the significant judgments made

.A40 The firm's policies or procedures may specify engagement documentation to be reviewed by the engagement quality reviewer. In addition, such policies or procedures may indicate that the engagement quality reviewer exercises professional judgment in selecting additional engagement documentation to be reviewed relating to significant judgments made by the engagement team.

.A41 Discussions about significant judgments with the engagement partner and, if applicable, other members of the engagement team, together with the engagement team's documentation, may assist the engagement quality reviewer in evaluating the maintenance of professional skepticism, when applicable to the engagement, by the engagement team in relation to those significant judgments.

.A42 For audits of financial statements, SAS No. 146¹⁷ provides examples of the impediments to the maintenance of professional skepticism at the engagement level, unconscious auditor biases that may impede the maintenance of professional skepticism, and possible actions that the engagement team may take to mitigate impediments to the maintenance of professional skepticism at the engagement level.

.A43 For audits of financial statements, the requirements and relevant application material in AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*;¹⁸ AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*;¹⁹ and other AU-C sections also provide examples of areas in an audit where the auditor maintains professional skepticism or examples of where appropriate documentation may help provide evidence about how the auditor maintained professional skepticism. Such guidance may also assist the engagement quality reviewer in evaluating the maintenance of professional skepticism by the engagement team.

¹⁷ Paragraphs .A33–.A35 of SAS No. 146.

¹⁸ Paragraph .A255 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

¹⁹ Paragraph .A11 of AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*.

Whether Relevant Ethical Requirements Relating to Independence Have Been Fulfilled (Ref: par. .25d)

.A44 SAS No. 146²⁰ requires the engagement partner, prior to dating the auditor's report, to take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled.

Whether Consultation Has Taken Place on Difficult or Contentious Matters or Matters Involving Differences of Opinion (Ref: par. .25e)

.A45 SQMS No. 1²¹ addresses consultation on difficult or contentious matters and differences of opinion within the engagement team or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management.

Sufficient and Appropriate Involvement of the Engagement Partner on the Engagement (Ref: par. .25f)

.A46 SAS No. 146²² requires the engagement partner to determine, prior to dating the auditor's report, that the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. SAS No. 146 also indicates that the documentation of the involvement of the engagement partner may be accomplished in different ways. Discussions with the engagement team, and review of such engagement documentation, may assist the engagement quality reviewer's evaluation of the basis for the engagement partner's determination that the engagement partner's involvement has been sufficient and appropriate.

.A47 SAS No. 146 is adapted, as necessary, to engagements performed in accordance with generally accepted auditing standards other than audits of financial statements. Accordingly, the requirement in paragraph .25f is applicable to those engagements.

Engagement Quality Reviewer's Review of Financial Statements and Engagement Reports (Ref: par. .25g)

.A48 For audits of financial statements, the engagement quality reviewer's review of the financial statements and auditor's report thereon is consistent with the engagement quality reviewer's understanding of those matters based on the review of selected engagement documentation and discussions with the engagement team. In reviewing the financial statements or financial information, the engagement quality reviewer may also become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team's procedures or conclusions. The guidance in this paragraph also applies to reviews of financial statements or financial information and the related engagement report.

.A49 For engagements other than audits or reviews of financial statements or financial information, the engagement quality reviewer's review of the engagement report and, when applicable, the subject matter information may include considerations similar to those described in paragraph .A46 (for example, whether the presentation or description of matters relating to the significant judgments made by the engagement team are consistent with the engagement

²⁰ Paragraph .21 of SAS No. 146.

²¹ Paragraphs 32d–e and A80–A83 of SQMS No. 1.

²² Paragraph .40a of SAS No. 146.

quality reviewer's understanding based on the procedures performed in connection with the engagement quality review).

Unresolved Concerns of the Engagement Quality Reviewer (Ref: par. .26)

.A50 The firm's policies or procedures may specify the individual or individuals in the firm to be notified if the engagement quality reviewer has unresolved concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate. Such individuals may include the individual assigned the responsibility for the appointment of engagement quality reviewers. With respect to such unresolved concerns, the firm's policies or procedures may also require consultation within or outside the firm (for example, a professional or regulatory body).

Documentation (Ref: par. .28–.30)

.A51 Paragraphs 58–61 of SQMS No. 1 address the firm's documentation of its system of quality management, which includes the firm's policies and procedures addressing engagements that are required to be subject to engagement quality reviews. This section addresses additional documentation requirements related to such policies and procedures as well as documentation requirements related to the performance of engagement quality reviews undertaken at the engagement level.

.A52 The form, content, and extent of the documentation of the engagement quality review may depend on the following factors:

- The nature and complexity of the engagement
- The nature of the entity
- The nature and complexity of the matters subject to the engagement quality review
- The extent of the engagement documentation reviewed

.A53 The performance and notification of the completion of the engagement quality review may be documented in a number of ways. For example, the engagement quality reviewer may document the review of engagement documentation electronically in the IT application for the performance of the engagement. Alternatively, the engagement quality reviewer may document the review through means of a memorandum. The engagement quality reviewer's procedures may also be documented in other ways, for example, in the minutes of the engagement team's discussions when the engagement quality reviewer was present.

.A54 Paragraph .24*b* requires that the firm's policies or procedures preclude the engagement partner from releasing the engagement report until the completion of the engagement quality review, which includes resolving matters raised by the engagement quality reviewer. Provided that all requirements with respect to the performance of the engagement quality review have been fulfilled, the documentation of the review may be finalized after the release of the engagement report but before the assembly of the final engagement file.

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PR-C Section 100

Concepts Common to All Peer Reviews

Effective for peer reviews commencing on or After May 1, 2022.

Introduction

Scope of This Section

.01 This section contains general principles and responsibilities for the AICPA Peer Review Program (the program) and applies to

- a.* firms and individuals (Ref: par. .45–.47) enrolled in the program (Ref: par. .A1),
- b.* firms and individuals who perform and report on peer reviews, and
- c.* administering entities (AEs) of peer reviews (Ref: par. .A2).

The AICPA Peer Review Board (board), among other responsibilities, determines program enrollment eligibility, peer reviewer qualifications, and who may administer the program.

.02 The AICPA Standards for Performing and Reporting on Peer Reviews (the standards) are not intended for peer reviews of

- a.* organizations that are not public accounting firms or
- b.* a firm's accounting and auditing practice applicable to engagements subject to PCAOB permanent inspection. (Ref: par. .A3)

Authorization of the Program

.03 AICPA bylaws and the AICPA Code of Professional Conduct require that members engaged in the practice of public accounting are practicing with a firm that is enrolled in an Institute-approved practice-monitoring program (AICPA Peer Review Program) if the firm

- a.* performs services within the scope of these standards and
- b.* issues reports purporting to be in accordance with AICPA professional standards.

These standards are applicable to firms and individuals engaged in the practice of public accounting in the United States or its territories. (Ref: par. .A4–.A6)

.04 These standards do not require firms that only perform preparation engagements under the Statements on Standards for Accounting and Review Services (SSARs) to enroll in the program. (Ref: par. .A7)

Relationship of Peer Review With Quality Control Standards

.05 Users of these standards should understand the quality control standards established by the AICPA. The firm's system of quality control may affect both the conduct of individual engagements and the conduct of a firm's accounting and auditing practice. However, deficiencies in or instances of noncompliance with a firm's system of quality control do not, in and of themselves, indicate

that an engagement was not performed in accordance with the requirements of the applicable professional standards. (Ref: par. .A8–.A9)

Effective Date

.06 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.07 The overall objective of the program is to promote and enhance quality in the accounting and auditing services provided by the firms (and individuals) subject to the standards, in service of the public interest. (Ref: par. .A10)

.08 There are two types of peer reviews:

- a. *System reviews.* For guidance, see section 210, *General Principles and Responsibilities for Reviewers — System Reviews*, and section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*.
- b. *Engagement reviews.* For guidance, see section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*, and section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*.

.09 Firms that perform engagements under the Statements on Auditing Standards (SASs) or *Government Auditing Standards*, examinations under the Statements on Standards for Attestation Engagements (SSAEs), or engagements under PCAOB standards as their highest level of service must have system reviews. Firms that perform services under SSARSs or services under the SSAEs not included in system reviews as their highest level of service are eligible to have engagement reviews. (Ref: par. .A11)

.10 Engagements performed under international standards should be included in the scope of a peer review. Under U.S. professional standards, the engagement should comply with elements of both the international standards and U.S. professional standards. However, the peer reviewer should test compliance with only the U.S. professional standards. Testing of compliance with any international standards is not included in the scope of the review. The peer reviewer should consult with AICPA staff for further guidance, if necessary. (Ref: par. .A12)

Definitions

.11 For the purposes of all sections of these standards, the following terms have the meanings attributed as follows:

Acceptance date. A peer review is accepted on the date the peer review committee (the committee) or report acceptance body (RAB) concludes a peer review was performed and reported on in accordance with the standards or, for *pass with deficiencies* or *fail* reports, when the reviewed firm has agreed to perform required corrective actions, if any, as a condition of acceptance. (Ref: par. .A13–.A14)

Accounting and auditing practice. A practice that performs engagements under Statements on Auditing Standards (SASs), Statements on Standards for Accounting and Review Services (SSARSs), Statements on Standards for Attestation Engagements (SSAEs), *Government Auditing Standards* (the Yellow Book) issued by the

U.S. Government Accountability Office, or PCAOB standards. Engagements covered in the scope of the program are those included in the firm's accounting and auditing practice that are not subject to PCAOB permanent inspection.

Administering entity (AE). A state CPA society, group of state CPA societies, the National Peer Review Committee (National PRC), or other entity that is approved by the board to administer the AICPA Peer Review Program.

Allegation or investigation. A formal declaration, statement, or other similar assertion, the validity of which has not been established, indicating that there may be deficiencies in the reviewed firm, reviewer, or reviewing firm's compliance with a regulatory, monitoring, or enforcement body's (regulatory body's) rules (procedures, laws, professional standards, or practices). (Ref: par. .A15)

Association of CPA firms (association). Any group, affiliation, or alliance of accounting firms. The term also applies to two or more firms or a group of firms (whether a formal or informal group) that jointly market or sell services. Firms and other entities in the association cooperate with one another to enhance their capabilities to provide professional services. (Ref: par. .A54–.A56)

Captain. The reviewer that has the ultimate responsibility for the review, including the work performed by team members.

Closing meeting. A meeting between the captain and the reviewed firm held in advance of the exit conference to discuss the review team's observations, matters, findings, deficiencies, and significant deficiencies identified; the expected report rating; and the reviewed firm's responsibilities related to such matters.

Commencement date. The earlier date of when the reviewer begins the review of engagements or when the reviewer learns information that affects the results of the current review. (Ref: par. .A16)

Completion date. For *pass* reports, the completion date is the same as the acceptance date. For *pass with deficiencies* or *fail* reports, the completion date is the date the reviewed firm has completed all required corrective actions to the satisfaction of the committee (or its designee). (Ref: par. .A14)

Compliance matter. When a firm's properly designed quality control policy or procedure does not operate as designed, as evidenced by the failure of reviewed firm personnel to comply with such system.

Consent agenda. A list of reviews, corrective actions, implementation plans, and other items that allow RAB members to vote on all items at one time without discussion; however, any RAB member may extract any item from the consent agenda for discussion and a separate vote if necessary. The following minimum criteria must be met for a review to be accepted using a consent agenda: (Ref: par. .A17)

- A report rating of *pass*
- No matters for further consideration (MFCs)
- Without reviewer performance feedback

Items related to corrective actions and implementation plans should be accepted using a consent agenda only if

- there are clearly identifiable actions or procedures that could be accepted by the technical reviewer or CPA on staff (see paragraph .08 of section 420, *Corrective Actions and Implementation Plans*),
- requests to waive corrective actions or implementation plans are specific and easy to understand, or (Ref: par. .A18)
- there is no apparent reason that requests to extend due dates should not or would not be approved by the RAB. (Ref: par. .A19)

Other items may be approved using a consent agenda if there are clearly identifiable actions that do not require discussion, assessment, or a vote by the full peer review committee.

Control risk. The risk that an engagement will not be performed or reported on in conformity with the requirements of applicable professional standards in all material respects due to a failure in the reviewed firm's system of quality control.

Corrective actions. Remedial actions prescribed by the committee, RAB, or board that should be agreed to and completed by reviewed firms or peer reviewers: (Ref: par. .A20)

- *Peer reviewers.* A remedial action prescribed by the committee or board in a performance deficiency letter that describes deficiencies in the reviewer's performance. (Ref: section 200, *General Principles and Responsibilities for Reviewers*, section 210, *General Principles and Responsibilities for Reviewers — System Reviews*, and section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*)
- *Reviewed firms.* A remedial action prescribed by the committee, RAB, or board of a reviewed firm as a condition of acceptance of a *pass with deficiencies* or *fail* peer review report in response to a deficiency or significant deficiency. A peer review with corrective actions is considered accepted the date the firm acknowledges its responsibility to complete the corrective actions. (Ref: section 300, *General Principles and Responsibilities for Reviewed Firms*, section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*, and section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*)

CPA on staff. The CPA responsible for managing the program at the AE.

Deferred acceptance. When the RAB does not have sufficient information to conclude whether the review was performed or reported on in accordance with the standards. Deferred reviews are subsequently represented to the RAB after reasons for deferral have been resolved by the reviewer or reviewed firm. (Ref: par. .A14)

Deficiency (engagement reviews). One or more matters that the review captain concludes result in an engagement that is not performed or reported on in conformity with the requirements of applicable professional standards in all material respects. Deficiencies should be documented in a peer review report with a rating of *pass with deficiencies* or *fail*. (Ref: par. .A21)

Deficiency (system reviews). When evaluating the reviewed firm's system of quality control taken as a whole, one or more matters that

the team captain has concluded could create a situation in which the reviewed firm would not have reasonable assurance of performing or reporting in conformity with the requirements of applicable professional standards in one or more important respects. Deficiencies should be documented in a peer review report with a rating of *pass with deficiencies*.

Delayed acceptance. When the RAB has sufficient information to conclude that the peer review was performed and reported on in accordance with the standards but there are minor revisions that need to be addressed prior to publicizing the results of the peer review. (Ref: par. .A13–.A14)

Design matter. When the reviewed firm's system of quality control is missing a quality control policy or procedure or the reviewed firm's existing quality control policies and procedures, even if fully complied with, would likely result in engagements not performed or reported on in accordance with professional standards.

Detection risk. The risk that the reviewer will fail to detect deficiencies or significant deficiencies in the reviewed firm's system of quality control.

Due date. The date the peer review report and all required peer review materials are to be submitted to the AE or the date all supporting documentation for corrective actions and implementation plans is to be submitted to the AE.

Engagement partner. The partner or other person in the firm who is responsible for the engagement and its performance and for the report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

Exit conference. A meeting between the captain and the reviewed firm held to discuss a summary of the peer review results, the firm responses, and the report rating.

Fair procedures. Procedures related to the potential termination of a firm's enrollment in the AICPA Peer Review Program that provide for an orderly proceeding, achieve a fair result, and adequately safeguard the rights of firms and individuals.

Familiarity threat. A risk that due to a long-standing or close personal relationship with committees, RABs, technical reviewers, peer reviewers, firms subject to peer review, or others involved in the program, the evaluating party will not exercise a proper level of objectivity.

Finding (engagement reviews). One or more matters that the review captain concludes result in an engagement not performed or reported on in conformity with the requirements of applicable professional standards. A finding should be documented as a finding for further consideration (FFC) on an FFC form.

Finding (system reviews). One or more related matters that result from a condition in the reviewed firm's system of quality control or compliance with the system such that there is more than a remote possibility that the reviewed firm would not perform or report in conformity with the requirements of applicable professional standards. A finding

should be documented as a finding for further consideration (FFC) on an FFC form.

Highest-risk areas. The account or audit areas of most importance to an engagement based on a reviewer's judgment and experience.

Implementation plan. Actions required of a reviewed firm in response to a finding included on an FFC form. (Ref: par. .A20)

Ineligible. The term used to describe a reviewer who does not meet the required qualifications and, therefore, is not approved to schedule, commence, continue to perform, or participate in a peer review for any AE. (Ref: par. .06 of section 200 and .20–.22 and .A24 of section 430)

Inherent risk. In the absence of a system of quality control, the risk of a reviewed firm's engagement not being performed or reported on in conformity with the requirements of applicable professional standards in all material respects.

Initial engagement. The first accounting or auditing service performed for a client, in a particular industry, engagement, or as a level of service for a firm.

Isolated matter. An incident (or limited incidents) of noncompliance with professional standards or the firm's quality control policies and procedures on one or more engagements (or elements of the quality control system), but the same standards or policies and procedures were complied with on the remaining selected engagements or elements. (Ref: par. .A22)

Limitation or restriction. A corrective or disciplinary action or sanction imposed on a reviewer or reviewing firm by a regulatory body. (Ref: par. .A15)

Limited restriction. Prohibits an individual from performing peer reviews in a specific capacity such as limited to a specific industry or engagement (for example, an individual is prohibited from performing employee benefit plan audits).

Matter. One or more "no" answers to questions in peer review checklists identified during a system review or an engagement review.

- *Engagement reviews.* One or more "no" answers to questions in peer review checklists that were not resolved to the review captain's satisfaction. These are documented as matters for further consideration (MFCs) on an MFC form. (Ref: sections 220 and 320)
- *System reviews.* One or more "no" answers to questions in peer review checklists that a reviewer concludes warrant further consideration in the evaluation of a firm's system of quality control. A matter should be documented as a matter for further consideration (MFC) on an MFC form. (Ref: sections 210 and 310)

Must-cover. An engagement that does not have to be selected for review, but a team member must have recent experience in the industry or level of service to aid in the risk assessment process and to determine whether that engagement should be selected for review. Appendix C, "Additional Requirements for Must-Select and Must-Cover Engagements," of section 210 contains the engagements with this designation.

Must-select. An engagement that must be included in the sample of engagements selected for review. Appendix C of section 210 contains the industries or engagements with this designation.

Nonconforming engagement. An engagement identified as not performed or reported on in accordance with the requirements of applicable professional standards in all material respects.

Oversight Task Force (OTF). The standing task force of the board responsible for establishing oversight policies and procedures to ensure that AEs are complying with the administrative procedures established by the Peer Review Board, reviews are being conducted and reported on in accordance with the standards, and the results of the reviews are being evaluated on a consistent basis in all jurisdictions. (Ref: par. .A23)

Partner. Any individual with authority to bind the firm with respect to the performance of a professional services engagement. Partners may include employees with this authority who have not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.

Peer Review Board (board). The AICPA senior technical committee that governs the Peer Review Program.

Peer review committee (committee). A group of individuals appointed by an AE to oversee the administration, acceptance, and completion of peer reviews and performance of peer reviewers.

Peer review contact. A partner of the firm designated as the liaison between the review team, AE, and the reviewed firm.

Peer reviewer (reviewer). An independent evaluator who conducts a peer review.

Peer review risk. The risk that the reviewer issues an inappropriate report on the firm's system of quality control. It is composed of inherent risk, control risk, and detection risk.

Performance deficiency. Occurs when a pattern of reviewer performance findings exists or the reviewer did not do either of the following: (Ref: par. .A24–.A25)

- a. Appropriately conclude on whether an engagement was performed or reported on in conformity with applicable professional standards in all material respects prior to technical review, oversight, or RAB consideration and did not demonstrate sufficient knowledge and experience required to review the engagement and identify issues prior to technical review, oversight, or RAB consideration
- b. Appropriately aggregate or evaluate matters noted on the review, such that the RAB determined a deficiency was present when the reviewer did not elevate the matter beyond an MFC, or the RAB determined a significant deficiency was present when the reviewer did not elevate the matter beyond an FFC

Performance deficiency letter. A letter issued to the reviewer by the committee (or its designated body) or board that requires the reviewer to complete one or more corrective actions that are intended to improve the reviewer's future performance. (Ref: par. .A25)

Performance feedback form. A form used to document reviewer performance deficiencies or findings on individual reviews. The form is issued by the committee or board to the reviewer to communicate specific areas of needed improvements based on performance that was not in accordance with program guidance. (Ref: par. .A24)

Performance finding. A situation in which the reviewer has not performed in accordance with program guidance but that does not rise to the level of a performance deficiency.

Period end. The point in time or period of time for which financial information is represented in accordance with a financial reporting framework.

Personnel. Partners and staff.

Piggyback review. The review team performs a review of one or more engagements contemporaneously with testing the reviewed firm's internal inspection procedures.

Professional judgment. The application of relevant training, knowledge, and experience, within the context provided by peer review and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of peer reviews.

Professional skepticism. An attitude that includes a questioning mind and a critical assessment of evidence.

Quality control function. Performing an engagement quality control review as part of the engagement performance element of a firm's system of quality control or supervising or performing an inspection as part of the monitoring element of a firm's system of quality control.

Reciprocal peer review. A firm performs a peer review for the firm that performed its most recent review; such reviews are not permitted.

Repeat finding, deficiency, or significant deficiency (system reviews). A finding, deficiency, or significant deficiency identified during the current review that has the same systemic cause identified in the prior review's FFC forms or report. (Ref: par. .A26)

Repeat finding or deficiency (engagement reviews). An engagement finding or deficiency that is the same as noted in the prior review. (Ref: par. .A27)

Report Acceptance Body (RAB). A group of individuals appointed by the committee who are delegated the report acceptance function on behalf of the committee.

Report ratings (engagement reviews). A peer review report can have one of three possible ratings: (Ref: par. .A28–A29)

Pass. A report with a peer review rating of *pass* is issued when the review captain concludes that nothing came to the captain's attention that caused the captain to believe that the engagements submitted for review were not performed and reported on in conformity with the requirements of applicable professional standards in all material respects.

Pass with deficiencies. A report with a peer review rating of *pass with deficiencies* is issued when the review captain concludes at least one but not all the engagements submitted for review were nonconforming.

Fail. A report with a peer review rating of *fail* is issued when the review captain concludes all the engagements submitted for review were nonconforming.

Report ratings (system reviews). A peer review report can have one of three possible ratings: (Ref: par. .A28–.A29)

Pass. The system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

Pass with deficiencies. Except for the deficiencies described, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

Fail. As a result of the significant deficiencies described, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year ended was not suitably designed or complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

Scope limitation (system and engagement reviews). Exclusions of one or more engagements or other limitations that affect the performance of a peer review. A description of any such exclusion or limitation should be described in the peer reviewer's report. (Ref: par. .A28–.A29)

Significant deficiency. One or more matters in a system review that the reviewer has concluded create a situation in which the reviewed firm's system of quality control does not provide the reviewed firm with reasonable assurance of performing or reporting in conformity with the requirements of applicable professional standards in all material respects. Significant deficiencies should be documented in a peer review report with a rating of *fail*.

Staff. Professionals, other than partners, including any specialists that the firm employs.

Surprise engagement. The engagement selection provided to the firm to mitigate the risk that the firm has not complied with the firm's policies and procedures related to timely completion of the assembly of final engagement files by engagement teams.

Suspension. Sanction imposed by an AE, AICPA staff, or the board for not cooperating that may prohibit a reviewer from being scheduled or performing reviews.

Systemic cause (system reviews). A condition in the firm's system of quality control that allowed noncompliance to occur and remain undetected.

Requirements

Defining Professional Requirements in the Standards

.12 Each PR-C section uses the following two categories of requirements, identified by specific terms, to describe the degree of responsibility it imposes on reviewers, firms, and administrators of the program:

- a. *Unconditional requirements.* The user must comply with an unconditional requirement in all cases in which such a requirement is relevant. The word "must" is used to indicate an unconditional requirement.
- b. *Presumptively mandatory requirements.* The user must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances discussed in paragraph .15. The word "should" is used to indicate a presumptively mandatory requirement.

Complying With Relevant Requirements

.13 Reviewers, firms, and administrators of the program should comply with all applicable sections of the standards. (Ref: par. .A30)

.14 Reviewers, firms, and administrators of the program should understand the entire text of a section of the standards, including its application and other explanatory material, to understand its objectives and apply its requirements properly.

Departure From a Relevant Requirement

.15 In rare circumstances, the user may judge it necessary to depart from a relevant presumptively mandatory requirement. In such circumstances, the user should perform alternative procedures to achieve the objective. The user should consult with AICPA staff or the AE prior to departing from a relevant requirement. (Ref: par. .A31)

Interpretive Peer Review Publications

.16 Reviewers, firms, and administrators of the program should consider applicable interpretive publications in the performance of peer reviews. (Ref: par. .A32)

Other Peer Review Publications

.17 In applying the peer review guidance included in an other peer review publication, the user should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the peer review. (Ref: par. .A33)

Confidentiality

.18 A peer review should be conducted in compliance with the confidentiality requirements set forth in the "Confidential Client Information Rule" (ET sec. 1.700.001) and its interpretations.

.19 Confidential information should be disclosed only as required by law, or in accordance with sections 200 and 400, (Ref: par. .A34)

- a. to anyone not involved in performing the review,
- b. to anyone not administering or carrying out the program, or
- c. for use in any way not related to meeting the objectives of the standards.

Ethical Requirements Relating to Peer Review

.20 Enrolled firms, reviewing firms, and individual CPAs within the AEs should comply with relevant ethical requirements. If circumstances come to the firm or reviewer's attention that bring into question whether independence was impaired, the AE or AICPA staff should be consulted. (Ref: par. .A35–.A38)

Professional Skepticism and Professional Judgment

.21 Professional skepticism and professional judgment should be used throughout a peer review.

Timing of Peer Reviews

.22 Firms enrolled in the program, in accordance with paragraph .03, should have a peer review once every three years of their accounting and auditing practice that covers a one-year period (peer review year). (Ref: par. .A39–.A40)

.23 A firm should enroll in the program no later than the date the firm issues the report on its first engagement within the scope of the standards (enrollment date).

.24 The firm should consult with the peer reviewer to determine its initial peer review year. The AE should be consulted when the peer review year is not the 12-month period after the report date of the initial engagement. The following should be considered to determine the peer review year: (Ref: par. .A41)

- a. The firm's practice
- b. The period ends of the firm's engagements
- c. The report dates of the firm's engagements
- d. The number and type of engagements to be encompassed in the review
- e. The requirements by any other organization for the firm to have a peer review (Ref: par. .A42)

.25 The firm's initial peer review due date should be within 18 months after the firm issues the report on its first engagement within the scope of the standards.

.26 If the firm fails to enroll by the due date described in paragraph .25, the initial peer review due date should be 90 days from the date the firm enrolled in the program.

.27 The subsequent peer review due date should be no more than 42 months from the previous peer review year-end. (Ref: par. .A43)

.28 A firm should have prior approval by the AE to change its peer review year-end. A change in peer review year-end will be applicable to current and subsequent peer reviews. (Ref: par. .A44)

.29 A firm should have prior approval by the AE to extend its peer review due date and the extension should be applicable only to the current peer review. (Ref: par. .A45)

.30 A firm should ensure that any change in the review due date or year-end approved by the AE is communicated to and recognized by any other organizations requiring it to have a peer review. (Ref: par. .A42)

.31 If a firm, having previously represented that it has no engagements within the scope of the standards, is enrolled in the program and performs its first engagement within the scope of the standards, the due date should be 18 months from that engagement's period end (18 months from the report date if it is a financial forecast, projection, or agreed-upon procedures engagement).

.32 If a firm fails to immediately notify the AE when it performs an engagement that meets the requirements of paragraphs .18–.19 of section 320, then the firm should participate in a system review with a peer review year that covers the engagement.

.33 If a firm resigns or is dropped from the program and subsequently reenrolls in the program, the firm's due date is the later of the due date originally assigned or 90 days after reenrolling.

Administration

.34 All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society; group of state CPA societies; one of the board's committees, such as the National Peer Review Committee (National PRC); or other entity (collectively hereinafter referred to as an "administering entity" or "AE") approved by the board to administer peer reviews. (Ref: par. .A46)

.35 Firms are required to have their reviews administered by the National PRC if they meet any of the following criteria: (Ref: par. .A47)

- a. The firm performed or "played a substantial role in" (as defined by the PCAOB) an engagement under PCAOB standards with a period end during the peer review year.
- b. The firm is a provider of quality control materials (QCM) (or is affiliated with a provider of QCM) that are used by firms that it peer reviews.

Peer Review Documentation and Retention Policy

.36 The reviewer should prepare peer review documentation with enough detail to enable an experienced peer reviewer having no previous connection with the review to understand the following:

- a. The documentation's purpose, source, and the conclusions reached
- b. Evidence of the work performed
- c. That the reviewer complied with these standards
- d. That the basis for the reviewer's conclusions is supported

.37 Reviewers and technical reviewers should use the materials and checklists developed and issued by the board to meet the requirements of the program.

.38 If the reviewer determines additional materials and checklists not issued by the board are needed to complete a review, the other materials and checklists must

- a.* include the same elements and be more comprehensive than those versions issued by the board and
- b.* be approved by the AE prior to commencement of the review.

.39 Peer review documentation submitted to the AE should be in electronic format as prescribed by the AICPA.

.40 Peer review documentation should not be retained by the reviewer or AE for an extended period after the peer review's completion, except for certain documents that are retained until the subsequent peer review's acceptance and completion. Refer to section 200, *General Principles and Responsibilities for Reviewers*, and section 400, *General Principles and Administration Responsibilities*, for specific document-retention requirements for reviewers and administrators, respectively. (Ref: par. .A48–.A49)

Oversight

.41 Peer reviews, reviewed firms, and reviewers are subject to oversight by the AE and the board to ensure compliance with and consistent application of the standards. (Ref: par. .A50)

.42 AEs are subject to oversight by the board and other bodies agreed upon by the board.

Disagreements

.43 If a disagreement arises between any parties to a peer review that cannot be resolved through other means, the disagreeing parties should consult with their AE, and if necessary, request that a panel of the AE's peer review committee members resolve the disagreement. The panel must reach a decision to resolve the disagreement. (Ref: par. .06 of section 400)

.44 If any of the disagreeing parties believe a review of the panel's decision is warranted, they should request an appeal by writing to the board and explaining the reasons a review of the panel's decision is warranted. A panel formed by the board will review and consider the request and take further action pursuant to fair procedures that it has established.

Individual Enrollment When a Firm Is Without CPA-Majority Ownership

.45 An individual CPA should enroll if the CPA (Ref: par. .A5 and .A51)

- a.* practices in a firm not eligible to enroll (Ref: par. .A52) and
- b.* performs compilations of financial statements in accordance with the SSARS.

.46 An individual enrolled in the program should have an engagement review in accordance with these standards. Peer review documentation should be tailored to reflect that an individual, not a firm, is being peer reviewed. (Ref: par. .A53)

.47 If an individual enrolled in the program meets the reviewer qualifications in paragraph .05 of section 200, the individual would be the reviewer (not the firm ineligible to enroll) and that fact should be made evident throughout the review.

Associations of CPA Firms

.48 For a member firm of an association of CPA firms (association) to conduct peer reviews of another association member firm enrolled in the program, in addition to the peer review independence requirements, the association and its member firms must meet all the following independence criteria:

- a. The association, as distinct from its member firms, does not perform any professional services other than those it provides to its member firms or affiliates. (Ref: par. .A54)
- b. The association does not make representations regarding the quality of professional services performed by its member firms to assist member firms in obtaining engagements unless the representations are objective or quantifiable. (Ref: par. .A55)
- c. Referral or participating work among member firms is arranged directly by the firms involved.

.49 For a member firm of an association to conduct a peer review of another association member firm enrolled in the program, the association must submit an Association Information Form (AIF) to, and obtain approval from, the board or its designee prior to any aspect of the review being planned, scheduled, or performed. All review teams must still be approved by the AE. (Ref: par. .A56)

.50 In an association-formed review team, the captain should be from an association member firm.

.51 An association-formed review should be performed in accordance with these standards. Additionally, the peer review report should be issued on the letterhead of and signed by the captain's firm (not the association).

.52 An association of CPA firms cannot be a network, as defined by the "Network and Network Firms" interpretation (ET sec. 1.220.010) under the "Independence Rule," and conduct peer reviews of another association member firm. A network firm is not independent with respect to other firms in the same network.

.53 Whether an association is a network and whether an entity is a network firm should be applied consistently by all members of the association.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 A reference to a *firm* or *firms* includes individuals enrolled in the program.

.A2 The program may not be administered by any entity without written permission from the board.

.A3 For purposes of the program, the board determines which engagements meet the criteria to be considered subject to PCAOB permanent inspection. Currently, this includes audits of SEC issuers and the audits and related compliance and exemption engagements for broker-dealers registered with the SEC or dually registered with both the SEC and Commodity Futures Trading Commission (CFTC). Securities Investor Protection Corporation (SIPC) agreed-upon procedures engagements for SEC registered broker-dealers and audits of broker-dealers only registered with the CFTC are in the scope of the program.

Authorization of the Program (Ref: par. .03–.04)

- .A4 A firm does not need to have any AICPA members to enroll in the program.
- .A5 If authorized by Council, an individual member may enroll in the program if the firm is not eligible to enroll in the program. A CPA practicing in such a firm may enroll in certain circumstances as outlined in paragraphs .45–.47.
- .A6 Specifically, these requirements are located in AICPA BL section 220, *Requirements for Admission to Membership*, and BL section 230, *Requirements for Retention of Membership*, (BL sec. 2.2.3 and 2.3.4, respectively) and the "Form of Organization and Name Rule" (ET sec. 1.800.001) of the AICPA Code of Professional Conduct.
- .A7 A firm that performs only preparation engagements under the SSARs may be required to enroll in the program by a regulatory body, for example, for licensing.

Relationship of Peer Review With Quality Control Standards (Ref: par. .05)

- .A8 Quality control systems, policies, and procedures are the responsibility of the firm in conducting its accounting and auditing practice. Under QM section 10A, *A Firm's System of Quality Control*, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that
- a. the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and
 - b. reports issued by the firm are appropriate in the circumstances.
- .A9 The nature and extent of a firm's system of quality control depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

Objectives (Ref: par. .07–.10)

- .A10 The objective of the program is achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice.
- .A11 The type of peer review is determined based on the engagements performed as the firm's highest level of service, as shown in the following chart:

<i>Engagements as the Firm's Highest Level of Service</i>	<i>System Review</i>	<i>Engagement Review</i>
Statements on Auditing Standards (SASs)		
Engagements	X	
Government Auditing Standards (GAS)		
Financial audits	X	
Attestation engagements (examination, review, or agreed-upon procedures under GAS)	X	
Performance audits	X	

(continued)

<i>Engagements as the Firm's Highest Level of Service</i>	<i>System Review</i>	<i>Engagement Review</i>
Statements on Standards for Attestation Engagements (SSAEs)		
Examination engagements	X	
Review engagements		X
Agreed-upon procedures engagements		X
PCAOB Standards		
Audits	X	
Statements on Standards for Accounting and Review Services (SSARSs)		
Reviews of financial statements		X
Compilation engagements		X
Preparation of financial statements engagements		X

If a firm is required to have a system review, all the engagements listed in the preceding table would be subject to selection for review based on periods ending during the year under review, except for financial forecasts, projections, and agreed-upon procedures engagements. Financial forecasts, projections, and agreed-upon procedures engagements with accountant's report dates during the year under review would be subject to selection.

.A12 The International Auditing and Assurance Standards Board (IAASB) is not currently recognized by AICPA Council to promulgate technical standards (nor is the International Public Sector Accounting Standards Board); therefore, compliance with auditing, review, or other assurance or related services standards issued by the IAASB, or any other audit or assurance standards outside of the United States, is not included in the scope of peer review.

Definitions (Ref: par. .11)

.A13 Implementation plans do not affect the acceptance or completion date of a review.

.A14 The committee or RAB may require revisions to peer review documents. In those situations, the review is not considered accepted until the revisions have been made to the satisfaction of the committee or RAB (or its designee).

.A15 Regulatory bodies may include, but are not limited to, the following:

- a. The AICPA or state CPA society ethics committees
- b. The AICPA Joint Trial Board
- c. State boards of accountancy
- d. The SEC
- e. The PCAOB
- f. The Department of Labor
- g. The Department of Health and Human Services
- h. Other governmental agencies or other organizations that have the authority to regulate accountants (in connection with engagements within the firm's accounting and auditing practice)

.A16 Indications of when a reviewer has learned information that affects the results of the review include, but are not limited to, the following examples:

- a. A reviewer identifies a design deficiency in the firm's system of quality control.
- b. A reviewer learns about the firm's noncompliance with state board of accountancy licensing requirements.

.A17 An AE may have more restrictive consent agenda criteria or may choose not to utilize a consent agenda.

.A18 Requests to waive corrective actions that are specific and easy to understand include, for example, when a firm is asked to join an Audit Quality Center but represents it has given up those engagements.

.A19 Requests to extend due dates where there is no reason to believe the extension should not or would not be approved by the RAB include situations such as a request for a 30-day extension after being granted a 90-day extension because the managing partner has been in the hospital.

.A20 Firm and outside parties may utilize guidance in section 420, appendix A, "Guidance for Outside Parties Engaged to Assist Firms in Completing Corrective Actions and Implementation Plans," to assist in completing corrective actions and implementation plans.

.A21 "In all material respects" is a matter of professional judgment and is entity-specific based on size or nature, or both. Materiality is described as follows: Misstatements, including omissions, are material if there is substantial likelihood that, individually or in the aggregate, they would influence the judgment of a reasonable user made based on the financial statements.

.A22 More than one incident of noncompliance may still be considered isolated if the reviewer is able to conclude there is no systemic cause and such instances of noncompliance are insignificant to the reviewer's evaluation of the firm's system of quality control.

.A23 The board may appoint subcommittees and task forces to assist the board in carrying out its responsibilities. The work of the subcommittees and task forces is subject to review by the board. For example, the OTF may be delegated the responsibility to issue reviewer performance deficiency letters and the evaluation of reviewer removal recommendations.

.A24 Refer to section 430, *Reviewer Monitoring and Performance*, for examples of reviewer performance findings and deficiencies that may be communicated to the reviewer on a performance feedback form.

.A25 A performance deficiency letter can be issued for a pattern of reviewer performance findings, reviewer performance deficiencies, egregious reviewer performance, or significant failures to timely submit documents when there is no evidence of improvement after the suspension for timeliness is lifted.

.A26 The words used to describe the systemic cause are not indicative of whether it is a repeat finding, deficiency, or significant deficiency, and professional judgment will be used to conclude whether the systemic cause is repeated.

.A27 As an example, omitting the exact same disclosure in an engagement selected in the previous peer review and in an engagement selected in the current peer review would constitute a repeat finding or deficiency. Omitting one disclosure in an engagement selected in the previous peer review and omitting an entirely different disclosure in an engagement selected in the current peer review would not constitute a repeat finding or deficiency.

.A28 In the event of a scope limitation, a report with the applicable peer review rating (with a scope limitation) is issued.

.A29 The review captain should not expand the scope beyond the original selection of engagements in an effort to change the conclusion from a peer review rating of *fail*.

Complying With Relevant Requirements (Ref: par. .13–.14)

.A30 The board may, at its discretion, modify the standards and related guidance without an exposure period if the circumstances warrant such action. In these circumstances, the board will discuss such modifications during meetings open to the public and will communicate any recommended courses of action to firms, reviewers, and AEs on a timely basis.

Departure From a Relevant Requirement (Ref: par. .15)

.A31 The need for a user to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in that specific circumstance, the required procedure would be ineffective in achieving the objective.

Interpretive Peer Review Publications (Ref: par. .16)

.A32 Interpretive publications are not standards. Interpretive publications are recommendations on the application of the standards in specific circumstances. An interpretive publication is issued under the authority of the board only after all members of the board have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the standards. Examples of interpretive publications are application and other explanatory material, appendixes, and exhibits to the standards, which are included within these PR-C sections.

Other Peer Review Publications (Ref: par. .17)

.A33 Other peer review publications, such as reviewer alert articles, are nonauthoritative; however, they may help the user understand and apply the standards.

Confidentiality (Ref: par. .18–.19)

.A34 Information concerning the reviewed firm or any of its clients or personnel that is obtained through the review is confidential.

Ethical Requirements Relating to Peer Review (Ref: par. .20)

.A35 Ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.

.A36 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

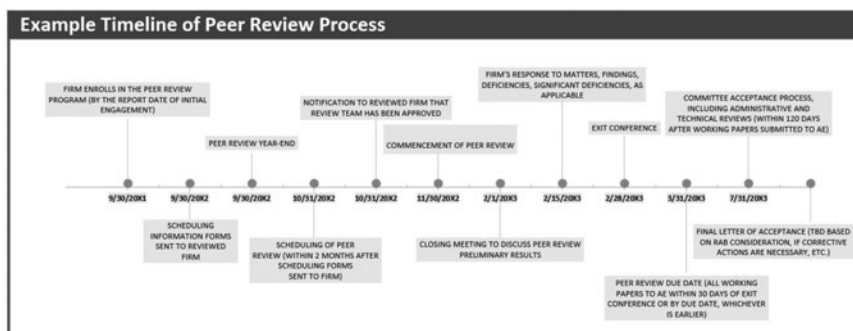
- a. Responsibilities
- b. The public interest
- c. Integrity
- d. Objectivity and independence
- e. Due care
- f. Scope and nature of services

.A37 In the case of a peer review, it is in the public interest and, therefore, required by this section that the reviewer and any other individuals who participate on the peer review be independent of the reviewed firm. The concept of independence refers to both independence in fact and independence in appearance. *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to the reviewed firm but also to those who may use the peer review report. *Integrity* requires the reviewer to be honest and candid within the constraints of the reviewed firm's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a reviewer's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Guidance on threats to independence is set forth in the AICPA's "Conceptual Framework for Independence" (ET sec. 1.210.010).

.A38 Due care, as addressed by the "Due Care" principle (ET sec. 0.300.060), requires all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner.

Timing of Peer Reviews (Ref: par. .22–.33)

.A39 The following timeline provides an example of various steps in the peer review process.



.A40 Ordinarily, a peer review is performed within three to five months following the peer review year-end.

.A41 Ordinarily, the initial peer review year is the 12-month period after the report date of the initial engagement performed by the firm within the scope of the standards.

.A42 Organizations that may require a peer review include, but are not limited to, state boards of accountancy, the Government Accountability Office, and other regulators.

.A43 Ordinarily, a firm should maintain the same peer review year-end for subsequent reviews.

.A44 AEs will consider factors including, but not limited to, those described in paragraph .24 when a firm has requested a change in its peer review year. AEs will not approve a change in peer review year that would have a public interest concern, such as when a must-select engagement would be excluded from the scope of the peer review.

.A45 An AE will ordinarily approve a review due date extension of three months or less. If a firm's peer review is subject to oversight, the AE may approve an extension of up to six months.

Administration (Ref: par. .34–.35)

.A46 AEs approved by the board are authorized to establish dues or registration fees within their individual jurisdictions to fund the administration of the program.

.A47 Firms that are not required to have their review administered by the National PRC may choose to do so.

Peer Review Documentation and Retention Policy (Ref: par. .36–.40)

.A48 The AICPA or an AE may retain peer review documentation beyond the retention requirements if such documentation is needed to comply with peer review standards and guidance. For example, the peer review report may be retained in order to track the number of consecutive non-pass peer review reports a firm has received.

.A49 The AICPA may retain data derived from peer review documentation beyond the retention requirements to monitor trends in peer reviews, facilitate research, and otherwise promote quality in the accounting and auditing services provided by CPA firms. Any such data provided to others will exclude firm-identifying information (for example, firm name, location, and employer identification number) that could link the data back to a firm, firm's client, review, or reviewer. This data may be provided to parties outside of the AICPA only with the firm's consent. The AICPA will describe the nature of the data that may be shared and the reason behind the request when asking for consent from firms.

Oversight (Ref: par. .41–.42)

.A50 The objectives of oversight are to enhance quality in accounting and auditing by providing reasonable assurance of compliance with and consistent application of the standards throughout the program. The board may appoint other individuals or bodies to perform oversight at its discretion.

Individual Enrollment When a Firm Is Without CPA-Majority Ownership (Ref: par. .45–.47)

.A51 An individual enrolled in the program is provided fair procedures related to hearings and appeals established by the board equivalent to those provided to enrolled firms.

.A52 A firm or organization without CPA-majority ownership (a non-CPA-owned entity) would not be eligible to enroll in the program. The characteristics of such a firm are discussed in appendix B, "Council Resolution Concerning the Form of Organization and Name Rule," of the Code of Professional Conduct.

.A53 An individual enrolled in the program may choose to have a system review.

Associations of CPA Firms (Ref: par. .48–.53)

.A54 For purposes of this requirement, *professional services* include accounting, tax, personal financial planning, litigation support, and professional services for which standards are promulgated by bodies designated by AICPA Council.

.A55 Member firms may independently publicize their membership in the association. In addition, an association may respond to inquiries and prepare promotional materials that firms may use to obtain professional engagements on their own behalf.

.A56 The AIF contains questions regarding general information about the association, independence matters, and whether the association requests to be approved to assist its members in the formation of review teams, provide technical assistance to such review teams, or do both. The National PRC is currently designated by the board to consider all AIFs for approval, regardless of whether an association has any firms whose peer reviews are administered by the National PRC.

PR-C Section 200

General Principles and Responsibilities for Reviewers

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains general principles and responsibilities for reviewers. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*.

Effective Date

.02 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.03 The objective of the reviewer is to perform a peer review in accordance with the Standards for Performing and Reporting on Peer Reviews (the standards) established by the Peer Review Board (the board) of the American Institute of Certified Public Accountants to enhance the effectiveness of and contribute to the quality of our profession.

Definitions

.04 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Reviewer Qualifications

.05 To qualify as a reviewer, CPAs should consider whether their day-to-day involvement in their firm's accounting and auditing practice is sufficiently comprehensive to enable them to perform a peer review with professional expertise. At a minimum, a reviewer should meet the following qualifications: (Ref: par. .A1)

- a. Be a member of the AICPA in good standing, licensed to practice as a CPA, and employed by or an owner of a firm enrolled in the program. (Ref: par. .A2)
- b. Be in public practice as a partner, manager, or person with equivalent responsibilities in the accounting or auditing practice or carrying out a quality control function in the CPA's firm. (Ref: par. .A3)

- c. Have current practice experience by performing or supervising accounting or auditing engagements in the CPA's firm or carrying out a quality control function in the firm, with reports dated within the last 18 months. (Ref: par. .A4)
- d. Have spent the last five years in the practice of public accounting in the accounting or auditing function.
- e. Be employed by or be the owner of a firm that has received a report with a peer review rating of *pass* or *pass with scope limitations* for its most recent peer review. (The report should have been accepted timely.) (Ref: par. .A5–.A6)
- f. Possess current knowledge of professional standards and experience related to the kind of practice and the industries of the engagements to be reviewed. (Ref: par. .A7)
- g. Obtain at least 48 hours of AICPA-required continuing professional education (CPE) every 3 years in subjects relating to accounting, auditing, and quality control with a minimum of 8 hours in any 1 year.
- h. Be free of restrictions from regulatory or governmental bodies on the CPA's ability to practice public accounting. (Ref: par. .A8)
- i. Provide qualifications and experience via a reviewer resume.

.06 Reviewers should not commence, continue to perform, or participate in a peer review if they do not possess all necessary qualifications, and should refrain from these activities until it has been determined they are qualified according to paragraph .05. (Ref: par. .A9–.A10 and .A24 of section 430)

.07 Reviewers should notify their administering entity (AE) or AICPA staff when they do not meet the qualifications in paragraph .05. If an AE or AICPA staff contact the reviewer to validate the reviewer's qualifications, the reviewer should respond to the communication within the specified time. (Ref: par. .A11)

.08 In order to be qualified as captain for a peer review of a firm whose review is required to be administered by the National Peer Review Committee (PRC), a captain should currently be employed by or be an owner of a firm whose most recent review was administered by the National PRC. (Ref: par. .A12–.A13)

Reviewer Allegations, Investigations, Limitations, or Restrictions

.09 Reviewers and reviewing firms should notify the relevant AE of communications from regulatory, monitoring, or enforcement bodies in the conduct of engagements in a firm's accounting and auditing practice performed by the reviewer. Notification should happen prior to being scheduled to perform a peer review or immediately, if already scheduled to perform a peer review. (Ref: par. .A14–.A15)

.10 Reviewers and reviewing firms should notify AICPA staff and all relevant AEs of any limitations or restrictions on the reviewer's or reviewing firm's ability to practice or perform peer reviews. Notification should happen prior to being scheduled to perform a peer review or immediately, if already scheduled to perform a peer review. (Ref: par. .A16–.A18)

.11 A reviewer does not meet the required qualifications described in paragraph .05 if the reviewer's ability to practice public accounting or perform peer reviews has been restricted by a regulatory, monitoring, or enforcement body, beginning on the date that the reviewer is notified of the restriction and ending on the date that the restriction has been removed.

.12 If a limited restriction is imposed on a reviewer, the extent of the limited restriction should determine whether the reviewer still meets the qualifications. (Ref: par. .A19)

Reviewer Resume

.13 Reviewer resumes should be updated at least annually to accurately reflect reviewer qualifications and experience. (Ref: par. .A20)

.14 The reviewer's resume should provide the following information for the AE to determine if the reviewer has current or recent experience by level of service, engagement, and industry: (Ref: par. .A21–.A22)

- a. Whether the reviewer was performing, supervising, or carrying out a quality control function
- b. The date of the last report for the engagement the reviewer was involved in
- c. The approximate number of engagements the reviewer was involved in
- d. Whether the reviewer currently meets relevant industry-specific educational requirements
- e. Whether experience was obtained from the reviewer's firm or another firm (Ref: par. .A23)

.15 The reviewer resume should communicate if the reviewer, the reviewer's firm, or a firm the reviewer has obtained industry experience from has received communications relating to allegations or investigations or has been restricted.

Ethical Requirements Relating to a Peer Review

.16 The reviewer must be independent from the reviewed firm. The reviewer's independence would be considered impaired in the following circumstances:

- a. A reviewer or a reviewer's firm participates in a reciprocal peer review. (Ref: par. .A24)
- b. A reviewer who owns securities or has an interest in a reviewed firm's client reviews an engagement of that client.
- c. A reviewer who was directly involved in the development, maintenance, or distribution of the reviewed firm's quality control materials; reports to those who were directly responsible for the development, maintenance, or distribution of the materials; or receives more than a *de minimus* amount of revenues or other monies generated by the sale of the materials, reviews an engagement performed and reported on using those materials.
- d. Fees for any products or services provided or shared between firms are material to any party to the peer review. (Ref: par. .A25)
- e. Products or services provided to or shared by the reviewed firm are an integral part of the reviewed firm's system of quality control. (Ref: par. .A26–.A27)
- f. The reviewing firm performed the monitoring of the reviewed firm's accounting and auditing practice or pre- or post-issuance reviews of engagements with periods ending during (or, for financial forecasts, projections, or agreed-upon procedures engagements, report dates in) the year immediately preceding or during the peer review year.

.17 The effect on independence of family and other relationships and the possible resulting loss of the appearance of independence should be considered when assigning reviewers to engagements.

.18 Reviewers have no responsibility to detect illegal acts that have either a direct or indirect effect on the firm's ability to practice public accounting. If a reviewer comes across an illegal act during a review, the reviewer should consult with AICPA staff and should consider consulting with an attorney.

Performing a Peer Review

.19 Before agreeing to perform a peer review, a reviewer should do the following:

- a. Obtain and consider information about the firm to be reviewed, including size, nature of practice, industry specializations, and levels of service. (Ref: par. .A28)
- b. Assess the reviewer's own capability and availability to perform the peer review.
- c. Consider the review due date to account for adequate time to assess appropriate responses. (Ref: par. .A29)
- d. Consider the need for additional reviewers with appropriate levels of expertise and experience to perform the review.
- e. Consider the need for individuals with expertise in specialized areas to assist in a consulting capacity. (Ref: par. .A30)

.20 Reviewers should not have contact with any client of the reviewed firm in connection with the peer review without prior approval of the firm and client.

Reviewed Firm Acquisition or Divestiture

.21 If a firm has had an acquisition of another practice or a portion thereof or a divestiture of a significant portion of its practice during or subsequent to its peer review year, the reviewer or the reviewed firm should consult with the AE and AICPA staff prior to the commencement of the review to consider the appropriate scope of the review or other actions that should be taken. (Ref: par. .A31)

Creating a Review Team

.22 A captain should assemble a review team of one or more individuals depending on the size and nature of the reviewed firm's practice and other factors.

.23 A captain should ensure that all team members possess the necessary qualifications and competencies to perform assigned responsibilities and that team members are adequately supervised.

.24 All members of the review team should be approved by the AE prior to the commencement of the peer review. (Ref: par. .A32)

Obtaining Written Representations

.25 The captain should request written representations from members of management of the firm whom the captain believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control. (Ref: par. .A33–.A34)

.26 The written representations should be in the form of a representation letter on firm letterhead, addressed to the captain, and signed by a member of

management, as described in paragraph .25, as of the date of the peer review report. (Ref: par. .A35)

.27 If a representation made by management is contradicted by other information obtained, the captain should investigate the circumstances and consider the reliability of the representations made and any effect on the report.

Reviewer's Performance and Cooperation

.28 The captain should do the following:

- a. Supervise, perform, and report on the review in accordance with the standards.
- b. Accept responsibility for the work of team members, including specialists. (Ref: par. .A36–.A37)
- c. Communicate the review results to the reviewed firm and to the AE.
- d. Ensure that peer review documentation is complete and submitted to the AE on a timely basis. (Ref: par. .A38)

.29 If a reviewer does not cooperate by performing the review in a timely and professional manner in accordance with the requirements of the standards, the AE or AICPA staff should communicate the failure to the reviewer, and it may result in a suspension or removal from the list of qualified peer reviewers. The reviewer should respond to the communication within the specified time. (Ref: par. .A39–.A40)

.30 Peer review documentation should be retained by the review team until 120 days after the peer review is completed.

Reviewer Performance Findings and Deficiencies

.31 A reviewer's performance is evaluated by the committee or Report Acceptance Body (RAB), AICPA staff, and the board. If a reviewer's work exhibits performance findings or deficiencies, the reviewer should correct areas of non-compliance that are identified by the committee or RAB on a reviewer performance feedback form. (Ref: par. .A41)

.32 If a reviewer notifies an AE that performance findings or deficiencies are present on reviews that the reviewer submitted, and those reviews have not yet been subject to technical review, the reviewer should make the appropriate corrections on those reviews. If the reviewer corrects the noncompliance, then the reviewer should not receive a reviewer performance feedback form.

.33 If a reviewer exhibits a pattern of performance findings or has more than one reviewer performance deficiency, the committee (or its designated body) or board should consider whether it is appropriate to issue a performance deficiency letter requiring the reviewer to complete one or more corrective actions. Those actions are applicable to the reviewer's participation in the performance of any peer review and, therefore, are recognized by all AEs. (Ref: par. .A42)

.34 The committee (or its designated body) or board that issued the performance deficiency letter will determine when a corrective action is no longer required. To assist the committee (or its designated body) or board in making this determination, the reviewer should provide evidence that supports the reviewer's remediation of the related performance deficiency for each corrective action to the AE or board. (Ref: par. .A43)

.35 If a reviewer fails to correct reviewer performance deficiencies after a corrective action has been required, refuses to cooperate with the committee

(or its designated body) or board (for example, by not signing the performance deficiency letter within 30 days), or has committed egregious acts in the performance of a peer review, the committee (or its designated body) should recommend to the board that the reviewer be prohibited from performing peer reviews in the future. (Ref: par. .A41 and .A44–.A45)

Reviewer Appeals

.36 A reviewer should provide a written appeal to the board, within 30 days of receipt of the communication, explaining why the reviewer believes the deficiencies, actions, or decisions are unwarranted if the reviewer disagrees with any of the following: (Ref: par. .A41)

- a. Performance deficiencies communicated on a performance deficiency letter
- b. Corrective actions required by the committee (or its designated body) or board
- c. Decisions related to being deemed ineligible to perform reviews
- d. Other actions imposed on the reviewer by the committee (or its designated body) or board

.37 The corrective actions imposed by the committee (or its designated body) or board should remain in effect on the reviewer during the appeals process and should remain in effect until the committee (or its designated body) or board concludes otherwise.

.38 If a reviewer's firm has experienced a natural disaster or other catastrophic event that directly affects its ability to comply with requirements of the standards, the reviewing firm should communicate this information to the reviewed firm and AE as soon as possible. Contacting the reviewed firm and the AE is especially important when the peer review has commenced but the reviewing firm has doubts about its ability to complete the review. In response to natural disasters and other catastrophic events, the board will evaluate the facts and circumstances and communicate recommended courses of action to AEs. Refer to section 430, *Reviewer Monitoring and Performance*, for factors that the AE will consider when determining the best course of action.

Application and Other Explanatory Material

Reviewer Qualifications (Ref: par. .05–.08)

.A1 In rare circumstances, an exception may be approved by the AICPA prior to commencement of the peer review. The request must be made in writing and should thoroughly explain why the exception should be approved.

.A2 CPA license mobility may not be recognized for peer review purposes in certain states. Therefore, the reviewing firm and reviewers may be required to obtain applicable licenses in the state licensing jurisdiction of the reviewed firm.

.A3 A manager or person with equivalent responsibilities is a professional employee of the firm who has either a continuing responsibility for the overall planning and supervision of engagements for specified clients or authority to determine that an engagement is complete subject to final partner approval, if required.

.A4 A reviewer who becomes employed by or an owner of a newly formed firm (or a firm that has not had a peer review) may continue to serve in the same

capacity as a reviewer during an 18-month transition period, as long as the reviewer meets the other requirements in paragraph .05. The transition period begins with the earlier of the date of disassociation from the previous firm or the date the reviewer becomes employed by or an owner of a new firm. After the 18-month transition period, the reviewer's current experience is dependent on the practice composition of the new firm. A reviewer employed by or owner of a firm without any engagements subject to peer review, even if actively pursuing or with a signed engagement letter, does not meet current practice experience.

.A5 The requirement of having received a report with a peer review rating of *pass* or *pass with scope limitations* for its most recent peer review, that was accepted timely, is applicable to any firm through which a reviewer receives the necessary qualifications.

.A6 The AE will determine if the report has been accepted timely.

.A7 Current knowledge may be obtained from on-the-job training, training courses, or a combination of the two.

.A8 If a restriction is imposed on the reviewer's firm, the Oversight Task Force (OTF) will determine the impact to the individual's ability to qualify as a reviewer.

.A9 When a reviewer does not meet the required qualifications, the reviewer may not participate in the performance of peer reviews or serve as a PRC or RAB member.

.A10 If a reviewer performed a peer review while ineligible, the PRC of the AE may decide to perform oversight at the reviewer's expense or consider other appropriate measures. If the review has already been accepted, the committee may consider recalling the previously accepted peer review documents. This could put the reviewed firm in jeopardy of its practice unit or firm license in states where the firm is licensed.

.A11 The specified time may be different based on the circumstances of the request. Refer to section 400, *General Principles and Administration Responsibilities*, for details related to an AE's ineligibility process.

.A12 If a firm elects, but is not required, to have its peer review administered by the National PRC, the captain does not have to be employed by or be an owner of a firm whose most recent review was administered by the National PRC.

.A13 For other requirements for a captain in a system review, see section 210, *General Principles and Responsibilities for Reviewers — System Reviews*, and for other requirements of a captain in an engagement review, see section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*.

Reviewer Allegations, Investigations, Limitations, or Restrictions (Ref: par. .09-.12)

.A14 The receipt of communications relating to allegations or investigations does not automatically mean that a reviewer is ineligible to perform reviews. However, there may be situations in which the nature, significance, or pervasiveness of the alleged deficiencies or an existing preponderance of evidence would necessitate more immediate action in order to address the public interest. The AE's PRC will consider whether any action or oversight is appropriate. This decision may be appealed by the reviewer to the AE's PRC.

.A15 If a reviewer fails to notify the relevant parties of communications of allegations or investigations, limitations or restrictions, or both, within the

specified timing, the board may consider whether actions are warranted given the specific circumstances. Such actions may include, but are not limited to, the following:

- a. Oversight at the reviewer's expense
- b. Permanent removal from the list of qualified reviewers
- c. Referral of any AICPA members to the AICPA's Professional Ethics Division for violating the AICPA Code of Professional Conduct

.A16 Limitations or restrictions may include, but are not limited to, the following:

- a. Constraint of scope or volume of accounting and auditing engagements
- b. Required periodic reporting to the regulatory body
- c. Pre-issuance reviews of engagements
- d. Additional peer review or professional education requirements

.A17 If the restriction has been placed on the reviewer's firm or one or more of its offices, then the OTF will consider and investigate the specific circumstances, including how the restriction relates to the firm's accounting and auditing practice and personnel, to determine whether any of the individuals associated with the firm may serve as reviewers.

.A18 The reviewer, reviewing firm, the AE, or AICPA staff may receive notification or knowledge of a limitation or restriction on a reviewer or reviewing firm when a review is in different stages (scheduling, commencement, field-work, acceptance, or completion, within the working paper retention period or not). In these circumstances, the board will consider various factors in determining whether the review should be rescheduled or oversighted, other additional procedures should be performed, or a new review should be performed.

.A19 The OTF will assess whether the reviewer is qualified to perform any peer reviews or if the reviewer is restricted from reviewing specific industries or engagements.

Reviewer Resume (Ref: par. .13-.15)

.A20 To accurately reflect reviewer qualifications and experience, reviewers may need to update their reviewer resumes more frequently than annually. Situations that may warrant more frequent updates include, but are not limited to, the following:

- a. The renewal timing of a reviewer's license
- b. Issuance of reports in new levels of service, engagements, or industries
- c. A change in firm that the reviewer is employed by or owner of
- d. Peer review continuing education courses taken

.A21 Current experience is performing, supervising, or carrying out a quality control function on an engagement with a report date within the last 18 months.

.A22 Recent experience is having performed, supervised, or carried out a quality control function on an engagement in the reviewer's firm within the last five years.

.A23 A reviewer with current experience in an industry through a firm other than the firm the reviewer is employed by or is an owner of may be qualified to review engagements in that industry. At a minimum, the services

performed for another firm should include a review of the financial statements and involvement in or review of the significant judgments and conclusions of the engagement team.

Ethical Requirements Relating to a Peer Review (Ref: par. .16–.18)

.A24 A firm may not perform a reciprocal peer review, that is, a review of the firm that performed its most recent review. The prohibition against reciprocal peer reviews also means that a reviewer may not serve on a review team carrying out a review of a firm whose personnel participated in the most recent review of that reviewer's firm.

.A25 Examples of products or services include, but are not limited to,

- a. consultation;
- b. expenses, office facilities, or personnel; and
- c. quality control materials.

.A26 To evaluate whether products or services provided or shared are an integral part of a firm's system of quality control, the reviewer and reviewed firm consider the following factors:

- a. The size of the affected portion of the practice (Ref: par. .A27)
- b. The risk associated with the affected portion of the practice (for example, must-select industries)
- c. The degree of the reviewed firm's reliance on the product or service provided or shared
- d. The significance of the product or service provided or shared

If the products or services provided or shared are quality control materials (QCM) that are an integral part of a firm's system of quality control, a QCM review under the Standards for Performing and Reporting on Peer Reviews¹ or an examination under the Statements on Standards for Attestation Engagements² could be an appropriate safeguard to offset a potential independence impairment. However, the effectiveness of this safeguard will depend on the facts and circumstances of each peer review.

.A27 The size of the affected portion of the practice may be assessed by industry, level of service, or engagement hours.

Performing a Peer Review (Ref: par. .19–.20)

.A28 Although a reviewer is testing compliance only with U.S. professional standards, the reviewer may inquire of the firm regarding the firm's understanding of professional guidance for reporting on statements for international use to assist in planning the review.

.A29 Conducting the review 3–5 months after the firm's peer review year-end ordinarily allows adequate time (30 days prior to the due date) for the assessment and submission of the peer review documents.

.A30 If required by the nature of the reviewed firm's practice, individuals with expertise in specialized areas may assist the review team in a consulting

¹ A quality control materials (QCM) review is only available under the Standards for Performing and Reporting on Peer Reviews, effective for peer reviews commencing before May 1, 2022.

² The Statements on Standards for Attestation Engagements are codified in the AT-C sections.

capacity. For example, computer specialists, statistical sampling specialists, actuaries, or experts in CPE may participate in certain segments of the review.

Reviewed Firm Acquisition or Divestiture (Ref: par. .21)

.A31 A divestiture of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance with the system of quality control for reports issued under the firm's name during that year.

Creating a Review Team (Ref: par. .22–.24)

.A32 Various factors, including the industries of the engagements of the firm, its size, whether or not the review is administered by the National PRC, and other factors related to the knowledge and experience of the members of the review team will be considered to determine if the team has the appropriate qualifications and capability to perform the review.

Obtaining Written Representations (Ref: par. .25–.27)

.A33 Written representations are necessary information that describe matters significant to the peer review to assist in the planning, performance of, and reporting on the peer review. The specific representations are detailed in section 310, *General Principles and Responsibilities for Firms — System Reviews*, and section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*, as applicable.

.A34 Members of management responsible for and knowledgeable about the required representations normally include the managing partner and partner in charge of the firm's system of quality control.

.A35 The representation letter is addressed to the captain because the captain is concerned with events occurring during the peer review period and through the date of the peer review report that may require an adjustment to the report or other peer review documents.

Reviewer's Performance and Cooperation (Ref: par. .28–.30)

.A36 The captain will furnish instructions to the specialist regarding the manner in which materials and other notes relating to the review are to be accumulated to facilitate summarization of the reviewer's findings and conclusions. The specialist may be required to be available for or participate in the exit conference.

.A37 A specialist meeting criteria established by the AICPA, which are located on the AICPA website, may be approved as part of the review team, therefore assuming the responsibilities of a review team member.

.A38 Complete and timely peer review documentation relates to the initial submission of the report and review materials and to the timely completion of any additional actions necessary to complete the review. Additional actions may include completing any omitted documentation of the work performed on the review and resolving questions raised by the committee or technical reviewer accepting the review or by the board and AICPA staff.

.A39 A reviewer may be suspended in the jurisdiction of the reviewer's local AE for failing to do any of the following (this list is not all-inclusive):

- a. Submit required peer review documents to the AE within the required specified time.

- b. Respond to or resolve issues identified by the technical reviewer, committee, or RAB within the specified time, including responding to requests for additional procedures such as the expansion of scope on the review.
- c. Revise the report and finding for further consideration (FFC) forms, if applicable, as requested by the committee or RAB.
- d. Respond to requests for documents (in addition to those originally required to be submitted) or requests to complete documents.
- e. Submit peer review documents and other information for oversight.
- f. Update or verify a reviewer resume, as required.

.A40 Failure to update or verify a reviewer resume may result in a national suspension. The reviewer may also be referred to the board for removal if the reviewer fails to submit documentation to support the experience reflected on the reviewer's resume.

Reviewer Performance Findings and Deficiencies (Ref: par. .31–.35)

.A41 If a committee recommends to the board that a reviewer be prohibited from performing peer reviews in the future or a reviewer appeals to the board in accordance with paragraph .36, the board will review and consider the recommendation or appeal in accordance with the "AICPA Peer Review Board Rules of Procedures for Reviewers,"³ which are located on the AICPA website.

.A42 Corrective actions may include, but are not limited to, the following:

- a. Oversight (at the reviewer's expense) until evidence of performance improves
- b. Consulting with the AE to discuss the planning and performance of the next review
- c. Submitting all reports and appropriate documentation on all outstanding peer reviews before scheduling or performing another review
- d. Having pre-issuance reviews of the report and peer review documentation on future peer reviews by an individual acceptable to the committee
- e. Taking specified types of and amounts of CPE or training, or passing the related AICPA advanced certificate exam
- f. Removing or revising one or more resume codes until appropriate proof of experience and knowledge have been provided to the satisfaction of the committee

.A43 Supporting evidence may include, but is not limited to, CPE certificates or documentation of performance improvement that includes a letter or report from an individual acceptable to the committee on the results of oversight or pre-issuance review of a peer review.

.A44 Depending on the facts and circumstances, egregious acts by a reviewer include, but are not limited to, the following:

- a. Signing false documents
- b. Failure to perform a peer review board directive resulting from a hearing or review panel in a timely and professional manner

³ "AICPA Peer Review Board Rules of Procedures for Reviewers" governs the adjudication of all matters that may lead to the removal of a reviewer from the national list of qualified reviewers or to the imposition of other sanctions by the board.

- c. Continuing to schedule or perform reviews after receipt of a required corrective action letter or settlement agreement from the AICPA Professional Ethics Division that indicates the reviewer is restricted from performing reviews
- d. Failure to notify an AE when there has been a restriction placed by a regulatory, monitoring, or enforcement body on the reviewer's ability to perform audit and attest engagements, and the reviewer continues to perform peer reviews
- e. Knowingly providing advice to a firm that is contradictory to the standards, such as informing the firm that it may distribute the peer review report prior to committee acceptance or omitting engagements from the scope of the review without the appropriate scope limitations or approvals in compliance with the guidance
- f. Use of confidential material obtained during the peer review to enhance the reviewer's own firm (such as a client listing)
- g. Failure to maintain qualifications or otherwise cooperate with the program (for example, not meeting licensure or regulatory requirements), leading the AE or firm to find another reviewer to complete the review and causing the firm harm

.A45 The board may appoint a hearing panel to consider whether a reviewer should be prohibited from performing peer reviews in the future without recommendation from a committee.

PR-C Section 210

General Principles and Responsibilities for Reviewers — System Reviews

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains performance and reporting requirements and application guidance for reviewers engaged to perform a system review. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*, and section 200, *General Principles and Responsibilities for Reviewers*. Additionally, reviewers should familiarize themselves with the firm requirements in section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*.

Effective Date

.02 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objectives

.03 The objectives of the reviewer, in conducting a system review, are to do the following:

- a. Obtain reasonable assurance that the reviewed firm's system of quality control for its accounting and auditing practice has been designed and complied with to provide the firm with reasonable assurance of performing or reporting in conformity with the requirements of applicable professional standards in all material respects.
- b. Report on the reviewed firm's system of quality control and communicate as required by the Standards for Performing and Reporting on Peer Reviews (the standards) established by the Peer Review Board (the board) of the American Institute of Certified Public Accountants, in accordance with the reviewer's conclusions.

Definitions

.04 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Reviewer Qualifications for Team Captains

.05 In addition to meeting the requirements in section 200, a team captain must be a partner and complete initial and ongoing peer review training that meets the requirements established by the board. (Ref: par. .A1)

Reviewer Qualifications for Must-Select and Must-Cover Engagements

.06 In addition to the qualifications discussed in section 200, a reviewer of must-select engagements should meet the following criteria:

- a. Have completed additional training focused on must-select engagements that meets the requirements of the board. (Ref: par. .A2)
- b. Be presently involved in one of the following areas in the must-select engagements in the reviewer's firm:
 - i. Supervising or performing engagements
 - ii. Performing engagement quality control reviews on engagements
 - iii. Performing the inspection of must-select engagements as part of the firm's monitoring process
- c. Be employed by or be an owner of a firm that is a member of the respective audit quality center, if applicable.

.07 The additional training requirements in paragraphs .05 and .06 should be completed within one year prior to the commencement of the review of a must-select engagement.

.08 For must-select and must-cover engagements, a reviewer should have experience in and knowledge about rules and regulations appropriate to the level of service applicable to the industries of the engagements the individual will be reviewing.

Planning

.09 The reviewer should perform planning procedures before selecting engagements for review.

.10 The reviewer should obtain the following from the reviewed firm:

- a. Information regarding each engagement in the firm's accounting and auditing practice with a period end date (report date for financial forecasts, financial projections, and agreed-upon procedures engagements) during the peer review year and issued by the commencement date to allow the reviewer to be able to identify
 - i. the level of service,
 - ii. the number of audit or accounting hours (actual, if available, or estimated),
 - iii. the engagement partner,
 - iv. the industry,
 - v. whether an engagement was an initial engagement,

- vi. the office (if applicable), and
- vii. whether an engagement was a must-select or must-cover engagement (if applicable) (Ref: par. .A22)
- b. A list of firm personnel (Ref: par. .A3)
- c. Responses to inquiries about the areas to be addressed in the written representations
- d. The firm's prior
 - i. peer review report,
 - ii. letter of response (if applicable),
 - iii. letter of acceptance,
 - iv. findings for further consideration (FFCs) (if applicable), and
 - v. representation letter
- e. The firm's quality control documentation (Ref: par. .A4)

Understanding the Firm's Accounting and Auditing Practice and System of Quality Control

.11 The reviewer should obtain an understanding of the firm's accounting and auditing practice and system of quality control with respect to each of the quality control elements in accordance with quality control standards established by the AICPA.

.12 The understanding obtained by the reviewer should include knowledge about

- a. the firm's organization,
- b. the composition of its accounting and auditing practice, and
- c. the design of the reviewed firm's quality control policies and procedures in accordance with quality control standards established by the AICPA.

.13 To obtain an understanding of the firm's accounting and auditing practice and system of quality control, the reviewer should do the following:

- a. Inquire of appropriate management and other personnel.
- b. Review the firm's internal policies and procedures.
- c. Review the firm's quality control documentation.
- d. Inquire of the firm regarding elements of the system of quality control residing outside of the firm. (Ref: par. .A5)
- e. Complete the applicable quality control checklists.

.14 When obtaining an understanding of the firm's system of quality control, the reviewer should evaluate the design of the firm's quality control policies and procedures in relation to the size and nature of the firm's accounting and auditing practice and determine if the system of quality control is appropriately comprehensive and suitably designed.

Understanding and Assessing Peer Review Risk

.15 The reviewer should use the understanding of the firm's accounting and auditing practice and system of quality control to assess inherent and control risks. The assessment of risk is qualitative and not quantitative.

.16 To assess inherent risk, the reviewer should consider the following:

- a. Circumstances arising within the firm (Ref: par. .A6 and .A8–.A9)

- b. Circumstances outside the firm that affect the firm's accounting and auditing clients (Ref: par. .A7)

.17 To assess control risk, the reviewer should consider the results of the team captain's assessment of the firm's design of and compliance with quality control standards established by the AICPA. (Ref: par. .A10)

.18 The reviewer should determine an acceptable level of detection risk based on the assessment of inherent and control risk. There is an inverse relationship between the level of detection risk and the level of inherent and control risk. (Ref: par. .A11)

.19 The reviewer should document the assessment of peer review risk, which includes inherent risk, control risk, and detection risk, to provide a basis for engagement selections and the extent of procedures performed. (Ref: par. .A12).

Engagement Selection

.20 To obtain reasonable assurance that the firm is complying with its quality control policies and procedures and applicable professional standards, the reviewer should review a reasonable cross section of the firm's accounting and auditing engagements, with greater emphasis on those portions of the practice with higher combined assessed levels of inherent and control risk. (Ref: par. .A13–.A14 and .A16)

.21 There is a relationship between a reasonable cross section of the firm's accounting and auditing practice and a risk-based approach to engagement selections. The reviewer should document in the risk assessment key decisions made when the engagement selections do not include

- a. a level of service,
- b. public interest industries, (Ref: par. .A15)
- c. an engagement type within an industry, or
- d. industries where the firm performs a high volume of engagements. (Ref: par. .A16)

.22 To support the reviewer's selection of a reasonable cross section of the firm's accounting and auditing practice, the reviewer should document in the risk assessment the reviewer's consideration of industries that are represented in the firm's "other audits" category.

.23 If a reviewer significantly reduces the scope of procedures to be performed due to reliance on the firm's monitoring procedures, the reviewer should inform the administering entity (AE) and AICPA staff during review planning and document the reviewer's procedures in the Summary Review Memorandum. (Ref: par. .A17–.A18)

.24 Engagements subject to selection for review should be those with periods ending during the year under review, except financial forecasts or projections and agreed-upon procedures engagements. For engagements without period ends, engagements with report dates during the year under review would be subject to selection. (Ref: par. .A19–.A20)

.25 If an engagement selection has not been issued and there is not another engagement that can mitigate the risks associated with that engagement, the reviewer should assist the firm in determining if (Ref: par. .A21–.A22)

- a. the firm should request an extension in writing from the AE or
- b. the peer review should be performed, and the report should include a scope limitation as described in paragraph .29.

.26 If a U.S. firm has offices in foreign countries or other "foreign jurisdictions," the reviewer should consider whether those engagements should be subject to selection for review. If a report is issued on letterhead of an office in a foreign jurisdiction, the engagement should not be subject to selection for review. If the reviewer is unable to conclude whether an engagement should be subject to selection, the reviewer should consult with AICPA staff.

.27 Specific engagements should be selected in a system review (must select). Appendix C, "Additional Requirements for Must-Select and Must-Cover Engagements," contains the engagements included in these designations. (Ref: par. .A23)

.28 To provide the firm assembly time, the reviewer should provide the selection of engagements to be reviewed to the reviewed firm in advance, but no more than two weeks before the reviewer plans to begin reviewing the engagements. (Ref: par. .A24)

Scope Limitations

.29 It is presumed that all engagements and elements of the firm's system of quality control are subject to the peer review. In the rare situations in which there are exclusions or other limitations on the scope of the peer review, the reviewer should contact the AE and do the following:

- a. Assess the reasonableness of the reasons for exclusions
- b. Assess the effect on peer review risk assessments and scope
- c. Consider whether alternate procedures can be performed
- d. Determine the effect on the peer review and on the ability of the team captain to issue a peer review report

.30 In the event of an exclusion, the reasons for the exclusion and the considerations detailed in paragraph .29 should be documented in the peer review working papers, which will be evaluated by the peer review committee as part of the peer review acceptance process.

Procedures Performed in Response to Assessment of Peer Review Risk

.31 To test the firm's compliance with its system of quality control and applicable professional standards, the reviewer should do the following:

- a. Review and evaluate the highest-risk areas on selected engagements, including accounting and auditing documentation, and reports. (Ref: par. .A25)
- b. Interview firm personnel at various levels to assess their understanding of, and compliance with, the firm's system of quality control.
- c. Review evidence to determine whether the firm has complied with its policies and procedures for each element of its system of quality control, which may include evidence since the previous peer review. (Ref: par. .A26)
- d. Review other evidence as appropriate. (Ref: par. .A27–.A28)

.32 The reviewer should determine if the firm and its personnel are in compliance with licensure requirements of the state boards of accountancy in the states in which the firm and its personnel practice for the peer review year through the date of the peer review report by verifying the following: (Ref: par. .A29)

- a. The *practice unit* license (firm license) in the state in which the practice unit is domiciled (that is, where the main office is located)
- b. A sample of individual (personnel) licenses in the states in which the individuals primarily practice public accounting

.33 If the reviewer deems it appropriate to test out-of-state licenses, the reviewer should expect the firm to provide documentation supporting its compliance with, or approach to, out-of-state licensing requirements. AICPA online CPA mobility provisions may be used to assist the reviewer in evaluating the firm's approach to firm and individual out-of-state licensing. (Ref: par. A30)

.34 If a firm does not possess the required applicable licenses to issue accounting and auditing engagements at any time during the peer review year through the date of the peer review report, the reviewer must document this as a finding on an FFC form.

.35 If an individual with reporting responsibility does not have a current individual license to practice public accounting as required by the relevant state boards of accountancy, the reviewer should consider the engagements reported on by that individual as not performed or reported on in conformity with applicable professional standards in all material respects (nonconforming).

Evaluation of Engagements

.36 The reviewer should evaluate each engagement selected for review. The evaluation should include the following:

- a. Consideration of the financial statements or information and the related accountants' reports
- b. Review of accounting and audit documentation required by the applicable professional standards
- c. Consideration of information related to the engagement obtained through the peer review, including but not limited to engagement profile information, representations made by the firm, and other inquiries

.37 When evaluating an audit engagement, the reviewer's procedures should include determining whether the reviewed firm has appropriately done the following: (Ref: par. A31)

- a. Identified the significant risk areas on each audit engagement selected for the peer review
- b. Performed the necessary audit procedures related to the identified significant risk areas
- c. Documented the auditing procedures performed in these significant risk areas

.38 For each engagement reviewed, the reviewer should use peer review checklists and questionnaires to determine whether

- a. the financial statements are fairly presented in accordance with generally accepted accounting principles (GAAP) in all material respects (or when applicable, with a special purpose framework) and
- b. the firm has performed and reported on the engagement in accordance with the requirements of the applicable professional standards in all material respects.

.39 The reviewer should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards in all material respects (the engagement is nonconforming) and remind

the firm of its obligation under professional standards to take appropriate actions. (Ref: par. .A32)

.40 Team captains or AEs should not require firms to perform omitted procedures, reissue accounting or auditing reports, or have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make. The team captain should provide information about risks in the firm's system of quality control (as identified through the review and testing of quality control policies and procedures).

.41 At a minimum, a nonconforming engagement should be documented as a matter on a matter for further consideration (MFC) form.

Expansion of Scope

.42 If the reviewer concludes that one or more engagements are nonconforming or there is a matter in one or more elements of the firm's system of quality control, the reviewer should document the consideration of whether the application of additional peer review procedures — an expansion of scope — is necessary. (Ref: par. .A33–.A34)

Identifying, Aggregating, and Evaluating Matters, Findings, Deficiencies, and Significant Deficiencies

Identifying Matters, Findings, Deficiencies, and Significant Deficiencies

.43 The reviewer should document a matter on an MFC form when the reviewer identifies one or more "no" answers to questions on peer review checklists that the reviewer concludes warrant further consideration in the evaluation of a firm's system of quality control. Matters of a similar nature or systemic cause should be documented on one MFC form.

.44 The reviewer should determine the relative importance of matters noted during the peer review, individually and in the aggregate. To determine if a matter should be elevated to a finding, deficiency, or significant deficiency, the reviewer should consider the matter's relative importance to the firm's system of quality control, taking into consideration the nature, systemic cause, pattern, or pervasiveness of it. (Ref: par. .A35–.A36)

Determination of the Systemic Cause

.45 The reviewer should discuss and determine in concurrence with the firm the systemic cause of matters identified. (Ref: par. .A37–.A40)

.46 If the firm underwent regulatory or governmental oversight or inspection, and similar issues were raised in both the regulatory or governmental oversight and in the peer review, the reviewer should further understand the systemic causes identified by the reviewed firm and consider whether there may be a systemic issue related to the design of or compliance with the system of quality control.

.47 If the firm's response during the discussion and determination of the systemic cause of a matter is that the matter resulted from an "oversight" or was "isolated," the reviewer should investigate further. Refer to paragraphs. .48–.49 under "Isolated Matters" for additional procedures the reviewer should perform.

Isolated Matters

.48 If a matter is identified as isolated, the reviewer should follow the guidance in the sections "Expansion of Scope" and "Determination of the Systemic Cause." The reviewer should evaluate the pervasiveness of the issue, including expanding the scope if necessary, to provide evidence that the noncompliance with the firm's system of quality control was truly isolated. Reviewers should focus on the systemic cause of the matter when analyzing whether it is isolated. (Ref: par. .A41–.A42)

.49 Reviewers should document their considerations regarding an isolated matter, including, at a minimum,

- a. the details of the matter noted;
- b. how the reviewer expanded scope, if applicable; and
- c. why the reviewer concluded the matter was isolated.

The documentation should provide enough information for the AE's peer review committee to determine whether the conclusion is appropriate. (Ref: par. .A43)

Aggregating and Evaluating Matters

.50 To conclude on the results of a peer review, the reviewer should aggregate the matters documented during the peer review and determine whether the matters were the result of the design of the reviewed firm's system of quality control or the failure of its personnel to comply with the firm's quality control policies and procedures.

.51 To determine the relative importance of matters, both individually and in the aggregate, to the firm's system of quality control, the reviewer should consider each matter's

- a. nature (characteristics),
- b. systemic cause (what went wrong with the firm's system of quality control),
- c. pattern (repeated), and
- d. pervasiveness (whether it is found throughout the firm's system of quality control).

When the firm has responded to matters, the team captain should consider if the response is appropriate and if the response indicates additional impacts to the peer review conclusions. Additionally, the reviewer should evaluate each matter in the context of the firm's size, organizational structure, and the nature of its practice. The relative importance of peer review matters to the firm's system of quality control will determine the impact to the peer review conclusions. In rare circumstances in which it is not practicable to identify the systemic cause, the team captain should document the reason or reasons as part of the Summary Review Memorandum and on the related MFC form. (Ref: par. .A44–.A48)

.52 The reviewer should consider the interrelationships among the elements of quality control and weigh the matters against compensating policies and procedures to determine the impact to the peer review conclusions.

.53 The reviewer should document a finding on an FFC form when the reviewer concludes that one or more related matters result from a condition in the reviewed firm's system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not

perform or report in conformity with the requirements of applicable professional standards. Documentation of a finding should include the following:

- a. A description of the finding
- b. Reference to the applicable requirements of the Statements on Quality Control Standards
- c. The scenario that led to the finding
- d. Reference to nonconforming engagements as a result of the finding, if applicable

.54 The team captain should document a deficiency in the report when the reviewer has concluded the firm would not have reasonable assurance of performing or reporting in conformity with the requirements of applicable professional standards in one or more important respects due to the relative importance of the matter to the reviewed firm's system of quality control or compliance with it, taking into consideration the nature, systemic causes, pattern, or pervasiveness of the matter.

.55 The team captain should document a significant deficiency in the report when the captain has concluded the reviewed firm's system of quality control does not provide the reviewed firm with reasonable assurance of performing or reporting in conformity with applicable professional standards in all material respects due to the relative importance of the matter to the reviewed firm's system of quality control or compliance with it, taking into consideration the nature, systemic causes, pattern, or pervasiveness of the matter.

.56 The team captain should complete a disposition of matters for further consideration (DMFC) for all MFCs, indicating whether each MFC was

- a. discussed with the firm and deemed resolved or considered insignificant,
- b. included on a specific FFC form (individually or combined with other MFCs), or
- c. included as a deficiency or significant deficiency (individually or combined with other MFCs) in a report with a peer review rating of *pass with deficiencies* or *fail*, respectively.

Repeat Findings, Deficiencies, and Significant Deficiencies

.57 When the same systemic cause identified in the prior review is also identified in the current review, the reviewer should determine if a repeat finding, deficiency, or significant deficiency exists. To make this determination, the reviewer should review the results of the reviewer's planning procedures to determine if the firm implemented the planned actions documented in the prior review's FFC forms or letter of response, as applicable. If the actions were implemented, the reviewer should

- a. consider whether the actions taken were appropriate to remediate the weakness in the firm's system of quality control, and
- b. reconsider whether the same weakness from the prior review is causing the current finding, deficiency, or significant deficiency.

.58 If a repeat finding, deficiency, or significant deficiency is identified, it should be documented as such in the FFC form or report, as applicable. (Ref: par. .A27 of section 100)

Communication Requirements for Closing Meeting and Exit Conference

Closing Meeting Communication Requirements

.59 Prior to issuing the report or finalizing MFCs and FFCs, if applicable, the team captain should communicate the conclusions to the firm at a closing meeting. The team captain should discuss the following during the closing meeting: (Ref: par. .A49–.A50)

- a. Preliminary peer review results, including any matters, findings, deficiencies, or significant deficiencies, and the expected report rating if determinable at this point
- b. The firm's requirement to respond to the MFCs, FFCs, or deficiencies or significant deficiencies included in the peer review report
- c. The firm's required written representations
- d. Other suggestions and observations for the firm to consider (Ref: par. .A51)

.60 The closing meeting should be held within a reasonable time frame before the firm's due date to allow enough time for the firm to determine appropriate remediation with respect to findings, deficiencies, and significant deficiencies, if applicable. (Ref: par. .A52)

.61 The team captain should consider the need to have the team members participate or be available for consultation (in person or via teleconference) during the closing meeting or exit conference, especially when, in unusual circumstances, the team captain does not have the experience to review the industry of an engagement that was reviewed by a team member. (Ref: par. .A53)

Exit Conference Communication Requirements

.62 The team captain should review and evaluate the responses on the FFC forms and letter of response prior to the exit conference. The team captain should consider the following: (Ref: par. .A54–.A55)

- a. The firm's response should include
 - i. the firm's actions taken or planned to remediate the findings or deficiencies in the firm's system of quality control and nonconforming engagements, if applicable,
 - ii. timing of the remediation, and
 - iii. additional procedures to ensure the finding or deficiency is not repeated in the future.
- b. The action should be feasible, genuine, and comprehensive.
- c. If the firm has taken action, the reviewer should review documentation of actions taken and consider whether the action is appropriate. (Ref: par. .A56)

.63 After the firm has responded to the MFCs, FFCs, and deficiencies or significant deficiencies in the report and the team captain has assessed whether the responses are appropriate and has considered any additional impact to the peer review results, the team captain should communicate the results to the firm at an exit conference. The team captain should discuss the following during the exit conference:

- a. The peer review results to be submitted to the AE, including any changes to the information communicated at the closing meeting

after consideration of the firm's responses to MFCs, FFCs, and deficiencies and significant deficiencies in the report

- b. The appropriateness of the firm's response
- c. The firm's representation letter
- d. Potential implications of the peer review acceptance process and the impact to the acceptance and completion of the peer review and to the reviewed firm's enrollment in the program, including, but not limited to, the following:
 - i. Corrective actions for deficiencies and significant deficiencies and implementation plans for findings, if applicable
 - ii. Recommended report rating changes
 - iii. Oversight
- e. Peer review noncooperation implications of consecutive non-pass report ratings, if applicable

Written Representations

.64 The team captain should request management of the firm to provide written representations for the peer review year that are dated as of the date of the peer review report stating the following: (Ref: par. A57)

- a. Management has fulfilled its responsibility for the design of and compliance with a system of quality control for our accounting and auditing practice that provides us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
- b. Management acknowledges its responsibility for complying with the rules and regulations of state boards of accountancy and other regulations.
- c. Management has disclosed to the team captain all known instances of noncompliance or suspected noncompliance with the rules and regulations of state boards of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which the firm practices for the year under review. If there are known instances of noncompliance, management should summarize the instances and, if applicable, describe the remediation of the noncompliance.
- d. Management has discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, if applicable.
- e. Management has fulfilled its responsibility to remediate nonconforming engagements as stated by the firm on the [*MFC form, FFC form, or letter of response*], if applicable.
- f. Management understands the intended uses and limitations of the quality control materials it has developed or adopted. Management has tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist it in conforming with professional standards (including the Statements on Quality Control Standards) applicable to its accounting and auditing practice.
- g. Management has responded fully and truthfully to the team captain's inquiries.

- h.* Management has provided the team captain with all relevant information, which included
 - i.* all engagements with periods ending during (or, for financial forecasts or projections and agreed-upon procedures engagements, report dates in) the year under review and
 - ii.* all must-select engagements, as applicable.
- i.* Management has disclosed to the team captain if the firm performed must-select engagements for the period covered by the peer review, and, if so, at least one of each type of must-select engagement that was performed was selected and reviewed by the peer reviewer.
- j.* Management acknowledges that failure to properly include these engagements on the list could be deemed as failure to cooperate and may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, or enforcement body.
- k.* Management has provided the team captain communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end.
- l.* Management has either disclosed that there are no known limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end, or management has included a summary of the limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

.65 If a firm fails to discuss significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, the team captain should immediately consult with the AE because this constitutes a failure to cooperate, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated. (Ref: par. .A58)

.66 If, in addition to the representations required by paragraph .64, the team captain determines that it is necessary to obtain other representations based on the circumstances and nature of the peer review, the team captain should request such other written representations.

Reporting on System Reviews

.67 To determine the report rating, the team captain should use professional judgment and consider the understanding of the firm's system of quality control and the nature, systemic causes, pattern, and pervasiveness of matters and their relative importance to the firm's system of quality control taken as a whole, including limitations on the scope of the review. (Ref: par. .A59–.A62)

.68 The written report in a system review should (Ref: par. .A63)

- a.* be dated as of the exit conference date.

- b. be issued on letterhead of the firm performing the review.¹
- c. state at the top of the report the title "Report on the Firm's System of Quality Control."
- d. include headings for each of the following sections:
 - i. Firm's Responsibility
 - ii. Peer Reviewer's Responsibility
 - iii. Required Selections and Considerations
 - iv. Deficiency(ies) or Significant Deficiency(ies) Identified in the Firm's System of Quality Control (if applicable)
 - v. Scope Limitation (if applicable)
 - vi. Opinion
- e. state that the system of quality control for the accounting and auditing practice of the firm was reviewed and include the year-end covered by the peer review.
- f. state that the peer review was conducted in accordance with the standards.
- g. state that a summary of the nature, objectives, scope, limitations of, and procedures performed in a system review, as described in the standards, can be found on the AICPA website where the standards are summarized.
- h. include a URL reference to the AICPA website where the standards are located, and state that the summary includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.
- i. state that the firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of applicable professional standards in all material respects and for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of applicable professional standards, where appropriate, and for remediating weaknesses in its system of quality control, if any.
- j. state that the reviewer's responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on the review.
- k. identify engagements that are required to be selected and indicate whether single or multiple engagements (for example, an audit versus audits) were reviewed, when applicable.
- l. state that reviews by regulatory entities, as communicated by the firm, if applicable, were considered in determining the nature and extent of procedures.
- m. in the event of a scope limitation, include an additional paragraph before the opinion paragraph that describes the relationship of the excluded engagements or elements of the firm's system of quality control to the firm's practice as a whole, the highest level

¹ A report by a reviewer formed by an association of CPA firms should be issued on the letterhead of the firm of the team captain performing the review.

of service and industry concentration, if any, of the engagements excluded from potential selection, and the effect of the exclusion on the scope and results of the peer review. The reviewer should tailor the opinion, as appropriate, to address the scope limitation.

- n. identify the different peer review ratings that the firm could receive.
- o. in a report with a peer review rating of *pass*,
 - i. express an opinion that the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
 - ii. state that the firm has received a peer review rating of *pass*.
- p. in a report with a peer review rating of *pass with deficiencies*, (Ref: par. A64)
 - i. express an opinion that, except for the deficiencies previously described, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
 - ii. state that the firm has received a peer review rating of *pass with deficiencies*.
- q. in a report with a peer review rating of *fail*,
 - i. express an opinion that, as a result of the significant deficiencies previously described, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year ended was not suitably designed or complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
 - ii. state the firm has received a peer review rating of *fail*.
- r. in a report with a peer review rating of *pass with deficiencies* or *fail*,
 - i. have numbered deficiencies or significant deficiencies that include
 - (1) a description,
 - (2) reference to the applicable requirements of the Statements on Quality Control Standards,
 - (3) the scenario that led to the deficiency or significant deficiency, and
 - (4) reference to nonconforming engagements as a result of the deficiency or significant deficiency, if applicable.
 - ii. if there are repeat deficiencies or significant deficiencies, state that the deficiency or significant deficiency was noted

in the firm's previous peer review. This should be determined based on the systemic cause of the deficiencies or significant deficiencies. (Ref: par. .A65)

- iii. identify the level of service for any deficiencies or significant deficiencies.
- iv. identify the applicable industry if a deficiency or significant deficiency is industry specific.
- v. identify any must-select engagement types in which non-conforming engagements were noted as a result of a deficiency or significant deficiency.

.69 If a firm that is not required to have a system review elects to have one in accordance with paragraph .A1 of section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*, the peer review report should be modified to include the following sentence: "[Firm name] has represented to us that the firm did not perform engagements that would require a system review."

Submission of Peer Review Documentation to the AE by the Team Captain

.70 Within 30 days of the exit conference date or by the firm's peer review due date, whichever date is earlier, the team captain should complete electronically and submit to the AE, as applicable, the following documents: (Ref: par. .A66)

- a. Report and letter of response, if applicable
- b. Summary Review Memorandum
- c. FFC forms, if applicable
- d. MFC forms, if applicable
- e. DMFC, if applicable
- f. Firm's representation letter
- g. Engagement profiles and supplemental checklists for reviews of engagements subject to the Single Audit Act and the Uniform Guidance, if applicable
- h. Explanation of "no" answers for quality control checklists

.71 For all reviews administered by the National Peer Review Committee, the team captain should submit the following documents in addition to those required by paragraph .70, as applicable: (Ref: par. .A66)

- a. All documents required to be submitted for system reviews
- b. Engagement questionnaires or checklists
- c. Quality control documents and related practice aids
- d. Staff and focus group interview forms
- e. Planning documents
- f. Any other documents considered relevant by the team captain

Application and Other Explanatory Material

Reviewer Qualifications for Team Captains (Ref: par. .05)

.A1 Peer review training courses designed to meet the requirement are located on the Peer Review page of the AICPA website.

Reviewer Qualifications for Must-Select and Must-Cover Engagements (Ref: par. .06–.08)

.A2 The must-select additional training courses designed to meet the requirement are described on the Peer Review page of the AICPA website.

Planning (Ref: par. .09–.10)

.A3 The personnel list assists reviewers in performing their risk assessment procedures. The reviewer may request that the list include

- a. name,
- b. position, and
- c. years of experience
 - i. with the firm and
 - ii. in total.

.A4 Quality control documentation will likely include the firm's quality control document, evidence of the performance of the firm's monitoring procedures, and CPE documentation, among other documents.

Understanding the Firm's Accounting and Auditing Practice and System of Quality Control (Ref: par. .11–.14)

.A5 Examples of elements that could reside outside of the firm include, but are not limited to, membership in associations, joint ventures, non-CPA-owned entities, alternative practice structures, arrangements with outside consultants, third-party quality control materials, or CPE.

Understanding and Assessing Peer Review Risk (Ref: par. .15–.19)

.A6 Circumstances within the firm may include the following:

- a. The relationship of the firm's audit hours to total accounting and auditing hours
- b. The size of the firm's major engagements relative to the firm's practice as a whole
- c. Initial engagements and their impact on the firm's practice
- d. The industries in which the firm's clients operate, especially the firm's industry concentrations
- e. The results of the prior peer review
- f. The actions of the firm in response to the prior report and FFC forms
- g. The results of any regulatory or governmental oversight or inspection procedures (Ref: par. .A8)
- h. The risk level of the engagements performed (Ref: par. .A9)
- i. The extent of nonaudit services
- j. Significant changes in the firm's practice

.A7 Circumstances outside the firm may include the following:

- a. New professional standards or those being applied initially for one or more clients
- b. Changes in regulatory requirements
- c. Adverse economic developments in an industry in which one or more of the firm's clients operate
- d. Significant developments in the client's organization

.A8 Regulatory or governmental oversight agencies may include, but are not limited to, the Department of Labor or the Department of Health and Human Services. Refer to the guidance in appendix A, "Consideration of the Results of Regulatory Oversight or Inspections in the Planning and Performance of a Peer Review."

.A9 Examples of higher-risk engagements include, but are not limited to, audits of employee benefit plans, entities subject to the Single Audit Act, entities subject to SEC complex independence requirements, and others with high-risk features or complex accounting or auditing applications.

.A10 Control risk factors may include, but are not limited to, the team captain's evaluation of the firm's policies and procedures related to the following:

- a. CPE
- b. The firm's professional library
- c. Engagement acceptance
- d. Engagement review and supervision
- e. Engagement quality control review (EQCR)
- f. Monitoring processes
- g. Recruitment and hiring
- h. Monitoring independence
- i. Timely completion of the assembly of final engagement files by engagement teams

.A11 The lower the inherent and control risk, the higher the tolerable detection risk, and vice versa.

.A12 The assessed levels of risk are the key considerations in deciding the number and types of engagements to review and, where necessary, offices to visit. Through the assessment of risk, the reviewer determines the coverage of the firm's accounting and auditing practice that will result in an acceptably low peer review risk.

Engagement Selection (Ref: par. .20–.28)

.A13 Risk factors that may influence a reviewer's decision to select engagements include, but are not limited to, the following:

- a. Engagement size, in terms of the hours required to plan and perform the engagement
- b. Engagements involving experienced personnel hired from other firms and partners who also have office, regional, or firm-wide management, administrative, or functional responsibilities
- c. Engagements in which work on segments has been referred to other firms, foreign offices, domestic or foreign affiliates, or correspondents

- d. Engagements in which one or more affiliated entities (for example, parent companies and subsidiaries or brother and sister companies) constitute a large portion of the firm's overall clientele
- e. Engagements identified in the firm's quality control system or guidance material as having a high degree of risk
- f. Engagements in which departures from professional standards and failure to comply with the firm's quality control policies and procedures were noted in the preceding year's monitoring procedures
- g. Engagements in industries where the firm has experienced high instances of litigation, proceedings, or investigations

.A14 Risk factors that may influence a reviewer's decision to visit or select engagements from a particular office include, but are not limited to, the following:

- a. The number, size, and geographic distribution of offices
- b. The degree of centralization of accounting and auditing practice control and supervision
- c. The reviewer's evaluation, if applicable, of the firm's monitoring procedures
- d. Recently merged or recently opened offices
- e. The significance of industry concentrations and of specialty engagements, such as governmental compliance audits or regulated industries, to the firm and to individual offices
- f. Extent of nonaudit services to audit clients

.A15 Public interest industries are those that benefit the general welfare of the public, such as those that have recent regulatory and legislative developments. Public interest industries will vary across firms.

.A16 In response to the reviewer's assessed levels of risk and to obtain a reasonable cross section of the firm's accounting and auditing practice, it may be more appropriate for the engagement selection to include more than one engagement from a particular industry or engagement type (including must-select engagements).

.A17 The reviewer may determine that the firm's current year's internal monitoring procedures could enable the reviewer to reduce, in a cost-beneficial manner, the extent of the peer review procedures. Refer to the guidance in appendix B, "Considering the Firm's Monitoring Procedures to Reduce a Reviewer's Testing Procedures."

.A18 Staff may recommend that a panel from the board or its task forces review a firm's internal inspection or peer review planning in advance. In addition, a firm or peer reviewer may request that the AE review the internal inspection or peer review planning in advance.

.A19 If an engagement from the peer review year has not yet been issued, and a comparable engagement issued within the peer review year is not available, the prior year's engagement may be reviewed.

.A20 If an engagement from the peer review year and the subsequent year's engagement have been issued, the reviewer may select the more recently issued engagement based on the reviewer's assessment of peer review risk factors including, but not limited to, the following:

- a. Whether the engagement was performed during the peer review year

- b. The number of subsequent engagements available and selected for review
- c. Significant changes in the applicable professional standards
- d. The differences in issues identified in the engagements

.A21 Examples of when a firm may request an extension, or a scope limitation may be reflected in its peer review report, include, but are not limited to, the following:

- a. A firm performing its first must-select engagement with a period end during the peer review year that has not been issued prior to the commencement of the review
- b. A firm performing an initial engagement for a client and there are no other initial engagements that have been issued during the peer review year, nor are there any for the prior period

.A22 Failure of the firm or reviewer to consider a complete population of engagements may be considered not cooperating with the program, which may result in the recall of peer review acceptance if an omission is subsequently discovered.

.A23 At least one from each must-select engagement should be reviewed according to paragraph .27. A must-cover engagement is not required to be reviewed but should be considered in the reviewer's peer review risk assessment. A member of the review team should have at least recent experience in the must-select and must-cover engagements performed by the reviewed firm.

.A24 The reviewer may request that the firm provide access to one of the reviewer's selections (a surprise engagement) as soon as practical. The selection is ordinarily an audit engagement.

Procedures Performed in Response to Assessment of Peer Review Risk (Ref: par. .31–.35)

.A25 Factors to consider in determining the highest-risk audit areas include the following:

- a. The highest-risk audit areas in the client's industry (for example, revenue recognition for construction companies; inventory and accounts receivable for manufacturing and retail concerns; policy reserves for insurance companies; or loan loss allowances for financial institutions)
- b. The highest-risk audit areas noted during the review of the financial statements and discussions with engagement personnel (for example, review of loan defaults or follow-up of litigation matters)
- c. The highest-risk audit areas identified by the firm in planning or conducting the engagement, including those areas identified in the engagement profile
- d. Recent accounting and auditing developments and pronouncements
- e. Weaknesses noted in other engagements reviewed
- f. Weaknesses noted by the firm through its monitoring procedures

.A26 If no events relative to an element of a firm's system of quality control occurred during the peer review year, it may be necessary for a team captain to review evidence from prior to the peer review year. For example, if there were no instances of accepting new clients in the peer review year, it is appropriate

to test compliance in prior years, assuming the design of the policies and procedures is the same. Another example would be when the team captain reviews the monitoring and inspection results from the intervening periods to determine appropriate design and compliance of monitoring procedures. Looking at the intervening periods allows the team captain to evaluate whether the firm is properly communicating and remediating engagement and systemic issues identified.

.A27 Examples of other evidence include, but are not limited to,

- a. selected administrative or personnel files,
- b. correspondence files documenting consultations on technical or ethical questions,
- c. files evidencing compliance with human resource requirements, and
- d. the firm's technical reference sources.

.A28 A firm may have requirements embedded in its quality control policies and procedures that do not directly contribute to the firm's compliance with the quality control standards established by the AICPA. For example, voluntary membership requirements that do not directly contribute to the firm's compliance would not be tested, addressed, or reported on in the peer review process.

.A29 Acceptable documentation includes an original or copy of the license, print-out from an online license-verification system, correspondence from the licensing authority, or other reasonable alternative documentation. The reviewer's judgment may be needed to determine what alternative documentation is reasonable.

.A30 A reviewer may verify an out-of-state practice unit license or an out-of-state individual license on an individual engagement basis, when that engagement is selected for review and was performed by the reviewed firm in another state requiring a firm or individual license. The decision to perform further testing is based on the reviewer's understanding of the firm's quality control procedures related to licensing and the related risk of noncompliance.

Evaluation of Engagements (Ref: par. .36–.41)

.A31 Audit engagement areas where risk may be significant include, but are not limited to, fraud considerations, use of estimates, emerging issues, and assertions that are difficult to audit.

.A32 Although it is ultimately the firm's responsibility, the team captain and firm may collaborate to determine the remediation.

Expansion of Scope (Ref: par. .42)

.A33 An expansion of scope may include the review of all or relevant portions of one or more engagements. Additional engagements may be

- a. in the same industry,
- b. supervised by the same individual, or
- c. have characteristics associated with the failure to perform or report in conformity with applicable professional standards.

.A34 An expansion of scope may be necessary to determine

- a. the pattern and pervasiveness of matters identified,
- b. the systemic cause of a matter,

- c. if a matter is isolated, or
- d. if a matter should be elevated to a finding, deficiency, or significant deficiency.

Identifying, Aggregating, and Evaluating Matters, Findings, Deficiencies, and Significant Deficiencies

Identifying Matters, Findings, Deficiencies, and Significant Deficiencies ***(Ref: par. .43–.44)***

.A35 Exhibit A shows a broad understanding of the peer review process, from the evaluation of the design of the system of quality control, to the tests of compliance, to the determination of a matter, finding, deficiency, or significant deficiency. It also illustrates the aggregation of these items, their documentation, and their potential impact to the report rating.

.A36 One or more matters may be elevated to a finding, deficiency, or significant deficiency.

Determination of the Systemic Cause (Ref: par. .45–.47)

.A37 Matters may be symptoms of weaknesses in the firm's system of quality control.

.A38 The "no" answers identified when completing peer review checklists for the review and testing of quality control policies and procedures are a helpful resource for reviewers to assess the systemic cause.

.A39 Separate matters that are exactly the same may result from different weaknesses in the firm's system of quality control. Likewise, separate matters that are different may result from the same weakness in the firm's system of quality control.

.A40 The following are some examples of systemic causes that could affect the peer review report rating. The examples cover a broad range of conditions that may not be relevant to every peer review and are not a complete list.

- a. The failure related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.
- b. The failure related to an issue covered by a recent professional pronouncement, and the firm had failed to identify, through professional development programs or appropriate supervision, the relevance of that pronouncement to its practice.
- c. The failure may have been detected if the firm's quality control policies and procedures had been followed.
- d. The failure may have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the AE before reaching such a conclusion.

Isolated Matters (Ref: par. .48–.49)

.A41 The reviewer's ability to conclude that a matter is isolated may be dependent on the reviewer's ability to expand the scope to engagements or elements that are classified by common characteristics such as, but not limited to, the industry, level of service, the practitioners in charge, or must-select engagements.

.A42 A matter is not isolated if there is only one instance available for the reviewer to evaluate. For example, if the matter relates to noncompliance with professional standards regarding employee benefit plans and the firm performs only one employee benefit plan engagement, then the matter would not be considered isolated.

.A43 Considerations of an isolated matter may be documented in the related MFC form, DMFC form, or Summary Review Memorandum.

Aggregating and Evaluating Matters (ref: par. .50–.56)

.A44 The more direct the relationship between a specific quality control policy and procedure and the application of professional standards, the greater the probability that the firm may not perform or report in conformity with applicable professional standards in all material respects when that policy or procedure is not complied with.

.A45 An isolated matter or instance of noncompliance with the firm's system of quality control may be elevated to a finding, deficiency, or significant deficiency when evaluated with the review's other matters (in the aggregate). For example, a single disclosure matter and a single documentation matter may be isolated when taken individually, but they may have resulted from the same systemic cause, or an isolated matter may be materially significant in amount or nature, or both.

.A46 There may be circumstances in which the reviewer identifies few findings in the work performed by the firm but may conclude that the firm's system of quality control would not be effective if complied with. For example, a firm that is growing rapidly and adding personnel and clients may not be giving appropriate attention to the policies and procedures necessary in areas such as human resources (hiring, assigning personnel to engagements, and advancement) and acceptance and continuance of clients and engagements. A reviewer may conclude that these conditions could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more important respects and may result in a deficiency or significant deficiency in a report with a peer review rating of *pass with deficiencies* or *fail*.

.A47 Variances in individual performance and professional interpretation may affect the degree of compliance with a firm's system of quality control. However, the degree of compliance with the firm's quality control policies and procedures needs to be adequate to provide the reviewed firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

.A48 A design or compliance matter, by itself, may result in a peer review rating of *pass with deficiencies* or *fail* when one or more conditions are present in the firm's system of quality control and the reviewer has concluded that the conditions could create a situation in which the firm would not have reasonable assurance of performing or reporting in conformity with applicable professional standards in one or more respects. Examples include, but are not limited to, the following:

- a. Failure to establish or comply with quality control policies and procedures designed to provide the firm with reasonable assurance that the internal culture is based on recognition that quality is essential in performing engagements. This may be evidenced by the lack of a quality control document, failure to appropriately respond to findings in a regulatory investigation, or failure to have a timely peer review.
- b. Failure to comply with relevant ethical requirements. This may be evidenced by failure to obtain independence confirmations from all personnel, failure to inform personnel on a timely basis of changes to the list of clients and related entities, or failure to address potential breaches of independence.
- c. Failure of the firm to undertake or continue relationships and engagements only when the firm is competent to perform the engagements. This may be evidenced by failure to have policies and procedures in place to require evaluation of the nature of the services to be provided, evaluation of the firm's resources to provide the services, or evaluation of the need to engage a third party to assist in new industries.
- d. Failure of the firm to have personnel with the competence, capabilities, and commitment to ethical principles necessary to

perform engagements in accordance with professional standards. This may be evidenced by failure to have policies and procedures requiring personnel to maintain a CPA license, comply with industry-specific CPE requirements, or ensure appropriate industry experience on engagement teams.

- e. Failure of the firm to comply with monitoring of the firm's system of quality control. This may be identified by lack of monitoring of appropriate CPE for all firm personnel, lack of monitoring of all elements of the firm's system of quality control in the firm's peer review year, or failing to appropriately respond to issues identified during engagement inspection.

Communication Requirements for Closing Meeting and Exit Conference

Closing Meeting Communication Requirements (Ref: par. .59–.61)

.A49 The closing meeting may also be attended by representatives of the AE, the board, AICPA staff, or other board-authorized organizations with oversight responsibilities.

.A50 The purpose of a separate closing meeting and exit conference is to provide the firm sufficient time to determine appropriate responses to the matters, findings, deficiencies, and significant deficiencies identified and to provide the team captain with sufficient time to assess the firm's responses prior to the report date (exit conference date). If these steps have been taken prior to the closing meeting or are not necessary, the closing meeting and exit conference may be combined.

.A51 Other suggestions and observations may include implications of upcoming changes in professional standards, operational or efficiency suggestions, and minor areas for improvement.

.A52 A reasonable time frame is typically 30 days.

.A53 If the engagement was reviewed by a specialist, it may be beneficial for the specialist to be available for or participate in the exit conference.

Exit Conference Communication Requirements (Ref: par. .62–.63)

.A54 The purpose of the firm's response on the FFC form or in the letter of response is for a firm to document the specific actions that will be taken to correct findings, deficiencies, and significant deficiencies noted by the reviewer.

.A55 The AE's peer review committee (committee) may require the firm to make and document appropriate considerations regarding nonconforming engagements as a condition of acceptance of the peer review. The firm response may affect other monitoring actions the committee may impose, including actions to verify that the firm adheres to the intentions indicated in its response.

.A56 Examples of firm actions that may be taken in response to nonconforming engagements include, but are not limited to, the following:

- a. Performing omitted procedures performed (including documentation)
- b. Reissuing reports and financial statements
- c. Notifying users to discontinue use of previously issued reports

Written Representations (Ref: par. .64–.66)

.A57 Exhibit A, "Illustrative Representation Letter," in section 310 provides an illustrative example of a firm's representation letter.

.A58 Examples of how a team captain may discover significant issues include the following:

- a. The AE provides the team captain with a referral specific to the firm or a professional within the firm.
- b. The team captain identifies information about significant issues within a firm from a news outlet or publicly available website (for example, via the PCAOB, state board of accountancy, and so on).

Reporting on System Reviews (Ref: par. .67–.69)

.A59 A report with a peer review rating of *pass* is issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

.A60 A report with a peer review rating of *pass with deficiencies* is issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects with the exception of a certain deficiency or deficiencies that are described in the report.

.A61 A report with a peer review rating of *fail* is issued when the team captain has identified significant deficiencies and concludes that the firm's system of quality control is not suitably designed to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects or the firm has not complied with its system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

.A62 In the event of a scope limitation, a report with the applicable peer review rating (*with a scope limitation*) is issued.

.A63 Exhibit B, "Illustrative Examples of the Reviewer's Report on the Firm's System of Quality Control," contains example reports that may be tailored by the reviewer to meet the requirements described in paragraph .69.

.A64 Reference to plural "deficiencies" could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

.A65 If there are repeat deficiencies that have occurred on prior consecutive reviews, the captain should state in the current report that "this deficiency was noted on previous reviews."

Submission of Peer Review Documentation to the AE by the Team Captain (Ref: par. .70–.71)

.A66 All peer reviews are subject to oversight and working papers may be requested by the AE or AICPA staff.

.A67

Appendix A — Consideration of the Results of Regulatory Oversight or Inspections in the Planning and Performance of a Peer Review (Ref: par. .A8)

.01 This appendix contains information related to team captain considerations when a reviewed firm has undergone oversight or inspection by regulatory or governmental bodies.

Oversight or Inspections by Regulatory or Governmental Entities

.02 Oversight or inspections by regulatory or governmental entities (for instance, the Department of Labor, the Department of Health and Human Services, or other local, state, or federal entities) performed on a firm are certainly relevant when assessing peer review risk. The goals of regulatory or governmental oversight, however, may differ from the purpose of a system review. Therefore, although it would be inappropriate for a team captain to place reliance on regulatory or governmental oversight results, it is appropriate for a team captain to consider the following factors when determining the impact of regulatory or governmental oversight and communications from regulatory or governmental bodies on peer review risk:

- a. *The impact of regulatory or governmental oversight on the scope of the peer review.* Both the inherent risk and control risk associated with a peer review may be affected if the engagements subject to regulatory or governmental oversight are also within the scope of engagements that can be selected for peer review. For example, the nature, systemic cause, pattern, or pervasiveness of issues identified by oversight may affect the assessed inherent risk as it relates to the firm's demonstrated expertise in performing the relevant engagements and the assessed control risk as it relates to how the system of quality control is designed to prevent issues in the relevant engagements and the effectiveness of those controls.

Although more substantive comments are more likely to affect the peer review engagement selections, a lack of comments from oversight or inspection does not necessarily indicate that the firm's system of quality control is operating effectively for the relevant industry practice. Ultimately, the impact to the peer review risk assessment (and thus the nature, timing, and extent of testing performed) will be based on the evaluation of the significance of the comments related to the firm's accounting and auditing practice performed by the team captain.

Finally, understanding the systemic causes of and firm responses to any deficiencies or indications of engagements that were not performed or reported on in conformity with applicable professional standards in all material respects identified by the oversight body is vital when determining the impact of oversight or inspection on the peer review risk assessment and engagement selection. Understanding these systemic causes and firm responses might also help the team captain identify the systemic causes of any similar matters that are identified as a result of the review team's review of engagements during the peer review.

- b. *The timing of the regulatory or governmental oversight results.* The time period covered by the regulatory oversight results is also relevant in determining the usefulness of the information when assessing peer review risk and determining the impact (if any) on the nature, timing, and extent of peer review procedures. For example, the oversight results from more recently completed oversight are likely to be more relevant than the results from older oversight. Any open or ongoing oversight, the status of that oversight, and the firm's preliminary remediation plans (if applicable) would also be relevant for a team captain's risk assessment.
- c. *The firm's responsiveness to regulatory or governmental oversight results.* The degree of the firm's responsiveness to oversight findings and other communications, as evidenced by the remediation planned or taken, is also an important aspect of the team captain's risk assessment. Remediation efforts by the firm may affect industries that are subject to peer review and may assist the team captain when considering the design of the firm's system of quality control or compliance with it.
- d. *The size of the firm relative to its specialized industry practices.* The relative significance of the specialized industry practices subject to regulatory oversight as compared to the firm's total practice is an important factor when determining the relevance of the oversight results to the peer review, as this may affect the reviewer's evaluation of the firm's design of and compliance with its system of quality control.

Inspections by the PCAOB

.03 Although PCAOB inspection reports cover only the portion of a firm's practice that is subject to permanent inspection, most firms typically have only one system of quality control. As a result, the PCAOB inspection report may contain information that could assist the reviewer in assessing peer review risk. The firm will have valuable insight on both the public and nonpublic portions (if made available) of either the most recently released PCAOB inspection reports or any ongoing PCAOB inspection. These insights will assist the team captain in identifying risks with the firm's system of quality control.

.04 Similarly to other oversight or inspections, the nature, relative importance, systemic cause, pattern, or pervasiveness of the findings contained in PCAOB inspection reports may affect the nature, timing, and extent of peer review procedures. By performing the following steps, a team captain can properly identify risks associated with the firm's system of quality control:

- a. Consider the information contained in public portions of recent PCAOB inspection reports.
- b. Consider the information in the nonpublic portions of the PCAOB inspection reports, if made available by the firm.
- c. Consider the information made available by the firm related to any ongoing PCAOB inspections.
- d. Perform further inquiry of the firm to determine the offices, and partners, related to findings detailed in the PCAOB report.
- e. Determine which PCAOB findings (if any) may be applicable to the portion of the firm's practice that was not subject to PCAOB inspection.
- f. Understand the systemic causes of the findings (as determined by the firm).

- g.* Understand how the firm remediated the findings for the most current inspection (or the firm's remediation plan).
- h.* Consider the firm's remediation history with respect to PCAOB inspection findings (if any).

.05 As a reminder, discussing PCAOB inspection findings does not permit the peer reviewer to request the nonpublic portions of the PCAOB inspection report.

.A68

Appendix B — Considering the Firm's Monitoring Procedures to Reduce a Reviewer's Testing Procedures (Ref: par. .23)

.01 This appendix contains information on the team captain's considerations of the firm's monitoring procedures when the team captain plans to reduce scope based on those procedures. If a firm and team captain work collaboratively and with an integrated approach, regardless of the size of the firm, the team captain could maximize the benefits of taking into account a firm's current-year internal inspection and other relevant factors (for example, regulatory oversight from the PCAOB or other regulatory or governmental entities, such as the Department of Labor [DOL], the Department of Health and Human Services [HHS], or local regulatory agencies) in determining inherent and control risk. However, given that the peer review covers a defined year, internal inspection procedures and results for a year outside the peer review year are not likely to be relevant.

.02 In making a judgment about the effects that the firm's current-year internal inspection procedures will have on the selection of offices and engagements to be reviewed, the team captain will likely need to consider the following:

- a. The firm's cooperation and willingness to share all relevant information
- b. Whether the firm's internal inspection procedures are robust
- c. Whether the firm's internal inspection includes all clients, even those not subject to the AICPA's peer review standards
- d. The potential biases of the firm's internal inspectors and the impact of those biases on the internal inspection results

.03 The team captain will also likely need to consider the extent of the review team's involvement in the internal inspection process, including the following:

- a. Level of involvement in internal inspection planning, such as inclusion in discussions or meetings, and the team captain's approval of internal inspectors' qualifications, the internal inspection's risk assessment, scopes, risk-based approach, and office or engagement selections.
- b. Coordination of peer review planning with internal inspection planning.
- c. The team captain's in-depth understanding of the firm's internal inspection process, including an assessment of its design and effectiveness.
- d. The level of contemporaneous testing of the firm's internal inspection procedures (commonly called "piggyback reviews" or "piggyback testing"). The less piggyback testing a review team performs, the more direct testing the review team would need to perform, and vice versa. In order to be effective, procedures for piggyback testing would need to be similar to those for direct testing. For example, engagement piggyback testing procedures could include a review of financial statements, working papers, and the engagement checklist being used by the internal inspector, as well as participation by the review team in discussions, meetings, or both between the internal inspector and the engagement partner or manager and related follow-up procedures. Although test-

ing of internal inspection procedures can be performed after the internal inspection procedures are completed, this type of testing will not provide the peer reviewer with the same level of understanding and insight into the internal inspection process as piggyback testing would. In addition to piggyback testing, a reviewer may perform supplant reviews, for which the reviewer becomes a member of the internal inspection team and participates in one or more reviews of engagements. Supplant reviews enable a reviewer to evaluate the internal inspection team's process and decision-making, and as with piggyback reviews, there is a correlation between the level of the reviewer's involvement in the internal inspection and direct testing.

- e.* Assessment of how the internal inspectors resolve open matters and deal with potential issues detected in their reviews.
- f.* The scopes and selections of the internal inspectors and the use of peer review to balance out the coverage.
- g.* The correlation between the findings of the reviewer and internal inspection, evaluated with regard to the peer review's scope.

.04 The results of these considerations assist the team captain in determining the appropriate amount of procedures to be performed by the review team. A team captain may be able to significantly reduce the scope of the procedures the review team directly performs. For example, a significant reduction would be permitted when the extent of the peer reviewer's involvement with the firm's internal inspection is so timely and significant that the peer review and internal inspection can be viewed as an integrated activity. In this example, the collaboration would result in a reallocation of effort and resources between the review team and the firm in such a way that the overall scope and the effort involved are not diminished and, if anything, are enhanced. The resulting peer review would remain as rigorous as a peer review in which there is no consideration of internal inspections or other inputs.

.05 Ultimately, if the reviewer plans to consider the current-year internal inspection procedures to reduce the scope of the peer review, the team captain would need to determine that the firm's internal inspection procedures

- a.* were applied properly in the reviews of individual practice offices and engagements.
- b.* were carried out conscientiously by competent persons with appropriate expertise and objectivity.
- c.* produced findings that are representative of the work performed by the firm and therefore can be considered by the review team to reach an overall conclusion regarding the firm's compliance with its quality control policies and procedures.

.06 As stated when discussing piggyback testing, testing performed by the review team in order to reach these conclusions can be performed contemporaneously or after internal inspection procedures have been completed.

.07 Examples of procedures a review team would perform when testing the effectiveness of the internal inspection procedures contemporaneously with the performance by the internal inspection team performing the procedures include the following:

- a.* Re-performing the review of a sample of engagements subjected to internal inspection procedures

- b. Re-performing the review of a sample of the quality control policies and procedures (functional elements) subjected to internal inspection procedures in the offices
- c. Comparing the review team's findings to the internal inspection team's findings and resolving any differences
- d. Attending discussions of engagement findings and the overall office findings, if applicable

.08 Examples of procedures a review team would perform when testing the effectiveness of the internal inspection procedures after the procedures have been completed include the following:

- a. Re-performing the review of a sample of engagements
- b. Re-performing the review of a sample of the quality control policies and procedures (functional elements) subjected to internal inspection procedures in the offices
- c. Comparing the review team's findings to the internal inspection team's findings and resolving any differences

Practical Examples Related to Relying on a Firm's Internal Inspection Procedures

.09 The following are example scenarios a team captain could encounter when considering whether or not to rely on a firm's internal inspection procedures. Of course, these examples cannot address all the different factors a team captain could consider, and thus, the team captain will need to use judgment in determining whether and to what extent the reviewer could reduce or modify scope.

Example 1: A firm has 800 employees, 10 offices, and a strong centralized quality control department; operates by industry segment; and has pre-issuance reviews and annual internal inspections. It is registered with the PCAOB, undergoes annual PCAOB inspection, and has one system of quality control for both SEC and non-SEC engagements. Based on various factors, the peer reviewers have assessed inherent and control risk as low. Prior peer reviews have been *pass* reports. Internal inspection appears robust, and beginning last year, the firm lowered the bar for "no" responses on checklists used for internal inspections. The peer reviewers were integrally involved in the internal inspection, approved the planning, and attended several office exit conferences. In addition, they performed piggybacks on 5% of the firm's internal inspection procedures, and those procedures confirmed other internal inspection results. The PCAOB was involved in the current year's internal inspection planning, and results of the prior year's PCAOB inspection mirrored prior internal inspection results. Results from a DOL audit that covered the peer review year raised an issue that was also highlighted during the current year's internal inspection. *The peer reviewers could consider maximum reliance on the internal inspection process and thus consider a reduction in scope or procedures.*

Example 2: A firm has 300 employees and 5 offices. The firm has undergone several mergers in the past two years. Engagements undergo pre-issuance review, and each office performs its own internal inspection that is then sent to the main office. The firm engaged new peer reviewers and asked them to implement the guidance contained in this document with the intent of reducing scope and procedures and thus costs. The peer reviewers participated in planning meetings and performed a number of piggybacks. However, the peer reviewers disagree with some of the judgments made by the internal inspectors and believe that the results from the offices are not being consolidated adequately. They are concerned that the integration of the firms has not been successful. The firm is registered with the PCAOB and underwent an inspection in the past

year. However, the report is not yet public, and the firm is unable or unwilling to communicate the results or its experiences with the peer reviewers. *The peer reviewer would not be able to place significant reliance on internal inspection to reduce scope or procedures in this example.*

Example 3: A firm has 60 employees and 2 offices. It performs pre-issuance reviews and annual internal inspections. The peer reviewers have assessed inherent and control risk as moderate. Prior peer reviews have been *pass* reports with a few findings for further consideration. The firm has a very experienced and highly regarded quality control director who is assisted by several of the firm's more technical partners each year in performing the internal inspection. They approach the internal inspection seriously. The peer reviewers were integrally involved in the internal inspection, approved the planning, and attended several office exit conferences. In addition, they performed piggybacks on 7% of the firm's internal inspection procedures, and those procedures confirmed other internal inspection results, even though they revealed several issues that might lead to findings. The firm is registered with the PCAOB and underwent an inspection in the prior year. The quality control director shared the PCAOB's matter sheets with the peer reviewers. The PCAOB had noted that staff was not adequately documenting considerations related to fraud on the SEC engagements. The internal inspectors paid particular attention to this matter and agreed that it was a problem for one of the offices. *The peer reviewers could consider moderate reliance on the internal inspection process and, thus, some reduction in scope or procedures.*

Example 4: A firm has 20 employees and 1 office. It has no SEC engagements and is not registered with the PCAOB. Its last peer review was *pass* with no findings. The firm performs pre-issuance reviews and annual internal inspections. The partner that performs the internal inspection is also the pre-issuance reviewer or engagement partner on many of the firm's audit engagements. The firm's annual internal inspection is performed in the spring, but, due to scheduling conflicts, its peer reviewers, who come from out of state, are only available in the fall. The two peer reviewers typically review four audits and four reviews or compilations, within a two- or three-day time frame. *Cost-benefit and other considerations would most likely lead the firm and the peer reviewers to conclude that there should be no reliance on the internal inspection to reduce scope or procedures.*

.A69

Appendix C — Additional Requirements for Must-Select and Must-Cover Engagements (Ref: par. .27)

.01 This appendix contains the engagements identified as must select and must cover.

Must-Select Engagements

.02 The following paragraphs discuss must-select engagements. One or more engagements should be reviewed from each must-select engagement type, taking into consideration requirements related to assessing peer review risk and engagement selection. (Ref: par. .20–.21, .23–.25, and .28)

Engagements Under Government Auditing Standards

.03 *Government Auditing Standards* (GAS), issued by the U.S. Government Accountability Office, requires auditors conducting engagements in accordance with those standards to have a peer review that includes the review of at least one engagement conducted in accordance with those standards. Additionally, if the firm performs engagements of entities subject to the Single Audit Act, the reviewer must evaluate a compliance audit.

.04 Inclusion of a must-select engagement should not supersede the reviewer's consideration of engagements and industries that have a significant public interest, such as state and local governments, school districts, and Department of Housing and Urban Development (HUD) engagements. For example, if for-profit HUD multifamily housing project audit engagements constitute a significant percentage of a firm's practice, one would expect the reviewer to select at least one such engagement for review. However, if the firm also performed an audit of an engagement subject to the Single Audit Act, such as a local government or not-for-profit organization, one such engagement must also be selected to perform an evaluation of the firm's single audit compliance. Peer reviewers should also consider audit firm experience such as how many governmental audits the firm performs, the number of years' experience in performing these engagements, the number of team members with experience, whether the team members have undergone CPE or specialized training, and reasonableness of hours spent on GAS engagements. Further consideration should be given to communications from regulatory agencies.

Audits of Employee Benefit Plans Under ERISA

.05 Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk associated with, audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA).

.06 For employee benefit plans under ERISA, the peer reviewer should consider whether the engagement selection process has adequately addressed the risks involved in ERISA Section 103(a)(3)(C) audits (formerly called "limited-scope" audits) versus non-ERISA 103(a)(3)(C) audits (formerly called "full-scope" audits) and in different types of benefit plans such as defined benefit, defined contribution, and voluntary health and welfare plans. If a firm has more than one of the preceding types of plans, a selection from each type of plan is not required; however, the reviewer must consider the unique risks associated with those types of plans and document how these risks were addressed in the risk assessment. Peer reviewers should also consider audit firm experience such as how many ERISA audits the firm performs, the number of years' experience in

performing these engagements, the number of team members with experience, whether the team members have undergone CPE or specialized training, and reasonableness of hours spent on ERISA engagements. Consideration should also be given to communications from regulatory agencies.

Audits Under FDICIA

.07 The 1993 Federal Deposit Insurance Corporation guidelines implementing the Federal Deposit Insurance Corporation Improvement Act (FDICIA) require auditors of federally insured depository institutions having total assets of \$500 million or more at the beginning of the fiscal year to have a peer review that includes the review of at least one audit of an insured depository institution subject to the FDICIA.

.08 For FDICIA engagements, peer reviewers should take into consideration the amount of total assets held by the federally insured depository institution (less than \$500 million, more than \$500 million, more than \$1 billion). Peer reviewers should also consider audit firm experience, such as how many FDICIA audits the firm performs, the length of experience in performing these engagements, the number of team members with experience, whether the team members have undergone CPE or specialized training, and reasonableness of hours spent on FDICIA engagements. Further consideration should be given to the risks of the audited company, such as the level of reporting the institution complies with (the holding company level or the bank subsidiary level, and the regulatory issues associated with each), the balance of the lending portfolio (the industries and concentration percentage of the portfolio), any regulatory correspondence and examination results, capital ratios, financial institution management experience, economic environment and geographic location of the institution, number of branches, and experience and longevity of the board of directors and audit committee.

Examinations of Service Organizations

.09 Due to the reliance of user entities on system and organization control (SOC) reports, particularly SOC 1® and SOC 2® reports,² there is a significant public interest in examinations of service organizations relevant to user entities. If a firm performs an examination of one or more service organizations and issues a SOC 1 or SOC 2 report, at least one examination should be reviewed. If a firm performs both SOC 1 and SOC 2 engagements and a proper risk assessment determined that only one SOC engagement should be selected, a SOC 1 engagement should be reviewed due to the reliance on the report by other auditors.

.10 The peer reviewer should consider whether the engagement selection process has adequately addressed the risks involved in different types of SOC engagements (SOC 1 and SOC 2 engagements). If a firm performs more than one of the preceding types of SOC engagements, the reviewer must consider the unique risks associated with each engagement and document how these risks were addressed in the risk assessment. Peer reviewers should also consider audit firm experience, such as how many SOC engagements the firm performs, the length of experience in performing these engagements, the number of team members with experience, whether the team members have undergone CPE or specialized training, whether the firm utilizes a group that specializes in

² In 2017, the AICPA introduced the term *system and organization controls* (SOC) to refer to the suite of services practitioners may provide relating to system-level controls of a service organization and system- or entity-level controls of other organizations. Formerly, SOC referred to service organization controls. By redefining that acronym, the AICPA enables the introduction of new internal control examinations that may be performed (a) for other types of organizations, in addition to service organizations, and (b) on either system-level or entity-level controls of such organizations.

internal controls for completing its SOC engagements, and reasonableness of hours spent on SOC engagements. Additional consideration should be given to whether the firm performs SOC engagements with significant subservice organizations identified in the auditor's opinion (the inclusive method is higher risk than the carve-out method). Further consideration should be given to communications from regulatory agencies. Although SOC 1 and SOC 2 engagements are different, noncompliance for one type may be indicative of noncompliance in the other. SOC 3® engagements are not must-select engagements, but when considering the pervasiveness of a systemic cause and the portion of the firm's practice that may be affected by matters identified with other SOC engagements, the reviewer should also consider SOC 3 engagements.

Must-Cover Engagements

.11 The board periodically assesses engagements that may currently have the most significant public interest and deems them must-cover engagements. These engagements, in addition to the must-select engagement types described previously, are must-cover engagements for all firms.

.12 The following are must-cover engagements: (Ref: par. .11 of section 100)

- a. Internal control reports issued under the FDICIA when total assets exceed \$1 billion
- b. State and local governments
- c. Any industry that has a 10% or more concentration of the firm's audit practice

.A70

Exhibit B — Illustrative Examples of the Reviewer's Report on the Firm's System of Quality Control

This exhibit contains various illustrations of a peer reviewer's report on a firm's system of quality control (system reviews).

Illustration 1 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass

Illustration 2 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With a Scope Limitation

Illustration 3 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies

Illustration 4 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies With a Scope Limitation

Illustration 5 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Fail

Illustration 6 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Fail With a Scope Limitation

Illustration 1 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association-formed review team]

Report on the Firm's System of Quality Control

[Exit Conference Date]

To the Partners of *[or other appropriate terminology]* XYZ & Co. and the Peer Review Committee of the *[insert the name of the applicable administering entity]*,¹

We² have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)³ in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at

¹ The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of *[or appropriate terminology]* XYZ & Co. and the National Peer Review Committee"

² The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

³ The report of a firm who is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on our review.

Required Selections and Considerations

Engagements selected for review included engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of employee benefit plans; audits performed under FDICIA; and examinations of service organizations (SOC 1® and SOC 2® engagements).⁴

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Opinion

In our opinion, the system of quality control for the accounting and auditing practice of XYZ & Co.⁵ in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass*.

[Name of team captain's firm]

⁴ If the firm performs audits of employee benefit plans; engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of depository institutions with total assets of \$500 million or more at the beginning of the institution's fiscal year; examinations of service organizations (SOC 1® and SOC 2® engagements); or other engagements required to be selected by the board, the engagement(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under *Government Auditing Standards* (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate a compliance audit under the Single Audit Act, this portion of the sentence should read as follows: "*Government Auditing Standards*, compliance audits under the Single Audit Act," and so on. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

⁵ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

Illustration 2 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With a Scope Limitation

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association-formed review team]

Report on the Firm's System of Quality Control

[Exit Conference Date]

To the Partners of *[or other appropriate terminology]* XYZ & Co. and the Peer Review Committee of the *[insert the name of the applicable administering entity]*,¹

We² have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)³ in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

The nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of the applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on our review.

Required Selections and Considerations

Engagements selected for review included engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of employee benefit plans; audits performed under FDICIA; and examinations of service organizations (SOC 1[®] and SOC 2[®] engagements).⁴

¹ The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of *[or appropriate terminology]* XYZ & Co. and the National Peer Review Committee".

² The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

³ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

⁴ If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of depository institutions with total assets of \$500 million or more at the beginning of the institution's fiscal year; examinations of service organizations (SOC 1[®] and SOC 2[®] engagements); or other engagements required to be selected by the board, the engagement(s) selected for review should be identified

(continued)

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Scope Limitation⁵

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of its former partners who left the firm during the peer review year. Accordingly, we were unable to include in our engagement selection any of the divested engagements. That partner's responsibility was concentrated in the construction industry. The engagements excluded from our engagement selection process included audit engagements and comprised approximately 15% of the firm's audit and accounting practice during the peer review year.

Opinion

In our opinion, except for any deficiencies or significant deficiencies that might have come to our attention had we been able to review divested engagements, as previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.⁶ in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass (with a scope limitation)*.

[Name of team captain's firm]

Illustration 3 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association-formed review team]

Report on the Firm's System of Quality Control

[Exit Conference Date]

To the Partners of [or other appropriate terminology] XYZ & Co. and the Peer Review Committee of the [insert the name of the applicable administering entity],¹

(footnote continued)

in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under *Government Auditing Standards* (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate a compliance audit under the Single Audit Act, this portion of the sentence should read as follows "*Government Auditing Standards*, compliance audits under the Single Audit Act," and so on. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

⁵ The scope limitation paragraph provided is an example for illustrative purposes only.

⁶ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

¹ The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee."

We² have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)³ in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of the applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on our review.

Required Selections and Considerations

Engagements selected for review included engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of employee benefit plans; audits performed under FDICIA; and examinations of service organizations (SOC 1® and SOC 2® engagements).⁴

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Deficiencies⁵ Identified in the Firm's System of Quality Control

We noted the following deficiencies⁶ during our review:

² The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

³ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

⁴ If the firm performs audits of employee benefit plans; engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of depository institutions with total assets of \$500 million or more at the beginning of the institution's fiscal year; examinations of service organizations (SOC 1® and SOC 2® engagements); or other engagements required to be selected by the board, the engagement(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under *Government Auditing Standards* (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate a compliance audit under the Single Audit Act, this portion of the sentence should read as follows "Government Auditing Standards, compliance audits under the Single Audit Act," and so on. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

⁵ This should be tailored to indicate a single deficiency, when applicable.

⁶ The deficiencies provided are examples for illustrative purposes only.

1. The firm's quality control policies and procedures addressing continuing professional education (CPE) are not suitably designed or complied with to provide reasonable assurance that its personnel will have the competence necessary to perform engagements in accordance with professional and regulatory requirements. Although the firm's policies require that personnel attain a minimum of 40 hours of CPE courses annually and comply with CPE requirements of the applicable external bodies, the firm lacks appropriate procedures to determine whether the personnel are in compliance with these requirements. During our review, we noted several personnel who did not comply with CPE requirements of *Government Auditing Standards*. In our opinion, this contributed to audit engagements performed under *Government Auditing Standards* that did not conform to professional standards in all material respects.
2. The firm's quality control policies and procedures regarding engagement performance have not been suitably designed or complied with to provide reasonable assurance that audit engagements are consistently performed in accordance with professional standards. The firm requires the use of a non-industry-specific audit program but does not require that program to be tailored to cover requirements of specialized industries or those subject to regulatory bodies. During our review, we noted procedures were not performed to determine if a banking institution met its minimum capital requirements. In our opinion, this contributed to audit engagements in the banking industry that did not conform to professional standards in all material respects.

Opinion

In our opinion, except for the deficiencies previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.⁷ in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass with deficiencies*.

[Name of team captain's firm]

Illustration 4 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies With a Scope Limitation

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association-formed review team]

Report on the Firm's System of Quality Control

[Exit Conference Date]

To the Partners of [or other appropriate terminology] XYZ & Co. and the Peer Review Committee of the [insert the name of the applicable administering entity],¹

⁷ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

¹ The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee"

We² have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)³ in effect for the year ended June 30, 20XX. Except as subsequently described, our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of the applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of the applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on our review.

Required Selections and Considerations

Engagements selected for review included audits of employee benefit plans; audits performed under FDICIA; and examinations of service organizations (SOC 1[®] and SOC 2[®] engagements).⁴

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Deficiency⁵ Identified in the Firm's System of Quality Control

We noted the following deficiency⁶ during our review:

² The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

³ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

⁴ If the firm performs audits of employee benefit plans; engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of depository institutions with total assets of \$500 million or more at the beginning of the institution's fiscal year; examinations of service organizations (SOC 1[®] and SOC 2[®] engagements); or other engagements required to be selected by the board, the engagement(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under *Government Auditing Standards* (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate a compliance audit under the Single Audit Act, this portion of the sentence should read as follows "Government Auditing Standards, compliance audits under the Single Audit Act," and so on. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

⁵ This language should be tailored to indicate multiple deficiencies, when applicable.

⁶ The deficiency provided is an example for illustrative purposes only.

1. The firm's quality control policies and procedures regarding engagement performance have not been suitably designed or complied with to provide reasonable assurance that audit engagements are consistently performed in accordance with applicable regulatory requirements. As noted in the following text, we were unable to select the firm's only audit subject to *Government Auditing Standards* (the Yellow Book). As a result, the firm was not in compliance with the Yellow Book peer review engagement selection requirements.

Scope Limitation⁷

In performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (the Yellow Book). As a result, we were unable to review all the engagements required to be selected by the standards established by the Peer Review Board of the AICPA.

Opinion

In our opinion, except for the effects of the deficiency previously described and any additional deficiencies or significant deficiencies that might have come to our attention had we been able to review the engagement as previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.⁸ in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass with deficiency (with a scope limitation)*.

[Name of team captain's firm]

Illustration 5 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Fail

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association-formed review team]

Report on the Firm's System of Quality Control

[Exit Conference Date]

To the Partners of [or other appropriate terminology] XYZ & Co. and the Peer Review Committee of the [insert the name of the applicable administering entity],¹

We² have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)³ in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing

⁷ The scope limitation paragraph provided is an example for illustrative purposes only.

⁸ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

¹ The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee."

² The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

³ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of the applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of the applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control and the firm's compliance therewith based on our review.

Required Selections and Considerations

Engagements selected for review included engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of employee benefit plans; audits performed under FDICIA; and examinations of service organizations (SOC 1® and SOC 2® engagements).⁴

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Significant Deficiencies⁵ Identified in the Firm's System of Quality Control

We noted the following significant deficiencies⁶ during our review:

1. The firm's quality control policies and procedures do not provide reasonable assurance that the firm will comply with applicable professional standards and will issue reports that are appropriate in the circumstances, as a result of the following significant deficiencies:

⁴ If the firm performs audits of employee benefit plans; engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of depository institutions with total assets of \$500 million or more at the beginning of the institution's fiscal year; examinations of service organizations (SOC 1® and SOC 2® engagements); or other engagements required to be selected by the board, the engagement(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under *Government Auditing Standards* (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate a compliance audit under the Single Audit Act, this portion of the sentence should read as follows "Government Auditing Standards, compliance audits under the Single Audit Act," and so on. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

⁵ This language should be tailored to indicate a single significant deficiency, when applicable.

⁶ When considered together, the deficiencies rise to the level of significant deficiencies. The significant deficiencies provided are examples for illustrative purposes only.

- a. The firm lacks policies and procedures addressing new engagement acceptance to reasonably ensure it only undertakes engagements that it has the capabilities, resources, and professional competence to complete in accordance with applicable professional standards.
- b. The firm lacks policies and procedures addressing continuing professional education (CPE) to require its personnel to obtain relevant training to prepare for engagements in new industries or service areas.
- c. Firm leadership has not implemented policies and procedures to provide clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's commitment to quality.

In our opinion, the significant deficiencies described previously contributed to an employee benefit plan audit that did not conform to professional standards in all material respects. During our review, we discovered that the firm had undertaken an employee benefit plan audit without performing appropriate acceptance procedures, including the engagement partner obtaining relevant CPE or otherwise obtaining sufficient knowledge to conduct the audit.

2. The firm's quality control policies and procedures addressing continuing professional education (CPE) are not sufficient to provide reasonable assurance that its personnel will have the competence necessary to perform engagements in accordance with professional and regulatory requirements. The courses taken by firm personnel did not provide them with sufficient information about current developments in accounting and auditing matters. In our opinion, this led to firm personnel being unable to appropriately address recent pronouncements and new disclosure requirements and failure to consider new auditing standards and other required communications. This contributed to audit engagements performed under *Government Auditing Standards*, and audits in other industries, that did not conform to professional standards in all material respects.
3. The firm's quality control policies and procedures regarding monitoring do not provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The firm's quality control policies and procedures do not
 - a. include an ongoing consideration and evaluation of the firm's system of quality control, including inspection or a periodic review of engagement documentation, reports, and clients' financial statements for a selection of completed engagements.
 - b. require responsibility for the monitoring process to be assigned to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.
 - c. assign the performance of monitoring the firm's system of quality control to qualified individuals.

Opinion

In our opinion, as a result of the significant deficiencies previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.⁷ in effect for the year ended June 30, 20XX, was not suitably designed or complied with to provide the firm with reasonable assurance of performing or reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *fail*.

[Name of team captain's firm]

Illustration 6 — A Reviewer's Report on the Firm's System of Quality Control With a Peer Review Rating of Fail With a Scope Limitation

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association-formed review team]

Report on the Firm's System of Quality Control

[Exit Conference Date]

To the Partners of *[or other appropriate terminology]* XYZ & Co. and the Peer Review Committee of the *[insert the name of the applicable administering entity]*,¹

We² have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm)³ in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a system review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm's Responsibility

The firm is responsible for designing and complying with a system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with the requirements of the applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with the requirements of the applicable professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

⁷ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

¹ The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of *[or appropriate terminology]* XYZ & Co. and the National Peer Review Committee."

² The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

³ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

Peer Reviewer's Responsibility

Our responsibility is to express an opinion on the design of and compliance with the firm's system of quality control based on our review.

Required Selections and Considerations

Engagements selected for review included engagements performed under *Government Auditing Standards*; audits of employee benefit plans, audits performed under FDICIA, and examinations of service organizations (SOC 1® and SOC 2® engagements).⁴

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Significant Deficiencies⁵ Identified in the Firm's System of Quality Control

In addition, we noted the following significant deficiencies⁶ during our review:

1. The firm's quality control policies and procedures provide reasonable assurance that the firm and its personnel will comply with relevant ethical requirements. The firm's quality control policies and procedures require that written independence representations be obtained annually from all partners and personnel and then be reviewed by a partner in the firm assigned overall responsibility for such matters. During our review, we noted that the responsible partner left the firm in the early part of the year and her responsibilities in this area had not been reassigned. In our opinion, this contributed to several of the firm's personnel failing to sign such a representation. Written independence representations were subsequently obtained but there were instances where the firm was not independent with respect to the financial statements on which it reported, which caused the engagements to not conform to professional standards in all material respects.
2. The firm's policies and procedures regarding acceptance and continuance of clients are not complied with to provide it with reasonable assurance that its personnel are competent to perform the engagement and have the capabilities to do so. The firm accepted an audit in a specialized industry in which it had no experience or expertise and did not take steps to obtain competency prior to issuing the audit report. In our opinion, this contributed to an employee benefit plan audit that was not performed in accordance with professional standards in all material respects.

⁴ If the firm performs audits of employee benefit plans; engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act; audits of depository institutions with total assets of \$500 million or more at the beginning of the institution's fiscal year; examinations of service organizations (SOC 1® and SOC 2® engagements); or other engagements required to be selected by the board, the engagement(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the reviewer selected an engagement under *Government Auditing Standards* (excluding engagements subject to the Single Audit Act) and also selected an engagement solely to evaluate a compliance audit under the Single Audit Act, this portion of the sentence should read as follows "Government Auditing Standards, compliance audits under the Single Audit Act," and so on. For SOC engagements, the paragraph should be tailored to reflect the type(s) selected for review. The paragraph should be tailored to indicate if single or multiple engagements were selected for review (for example, an audit versus audits). If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

⁵ This language should be tailored to indicate a single significant deficiency, when applicable.

⁶ When considered together, the deficiencies rise to the level of significant deficiencies. The significant deficiencies provided are examples for illustrative purposes only.

3. The firm's use of the standardized planning forms required by its quality control policies and procedures for engagement performance are not consistently complied with to provide reasonable assurance that audit engagements are performed in accordance with professional standards. Despite such forms including audit planning steps for considering preliminary judgments about materiality levels, fraud risk factors, planned assessed level of control risk, analytical review procedures, and conditions that may require an extension of or a modification of tests, we noted several engagements that lacked sufficient evidence of such considerations. In our opinion, this contributed to audits of employee benefit plans and audit engagements in other industries that did not conform to professional standards in all material respects.

Scope Limitation⁷

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of the firm's four offices that divested from the firm during the peer review year. As a result, we were unable to include within our engagement selection any engagements issued by that office. The engagements excluded from our engagement selection process included audit engagements and composed approximately 20% of the firm's audit and accounting hours during the peer review year.

Opinion

In our opinion, as a result of the significant deficiencies previously described, and any additional significant deficiencies that might have come to our attention had we been able to review engagements from the divested office as previously described, the system of quality control for the accounting and auditing practice of XYZ & Co.⁸ in effect for the year ended June 30, 20XX, was not suitably designed or complied with to provide the firm with reasonable assurance of performing or reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *fail (with a scope limitation)*.

[Name of team captain's firm]

⁷ The scope limitation paragraph provided is an example for illustrative purposes only.

⁸ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

PR-C Section 220

General Principles and Responsibilities for Reviewers — Engagement Reviews

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains performance and reporting requirements and application guidance for reviewers engaged to perform an engagement review. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*, and section 200, *General Principles and Responsibilities for Reviewers*. Additionally, the review captain should be familiar with the firm requirements in section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*.

.02 Engagement reviews are available to firms that perform engagements under the Statements on Standards for Accounting and Review Services (SSARSs) and engagements under the Statements on Standards for Attestation Engagements (SSAEs) other than examinations as their highest levels of service. (Ref: par. .A1)

Effective Date

.03 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objectives

.04 In performing an engagement review, the objectives of the review captain are to

- a. evaluate whether the engagements submitted for review are performed and reported on in conformity with applicable professional standards in all material respects and
- b. report on the evaluation of selected engagements.

Definitions

.05 Terms applicable to this section are defined in paragraph .11 in section 100.

Requirements

Planning

.06 The reviewer should perform planning procedures before selecting engagements for review.

.07 The review captain should obtain from the reviewed firm the following:

- a. The number of engagements performed by level of service and industry for each engagement partner
- b. Responses to inquiries about the areas to be addressed in the written representations
- c. The firm's prior
 - i. peer review report,
 - ii. letter of response (if applicable),
 - iii. letter of acceptance,
 - iv. findings for further consideration (FFCs) (if applicable), and
 - v. representation letter

.08 The review captain should determine if the firm and its personnel are in compliance with licensure requirements of the state boards of accountancy in which the firm and its personnel practice for the peer review year through the issuance dates of the reviewed engagements by verifying the following: (Ref: par. .A2)

- a. The practice unit license (firm license) in the state in which the practice unit is domiciled (main office is located)
- b. Individual (personnel) licenses in the state in which the individual primarily practices public accounting for appropriate personnel on engagements selected

.09 If the review captain deems it appropriate to test out-of-state licenses, the review captain should expect the firm to provide documentation supporting its compliance with, or approach to, out-of-state licensing requirements. AICPA online CPA mobility provisions may be used to assist the review captain in evaluating the firm's approach to firm and individual out-of-state licensing. (Ref: par. .A3)

.10 If a firm does not possess the required applicable licenses to perform accounting and auditing engagements anytime during the peer review year through the issuance dates of the reviewed engagements, the review captain must document this on an FFC.

.11 If an individual with reporting responsibility does not have a current individual license to practice public accounting as required by state boards of accountancy, the review captain should consider the engagements reported on by that individual as not performed or reported on in conformity with applicable professional standards in all material respects (nonconforming).

Engagement Selection

.12 The review captain should select the following: (Ref: par. .A4–.A5)

- a. One engagement from each of the following levels of service performed by the firm:
 - i. Reviews of financial statements (performed under SSARSs)
 - ii. Compilations of financial statements with disclosures (performed under SSARSs)
 - iii. Compilations of financial statements that omit substantially all disclosures (performed under SSARSs)

- iv. Engagements performed under the SSAEs other than examinations
 - b. One engagement from each engagement partner responsible for the issuance of reports listed in item (a).
 - c. At least two engagements, unless only one is performed
- .13** The review captain should select a preparation engagement only in the following instances:
- a. It is the only level of service performed by an engagement partner.
 - b. It is the only engagement performed with disclosures.
 - c. It is the only engagement performed without disclosures.
 - d. Doing so is necessary to meet the minimum requirement of two engagements selected for review.
- .14** The review captain should select only the number of engagements needed to meet the requirements in paragraphs .12–.13.

Scope Limitations

.15 It is presumed that all engagements subject to the peer review will be included in the scope of the review. In the rare situations in which there are exclusions or other limitations on the scope of the review, a review captain should carefully consider the implications of such exclusions. This includes communicating with the firm and the administering entity (AE) the effect on the review and on the ability of the review captain to issue a peer review report.

Evaluation of Engagements

.16 The review captain should evaluate each engagement submitted for review. The evaluation should include the following:

- a. Consideration of the financial statements or information and the related accountant's reports on the engagements performed under the SSARSs and SSAEs
 - b. Review of all other documentation required by applicable professional standards on the engagements
 - c. Consideration of the information related to the engagement obtained through the peer review including, but not limited to, engagement profile information and other inquiries
- .17** For each engagement reviewed, the review captain should use peer review checklists and questionnaires to determine if
- a. the financial statements are fairly presented in accordance with generally accepted accounting principles in all material respects (or when applicable, with a special purpose framework) and
 - b. the firm has performed and reported on the engagement in accordance with the SSARSs or SSAEs in all material respects.

.18 The review captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards in all material respects and remind the firm of any related obligations under professional standards to take appropriate actions. (Ref: par. .A6)

.19 Review captains or AEs should not require firms to perform omitted procedures, reissue accounting reports, or have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make.

Identifying, Evaluating, and Aggregating Matters, Findings, and Deficiencies

.20 The review captain should determine the relative importance of matters noted during the review, individually and in the aggregate. To assist the review captain in determining the relative importance of matters, the reviewer should consult appendix A, "Examples of Noncompliance With Applicable Professional Standards." (Ref: par. .A7–.A8 and .A29)

.21 The review captain should document a matter on a matter for further consideration (MFC) form when the review captain identifies one or more "no" answers on peer review engagement checklists that were not resolved to the review captain's satisfaction.

.22 The review captain should document a finding on a finding for further consideration (FFC) form when the review captain concludes the submitted engagement was not performed or reported on in conformity with the requirements of the applicable standards.

.23 The review captain should document a deficiency in the report when the review captain concludes at least one engagement submitted for review was not performed or reported on in conformity with the requirements of the applicable standards in all material respects.

.24 The review captain should complete a Disposition of Matter for Further Consideration (DMFC) for all MFCs, indicating whether each one was

- a. included on a specific FFC form (individually or combined with other MFCs) or
- b. included as a deficiency (individually or combined with other MFCs) in a report with a peer review rating of *pass with deficiencies* or *fail*.

Communication Requirements for Closing Meeting and Exit Conference

.25 Prior to issuing the report or finalizing MFCs and FFCs, if applicable, the review captain should communicate the conclusions to the firm at a closing meeting. The review captain should discuss the following during the closing meeting: (Ref: par. .A9–.A11)

- a. Preliminary peer review results, including any matters, findings, or deficiencies, and the expected report rating
- b. The firm's requirement to respond to the MFCs, FFCs, or deficiencies included in the peer review report
- c. The firm's required written representations
- d. Other suggestions and observations for the firm to consider (Ref: par. .A12)

.26 The closing meeting should be held within a reasonable time frame before the firm's due date to allow enough time for the firm to determine appropriate remediation with respect to findings and deficiencies, if applicable. (Ref: par. .A13)

.27 The review captain should review and evaluate the responses on the FFCs and letter of response prior to the exit conference. The review captain should consider the following: (Ref: par. .A14–.A15)

- a. The firm's response should include the firm's actions taken or planned to remediate the findings or deficiencies, including timing of the remediation, and additional procedures to ensure the findings or deficiencies are not repeated in the future.
- b. The firm's actions should be feasible, genuine, and comprehensive.
- c. If the firm has acted, the review captain should review documentation of actions taken and consider whether the actions are appropriate. (Ref: par. .A16)

.28 After the firm has responded to the MFCs, FFCs, and deficiencies in the report and the review captain has assessed whether the responses are appropriate and has considered any additional impact to the peer review results, the review captain should communicate the results to the firm at an exit conference. The review captain should discuss the following during the exit conference:

- a. The peer review results to be submitted to the AE, including any changes to the information communicated at the closing meeting after consideration of the firm's responses to MFCs, FFCs, and deficiencies in the report
- b. The appropriateness of the firm's response
- c. The firm's representation letter
- d. Potential implications of the peer review acceptance process and their impact on the acceptance and completion of the peer review and on the reviewed firm's enrollment in the program including, but not limited to,
 - i. corrective actions for deficiencies and implementation plans for findings, if applicable;
 - ii. recommended report rating changes; and
 - iii. oversight
- e. Peer review noncooperation implications of consecutive non-pass report ratings, if applicable

Written Representations

.29 The review captain should request management of the firm to provide written representations for the peer review year that are dated as of the date of the peer review report stating the following: (Ref: par. .A17)

- a. Management has fulfilled its responsibility for the design of and compliance with a system of quality control for our accounting practice that provides us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
- b. Management acknowledges its responsibility for complying with the rules and regulations of state boards of accountancy and other regulations.
- c. Management has disclosed to the review captain all known instances of noncompliance or suspected noncompliance with the rules and regulations of state boards of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review. (If there are known instances of noncompliance, management should summarize the instances and, if applicable, describe its remediation of the noncompliance.)

- d. Management has discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, if applicable.
- e. Management has fulfilled its responsibility to remediate nonconforming engagements, as stated by the firm in the letter of response, if applicable.
- f. Management understands the intended uses and limitations of the quality control materials it has developed or adopted. Management has tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist it in conforming with professional standards (including the Statements on Quality Control Standards) applicable to its accounting and auditing practice.
- g. Management has responded fully and truthfully to the review captain's inquiries.
- h. Management has provided the review captain with all relevant information including all engagements with periods ending during (or, for financial forecasts or projections and agreed-upon procedures engagements, report dates in) the year under review.
- i. Management has disclosed to the review captain that the firm did not perform any engagements under the Statements on Auditing Standards (SASs) or *Government Auditing Standards*, examinations under the Statements on Standards for Attestation Engagements (SSAEs), or engagements under the Public Company Accounting Oversight Board (PCAOB) standards that are not subject to PCAOB permanent inspection.
- j. Management acknowledges that failure to properly include the engagements listed in (i) could be deemed a failure to cooperate and may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, or enforcement body.
- k. Management has provided the review captain communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end.
- l. Management has disclosed that there are no known limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end, or management should include a summary of the limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

.30 If a firm fails to discuss significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the review captain, the review captain should immediately consult with the relevant AE because this constitutes a failure to cooperate, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated. (Ref: par. .A18)

.31 If, in addition to the representations required by paragraph .29, the review captain determines that it is necessary to obtain other representations based on the circumstances and nature of the peer review, the review captain should request such other written representations.

Reporting on Engagement Reviews

.32 To determine the report rating, the review captain should use the results of the evaluation of engagements reviewed. (Ref: par. .A19–.A23)

.33 The written report in an engagement review should (Ref: par. .A24)

- a. be dated as of the exit conference date.
- b. be issued on letterhead of the firm performing the review.
- c. state at the top of the report the title "Report on the Firm's Conformity With Professional Standards on Engagements Reviewed."
- d. include headings for each of the following sections:
 - i. Firm's Responsibility
 - ii. Peer Reviewer's Responsibility
 - iii. Deficiency(ies) Identified in the Firm's Conformity With Professional Standards on Engagements Reviewed (if applicable)
 - iv. Scope Limitation (if applicable)
 - v. Conclusion
- e. state that the review captain reviewed selected accounting engagements of the firm and include the year-end covered by the peer review.
- f. state that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews (the standards) established by the Peer Review Board of the American Institute of Certified Public Accountants.
- g. state that the nature, objectives, scope, limitations of, and procedures performed in an engagement review as described in the standards can be found on the AICPA website where the standards are summarized.
- h. include a URL reference to the AICPA website where the standards are located and state that the summary includes an explanation of how engagements identified as not performed or reported on in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.
- i. state that the firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects and for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.
- j. state that the peer reviewer's responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.

- k. state that an engagement review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, the review captain expresses no opinion or any form of assurance on that system. (Ref: par. .A25)
- l. in the event of a scope limitation, include an additional paragraph before the last paragraph that describes the relationship of the excluded engagements to the firm's practice, the highest level of service and industry concentration, if any, of the engagements excluded from the potential selection, and the effect of the exclusion on the scope and results of the peer review. Tailor the conclusion, as appropriate, to address the scope limitation.
- m. identify the different peer review ratings that the firm could receive.
- n. in a report with a peer review rating of *pass*, state
 - i. that nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.
 - ii. that the firm has received a peer review rating of *pass*.
- o. in a report with a peer review rating of *pass with deficiencies*, state
 - i. that because of the deficiencies previously described, the review captain believes that at least one but not all the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.
 - ii. that the firm has received a peer review rating of *pass with deficiencies*.
- p. in a report with a peer review rating of *fail*, state
 - i. that because of the deficiencies previously described, the review captain believes that all the engagements submitted for review were not performed or reported on in conformity with applicable professional standards in all material respects.
 - ii. that the firm has received a peer review rating of *fail*.
- q. in a report with a peer review rating of *pass with deficiencies or fail*,
 - i. include descriptions of the deficiencies (each of these should be numbered).
 - ii. if there are any repeat deficiencies, state that the deficiency was noted in the firm's previous peer review. (Ref: par. .A26–.A27)
 - iii. identify the level of service for any deficiencies. If the deficiency is industry specific, also identify the industry.

Submission of Peer Review Documentation to the AE by the Review Captain

.34 Within 30 days of the exit conference date or by the firm's peer review due date, whichever date is earlier, the review captain should submit to the

AE or complete electronically, as applicable, the following documents: (Ref: par. .A28)

- a. Report and letter of response, if applicable
- b. Review Captain Summary
- c. Review summary
- d. FFC forms, if applicable
- e. MFC forms, if applicable
- f. DMFC, if applicable
- g. Firm's representation letter

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Firms eligible to have an engagement review may elect to have a system review. Refer to section 210, *General Principles and Responsibilities for Reviewers — System Reviews*, for the requirements of a system review.

Planning (Ref: par. .06–.11)

.A2 Acceptable documentation includes an original or copy of the license, print-out from an online license verification system, correspondence from the licensing authority, or other reasonable alternative documentation. The review captain's judgment may be needed to determine what alternative documentation is reasonable.

.A3 The review captain may verify an out-of-state practice unit license or an out-of-state individual license on an individual engagement basis when that engagement is selected for review and was performed by the reviewed firm in another state requiring a firm or individual license. The decision to perform further testing is based on the reviewer's evaluation of the firm's responses to inquiries.

Engagement Selection (Ref: par. .12–.14)

.A4 The objective of the engagement selection requirements is to select one engagement from each engagement partner and one engagement from each level of service listed in paragraph .12a for the firm.

.A5 Engagement selection may also include consideration of industries.

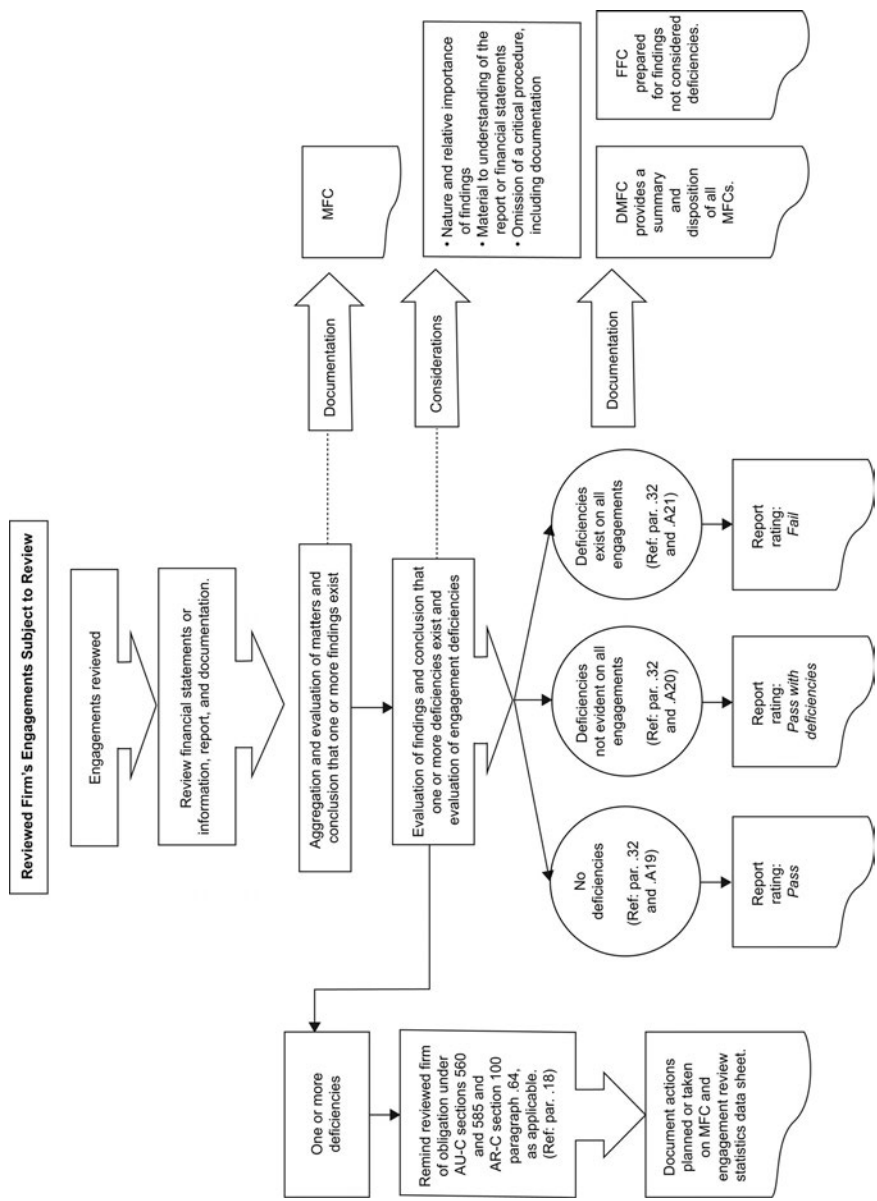
Evaluation of Engagements (Ref: par. .16–.19)

.A6 Although it is ultimately the firm's responsibility, the review captain and firm may collaborate to determine what remediation is necessary in the circumstances.

Identifying, Evaluating, and Aggregating Matters, Findings, and Deficiencies (Ref: par. .20–.24)

.A7 Exhibit A shows a broad understanding of the peer review process, from the review of submitted engagements to the determination of a matter, finding, or deficiency. It also illustrates the aggregation of these items, their documentation, and their potential impact on the report rating.

Exhibit A



.A8 One or more matters may be elevated to a finding or deficiency. To determine if a matter should be elevated, the review captain should consider the matter's nature and relative importance, if the matter is material to the understanding of the report or financial statements, or if the matter represents the omission of a critical procedure including documentation.

Communication Requirements for Closing Meeting and Exit Conference (Ref: par. .25–.28)

.A9 The closing meeting and exit conference may be attended by representatives of the AE, the board, AICPA staff, or other board-authorized organizations with oversight responsibilities.

.A10 The purpose of a separate closing meeting and exit conference is to provide the firm with sufficient time to determine appropriate responses to the matters, findings, or deficiencies identified and to provide the review captain with sufficient time to assess the firm's responses prior to the report date (exit conference date). If these steps have been taken prior to the closing meeting or are not necessary, the closing meeting and exit conference may be combined.

.A11 Team members or specialists may participate in or be available for the closing meeting and exit conference. This may be useful when the review captain does not have the experience to review the industry of an engagement that was reviewed by a team member.

.A12 Examples of other suggestions and observations include implications of upcoming changes in professional standards, operational or efficiency suggestions, and minor areas for improvement.

.A13 A reasonable time frame is typically 30 days.

.A14 The purpose of the firm's response on the FFC or in the letter of response is for a firm to document the specific actions that will be taken to correct findings or deficiencies noted by the review captain.

.A15 The AE's peer review committee (committee) may require the firm to make and document appropriate considerations regarding nonconforming engagements as a condition of acceptance of the peer review. The firm's response may affect other monitoring actions the committee may impose, including actions to verify that the firm adheres to the intentions indicated in its response.

.A16 Examples of firm actions taken in response to nonconforming engagements may include, but are not limited to,

- a. omitted procedures performed (including documentation),
- b. reissued report and financial statements, or
- c. notification to users to discontinue use of previously issued reports.

Written Representations (Ref: par. .29–.31)

.A17 Exhibit A, "Illustrative Representation Letter," in section 320 provides an illustrative example of a firm's representation letter.

.A18 Examples of how a review captain may discover significant issues include the following:

- a. The AE provides the review captain with a referral specific to the firm or a professional within the firm.

- b. The review captain identifies information about significant issues within a firm from a news outlet or publicly available website (for example, via the PCAOB).

Reporting on Engagement Reviews (Ref: par. .32–.33)

.A19 A report with a peer review rating of *pass* is issued when the review captain concludes that the engagements submitted for review were performed and reported on in conformity with the requirements of applicable professional standards in all material respects.

.A20 A report with a peer review rating of *pass with deficiencies* is issued when the review captain concludes that at least one but not all the engagements submitted for review contain a deficiency.

.A21 A report with a peer review rating of *fail* is issued when the review captain concludes all the engagements submitted for review contain a deficiency.

.A22 The review captain should not expand the scope beyond the original selection of engagements in an effort to change the conclusion from a peer review rating of *fail* in these circumstances.

.A23 In the event of a scope limitation, a report with the applicable peer review rating (*with a scope limitation*) is issued.

.A24 Exhibit B, "Illustrative Examples of a Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed," contains example reports that may be tailored by the reviewer to meet the requirements described in paragraph .33.

.A25 Review of a firm's documentation or procedures related to its system of quality control is outside the scope of an engagement review. An engagement review does not include tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a system review. Therefore, an engagement review does not provide the review captain with a basis for expressing any form of assurance on the firm's system of quality control for its accounting practice.

.A26 The following is an example of a repeat deficiency: a review captain documented a disclosure deficiency or finding in the prior review, and the same disclosure deficiency is documented in the current review.

.A27 If a repeat deficiency has occurred on two or more prior reviews, the review captain should state in the current report that "this deficiency was noted on previous reviews."

Submission of Peer Review Documentation to the AE by the Review Captain (Ref: par. .34)

.A28 All peer reviews are subject to oversight and working papers may be requested by the AE or AICPA staff.

.A29

Appendix A — Examples of Noncompliance With Applicable Professional Standards

The following is a list of examples of noncompliance with applicable professional standards. This is not an all-inclusive list, and the reviewer should decide if the noncompliance is a matter, finding, or deficiency as described in paragraphs .20–.24 and by using the following guidance. (Ref: par. .20–.24 and .A7)

List of Matters and Findings That Generally Would Not Result in a Deficiency

Reports

- Omission of phrases or use of phrases not in conformity with the applicable professional standards for the report issued
- Compilation reports that failed to include the paragraph regarding the omission of supplemental information, as applicable in the circumstances
- Reports that reflected financial statement titles and terminology not in accordance with applicable professional standards
- Failure to explain the degree of responsibility the accountant is taking with respect to supplementary information

Financial Statement Measurement

- Types of revenues and expenses not presented and disclosed in accordance with applicable professional standards (for example, freight revenue and related shipping and handling expenses)
- Financial statements prepared on a basis of accounting other than generally accepted accounting principles (GAAP) that are properly reported on but contain inconsistencies between the report and the financial statements, where the actual basis is readily determinable

Presentation and Disclosure

- Supplementary information not clearly segregated or marked as supplementary and departures from standard report presentation with respect to supplementary information
- Reviewed financial statement presentation that is inappropriate for the type of not-for-profit organization being reported on
- Compiled financial statements prepared using a special purpose framework reflecting titles normally associated with financial statements prepared under GAAP when the applicable financial reporting framework is not clearly identified
- Failure to disclose the accounting policy related to advertising costs in the notes to the financial statements
- Omission of the disclosure of the method of income recognition as required by applicable professional standards
- Misclassification of items on the statement of cash flows

- Omitted or inadequate disclosures related to account balances or transactions (for example, disclosure deficiencies relating to accounting policies, inventory, valuation allowances, long-term debt, related-party transactions, or concentrations of credit risk)
- Bank overdrafts not properly presented on the balance sheet, failure to accrue income taxes where the accrual and provision are not expected to be significant to the financial statements taken as a whole, and missing insignificant disclosures in the financial statements
- Financial statement titles that were inconsistent with the accountant's report

**Statements on Standards for Accounting and Review Services
Procedures (Including Documentation)**

- The written communication of the understanding with management regarding the services to be performed (for example, an engagement letter) exists but fails to address the requirements of the applicable professional standards

List of Matters and Findings That Generally Would Result in a Deficiency

Reports

- Issuance of a review report when the accountant is not independent
- Inappropriate references to GAAP in the accountant's report when the financial statements were prepared using a special purpose framework
- Failure to disclose the lack of independence in a compilation report
- Failure to appropriately modify a report for a scope limitation or significant departure from the basis of accounting used for the financial statements
- Failure to adopt current applicable professional standards, or the accountant's report does not contain the critical elements of the current applicable professional standards
- Failure to disclose, in the accountant's report, significant departures from professional standards (examples include omission of significant income tax provisions on interim financial statements, omission of significant disclosures related to defined employee benefit plans, or omission of required supplemental information for a common-interest realty association)
- Failure to indicate on the accountant's report the periods covered by the report, and they cannot be determined from reading the financial statements
- Failure to include a separate paragraph for departures from the financial reporting framework, including dollar amounts or a statement that the impact was not determined
- A compilation report that fails to include all the reasons why the accountant is not independent when such reasons are presented (for example, the report provides only one of three reasons)

- A review report on financial statements that omits disclosures required by GAAP and that is not appropriately modified for the omissions
- For a compilation engagement, failure to disclose the omission of substantially all disclosures or the statement of cash flows (if applicable) required by the applicable financial reporting framework
- For a compilation or review engagement performed in accordance with Statements on Standards for Accounting and Review Services (SSARSs), failure to appropriately modify the report in accordance with professional standards, when the financial statements are prepared in accordance with a special purpose framework
- For preparation engagements, failure to issue a disclaimer report, when the accountant is unable to include a statement on each page of the financial statements indicating, at a minimum, that "no assurance is provided"

Financial Statement Measurement

- Investments in marketable securities presented at cost and not fair market value, resulting in a material misstatement to the balance sheet
- Inclusion of material balances that are not appropriate for the basis of accounting used
- Failure to include material amounts or balances necessary for the basis of accounting used (examples include omission of accruals, failure to amortize a significant intangible asset, failure to provide for losses or doubtful accounts, or failure to provide for deferred income taxes)
- Improper accounting of a transaction (for example, recording a capital lease as an operating lease)
- Use of an inappropriate method of revenue recognition

Presentation and Disclosure

- Disclosure of omission of substantially all disclosures (in a compilation without disclosures) when, in fact, substantially all disclosures have been included
- Misclassification of transactions or balances and omission of significant required disclosures related to financial statement balances on transactions
- Failure to disclose that compiled financial statements that omit substantially all disclosures were prepared using a special purpose framework and the basis of accounting is not readily determinable from reading the accountant's compilation report
- For a preparation engagement, failure to include, either on the face of the financial statements or in a note to the financial statements, a description of the financial reporting framework when the financial statements have been prepared in accordance with a special purpose framework
- For a preparation engagement, failure to disclose the omission of substantially all disclosures or the statement of cash flows (if applicable) required by the applicable financial reporting framework

- For a preparation engagement, failure to disclose a material misstatement in the financial statements when the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework
- Significant departures from the financial statement formats prescribed by industry accounting and audit guides
- Omission of disclosures related to significant accounting policies applied (GAAP or special purpose framework)
- Failure to include a summary of significant assumptions in a financial forecast or projection
- Failure to segregate the statement of cash flows into the components of operating, investing, and financing
- Failure to disclose the cumulative effect of a change in accounting principles
- Failure to disclose significant related-party transactions
- Omission of actual financial statements that are referred to in the report
- Failure to include one or more statements of cash flows when comparative results of operations are presented in financial statements prepared in accordance with GAAP

SSARSs Procedures (Including Documentation)

- Failure to establish an understanding with management regarding the services to be performed through a written communication (for example, an engagement letter)
- Failure to document significant findings or issues
- Failure to document communications to the appropriate level of management regarding fraud or illegal acts that come to the accountant's attention
- For review engagements, failure to perform or document analytical and inquiry procedures, including the matters covered, and the development of and basis for the accountant's expectations
- For review engagements, failure to document significant unusual matters and their disposition
- For review engagements, failure to obtain a client management representation letter
- Failure to obtain all required signatures on the engagement letter (or other suitable written agreement)

.A30

Exhibit B — Illustrative Examples of a Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed

This exhibit contains various illustrations of a peer reviewer's report on the reviewed firm's conformity with professional standards on engagements reviewed.

Illustration 1 — A Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Pass

Illustration 2 — A Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Pass With Deficiencies

Illustration 3 — A Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Fail

Illustration 1 — A Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Pass

[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association-formed review team]

Report on the Firm's Conformity With Professional Standards on Engagements Reviewed¹

[Exit Conference Date]

To the Partners of *[or other appropriate terminology]* XYZ & Co. and the Peer Review Committee of the *[insert the name of the applicable administering entity]*.²

We³ have reviewed selected accounting engagements of XYZ & Co. (the firm)⁴ issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

¹ The report title and body should be tailored as appropriate when a single engagement is reviewed. The title should be changed to "Report on the Firm's Conformity With Professional Standards on an Engagement Reviewed."

² The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of *[or appropriate terminology]* XYZ & Co. and the National Peer Review Committee."

³ The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

⁴ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

A summary of the nature, objectives, scope, limitations of, and the procedures performed in an engagement review as described in the Standards may be found at www.aicpa.org/prsummary.

Firm's Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.

An engagement review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system.

Conclusion

Based on our review, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co.⁵ issued with periods ending during the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass*.

[Name of review captain's firm on firm-on-firm review or association-formed review team]

[or]

[Name], Review Captain [for committee-appointed review team review]

Illustration 2 — A Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Pass With Deficiencies

[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association-formed review team]

Report on the Firm's Conformity With Professional Standards on Engagements Reviewed¹

[Exit Conference Date]

To the Partners of *[or other appropriate terminology]* XYZ & Co. and the Peer Review Committee of the *[insert the name of the applicable administering entity]*:²

⁵ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

¹ The report title and body should be tailored as appropriate when a single engagement is reviewed. The title should be changed to "Report on the Firm's Conformity With Professional Standards on an Engagement Reviewed."

² The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of *[or appropriate terminology]* XYZ & Co. and the National Peer Review Committee."

We³ have reviewed selected accounting engagements of XYZ & Co. (the firm)⁴ issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in an engagement review as described in the Standards may be found at www.aicpa.org/prsummary.

Firm's Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.

An engagement review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system.

Deficiencies⁵ Identified in the Firm's Conformity With Professional Standards on Engagements Reviewed⁶

We noted the following deficiencies⁷ during our review:

1. On one review engagement of a manufacturing client, we noted that the accompanying accountant's report was not appropriately modified when the financial statements did not appropriately present or disclose matters in accordance with industry standards.
2. On a review engagement, we noted that the firm failed to obtain a management representation letter, and its working papers failed to document the matters covered in the accountant's inquiry and analytical procedures. These deficiencies were identified on the firm's previous review.

Conclusion

Because of the deficiencies previously described, we concluded that at least one but not all of the engagements submitted for review by XYZ & Co.⁸ issued with periods ending during the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material

³ The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

⁴ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

⁵ The wording should be tailored to indicate a single deficiency, when applicable.

⁶ The wording should be tailored to indicate a single engagement reviewed, when applicable.

⁷ The deficiencies provided are examples for illustrative purposes only.

⁸ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass with deficiencies*.

[Name of review captain's firm on firm-on-firm review or association-formed review team]

[or]

[Name], Review Captain [for committee-appointed review team review]

Illustration 3 — A Reviewer's Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Fail

[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association-formed review team]

Report on the Firm's Conformity With Professional Standards on Engagements Reviewed¹

[Exit Conference Date]

To the Partners of [or other appropriate terminology] XYZ & Co. and the Peer Review Committee of the [insert the name of the applicable administering entity]²

We³ have reviewed selected accounting engagements of XYZ & Co. (the firm)⁴ issued with periods ending during the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in an engagement review as described in the Standards may be found at www.aicpa.org/prsummary.

Firm's Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported on in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer's Responsibility

Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.

¹ The report title and body should be tailored as appropriate when a single engagement is reviewed. The title should be changed to "Report on the Firm's Conformity With Professional Standards on an Engagement Reviewed."

² The report of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the Partners of [or appropriate terminology] XYZ & Co. and the National Peer Review Committee."

³ The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

⁴ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

An engagement review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system.

Deficiencies⁵ Identified in the Firm's Conformity With Professional Standards on Engagements Reviewed⁶

We noted the following deficiencies⁷ during our review:

1. Our review disclosed several failures to adhere to applicable professional standards in reporting on material departures from generally accepted accounting principles (GAAP) and in conforming to standards for accounting and review services. Specifically, the firm did not disclose in certain compilation and review reports failures to conform with GAAP in accounting for leases, in accounting for revenue from construction contracts, and in disclosures made in the financial statements or the notes thereto concerning various matters important to an understanding of those statements. The compilation and review engagements were in the construction and manufacturing industries, respectively. In addition, the firm did not obtain management representation letters on review engagements.
2. During our review, we noted the firm did not modify its compilation reports on financial statements when neither the financial statements nor the footnotes noted that the statements were presented using a special purpose framework. This deficiency was noted in the firm's previous peer reviews.
3. In the construction industry compilation engagements that we reviewed, disclosures of material lease obligations as required by GAAP were not included in the financial statements, and the omissions were not disclosed in the accountant's reports.
4. During our review of the firm's engagements to prepare financial statements, we noted the firm did not issue a disclaimer that made clear no assurance was provided on the financial statements and also did not indicate that no assurance was provided on each page of the financial statements.

Conclusion

Because of the deficiencies previously described, we concluded that all the engagements submitted for review by XYZ & Co.⁸ issued with periods ending during the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *fail*.

[Name of review captain's firm on firm-on-firm review or association-formed review team]

[or]

[Name], Review Captain [for committee-appointed review team review]

⁵ This wording should be tailored to indicate a single deficiency, when applicable.

⁶ This wording should be tailored to indicate a single engagement reviewed, when applicable.

⁷ The deficiencies provided are examples for illustrative purposes only.

⁸ The report of a firm that is required to be registered with and inspected by the PCAOB should be tailored here to add "applicable to engagements not subject to PCAOB permanent inspection."

PR-C Section 300

General Principles and Responsibilities for Reviewed Firms

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains general principles and responsibilities for reviewed firms. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*.

Effective Date

.02 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.03 The objective of the reviewed firm is to enhance its effectiveness and contribute to the quality of our profession by undergoing a peer review performed in accordance with the Standards for Performing and Reporting on Peer Reviews (the standards) established by the Peer Review Board (the board) of the American Institute of Certified Public Accountants.

Definitions

.04 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Ethical Requirements Relating to a Peer Review

.05 A reviewed firm should maintain independence in fact and appearance from the reviewing firm or firms, reviewers, and any other individuals who participate in or are associated with the peer review.

Preparing for a Peer Review

Engage a Reviewer

.06 The firm should timely engage a reviewer to perform the peer review in accordance with the standards. The firm and the captain should agree on the commencement and anticipated exit conference dates. (Ref: par. .A1–.A2)

.07 The firm should consider whether the qualifications of the captain and team members, if applicable, are commensurate with the nature of the firm's practice.

.08 The firm should designate a partner from the firm as the peer review contact. The peer review contact should be knowledgeable about the nature of the firm's practice and is accountable for providing complete and accurate information to the peer review team and the administering entity (AE).

Licensure

.09 It is the reviewed firm's responsibility to understand and comply with its licensing requirements. Therefore, it should be prepared to respond to the reviewer's inquiries and requests for documentation. This is also important for out-of-state firm and individual licenses when licensing requirements may be more difficult to identify and understand.

Written Representations

.10 Written representations should be provided to the captain on firm letterhead from members of management of the firm whom the captain or AE believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control. (Ref: par. .A3–.A4)

.11 The written representations should be in the form of a representation letter on firm letterhead, addressed to the captain, and signed by a member of management described in paragraph .10, as of the date of the peer review report. (Ref: par. .A5)

Cooperating and Complying With the Requirements of the Program

.12 A firm should cooperate with the reviewer, AE, and the board in all matters related to the program. (Ref: par. .A6–.A7)

.13 A firm should ensure its peer review is submitted in compliance with the requirements of the program.

- a. A firm is considered not cooperating and its enrollment is subject to termination from the program for reasons including, but not limited to, the following: (Ref: par. .A7)
 - i. Once the review has commenced, not responding to inquiries or providing information necessary to ensure the review is accepted and completed
 - ii. Not providing documentation including the representation letter, quality control documents, engagement working papers, and all elements of the firm's system of quality control
 - iii. Not responding to matters for further consideration (MFCs) or findings for further consideration (FFCs) timely
 - iv. Limiting access to offices, personnel, or other once the review has commenced
 - v. Not facilitating the arrangement for the exit conference on a timely basis
 - vi. Failing to timely file a letter of response, if applicable
 - vii. Failing to cooperate during oversight

- viii. Failing to timely agree to and complete required corrective actions or implementation plans
- ix. Failing to ensure that the firm's peer review is submitted to the AE timely
- b. A firm is considered not complying with the requirements of the program and its enrollment is subject to termination from the program for reasons including, but not limited to, the following:
 - i. Withholding information significant to the peer review (Ref: par. .A8)
 - ii. Failing to correct deficiencies or significant deficiencies after consecutive non-pass (*pass with deficiencies* or *fail*) peer review reports (Ref: par. .A9)
 - iii. Failing to correct deficiencies or significant deficiencies after consecutive corrective actions required by the committee on the same peer review
 - iv. Receiving a peer review report with deficiencies or significant deficiencies that indicate the firm is so seriously deficient in its performance that the committee believes educational and remedial corrective actions or implementation plans would not be adequate
 - v. Failing to provide the AE with a substantive response, and the firm does not revise its response or provides additional responses that are not substantive as determined by the AE (Ref: par. .A10)
 - vi. Failing to provide substantive responses during the AE's process of determining if information provided by a firm was erroneous or omitted, which results in a significant change in the planning, performance, evaluation of results, or peer review report (Ref: par. .A11)
 - vii. Failing to timely notify the AE that it is performing a type of engagement or engagement in an industry that the firm had previously represented by written communication to the AE that it was no longer performing and had no plans to perform, in response to a related corrective action or implementation plan and the corrective action or implementation plan was eliminated by the AE based on that representation

.14 If a firm is deemed not cooperating or not complying with the requirements of the program due to the reasons described in paragraph .13, it should be notified by a delivery method providing proof of delivery (including electronic means) that the board will appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated in accordance with fair procedures established by the board.

.15 If a firm has AICPA members, the fact that the firm's enrollment in the program has been terminated, whether with or without a hearing, should be published in such form and manner as AICPA Council may prescribe.

Reenrollment in the Program

.16 To reenroll in the program, a firm should submit a request to reenroll in the program through an AE. If the firm was dropped or terminated from the program, the firm should address and remediate the circumstances that caused the firm to be dropped or terminated to be considered for reenrollment in the

program. Common criteria for reenrollment include, but are not limited to, submitting evidence to the AE or hearing panel that demonstrates the following: (Ref: par. .A12–.A14)

- a. Completion of the requested action in compliance with the requirements of the program
- b. Changes in the firm's system of quality control (such as personnel changes or procedural changes, methodologies to identify the complete population of engagements performed, access to technical resources or membership in quality centers, and voluntary changes in the practice or types of industries or engagements performed)
- c. Competency through completion of relevant CPE, training, or competency assessments
- d. Assessment of quality in the performance of engagements through internal or external monitoring results (such as pre-issuance reviews, post-issuance reviews, and internal inspections that reflect that engagements are materially performed and reported on in conformity with applicable professional standards)

.17 If reenrollment is approved and the firm is past its next peer review due date, the firm should complete its subsequent peer review

- a. within 90 days of reenrolling if the firm's most recent peer review is completed,
- b. within 90 days of the AE's report acceptance body (RAB) determining that actions taken are satisfactory to complete a commenced peer review, or
- c. by a later date set by the hearing panel or the AE.

Publicizing Peer Review Information

.18 The firm should not publicize the results of the review or distribute copies of the peer review report to its personnel, clients, or others until the date of acceptance. (Ref: par. .A15–.A20)

Acquisitions and Divestitures

.19 If a firm has had an acquisition of another practice or a portion thereof or a divestiture of a significant portion of its practice during or subsequent to its peer review year, the reviewed firm or the reviewer should consult with the relevant AE and AICPA staff prior to the commencement of the review to consider the appropriate scope of the review or other actions that should be taken. (Ref: par. .A21–.A22)

Resigning From the Program

.20 A firm may resign from the program when it is no longer performing engagements that require the firm to undergo a peer review. To resign from the program, a firm should submit a written request to the AE before the firm's peer review has commenced. A firm should consult with its state board of accountancy to determine if there are rules that require enrollment in the program even if the firm does not perform services that include issuing reports or when it is no longer performing engagements that require a firm to undergo a peer review.

.21 A firm enrolled in the program that has been notified that it is the subject of a hearing should not resign until the matter causing the hearing has been resolved.

.22 To resign from the program once a firm's peer review has commenced but has not been completed, a firm should submit a letter pleading guilty, acknowledging it has not cooperated with the program, waiving its right to a hearing, and for firms with AICPA members, agreeing to allow the AICPA to publish, in such form and manner as the AICPA Council may prescribe, the fact that the firm has resigned from the program before completion of its peer review, evidencing that it has not cooperated with the program. In addition, if (a) the firm has been notified of the reviewer's or AE's intent to issue or require a report with a peer review rating of *pass with deficiencies* or *fail* or (b) the reviewer or AE has knowledge of the discovery of an engagement that was not conducted in accordance with professional standards on which the firm must take, or would likely be required to take, action in accordance with professional standards, then the fact that the situation in item (a) or (b) existed would also be published for firms with AICPA members. If the firm does not sign the letter pleading guilty and waiving its right to a hearing, the firm will be referred to a board hearing panel. The panel will consider terminating the firm's enrollment due to not cooperating with the program. (Ref: par. .A23)

Natural Disasters and Other Catastrophic Events

.23 If a firm experiences a natural disaster or other catastrophic event that affects its ability to comply with the requirements of the standards, the firm should consult with its AE.

.24 If the situation affected both the firm's operations and its ability to comply with peer review requirements, the firm should discuss the following with the AE:

- a. The firm's current peer review year-end and due date
- b. The extent of damage to the firm's offices and the working papers subject to peer review, if applicable (This would include off-site storage or data-retention facilities that house working papers subject to peer review.)
- c. The availability, or lack thereof, of personnel that performed engagements subject to peer review
- d. The firm's ability to continue operating and performing engagements subject to peer review
- e. If known, whether the firm's scheduled peer reviewer was also affected
- f. The amount of time the firm deems necessary before it would be ready to undergo a peer review

The AE should assist in determining whether there could be a possible scope limitation due to the exclusion of any affected engagements or offices, the need for a change in year-end or an extension of due date, and the effect on the firm's continuing peer review cycle. These situations will be considered on a case-by-case basis.

.25 If the firm's scheduled reviewer was directly affected by a natural disaster or other catastrophic event and may no longer be able to perform the review, the firm should consult with its AE. The AE will assist the firm in determining whether it is appropriate to extend the peer review due date or if the firm should engage another reviewer to perform its peer review. (Ref: par. .A24)

Application and Other Explanatory Material

Preparing for a Peer Review

Engage a Reviewer (Ref: par. .06–.08)

.A1 *Timely* ordinarily means performing the review within three to five months after the peer review year-end; the firm may need to contact its reviewer in advance to meet this time frame. The review should be planned to provide the review team with sufficient time to perform the review and to provide the firm with sufficient time prior to the exit conference to determine appropriate responses to matters, findings, deficiencies, and significant deficiencies identified during the review.

.A2 The terms and conditions of the peer review may be summarized in an engagement letter between the reviewed firm and the reviewing firm.

Written Representations (Ref: par. .10–.11)

.A3 Written representations are necessary information that describe matters significant to the peer review to assist in the planning, performance of, and reporting on the peer review. The specific representations are detailed in section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*, and section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*, as applicable.

.A4 Members of management responsible for and knowledgeable about the required representations normally include the managing partner and partner in charge of the firm's system of quality control.

.A5 The representation letter is addressed to the captain because the captain is concerned with events occurring during the peer review period and through the date of the peer review report that may require an adjustment to the report or other peer review documents.

Cooperating and Complying With the Requirements of the Program (Ref: par. .12–.15)

.A6 Cooperation includes completing actions timely and in compliance with the requirements of the program.

.A7 A firm is considered not cooperating and is subject to being dropped from the program by the board for reasons including, but not limited to, failing to do the following:

- a. Timely file requested information with the AE, prior to the commencement of the peer review.
- b. Timely submit requested information to the reviewer that is necessary to plan or perform the firm's peer review, prior to the commencement of the peer review.
- c. Have a peer review by the due date.
- d. Accurately represent its accounting and auditing practice, as defined by the program, after notifying its AE that it does not perform engagements that require the firm to have a peer review.
- e. Timely pay in full the fees and expenses of the review team formed by an AE, or timely pay all fees related to the administration of

the program that have been authorized by the governing body of an AE and the AICPA.

If a firm is deemed not cooperating as a result of any of the failures described, it will be notified by a delivery method providing proof of delivery (including electronic means) that its enrollment will be dropped after 30 days if the firm does not cooperate. The board may drop a firm's enrollment with or without holding a hearing. A firm whose enrollment has been dropped or terminated from the program may appeal within 30 calendar days of notification pursuant to fair procedures established by the board. If a firm's enrollment is dropped or terminated for not accurately representing its accounting and auditing practice, or for subsequent failure to submit a peer review by a required due date, this may result in an investigation of a possible violation by a regulatory, monitoring, or enforcement body.

.A8 Information significant to the peer review may include, but is not limited to, the following:

- a. Failing to discuss communications received by the reviewed firm relating to allegations or investigations in the conduct of accounting, auditing, or attestation engagements from regulatory, monitoring, or enforcement bodies
- b. Omission or misrepresentation of information relating to the reviewed firm's accounting and auditing practice as defined by the standards, including, but not limited to, engagements performed under *Government Auditing Standards*, audits of employee benefit plans, audits performed under FDICIA, and examinations of service organizations (SOC 1® and SOC 2® engagements)

.A9 A firm should be notified after receiving a non-pass (*pass with deficiencies or fail*) peer review report of its responsibility to correct the deficiencies or significant deficiencies. This notification will be via a delivery method providing proof of delivery (including electronic means).

.A10 The AE has the authority to determine if a firm's response is substantive.

.A11 The AE has the authority to determine if erroneously provided or omitted information by a firm that results in a significant change in the planning, performance, evaluation of results, or peer review report is a matter of not cooperating with the program.

Reenrollment in the Program (Ref: par. .16-.17)

.A12 Reenrollment in the program is subject to evaluation by either the AE or a hearing panel of the board. The hearing panel or AE's peer review committee may also require other actions as a condition of reenrollment.

.A13 Determination of final acceptance or completion of a review is subject to the AE's RAB.

.A14 Reenrollment decisions subject to approval by a hearing panel of the board include, but are not limited to, the following:

- a. Drops for
 - i. not accurately representing the reviewed firm's accounting and auditing practice as defined by the standards
 - ii. failing to submit the reviewed firm's peer review by a required due date after being dropped for the preceding reason and subsequently being allowed to reenroll

- b. Terminations for
 - i. omitting or misrepresenting information related to the reviewed firm's accounting and auditing practice as defined by the standards
 - ii. failing to receive a *pass* report rating subsequent to receiving notification via certified mail, or other delivery method providing proof of delivery (including electronic means), after a peer review rating of *pass with deficiencies* or *fail*
 - iii. failing to correct deficiencies or significant deficiencies after consecutive corrective actions required by the committee on the reviewed firm's most recent peer review

Publicizing Peer Review Information (Ref: par. .18)

.A15 The firm's AE and AICPA staff may disclose to third parties the following information:

- a. The firm's name and address
- b. Whether the firm is enrolled in the program
- c. The date of acceptance and period covered by the firm's most recently accepted peer review
- d. The most recent date that the firm's enrollment in the program has been dropped or terminated, if applicable

This information is available in the AICPA public file for all firms enrolled in the program.

.A16 The firm may authorize its AE or AICPA staff to make its peer review results available to the public or to state boards of accountancy. Peer review results include, as applicable, the following:

- a. Peer review report
- b. Letter of response
- c. Acceptance letter
- d. Letters signed by the reviewed firm indicating that the peer review documents have been accepted with the understanding that the reviewed firm agrees to take certain actions
- e. Letter signed by the AE notifying the reviewed firm that certain required actions have been completed

The authorization ordinarily occurs during the firm's peer review scheduling process when the firm may choose not to opt out of the program's process for voluntary disclosure through Facilitated State Board Access (FSBA).

.A17 A firm may voluntarily become a member of one of the AICPA's audit quality centers or sections that require, as a condition of membership, making the firm's peer review results (described in paragraph .A16) open to public inspection.

.A18 When the firm's peer review is ongoing, the firm may give the AE or AICPA staff written authorization to provide specific information to third parties (in addition to the information in paragraph .A15). The following (or similar) types of objective information about the review may be provided, if known:

- a. The date the review is or was scheduled to take place
- b. The name of the reviewing firm, team captain, or review captain
- c. If the fieldwork on the peer review has commenced

- d.* The date the exit conference was expected to or did occur
- e.* A copy of any extension approval letters
- f.* Whether the peer review working papers have been received by the AE
- g.* Whether a must-select engagement was included in the scope as required by the standards
- h.* If a technical review is in process
- i.* Whether the review has been presented for acceptance
- j.* The date the review is expected to be presented for acceptance
- k.* The specific overdue letters (such as, but not limited to, scheduling the peer review or completion of remedial actions) requested by third parties

.A19 When there is evidence of an open ethics investigation and the firm knowingly makes an informed, voluntary, written waiver of the right to confidentiality, in those circumstances, AICPA Peer Review staff may provide information to the AICPA Professional Ethics Division. Information available for disclosure about the firm includes, but is not limited to, the following:

- a.* Fieldwork commencement date
- b.* Exit conference date
- c.* Review acceptance date
- d.* Levels of service and industries included in the firm's peer review information for prior or current peer reviews
- e.* Levels of service and industries included in prior or current peer reviews and those determined not to be in conformity with professional standards in all material respects
- f.* Signed confirmations by a firm representative that the enrolled firm did not perform any services or issue reports that would require the firm to undergo a peer review
- g.* Other similar information related to a prior or current peer review

.A20 The firm may give the AE or AICPA staff other written requests to provide information or documents to a third party, which will be considered on a case-by-case basis by the AE or the AICPA. However, neither the AE nor the AICPA will provide information that is subjective (due to different definitions or interpretations by third parties), even with firm authorization, such as the following:

- a.* Stating solely that the review is "in process" or responding to an inquiry solely regarding what the "general status" of a peer review is
- b.* The peer review report rating prior to the peer review's acceptance
- c.* Whether there are indications that the firm, reviewing firm, team captain, or review captain are cooperating (or not cooperating) with the AICPA or AE
- d.* An indication of the quality or completeness of peer review working papers received by the AE
- e.* Reasons why peer review working papers, implementation plans, or corrective actions are late
- f.* Whether a firm is close to submitting documents or completing implementation plans or corrective actions

- g.* Reasons for or the likely outcome if the firm is going through fair procedures to determine whether it is cooperating with the AICPA or the AE

Acquisitions and Divestitures (Ref: par. .19)

.A21 A divestiture of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance with the system of quality control for reports issued under the firm's name during that year.

.A22 Submission of the "Firm Structure Change" form may be considered a consultation with the AE and AICPA staff.

Resigning From the Program (Ref: par. .20–22)

.A23 The submission by the firm of a request to resign from the program once its peer review has commenced but has not been completed is considered not cooperating with the AE and may lead to the termination of the firm's enrollment in the program by a hearing panel of the board.

Natural Disasters and Other Catastrophic Events (Ref: par. .23–.25)

.A24 If a reviewer was affected by a natural disaster or other catastrophic event and is not able to complete a scheduled review, the AE will consider the following:

- a.* The firm's peer review year-end and the timing of when engagements falling within the peer review year are performed
 - b.* The length of time between when the situation arose and the firm's due date
 - c.* The amount of time that the currently scheduled peer reviewer or review team would need before being able to perform the peer review
 - d.* Whether the firm has very specialized industries or engagements
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PR-C Section 310

General Principles and Responsibilities for Reviewed Firms — System Reviews

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains requirements and application material for firms undergoing a system review. The requirements and guidance in this section supplement the requirements and application guidance in section 100, *Concepts Common to All Peer Reviews*, and section 300, *General Principles and Responsibilities for Reviewed Firms*.

.02 Firms that perform engagements under the Statements on Auditing Standards (SASs) or *Government Auditing Standards*, examinations under the Statements on Standards for Attestation Engagements (SSAEs), or engagements under PCAOB standards must have a system review. (Ref: par. .A1–.A2)

Effective Date

.03 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.04 The objective of the reviewed firm is to enhance its effectiveness and contribute to the quality of our profession by undergoing a system review performed in accordance with the Standards for Performing and Reporting on Peer Reviews (the standards) established by the Peer Review Board (the board) of the American Institute of Certified Public Accountants. (Ref: par. .A3)

Definitions

.05 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Planning

.06 The firm should make the following information available to the reviewer:

- a. Information regarding the firm's audit and accounting practice for each engagement with a period end date during the peer review year (or each financial forecast, financial projection, or agreed-upon procedures engagement with a report dated during the peer

review year) and that was issued by the commencement date of the review to allow the reviewer to be able to identify

- i. the level of service,
 - ii. the number of audit or accounting hours (actual, if available, or estimated),
 - iii. the engagement partner,
 - iv. the industry,
 - v. whether an engagement was an initial engagement,
 - vi. the office (if applicable), and
 - vii. whether an engagement was a must-select or must-cover engagement (if applicable) (Ref: par. .A4)
- b. A list of firm personnel (Ref: par. .A5)
 - c. Responses to inquiries about the areas to be addressed in the written representations
 - d. The firm's prior
 - i. peer review report,
 - ii. letter of response (if applicable),
 - iii. letter of acceptance,
 - iv. findings for further consideration (FFCs) (if applicable), and
 - v. representation letter
 - e. The firm's quality control documentation (Ref: par. .A6)

.07 The firm should assist the reviewer in meeting the objectives of performing a system review. The peer review contact should meet with the review team at the beginning of the review to orient them to firm policies and procedures and introduce them to appropriate personnel. (Ref: par. .A7–.A8)

Engagement Selection

.08 For each engagement selected for review, the reviewed firm should submit (masking client identity if it desires) the following: (Ref: par. .A9)

- a. The appropriate financial statements or information
- b. The accountant's or auditor's report, if applicable
- c. Engagement profile
- d. The documentation required by applicable professional standards for each engagement

Scope Limitations

.09 The firm should notify the team captain and the AE, prior to the commencement of the review, if it intends to exclude an engagement or elements of the firm's system of quality control. This notification should indicate

- a. its plans to exclude one or more engagements or aspects of functional areas from the peer review selection process,
- b. the reasons for the exclusion, and
- c. that it is requesting a waiver from the AE for the exclusion.

Testing Compliance With the Firm's System of Quality Control

.10 The firm should promptly respond to reviewer questions during the review. (Ref: par. .A10–.A12)

Responding to Matters, Findings, Deficiencies, and Significant Deficiencies

.11 The firm should discuss preliminary peer review results, including matters, findings, deficiencies, and significant deficiencies, with the reviewer. Ordinarily, this discussion occurs during the closing meeting. If the firm disagrees with one or more of the matters, findings, or deficiencies, and the firm and reviewer can't come to a resolution, the firm should contact the AE for assistance and follow the guidance in section 100 to resolve the disagreement. (Ref: par. .A13)

.12 The firm should respond to

- a.* matters via the matter for further consideration (MFC) form,
- b.* findings via the FFC form, and
- c.* deficiencies or significant deficiencies via a letter of response.

.13 Responses to matters, findings, deficiencies, or significant deficiencies should include an assessment of the systemic cause, which should provide enough detail for the reviewer to understand how the firm arrived at its conclusion.

.14 The firm's responses to findings, deficiencies, or significant deficiencies should (Ref: par. .A14–.A19)

- a.* include the firm's actions taken or planned to remediate the findings or deficiencies in the firm's system of quality control and non-conforming engagements, if applicable, including
 - i.* timing of the remediation and
 - ii.* additional procedures to ensure the finding or deficiency is not repeated in the future.
- b.* be feasible, genuine, and comprehensive.
- c.* be addressed to the AE's peer review committee (committee) in a letter of response, if applicable.
- d.* be dated as of the exit conference date in a letter of response, if applicable.
- e.* be on firm letterhead in a letter of response, if applicable.

The reviewer should review documentation of any action taken by the firm and consider whether the action is appropriate.

.15 The firm's draft responses should be provided to the team captain as soon as possible after the closing meeting to allow the team captain enough time to assess the firm's responses prior to the exit conference. (Ref: par. .A20–.A21)

Written Representations

.16 The firm should provide to the team captain written representations on firm letterhead for the peer review year, dated as of the date of the peer review report, that state the following: (Ref: par. .A22–.A23)

- a.* Management has fulfilled its responsibility for the design of and compliance with a system of quality control for our accounting and auditing practice that provides us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

- b. Management acknowledges its responsibility for complying with the rules and regulations of state boards of accountancy and other regulations.
- c. Management has disclosed to the team captain all known instances of noncompliance or suspected noncompliance with the rules and regulations of state boards of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which the firm practices, for the year under review. If there are known instances of noncompliance, management should summarize the instances and, if applicable, describe its remediation of the noncompliance.
- d. Management has discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, if applicable.
- e. Management has fulfilled its responsibility to remediate nonconforming engagements as stated by the firm on the [*Matter for Further Consideration Form, Finding for Further Consideration Form, or Letter of Response*], if applicable.
- f. Management understands the intended uses and limitations of the quality control materials it has developed or adopted. Management has tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist it in conforming with professional standards (including the Statements on Quality Control Standards) applicable to its accounting and auditing practice.
- g. Management has responded fully and truthfully to all of the team captain's inquiries.
- h. Management has provided the team captain with all relevant information, which included
 - i. all engagements with periods ending during (or, for financial forecasts or projections and agreed-upon procedures engagements, report dates in) the year under review.
 - ii. all must-select engagements, as applicable.
- i. Management has disclosed to the team captain if the firm performed must-select engagements for the period covered by the peer review, and, if so, at least one of each must-select engagement that was performed was selected and reviewed by the peer reviewer.
- j. Management acknowledges that failure to properly include these engagements on the list could be deemed as failure to cooperate and may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, or enforcement body.
- k. Management has provided to the team captain communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end.
- l. Management has disclosed that there are no known limitations or restrictions on the firm's or its personnel's ability to practice

public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end, or management has included a summary of the limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

.17 If, in addition to the representations required by paragraph .16, the team captain determines that it is necessary to obtain other representations based on the circumstances and nature of the peer review, the team captain should request such other written representations.

Subsequent Events

.18 If a firm performs a must-select engagement in an industry not subject to the current review after the year-end and before the due date of its system review, the reviewed firm should (Ref: par. .A24–.A25)

- a. immediately notify the AE and
- b. determine if the due date should be extended to include the must-select engagement.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Firms eligible to have an engagement review may elect to have a system review.

.A2 Joint ventures formed specifically to perform certain engagements are not required to have a peer review provided that

- a. each of the firms that sign the joint venture report is required to have system reviews and agree to list the joint venture on its client rosters during its peer reviews.
- b. the joint venture is not operating and structured as a separate firm. (Joint ventures do not include part-time work arrangements, when only one firm issues the report.) If the letterhead used for the joint venture does not identify the separate firms that joined together to perform the engagement, then the joint venture is operating as a separate firm.

Objective (Ref: par. .04)

.A3 The reviewed firm may benefit from knowing the reviewer's objectives in conducting a system review, which are to do the following:

- a. Obtain reasonable assurance that the reviewed firm's system of quality control for its accounting and auditing practice has been designed and complied with to provide the firm with reasonable assurance of performing or reporting in conformity with the requirements of applicable professional standards in all material respects.
- b. Report on the reviewed firm's system of quality control and communicate as required by the standards established by the board, in accordance with the reviewer's conclusions.

Planning (Ref: par. .06–.07)

.A4 For more information regarding engagements that must be selected or that fall into the "must-cover" category, refer to section 210, *General Principles and Responsibilities for Reviewers — System Reviews*, appendix C, "Additional Requirements for Must-Select and Must-Cover Engagements."

.A5 The personnel list assists reviewers in performing their risk assessment procedures. The reviewer may request that the list include

- a. name,
- b. position, and
- c. years of experience
 - i. with the firm and
 - ii. in total.

.A6 Quality control documentation will likely include the firm's quality control document, evidence of the performance of the firm's monitoring procedures, and CPE documentation, among other documents. Upon reviewing such documentation, the reviewer may determine that the firm's current-year internal monitoring procedures could enable the reviewer to reduce the extent of the peer review procedures.

.A7 To obtain an understanding of the firm's accounting and auditing practice and system of quality control, the reviewer will do the following:

- a. Inquire of appropriate management and other personnel
- b. Review the firm's internal policies and procedures
- c. Review the firm's quality control documentation
- d. Inquire of the firm regarding elements of the system of quality control residing outside of the firm (Ref: par. .A11)
- e. Complete the applicable quality control checklists

.A8 Examples of elements that could reside outside of the firm include, but are not limited to, membership in associations, joint ventures, non-CPA-owned entities, alternative practice structures, arrangements with outside consultants, third-party quality control materials, or CPE.

Engagement Selection (Ref: par. .08)

.A9 To obtain reasonable assurance that the firm is complying with its quality control policies and procedures and applicable professional standards, the reviewer will review a reasonable cross section of the firm's accounting and auditing engagements, with greater emphasis on those portions of the practice with higher combined assessed levels of inherent and control risk.

Testing Compliance With the Firm's System of Quality Control (Ref: par. .10)

.A10 To test the firm's compliance with its system of quality control and applicable professional standards, the reviewer will do the following:

- a. Review and evaluate highest-risk areas on selected engagements, including accounting and auditing documentation, and reports.
- b. Interview firm personnel at various levels to assess their understanding of, and compliance with, the firm's system of quality control.

- c. Review evidence to determine whether the firm has complied with its policies and procedures for each element of its system of quality control, which may include evidence since the previous peer review. (Ref: par. .A27 of section 210)
- d. Review other evidence as appropriate. (Ref: par. .A28–.A29 of section 210)
- e. Complete the applicable quality control checklists.

.A11 The reviewer's evaluation of each engagement submitted for review will include the following:

- a. Consideration of the financial statements or information and the related accountants' reports
- b. Review of accounting and audit documentation required by the applicable professional standards
- c. Consideration of the information related to the engagement obtained through the peer review including, but not limited to, engagement profile information, representations made by the firm, and other inquiries

.A12 When evaluating an audit engagement, the reviewer's procedures should include determining whether the reviewed firm has appropriately

- a. identified the significant risk areas on each audit engagement selected for the peer review,
- b. performed the necessary audit procedures related to the identified significant risk areas, and
- c. documented the auditing procedures performed in these significant risk areas.

Responding to Matters, Findings, Deficiencies, and Significant Deficiencies (Ref: par. .11–.15)

.A13 The closing meeting is designed to provide sufficient time for the firm to determine the appropriate responses to peer review results and for the reviewer to evaluate the firm's responses. The following are discussed during the closing meeting:

- a. Preliminary peer review results, including any matters, findings, deficiencies, or significant deficiencies, and the expected report rating if determinable at this point
- b. The firm's requirement to respond to the MFCs, FFCs, or deficiencies or significant deficiencies included in the peer review report
- c. The firm's required written representations
- d. Other suggestions and observations for the firm to consider

.A14 The purpose of the firm's response on the FFC form or in the letter of response is for a firm to document the specific actions that will be taken to correct findings, deficiencies, or significant deficiencies identified by the reviewer and to enhance the firm's current system of quality control.

.A15 If the firm's response is not deemed to be feasible, genuine, and comprehensive, the AE's technical reviewer or committee will request a revised response. If pervasive nonconformity has been identified by the reviewer, the firm's response may state that it has reviewed other engagements with similar attributes to determine if similar remediation is warranted on other engagements that were not selected by the reviewer.

.A16 Although it is ultimately the firm's responsibility, firms are encouraged to work with the team captain to develop remedial actions and responses that both parties believe will be effective in correcting the matters, findings, and deficiencies or significant deficiencies identified during the peer review. Improvement is more likely to occur when the responses describe specific actions to be taken. Firms are discouraged from defaulting to a response of "we'll fix it on the next engagement" unless the firm is able to articulate why that is the appropriate response. As required by paragraph .40 of section 210, team captains or AEs should not dictate specific remediation to nonconforming engagements because those are decisions for the firm and its client to make.

.A17 The committee may require the firm to make and document appropriate considerations regarding nonconforming engagements as a condition of acceptance of the peer review. The firm response may affect monitoring actions the committee may impose, including actions to verify that the firm adheres to the intentions indicated in its response.

.A18 Examples of actions a firm may take in response to nonconforming engagements include, but are not limited to, the following:

- a. Omitted procedures performed (including documentation)
- b. Reissued report and financial statements
- c. Notification to users to discontinue use of previously issued reports

.A19 Illustrations of letters of response are presented in exhibit B, "Illustrative Examples of a Firm's Letter of Response."

.A20 If the firm is unable to determine appropriate remediation of weaknesses in its system of quality control and nonconforming engagements, if applicable, prior to the exit conference, the firm's response may indicate interim steps that have been taken and confirm its intent to remediate when an appropriate response is determined. In these situations, the RAB considering the review will ordinarily assign an implementation plan or corrective action for the firm to provide its final remediation.

.A21 After the firm has responded to the MFCs, FFCs, and deficiencies or significant deficiencies in the report and the team captain has assessed whether the responses are appropriate and has considered any additional impact to the peer review results, the team captain should communicate the results to the firm at an exit conference. The following is discussed during the exit conference:

- a. Final peer review results, including any changes to the information communicated at the closing meeting after consideration of the firm's responses to MFCs, FFCs, and deficiencies or significant deficiencies in the report
- b. The appropriateness of the firm's response
- c. The firm's representation letter
- d. Potential implications of the RAB acceptance process and their impact to the acceptance and completion of the peer review, and the reviewed firm's enrollment in the program, including, but not limited to,
 - i. corrective actions for deficiencies or significant deficiencies and implementation plans for findings, if applicable;
 - ii. recommended report rating changes;
 - iii. oversight
- e. Peer review noncooperation implications of consecutive non-pass report ratings, if applicable

Written Representations (Ref: par. .16–.17)

.A22 The reviewed firm is not prohibited from making additional representations and may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made to the team captain.

.A23 An illustrative example of a firm's written representation letter is provided in exhibit A, "Illustrative Representation Letter."

Subsequent Events (Ref: par. .18)

.A24 Before requesting a due date extension, the firm would need to consider the effect of the extension on any state boards of accountancy requirements or other regulatory peer review requirements.

.A25 If the circumstances described in paragraph .18 represent a long-term change in the nature of the firm's business, the firm may consult with its AE and consider requesting a change in peer review year-end.

.A26

Exhibit A — Illustrative Representation Letter

The following illustrative letter includes written representations that are required by paragraphs .16–.17 of this section. The firm may tailor the language in this illustration and refer to attachments to the letter as long as adequate representations pertaining to the matters previously discussed, as applicable, are included to the satisfaction of the team captain.

[Entity Letterhead]

[Date]

To [Name of Team Captain]:

We are providing this letter in connection with the peer review of the system of quality control for the accounting and auditing practice of [name of firm] [applicable to engagements not subject to PCAOB permanent inspection (if applicable)] as of the date of this letter and for the year ended June 30, 20XX.

Management has fulfilled its responsibility for the design of and compliance with a system of quality control for our accounting and auditing practice that provides us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We have [no knowledge of][disclosed to you all known] situations in which [name of firm] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review.

We have provided to the team captain a list of all engagements with periods ending during (or, for financial forecasts or projections and agreed-upon procedures engagements, report dates in) the year under review, regardless of whether issued as of the date of this letter. This list appropriately identified and included, but was not limited to, all engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit Act, audits of employee benefit plans, audits performed under FDICIA, and examinations of service organizations (SOC 1® and SOC 2® engagements), as applicable. We understand that failure to properly include engagements subject to the scope of the peer review could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.

We have completed the following must-select engagements and issued their respective reports. To the best of our knowledge and belief, the peer review team has selected and reviewed at least one of each category:

1. Engagements performed under *Government Auditing Standards*
2. Compliance audits under the Single Audit Act
3. Audits of employee benefit plans
4. Audits performed under FDICIA
5. Examinations of service organizations (SOC 1 and SOC 2 engagements)]

[We confirm that it is our responsibility to remediate nonconforming engagements as stated by the firm in the [Matter for Further Consideration, Finding for Further Consideration, or Letter of Response (as applicable)]].

We have discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, if applicable. We have also provided the team captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. We confirm, to the best of our knowledge and belief, that there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting and auditing practice in all material respects.

Sincerely,

*[Name of Reviewed Firm Representative(s)]*¹

¹ Firm representatives are members of management, as described in paragraph .10 in section 300, *General Principles and Responsibilities for Reviewed Firms*.

.A27

Exhibit B — Illustrative Examples of a Firm’s Letter of Response

This exhibit contains various illustrations of a firm's letter of response to a peer review report rating of pass with deficiencies or *fail* (system reviews).

Illustration 1 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies

Illustration 2 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies With a Scope Limitation

Illustration 3 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Fail

Illustration 4 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Fail With a Scope Limitation

Illustration 1 — A Firm’s Letter of Response to a Report on the Firm’s System of Quality Control With a Peer Review Rating of Pass With Deficiencies

[Reviewed firm's letterhead]

[Date of the report]

*[Addressed to the peer review committee of the administering entity]*¹

Ladies and Gentlemen:

This letter represents our² response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended *[peer review year-end date]*. The remedial actions discussed in this letter will be monitored to ensure that they are effectively implemented as part of our system of quality control.

- 1.³ The firm modified its quality control policies and procedures to include monitoring of firm personnel's compliance with regulatory and organization membership requirements. The importance of meeting these CPE requirements was discussed in a recent training session held in connection with a recent firm-wide staff meeting. Additionally, the training session included sufficient Yellow Book CPE such that all firm personnel have met the regulatory requirements. The impact to the Yellow Book audits of failure to take sufficient CPE timely is currently being discussed with the Government Accountability Office (GAO) and the firm will remediate as necessary based on that discussion.

¹ The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the National Peer Review Committee."

² The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

³ The numbering of responses to coincide with the numbered comments in the report is optional.

2. In addition, at that training session, the importance of proper use of the firm's checklists appropriate to the industry of the engagement being performed was discussed. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on industry-specific issues. The omitted procedures have been performed.

These remedial actions will also be emphasized in our monitoring procedures and internal inspection.

We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

*[Name(s) of reviewed firm representative(s)]*⁴

Illustration 2 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Pass With Deficiencies With a Scope Limitation

[Reviewed firm's letterhead]

[Date of the report]

*[Addressed to the peer review committee of the administering entity]*¹

Ladies and Gentlemen:

This letter represents our² response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended *[peer review year-end date]*.

- 1.³ Due to circumstances that we deemed appropriate, we notified the peer reviewer that he would be unable to select our only audit subject to *Government Auditing Standards* in the peer review. This was an initial engagement and an engagement performed under *Government Auditing Standards*, so there were no previous audits for the reviewer to select. We have considered the consequences of noncompliance related to this matter. We understand that, until our firm's most recently completed peer review includes selection of an engagement performed under *Government Auditing Standards*, our audit reports for such engagements will need to include an exception regarding our lack of compliance with peer review requirements.

We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

*[Name(s) of reviewed firm representative(s)]*⁴

⁴ These are members of management as described in paragraph .25 of section 200, *General Principles and Responsibilities for Reviewers*.

¹ The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the National Peer Review Committee."

² The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

³ The numbering of responses to coincide with the numbered comments in the report is optional.

⁴ These are members of management as described in paragraph .25 of section 200.

Illustration 3 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Fail

[Reviewed firm's letterhead]

[Date of the report]

[Addressed to the peer review committee of the administering entity]¹

Ladies and Gentlemen:

This letter represents our² response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended [peer review year-end date]. The firm is committed to providing clear, consistent, and frequent actions and messages from all levels of the firm's management to emphasize the firm's commitment to quality. The remedial actions discussed in this letter will be monitored to ensure that they are effectively implemented as part of our system of quality control.

- 1.³ The firm modified its quality control policies and procedures to require the following:
 - a. Use of practice aids to document procedures performed to assess competency for undertaking new engagements. The practice aid is designed to ensure that the firm (1) is competent to perform the engagement and has the capabilities, including time and resources, to do so; (2) can comply with legal and relevant ethical requirements; and (3) has considered the integrity of the client.
 - b. Inclusion of a CPE plan for obtaining relevant training to prepare for engagements in new industries or service areas in the client acceptance file.
2. The firm has recalled the audit report for the employee benefit plan audit and has hired a third party to perform a pre-issuance review prior to reissuing our report.
3. We have joined the AICPA Governmental Audit Quality Center and Employee Benefit Plan Audit Quality Center. The firm modified its quality control policies and procedures to require personnel that perform engagements in these specialized areas to attend at least eight hours of CPE annually in the specialized areas. We are committed to promptly completing our evaluation of the audit engagements, including whether audited financial statements should be recalled and reissued to include the omitted disclosures. The omitted procedures will be performed and documentation will be added in a memo to the engagement files of the audit performed under *Government Auditing Standards* and the audits in other industries identified as not in conformity with professional standards.
4. The firm's system of quality control was modified to include monitoring procedures to provide it with reasonable assurance that the firm's policies and procedures relating to the system of quality

¹ The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the National Peer Review Committee."

² The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

³ The numbering of responses to coincide with the numbered comments in the report is optional.

control are relevant, adequate, and operating effectively. Specifically, the firm will monitor compliance with all functional areas of the system and will perform annual inspections on a sample of engagements. We intend to hire a Quality Control Director who will be responsible for developing and implementing our monitoring and inspection procedures.

The results of our peer review will be discussed in a firm-wide meeting to be held on *[date of meeting]*, and an emphasis on quality will be reinforced with all engagement partners and their teams.

We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

*[Name(s) of reviewed firm representative(s)]*⁴

Illustration 4 — A Firm's Letter of Response to a Report on the Firm's System of Quality Control With a Peer Review Rating of Fail With a Scope Limitation

[Reviewed firm's letterhead]

[Date of the report]

*[Addressed to the peer review committee of the administering entity]*¹

Ladies and Gentlemen:

This letter represents our² response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended *[peer review year-end date]*.

We notified our peer reviewer that he would be unable to review the engagements performed by one of our firm's four offices that divested from our firm during the peer review year. We have considered the consequences of this scope limitation on the results of our peer review.

- 1.³ The firm's monitoring procedures were modified to provide it with reasonable assurance that the firm's policies and procedures are relevant, adequate, and operating effectively. Specifically, the firm will monitor compliance with relevant ethical considerations and perform annual testing of a sample of personnel independence confirmations. We have contacted our attorney, clients, and applicable regulatory bodies to discuss the impact of the independence violations and will remediate the engagements as required by professional standards.
2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits. We have implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar. We have also joined the AICPA Employee Benefit Plan Audit Quality Center. The omitted procedures will be performed and documentation will be added in a memo to the engagement file. We will engage one of the accounting firms to review the engagement working papers

⁴ These are members of management as described in paragraph .25 of section 200.

¹ The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the National Peer Review Committee."

² The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

³ The numbering of responses to coincide with the numbered comments in the report is optional.

prior to finalizing the memo and to perform engagement quality control reviews of future employee benefit plan audits.

3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use. At our next staff meeting on [date of meeting], we will emphasize the importance of proper use of the firm's practice aids. We will also discuss the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on the firm's expectations for performing and documenting audit planning considerations.

The firm is committed to strengthening its monitoring policies and procedures. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as previously mentioned) has been sought, and these individuals will be available for consultation and guidance.

We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

[Name(s) of reviewed firm representative(s)]⁴

⁴ These are members of management as described in paragraph .25 of section 200.

PR-C Section 320

General Principles and Responsibilities for Reviewed Firms — Engagement Reviews

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains requirements and application material for firms engaged to have an engagement review. The requirements and guidance in this section supplement the requirements and application guidance in section 100, *Concepts Common to All Peer Reviews*, and section 300, *General Principles and Responsibilities for Reviewed Firms*.

.02 Firms that perform only engagements under the Statements on Standards for Accounting and Review Services (SSARs) or engagements under the Statements on Standards for Attestation Engagements (SSAEs) other than examinations are eligible to have engagement reviews. (Ref: par. .A1)

Effective Date

.03 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.04 The objective of the reviewed firm is to enhance its effectiveness and contribute to the quality of our profession by undergoing an engagement review performed in accordance with the Standards for Performing and Reporting on Peer Reviews (the standards) established by the Peer Review Board (the board) of the American Institute of Certified Public Accountants. (Ref: par. .A2)

Definitions

.05 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Planning

.06 The firm should make the following information available to the review captain:

- a.* The number of engagements performed by level of service and industry for each engagement partner

- b. Responses to inquiries about the areas to be addressed in the written representations
- c. The firm's prior
 - i. peer review report,
 - ii. letter of response (if applicable),
 - iii. letter of acceptance,
 - iv. findings for further consideration (FFCs) (if applicable), and
 - v. representation letter

Engagement Selection

.07 The firm should submit the engagements that meet the criteria of the review captain's selections. (Ref: par. .08 and .A3–.A7)

.08 For each engagement selected for review, the reviewed firm should submit the following (masking client identity if it desires):

- a. The appropriate financial statements or information
- b. The accountant's report, if applicable
- c. The engagement profile
- d. The firm's documentation required by applicable professional standards for each engagement

Scope Limitations

.09 The firm should notify the review captain and the administering entity (AE), prior to the commencement of the review, if it intends to exclude an engagement. This notification should indicate

- a. its plans to exclude one or more engagements from the peer review selection process,
- b. the reasons for the exclusion, and
- c. that it is requesting a waiver for the exclusion.

Evaluation of Engagements

.10 The firm should promptly respond to review captain questions during the review. (Ref: par. .A8)

Responding to Matters, Findings, and Deficiencies

.11 The firm should discuss matters, findings, and deficiencies with the review captain. Ordinarily, this discussion occurs during the closing meeting. If the firm disagrees with one or more of the findings or deficiencies, and the firm and reviewer can't come to a resolution, the firm should contact the AE for assistance and follow the guidance in section 100 to resolve the disagreement. (Ref: par. .A9)

.12 The firm should identify the appropriate remediation of findings and deficiencies. (Ref: par. .A10)

.13 The firm should respond to

- a. matters via the matter for further consideration (MFC) form,
- b. findings via the FFC form, and
- c. deficiencies via a letter of response.

.14 The firm's responses on the FFCs and letter of response should (Ref: par. .A11–.A14)

- a. include the firm's actions taken or planned to remediate the findings or deficiencies, including
 - i. timing of the remediation and
 - ii. additional procedures to ensure the finding or deficiency is not repeated in the future.
- b. be feasible, genuine, and comprehensive.
- c. be addressed to the AE's peer review committee (committee) in a letter of response, if applicable.
- d. be dated as of the exit conference in a letter of response, if applicable.
- e. be on firm letterhead in a letter of response, if applicable.

The review captain should review documentation of any action taken by the firm and consider whether the action is appropriate.

.15 The firm's draft responses should be provided to the review captain as soon as possible after the closing meeting to allow the review captain enough time to assess the firm's response prior to the exit conference. (Ref: par. .A15)

Written Representations

.16 The firm should provide to the review captain written representations on firm letterhead for the peer review year, dated as of the date of the peer review report, that state the following: (Ref: par. .A16–.A18)

- a. Management has fulfilled its responsibility for the design of and compliance with a system of quality control for our accounting practice that provides us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
- b. Management acknowledges its responsibility for complying with the rules and regulations of state boards of accountancy and other regulations.
- c. Management has disclosed to the review captain all known instances of noncompliance or suspected noncompliance with the rules and regulations of state boards of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which the firm practices for the year under review. If there are known instances of noncompliance, management should summarize the instances and, if applicable, describe its remediation of the noncompliance.
- d. Management has discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the team captain, if applicable.
- e. Management has fulfilled its responsibility to remediate nonconforming engagements as stated by the firm on the relevant form, if applicable.
- f. Management understands the intended uses and limitations of the quality control materials it has developed or adopted. Management has tailored and augmented the materials as appropriate such that the quality control materials encompass guidance

that is sufficient to assist it in conforming with professional standards (including the Statements on Quality Control Standards) applicable to its accounting and auditing practice.

- g. Management has responded fully and truthfully to the review captain's inquiries.
- h. Management has provided the review captain with all relevant information including all engagements with periods ending during (or, for financial forecasts or projections and agreed-upon procedures engagements, report dates in) the year under review.
- i. Management has disclosed to the review captain that the firm did not perform any engagements under the Statements on Auditing Standards or *Government Auditing Standards*, examinations under the SSAEs, or engagements under the PCAOB standards that are not subject to PCAOB permanent inspection.
- j. Management acknowledges that failure to properly include these engagements on the list could be deemed as failure to cooperate and may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, or enforcement body.
- k. Management has provided to the review captain communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end.
- l. Management has disclosed that there are no known limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end, or management has included a summary of the limitations or restrictions on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

.17 If, in addition to the representations required by paragraph .16, the review captain determines that it is necessary to obtain other representations based on the circumstances and nature of the peer review, the review captain should request such other written representations.

Subsequent Events

.18 If, after the year-end of its engagement review, a firm performs an engagement requiring a system review, the reviewed firm should

- a. immediately notify the AE and
- b. undergo a system review.

The system review is due the earlier of 18 months from the year-end of the engagement (or, for financial forecasts and projections, 18 months from the date of the report) requiring a system review or by the firm's next scheduled due date.

.19 If the firm fails to immediately notify the AE of the performance of an engagement described in paragraph .18, the firm should participate in a system review with a peer review year-end that covers that engagement.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Firms eligible to have an engagement review may elect to have a system review. See section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*, for the firm requirements of a system review.

Objective (Ref: par. .04)

.A2 The reviewed firm may benefit from knowing the review captain's objectives when performing an engagement review, which are to

- a. evaluate whether the engagements submitted for review are performed and reported on in conformity with applicable professional standards in all material respects and
- b. report on the evaluation of selected engagements.

Engagement Selection (Ref: par. .07–.08)

.A3 The review captain will make selections based on the following criteria:

- a. One engagement from each of the following levels of service performed by the firm:
 - i. Review of financial statements (performed under SSARSs)
 - ii. Compilation of financial statements with disclosures (performed under SSARSs)
 - iii. Compilation of financial statements that omits substantially all disclosures (performed under SSARSs)
 - iv. Engagements performed under the SSAEs other than examinations
- b. One engagement from each engagement partner responsible for the issuance of reports listed in item (a)
- c. At least two engagements, unless only one is performed

.A4 The review captain will select a preparation engagement only in one of the following instances:

- a. It is the only level of service performed by an engagement partner.
- b. It is the only engagement performed with disclosures.
- c. It is the only engagement performed without disclosures.
- d. The selection is needed to meet the minimum requirement that two engagements are selected for review.

.A5 The objective of the engagement-selection requirements is to select one engagement for each engagement partner and one engagement from each level of service listed in paragraph .A3a for the firm. Review captains will not select more engagements than necessary to meet this objective.

.A6 Engagement selection may also include consideration of industries.

.A7 As an example, a firm may have indicated that engagement partner A issues review reports on 4 construction contractors, 2 retailers, and 10 manufacturers, but engagement partner B issues compilation reports on 30 medical practices and review reports on 5 restaurants. The firm may be asked to submit one of engagement partner A's review reports on a construction contractor and

one of engagement partner B's compilation reports on a medical practice. The firm will choose the engagements based on those selections.

Evaluation of Engagements (Ref: par. .10)

.A8 The review captain's evaluation of each engagement submitted for review will include the following:

- a. Consideration of the financial statements or information and the related accountant's report on the engagements performed under the SSARSs and SSAEs
- b. Review of all other documentation required by applicable professional standards on the engagements
- c. Consideration of the information related to the engagement obtained through the peer review including, but not limited to, engagement profile information and other inquiries

Responding to Matters, Findings, and Deficiencies (Ref: par. .11–.15)

.A9 The closing meeting is designed to provide sufficient time for the firm to determine the appropriate responses to peer review results and for the reviewer to evaluate the firm's responses. The following are discussed during the closing meeting:

- a. Preliminary peer review results, including any matters, findings, or deficiencies, and the expected report rating, if determinable at this point
- b. The firm's requirement to respond to any MFCs, FFCs, or deficiencies included in the peer review report
- c. The firm's required written representations
- d. Other suggestions and observations for the firm to consider

.A10 Although it is ultimately the firm's responsibility, the review captain and firm may collaborate to determine the remediation. As required by paragraph .19 of section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*, review captains or AEs should not require firms to perform omitted procedures, reissue accounting reports, or have previously issued financial statements revised and reissued because those are decisions for the firm and its client to make.

.A11 The purpose of the firm's response on the FFC or in the letter of response is for a firm to document the specific actions that will be taken to correct findings and deficiencies noted by the review captain.

.A12 The committee may require the firm to make and document appropriate considerations regarding nonconforming engagements as a condition of acceptance of the peer review. The firm's response may affect other monitoring actions the committee may impose, including actions to verify that the firm adheres to the intentions indicated in its response.

.A13 Examples of actions a firm may take in response to nonconforming engagements include, but are not limited to, the following:

- a. Omitted procedures performed (including documentation)
- b. Reissued report and financial statements
- c. Notification to users to discontinue use of previously issued reports

.A14 Illustrative letters of response are presented in exhibit B, "Illustrative Examples of a Firm's Letter of Response."

.A15 After the firm has responded to the MFCs, FFCs, and deficiencies in the report and the review captain has assessed whether the responses are appropriate and has considered any additional impact to the peer review results, the review captain should communicate the results to the firm at an exit conference. The following are discussed during the exit conference:

- a. Final peer review results, including any changes to the information communicated at the closing meeting after consideration of the firm's responses to MFCs, FFCs, and deficiencies in the report
- b. The appropriateness of the firm's response
- c. The firm's representation letter
- d. Potential implications of the RAB acceptance process and their impact on the acceptance and completion of the peer review and on the reviewed firm's enrollment in the program, including
 - i. corrective actions for deficiencies and implementation plans for findings, if applicable;
 - ii. recommended report rating changes; and
 - iii. oversight
- e. Peer review noncooperation implications of consecutive non-pass report ratings, if applicable

Written Representations (Ref: par. .16–.17)

.A16 The reviewed firm is not prohibited from making additional representations and may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made to the review captain. For example, the list of engagements in paragraph .16I is a minimum required representation, and therefore, these engagements should not be removed if the firm does not perform any such engagements.

.A17 An illustrative example of a firm's written representation letter is provided in exhibit A, "Illustrative Representation Letter."

.A18 On committee-appointed review team reviews, the representation letter may be addressed "To the Review Captain."

.A19

Exhibit A — Illustrative Representation Letter

The following illustrative letter includes written representations that are required by paragraphs .16–.17 of this section. The firm may tailor the language in this illustration and refer to attachments to the letter as long as adequate representations pertaining to the matters previously discussed, as applicable, are included to the satisfaction of the review captain.

[*Entity Letterhead*]

[*Date of the Report*]

To [*Name of Review Captain*]:

We are providing this letter in connection with the peer review of [*name of firm*] as of the date of this letter and for the year ended June 30, 20XX.

Management has fulfilled its responsibility for the design of and compliance with a system of quality control for our accounting practice that provides us with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We have [*no knowledge of*][*disclosed to you all known*] situations in which [*name of firm*] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements through the issuance dates of the reviewed engagements in each state in which it practices for the year under review.

We have provided to the review captain a list of all engagements with periods ending during (or, for financial forecasts or projections and agreed-upon procedures engagements, report dates in) the year under review, regardless of whether issued. This list included, but was not limited to, all engagements performed under *Government Auditing Standards*, audits of employee benefit plans, audits performed under FDICIA, and examinations of service organizations (SOC 1® and SOC 2® engagements), as applicable. The firm does not perform engagements under the Statements on Auditing Standards (SASs) or *Government Auditing Standards*, examinations under the Statements on Standards for Attestation Engagements (SSAEs), or engagements under Public Company Accounting Oversight Board (PCAOB) standards that are not subject to permanent inspection by the PCAOB. We understand that failure to properly include these engagements on the list could be deemed as failure to cooperate. We also understand this may result in termination from the Peer Review Program and, if termination occurs, may result in an investigation of a possible violation by the appropriate regulatory, monitoring, and enforcement body.

[*We confirm that it is our responsibility to remediate nonconforming engagements as stated by the firm in the Letter of Response* (if applicable).]

We have discussed significant issues from reports and communications from regulatory, monitoring, and enforcement bodies with the review captain, if applicable. We have also provided the review captain with any other information requested, including communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. We confirm that, to the best of our knowledge and belief, there

are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.

We understand the intended uses and limitations of the quality control materials we have developed or adopted. We have tailored and augmented the materials as appropriate such that the quality control materials encompass guidance that is sufficient to assist us in conforming with professional standards (including the Statements on Quality Control Standards) applicable to our accounting practice in all material respects.

Sincerely,

*[Name of Reviewed Firm Representative(s)]*¹

¹ Firm representatives are members of management as described in paragraph .10 of section 300, *General Principles and Responsibilities for Reviewed Firms*.

.A20

Exhibit B — Illustrative Example of a Firm's Letter of Response

This exhibit contains an illustration of a firm's letter of response to a peer review report rating of *pass with deficiencies* or *fail* (engagement reviews).

Illustration — A Firm's Letter of Response to a Report on the Firm's Conformity With Professional Standards on Engagements Reviewed With a Peer Review Rating of Pass With Deficiencies or Fail

[Reviewed firm's letterhead]

[Date of the report]

[Addressed to the peer review committee of the administering entity]¹

Ladies and Gentlemen:

This letter represents our² response to the report on the engagement review of our firm's accounting practice for engagements submitted for review with periods ending during the year ended [peer review year-end date].

- 1.³ We have recalled and reissued the review report. The entire staff has participated in continuing professional education related to reporting and disclosures, with a particular focus on areas specific to the industries that we are engaged in. We will be performing a pre-issuance review by a partner not associated with the engagement to make sure that the accountant's report is appropriately modified when the financial statements depart from applicable professional standards.
2. We subsequently obtained a management representation letter and documented the matters covered in our inquiry and analytical procedures. Management representation letters will be obtained for all future review engagements issued by the firm. The firm has required that a manager review each engagement to ensure that the management representation letter is obtained and that all the required documentation, including the matters covered in the accountant's inquiry and analytical procedures, is included in the working papers.

We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

[Name(s) of reviewed firm representative(s)]⁴

¹ The response of a firm whose review is administered by the National Peer Review Committee should be addressed as follows: "To the National Peer Review Committee."

² The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

³ The numbering of responses to coincide with the numbered comments in the report is optional.

⁴ These are members of management as described in paragraph .25 of section 200, *General Principles and Responsibilities for Reviewers*.

PR-C Section 400

General Principles and Administration Responsibilities

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains performance requirements and application material for administration of the AICPA Peer Review Program (the program). The requirements and guidance in this section supplement the requirements and guidance in the following PR-C sections:

- a. Section 100, *Concepts Common to All Peer Reviews*
- b. Section 410, *The Report Acceptance Process*
- c. Section 420, *Corrective Actions and Implementation Plans*
- d. Section 430, *Reviewer Monitoring and Performance*

.02 In addition to the sections described by paragraph .01, individuals involved in the administration of the program should be familiar with reviewer and firm requirements in the following PR-C sections: (Ref: par. .A1)

- a. Section 210, *General Principles and Responsibilities for Reviewers — System Reviews*
- b. Section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*
- c. Section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*
- d. Section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*

Effective Date

.03 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.04 The objective of the administering entity (AE) is to carry out the program in accordance with the AICPA Standards for Performing and Reporting on Peer Reviews (the standards). The peer review committee (committee) assists the AE in its objectives by overseeing the administration, acceptance, and completion of peer reviews.

Definitions

.05 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Obligations of an Administering Entity

.06 In electing to administer the program, an AE agrees to do the following:

- a.* Comply with the standards.
- b.* Cooperate with the board in all matters related to the administration of the program. (Ref: par. .A2)
- c.* Engage an experienced CPA on staff to lead and manage the program. (Ref: par. .A3)
- d.* Appoint a peer review committee of at least six members to oversee the administration of the program. (Ref: par. .A4–.A5)
- e.* Comply with AICPA system security guidelines.
- f.* Establish a backup plan for key individuals involved in the administration of the program.
- g.* Establish familiarity threat policies and procedures that identify, evaluate the significance of, and apply safeguards to mitigate those threats. (Ref: par. .A6)
- h.* Annually submit a comprehensive and written oversight program that meets minimum requirements established by the board and ensures the program is performed in accordance with the standards. (Ref: par. .A7)
- i.* Establish policies and procedures to address disagreements that arise between parties to a peer review. (See appendix B, "Disagreements.")
- j.* Establish procedures to ensure consistent application of the standards.
- k.* Monitor reviewer performance. (See section 430.)
- l.* Perform procedures to verify that reviewer resumes accurately reflect the reviewer qualifications.
- m.* Monitor firms enrolled in the program within its jurisdiction.
- n.* Evaluate the qualifications and competencies of technical reviewers at least annually.
- o.* Ensure reviews are presented for evaluation to a report acceptance body (RAB) or accepted by the technical reviewer in a timely manner as follows: (Ref: par. .A8)
 - i.* Reviews required to be presented to a RAB are presented within 120 days of the receipt of the working papers from the captain.
 - ii.* Engagement reviews meeting the criteria to be accepted by a technical reviewer are accepted by the technical reviewer or presented to a RAB within 60 days of the receipt of the working papers from the captain.
 - iii.* Meeting materials are provided to RAB members at least seven days in advance of the date of the RAB meeting.

Document Retention

.07 The AE should retain peer review documentation at least 120 days, but no more than 150 days, after the peer review completion date, except for the following, as applicable: (Ref: par. .A9–.A10)

- a.* Peer review report
- b.* Letter of response
- c.* Firm representation letter
- d.* Findings for further consideration (FFCs)
- e.* Letter notifying the firm that its peer review has been accepted
- f.* Letters requesting the firm's completion of implementation plans and corrective actions
- g.* Letters requesting the firm's completion of additional implementation plans and corrective actions
- h.* Letters notifying the firm that implementation plans have been completed
- i.* Supporting documents evidencing completion of corrective actions and implementation plans, including documentation regarding the decision to waive, replace, or extend the due date
- j.* Committee-appointed review team (CART) engagement letter
- k.* Letters relating to peer review document recall considerations (See appendix C, "Considerations for the Recall of Peer Review Documents.")

If a firm is enrolled in the program but has not undergone a peer review in the last 3 years and 6 months since the year-end date of its last peer review, all other peer review documents should be retained at least 42 months, but no more than 43 months, after the peer review completion date.

Publicizing Peer Review Information

.08 Except as authorized by the reviewed firm, individuals involved in the administration of the program should disclose only the following information regarding a reviewed firm: (Ref: par. .A1 and .A11–.A13)

- a.* The firm's name and address
- b.* Whether the firm is enrolled in the program
- c.* The date of acceptance and the period covered by the firm's most recently accepted peer review
- d.* The most recent date the firm's enrollment in the program has been dropped or terminated, if applicable

.09 Individuals involved in the administration of the program should not provide subjective information about a firm's peer review, even with firm authorization. (Ref: par. .A14)

Ethical Requirements Relating to a Peer Review

.10 Individuals involved in the administration of the program should do the following:

- a.* Maintain objectivity in discharging their responsibilities.
- b.* Be free of bias, conflicts of interest, or undue influence of others that overrides professional judgment.

- c. Annually sign a confidentiality and conflict-of-interest agreement. (Ref: par. .A15)
- d. Not commence nor plan to commence any enforcement-related work, if applicable, as an employee, consultant, volunteer (or other similar arrangement) of the AICPA or state CPA society ethics committee, the AICPA Joint Trial Board, or a state board of accountancy (or other regulatory agencies, governmental bodies, or similar groups or subgroups). (Ref: par. .A16)

.11 Individuals associated with the AE that lack independence or have a conflict of interest with a reviewing firm, reviewer, or reviewed firm should recuse themselves from any discussion regarding the reviewed firm's peer review. Circumstances that would cause an individual to experience a conflict of interest include, but are not limited to, the following:

- a. The individual's firm performed the most recent or immediately preceding peer review of the affected firm.
- b. The individual served on the review team that performed the most recent or immediately preceding peer review of the affected firm.
- c. The individual served on a disagreement panel involving the firm's current review.
- d. The individual believes that the individual could not be impartial or objective.
- e. The individual's independence is impaired as a result of situations such as those described in paragraph .16 of section 200, *General Principles and Responsibilities for Reviewers*.

.12 Individuals associated with the AE who perform oversight on a peer review may participate in discussions related to the firm subject to oversight but should not vote on any motions related to the firm or firm's review.

.13 Individuals associated with the AE who are reviewers are also required to comply with the reviewer qualification requirements in section 200.

.14 Individuals associated with the AE should notify the relevant AE of any allegations against or investigations into them. Notification should occur prior to participating in the peer review process (such as performing technical reviews or participating in any committee or RAB meetings). The AE should monitor and consider the role that the individuals fill in the peer review process when determining the proper actions to take. (Ref: par. .A17)

CPA on Staff

Qualifications

.15 The CPA on staff should

- a. be licensed to practice as a CPA.
- b. be knowledgeable about the standards, administrative requirements, and processes.
- c. possess relevant audit experience and current knowledge of professional standards applicable to the reviews being administered.
- d. understand the significance of technical issues and the impact on reviews.

- e.* obtain at least 48 hours of CPE every 3 years in subjects relating to accounting, auditing, and quality control with a minimum of 8 hours in any 1 year.
 - f.* complete CPA-on-staff training that meets the requirements established by the board.
 - g.* be proficient with technology to effectively manage the program.
 - h.* agree to confidentiality and conflict-of-interest requirements of the program.
- .16** The CPA on staff should not
 - a.* be a member of the committee or a RAB.
 - b.* perform peer reviews within the AE's jurisdiction.
 - c.* be a full-time technical reviewer for the AE at which the CPA is employed. (Ref: par. .A18)

Peer Review Committee

Composition and Qualifications

.17 A majority of the committee members and the chairperson charged with the overall responsibility for administering the program should possess the qualifications required of a team captain in a system review, as addressed in paragraphs .05–.15 of section 200 and paragraph .32 of section 210. (Ref: par. .A19–.A20)

.18 Committee members should be members of the AICPA in good standing.

.19 A committee member does not meet the required qualifications of a committee member if the member's ability to practice public accounting or perform peer reviews has been restricted by a regulatory, monitoring, or enforcement body beginning on the date the member is notified of the restriction and ending on the date that the restriction has been removed. (Ref: par. .A21)

Responsibilities

- .20** The committee should do the following: (Ref: par. .A4 and .A22)
- a.* Carry out its activities in accordance with administrative procedures and guidance issued by the board.
 - b.* Oversee the administration, acceptance, and completion of peer reviews it has agreed to administer.
 - c.* Evaluate the adequacy of the policies and procedures required to be established by the AE per items *(f)–(i)* of paragraph .06.
 - d.* Monitor the performance of reviewers within its jurisdiction and, when appropriate, prescribe effective corrective actions or recommend to the board that a reviewer be prohibited from performing peer reviews in the future.
 - e.* Monitor firms that are not cooperating or not complying with the requirements of the program. (See appendix A, "Failure to Cooperate or Comply With the Requirements of the Program Referral Responsibilities.")

Report Acceptance Body

Qualifications

.21 A RAB member should

- a. be a member of the AICPA in good standing, licensed to practice as a CPA.
- b. be presently involved in public practice as a partner, manager, or person with equivalent responsibilities in the accounting or auditing practice or carrying out a quality control function in the member's firm. (Ref: par. .A23)
- c. have spent the last five years in the practice of public accounting in the accounting or auditing function.
- d. be employed by or be an owner of a firm that has received a report with a peer review rating of *pass* or *pass with scope limitations* for its most recent peer review. The report should have been accepted timely. (Ref: par. .A24)
- e. complete RAB member training that meets the requirements established by the board.
- f. agree to confidentiality and conflict-of-interest requirements of the program.

.22 A RAB member does not meet the required qualifications if the member's ability to practice public accounting or perform peer reviews has been restricted by a regulatory, monitoring, or enforcement body. The period that the member is not qualified begins on the date the member is notified of the restriction and ends on the date that the restriction has been removed. (Ref: par. .A25)

Report Acceptance Body Composition

.23 A minimum of three RAB members who are independent and free from any conflicts of interest should evaluate each peer review that requires RAB consideration. To accept any motions related to a peer review, a majority of the RAB members should agree to carry the motion.

.24 For the acceptance of system reviews (including corrective actions or implementation plans related to a system review),

- a. the chairperson of the RAB should possess the qualifications required of a system review team captain.
- b. a majority of the RAB members should possess the qualifications required of a system review team captain.
- c. at least one RAB member should have current experience in the must-select engagements included in the review. (Ref: par. .A26–.A27)

.25 If a RAB meeting includes a third party to meet the requirement for must-select experience discussed in paragraph .24, that individual should meet the following qualifications:

- a. Be a member of the AICPA in good standing, licensed to practice as a CPA, and employed by or an owner of a firm enrolled in the program.
- b. Be presently involved in public practice in the must-select engagements as a partner, manager, or person with equivalent

supervisory responsibilities or carrying out a quality control function in the individual's firm.

- c. Be employed by or an owner of a firm that has received a report with a peer review rating of *pass* or *pass with scope limitations* for its most recent system review. The report should have been accepted timely.
- d. Agree to confidentiality and conflict-of-interest requirements of the program.

Peer Review Evaluation

.26 The RAB should evaluate each peer review presented for acceptance to determine whether the review was performed and reported on in accordance with the standards. After the evaluation of the peer review documents, the RAB should vote on acceptance, deferral, or delayed acceptance of the review. Specific criteria for evaluating peer reviews are discussed in paragraphs .11–.15 of section 410.

.27 The RAB should require a reviewed firm to perform corrective actions for *pass with deficiencies* and *fail* reports. Determining when and what type of corrective actions to require is further discussed in paragraph .07 of section 420. (Ref: par. .A28–.A29)

.28 The RAB should consider an implementation plan only for

- a. repeat findings,
- b. findings that identify at least one must-select nonconforming engagement in a system review, or
- c. a finding related to the reviewed firm's licensure.

(See paragraphs .07–.08 of section 420.)

.29 The RAB should establish a due date for required corrective actions and implementation plans. The due date should be as soon as reasonably possible considering all known information, including, but not limited to, the following:

- a. The anticipated completion date of subsequent engagements
- b. The timing of CPE program presentations or availability
- c. The timing of the reviewed firm's monitoring procedures

Evaluating the Results of Corrective Actions and Implementation Plans

.30 The RAB should evaluate the results of corrective actions and implementation plans to determine if they have been completed as required and whether the reviewed firm should be required to perform additional actions. (See paragraphs .09–.10 of section 420.)

.31 When considering replacing or waiving corrective actions or implementation plans, the RAB should do the following:

- a. Review the facts and circumstances surrounding the deficiencies or findings.
- b. Consider the reasons for the original action.
- c. Consider replacing an action prior to waiving an action, if applicable. (See paragraph .12 of section 420.)

.32 If the reviewed firm requests a replacement or waiver of an action because it will no longer perform engagements in the industry or level of service related to the action, the RAB should replace or waive the action and require the firm to provide a written representation that

- a. states the firm is no longer performing or has plans to perform engagements in that industry or level of service.
- b. includes a listing of such engagements that were issued since the last peer review year-end.
- c. is signed by the appropriate member of management.
- d. is included in the letter of response if the firm represents it will no longer perform certain engagements or engagements in a specific industry prior to the review being submitted for acceptance.

.33 If the RAB waived corrective actions because a reviewed firm represented that it would no longer perform the engagements that were the source of deficiencies and the firm subsequently notifies the AE that the firm has accepted such an engagement, the RAB should evaluate whether the firm should perform any actions related to the recently accepted engagement.

Firm Cooperating and Complying With the Requirements of the Program

.34 The RAB should evaluate whether a reviewed firm is not cooperating or not complying with the requirements of the program due to reasons described in paragraphs .12–.13 of section 300, *General Principles and Responsibilities for Reviewed Firms*. (See appendix A.)

.35 For a reviewed firm that receives three consecutive non-pass (*pass with deficiencies* or *fail*) peer review reports, the RAB should assess whether the firm should be referred for failing to comply with the requirements of the program when the RAB evaluates the firm's most recent review for acceptance. For a reviewed firm that receives consecutive non-pass peer review reports (two total), the RAB should assess whether the firm should be referred for failing to comply with the requirements of the program after the firm has submitted the results of assigned corrective actions in its current review. (Ref: par. .A30–.A33)

.36 After a firm receives consecutive non-pass reports, the RAB or the committee should evaluate whether to refer the firm for potential termination. The evaluation of the firm's attempted improvement should include reviewing the previous peer review documents, including the reports, letters of response, and results from related corrective actions, and evaluating the following: (Ref: par. .A32–.A33)

- a. Whether the prescribed corrective actions were appropriate to address the cause of the deficiencies and gave the firm an opportunity to demonstrate the effectiveness of implemented changes
- b. Whether the firm was given an appropriate amount of time to improve
- c. Whether the firm implemented actions outside of required corrective actions to resolve deficiencies
- d. Whether actions taken by the firm appear genuine
- e. Whether there was improvement relative to the deficiencies identified
- f. Whether deficiencies were repetitive or substantially the same on the current review
- g. Whether deficiencies in the prior review were replaced with different deficiencies
- h. Whether deficiencies in the current year were of the same nature and severity as compared to the prior review deficiencies
- i. Other facts and circumstances as deemed necessary

.37 After evaluation, the firm should be referred to the committee or board if any of the following apply:

- a. It is evident the firm did not implement the actions in its letters of response or complete corrective actions required to date.
- b. Deficiencies in previous peer reviews are repeated in the current peer review.
- c. The firm has not made attempts to appropriately design or comply with its system of quality control.

(See appendix A.)

.38 The AE should maintain documentation of the RAB's and committee's evaluations of potential referrals to the board for termination for receiving consecutive non-pass reports.

.39 Referral of a firm to the board should include all supporting documentation. (Ref: par. .A34–.A35)

Considerations for the Recall of Peer Review Documents

.40 If, subsequent to the date of peer review acceptance, information becomes known that existed as of the date of the peer review report or acceptance that might have affected the performance or acceptance of the peer review, the RAB should evaluate the facts and circumstances and determine whether the acceptance letter should be recalled. In such cases, only the reviewed firm's most recently accepted peer review should be recalled. (Ref: par. .A36)

.41 Recall should not be considered as a result of (Ref: par. .A37)

- a. fee disputes,
- b. disagreements that occur after acceptance by the RAB,
- c. situations outside of the scope of peer review,
- d. situations not addressed in the standards, or
- e. other situations that did not have a direct impact on the underlying peer review period, procedures performed, or peer review documents.

.42 When peer review documents are being considered for recall,

- a. AICPA staff should be notified and consulted early in the process.
- b. all parties involved should cooperate with efforts to determine the impact any additional information may have on a review.
- c. all parties should continue to adhere to the confidentiality guidelines in paragraphs .19–.20 of section 100.
- d. peer review documentation should be retained after notification of potential recall until the matter is resolved.
- e. recall considerations should be documented and retained until the firm's subsequent review has been completed.

Reviewer Performance

.43 During the review acceptance process, the RAB should evaluate the captain's and review team's performance. (See paragraphs .01–.17 of section 430.)

Other RAB Responsibilities

.44 The RAB should periodically (at least annually) review a list of engagement reviews accepted by the technical reviewer.

Technical Reviewer

Qualifications

.45 A technical reviewer should

- a. be a member of the AICPA in good standing, licensed to practice as a CPA.
- b. complete initial and ongoing peer review captain training that meets the requirements established by the board within 12 months preceding the commencement of the technical review. (Ref: par. .A38)
- c. have an appropriate level of accounting and auditing knowledge and experience suitable for the work performed. (Ref: par. .A39)
- d. complete initial technical reviewer training that meets the requirements established by the board within 12 months before serving as a technical reviewer and complete or attend one of the following every calendar year thereafter:
 - i. a technical reviewer update training course developed by the AICPA
 - ii. the annual AICPA peer review conference
- e. obtain at least 48 hours of AICPA-required CPE every 3 years in subjects relating to accounting, auditing, and quality control, with a minimum of 8 hours in any 1 year.
- f. obtain at least 8 hours of CPE every 2 years in subjects related to single audits, if performing the technical review of a peer review that includes single audit engagements. The required CPE hours should include completion of technical reviewer training for single audits, which should be completed prior to performing the technical reviewer's first technical review of documents for a single audit engagement. (Ref: par. .A40)
- g. annually participate in a peer review that is equivalent to the highest level of technical review performed. Participation includes the following:
 - i. Reviewing and discussing the planning and scope of the peer review with the captain
 - ii. Reviewing the engagement checklists completed by the review team
 - iii. Attending meetings or participating in conference calls between the reviewer and reviewed firm to discuss issues encountered during the peer review
 - iv. Attending the closing meeting and the exit conference

.46 Technical reviewers who are not also peer reviewers should notify the relevant AE of any limitations or restrictions on their or their firm's ability to practice. Notification should happen prior to performing a technical review. (Ref: par. .A41)

Evaluating Peer Review Documentation

.47 Technical reviews are required to be performed on all peer reviews. The technical reviewer should review peer review documents, evaluate whether the peer review documentation provides satisfactory evidence of compliance with

the standards and supports the conclusions reached, and complete the technical reviewer's checklist. (See paragraphs .05–.10 of section 410.)

.48 For reviews that require RAB evaluation, the technical reviewer should provide the RAB with necessary information to properly evaluate the review. The required technical review working papers should be submitted to the AE in a timely manner to assist the AE in ensuring reviews are presented to a RAB within 120 days of receipt of the working papers from the captain and meeting materials are provided to RAB members at least 7 days in advance of the date of the RAB meeting. (See paragraphs .07 and .10 of section 410.)

.49 When engagement reviews meet the criteria to be accepted by the technical reviewer and such authority has been granted by the committee or RAB, the technical reviewer should accept the review on behalf of the RAB within 60 days of receipt of the working papers from the review captain. The technical reviewer should accept engagement reviews on the RAB's behalf only if such authority has been granted and the review meets the following minimum criteria:

- a. No matters (matters for further consideration [MFCs]) are noted.
- b. The review was not subjected to oversight.
- c. The technical reviewer did not identify any reviewer performance feedback.
- d. There are no other issues associated with the peer review warranting committee consideration or action that could affect the results of the peer review.

Evaluating Corrective Actions and Implementation Plans

.50 The technical reviewer should evaluate the results of corrective actions or implementation plans to determine if they meet the requirements imposed by the RAB. If no significant outstanding issues exist, the technical reviewer should do one of the following:

- a. Accept the results on behalf of the RAB, if such authority has been granted.
- b. Present the results to the RAB for acceptance.

(See paragraphs .09–.11 of section 420.)

.51 If results of corrective actions or implementation plans show there are significant outstanding issues, the technical reviewer should not accept the corrective actions or implementation plans. Instead, the technical reviewer should

- a. recommend the RAB require additional corrective actions or implementation plans and
- b. consider and recommend whether the reviewed firm should be referred to a hearing panel for not cooperating with the requirements of the program.

.52 The technical reviewer should evaluate due date extension requests for corrective actions and implementation plans and

- a. approve the extension request, if such authority has been granted (see paragraph .11 of section 420), or
- b. submit the request to the AE for RAB evaluation.

.53 The technical reviewer should evaluate requests to waive or replace corrective actions and implementation plans and submit the requests to the AE for RAB evaluation. (Ref: par. .A42)

Other Technical Reviewer Requirements

.54 Technical reviewers should be available to the RAB for questions or clarifications regarding their reviews being presented to the RAB. However, technical reviewers should not (Ref: par. .A43)

- a. actively present reviews to the RAB,
- b. make decisions on reviews on behalf of the RAB, or
- c. vote on acceptance of reviews.

Application and Other Explanatory Material**Scope of This Section (Ref: par. .01–.02)**

.A1 Individuals involved in the administration of the program include, but are not limited to,

- a. the CPA on staff,
- b. technical reviewers,
- c. administrators,
- d. committee members, and
- e. RAB members.

Obligations of an Administering Entity (Ref: par. .06)

.A2 If an AE fails to comply with the requirements of the program, refuses to cooperate, or is found to be deficient in administering the program in compliance with these standards, the board may (pursuant to fair procedures) take appropriate remedial actions.

.A3 The CPA on staff is responsible for evaluating whether technical reviewers are in compliance with the requirements outlined in paragraph .45, determining whether a technical reviewer's knowledge and experience are sufficient to perform technical reviews or oversight, and managing the performance of administrators and technical reviewers, including having the appropriate authority to manage and address any performance concerns of those individuals.

.A4 The committee may appoint individuals to serve on subcommittees and task forces as necessary to carry out its functions.

.A5 It is recommended that the AE document its committee and RAB structure and relationship.

.A6 Exhibit A, "Example Familiarity Threat Policies and Procedures," provides examples of familiarity threats and potential safeguards to assist AEs in creating their policies and procedures.

.A7 The *AICPA Peer Review Program Oversight Handbook* contains a detailed discussion of the minimum oversight requirements and the oversight process.

.A8 Circumstances in which it may be acceptable that a review is not presented or accepted in a timely manner include, but are not limited to, the following:

- a. Determination during technical review that oversight should be performed

- b. Submitted peer review documentation requires significant revisions or there are significant delays in receiving revised documents or responses to technical reviewer questions
- c. Enhanced oversight procedures
- d. Disagreements among the reviewer, reviewed firm, technical reviewer, or the AE

Document Retention (Ref: par. .07)

.A9 AEs may rely on the electronic peer review system to retain peer review documentation in accordance with the requirements if the documents are appropriately uploaded into the system. If any peer review documents are outside of the electronic peer review system, the AE retains those documents as follows:

Most Recently Completed Peer Review Documents (as Applicable)	Retention Period	
	<i>Enrolled Firms</i>	<i>Unenrolled Firms¹</i>
• FFCs • Firm representation letter • Letters requesting the reviewed firm's completion of an implementation plan • Supporting documents evidencing completion of corrective actions and implementation plans • CART review engagement letter • Letters relating to peer review document recall considerations	At least 120 days, but no more than 150 days, after completion of subsequent review	At least 42 months, but no more than 43 months, after the resignation, drop, or termination date
<i>When a firm receives a report with a pass rating:</i> • Peer review report • Letter notifying the firm that its peer review has been accepted • Letters notifying the firm that the implementation plan has been completed	At least 120 days, but no more than 150 days, after completion of subsequent pass review	At least 42 months, but no more than 43 months, after the resignation, drop, or termination date

(continued)

¹ Unenrolled firms, for purposes of document retention, are firms that resigned or were dropped or terminated from the program.

Most Recently Completed Peer Review Documents (as Applicable)	Retention Period	
	<i>Enrolled Firms</i>	<i>Unenrolled Firms</i>
<i>When a firm receives a report with a non-pass rating:</i> • Peer review report • Letter of response • Letter notifying the firm that its peer review has been accepted • Letters indicating that the peer review documents have been accepted with the understanding that the firm agrees to take certain actions • Letters notifying the firm the implementation plans have been completed • Letters notifying the firm that required actions have been completed	At least 120 days, but no more than 150 days, after completion of a subsequent review with a pass report, not to exceed 3 peer reviews	At least 42 months, but no more than 43 months, after the resignation, drop, or termination date
• All other documents (for example, the Summary Review Memorandum or MFCs)	<i>Completion date for the review:</i> • At least 120 days, but no more than 150 days, after completion of the review	<i>Completion date for the review:</i> • At least 120 days, but no more than 150 days, after completion of the review
<i>When a firm's peer review is not completed (for example, when a firm is terminated and does not reenroll):</i> • All peer review documents	N/A	• At least 42 months, but no more than 43 months, after the resignation, drop, or termination date

.A10 The AICPA or the AE's committee may require any or all peer review documentation for specific reviews to be retained for a longer period than specified in paragraph .07 if there are regulatory investigations, pending litigation, or other appropriate circumstances.

Publicizing Peer Review Information (Ref: par. .08–.09)

.A11 A firm may be a voluntary member of one of the AICPA's audit quality centers or sections that requires, as a condition of membership, that certain peer review documents be open to public inspection. Other firms may voluntarily instruct their AEs to make the peer review results available to certain other state boards of accountancy. In these cases, the firm permits the AEs to make its peer review results available to the public or to state boards of accountancy. Peer review results include, as applicable, the following:

- a. Peer review report
- b. Letter of response
- c. Acceptance letter
- d. Letters acknowledged by the reviewed firm indicating that the peer review documents have been accepted with the understanding that the reviewed firm agrees to take certain actions
- e. Letters notifying the reviewed firm that certain required actions have been completed

.A12 When there is evidence of an open ethics investigation and the firm makes an informed and voluntary waiver of confidentiality in writing, AICPA Peer Review Program staff may provide information to the AICPA Professional Ethics Division. Information available for disclosure about the firm includes, but is not limited to, the following:

- a. Fieldwork commencement date
- b. Exit conference date
- c. Review acceptance dates
- d. Levels of service and industries included in the firm's peer review information for prior or current peer reviews
- e. Levels of service and industries included in prior or current peer reviews and those determined not to be in conformity with professional standards in all material respects
- f. Signed confirmations by a firm representative that the enrolled firm did not perform any services or issue reports that would require the firm to undergo a peer review
- g. Other similar information related to a prior or current peer review

.A13 If a firm has authorized the AE in writing to provide specific information (in addition to the information in paragraph .08) to third parties, the following (or similar) types of objective information about the review may be provided, if known:

- a. The date the review is or was scheduled to take place
- b. The name of the reviewing firm, team captain, or review captain
- c. If the fieldwork on the peer review has commenced
- d. The date the exit conference was expected to or did occur
- e. A copy of any extension approval letters
- f. Whether the peer review working papers have been received by the AE
- g. Whether a must-select engagement was included in the scope, as required by the standards
- h. If a technical review is in process

- i.* Whether the review has been presented to a RAB
- j.* The date the review is expected to be presented to a RAB
- k.* The specific overdue letters (such as, but not limited to, scheduling the peer review or completion of remedial actions) requested by third parties

.A14 Subjective information includes, but is not limited to, the following:

- a.* A statement indicating only that the review is "in process," or a response to an inquiry regarding the "general status" of a peer review
- b.* The peer review report rating prior to the peer review's acceptance
- c.* Whether there are indications that the firm, reviewing firm, team captain, or review captain are cooperating (or not cooperating) with the AICPA or AE
- d.* An indication of the quality or completeness of peer review working papers received by the AE
- e.* Reasons why peer review working papers, implementation plans, or corrective actions are late
- f.* Whether a firm is close to submitting documents or completing implementation plans or corrective actions
- g.* Reasons for, or the likely outcome of, fair procedures to determine whether the firm is cooperating with the AICPA or the AE

Ethical Requirements Relating to a Peer Review **(Ref: par. .10–.14)**

.A15 Templates for confidentiality and conflict-of-interest agreements are updated periodically by the board.

.A16 Individuals involved in administration of the program are described in paragraph .A1; however, the requirement in paragraph .10*d* is limited to individuals serving as committee members, RAB members, or technical reviewers.

.A17 Depending on the circumstances, and taking into consideration the need to serve the public interest, possible actions are oversight of the individuals' peer reviews or having them recuse themselves from the report acceptance process (in its entirety or just from the report acceptance process for reviews with engagements in the industry or other classification addressed by the allegation or investigation).

CPA on Staff

Qualifications (Ref: par. .15–.16)

.A18 The CPA on staff may perform technical reviews on a short-term basis such as when technical reviewers are unavailable for extended periods or there is a high volume of reviews. The CPA on staff may also perform technical reviews for another AE's jurisdiction.

Peer Review Committee

Composition and Qualifications (Ref: par. .17-.19)

.A19 In rare circumstances, an exception may be approved by the AICPA when a request is submitted in writing that thoroughly explains why the exception should be approved for an individual who does not meet the required qualifications described in paragraph .17.

.A20 When a committee member is not team captain-qualified but is practicing with a firm that has a non-pass rating in its most recent peer review report, the AE may consult with AICPA staff and establish safeguards to address the roles of such committee members.

.A21 Restrictions by regulatory, monitoring, or enforcement bodies that are outside of the program may disqualify a committee member. When such a restriction relates only to the committee member's firm, the AE may consider the nature and circumstances of partial or limited restrictions to determine whether the committee member no longer meets the required qualifications.

Responsibilities (Ref: par. .20)

.A22 In the event of a disagreement between the AE and either the reviewer or the reviewed firm that cannot be resolved by ordinary good-faith efforts, the AE may request that the matter be referred to the board for final resolution. The AE's committee is responsible for determining whether a disagreement exists that should be referred, and if so, may refer the matter to the board for resolution. In these circumstances, the board may consult with representatives of other AICPA committees or with appropriate AICPA staff.

Report Acceptance Body

Qualifications (Ref: par. .21-.22)

.A23 A manager or person with equivalent responsibilities is a professional employee of the firm who has either a continuing responsibility for the overall planning and supervision of engagements for specified clients or authority to determine that an engagement is complete subject to final partner approval, if required.

.A24 The AE will determine if the report has been accepted timely, which is ordinarily within three years and six months of the most recently accepted review's acceptance date. Considerations regarding timely acceptance are discussed in paragraph .A8.

.A25 Restrictions by regulatory, monitoring, or enforcement bodies that are outside of the program may disqualify a RAB member. When such a restriction relates to the RAB member's firm, the AE may consider the nature and circumstances of partial or limited restrictions to determine whether the RAB member no longer meets the required qualifications.

Report Acceptance Body Composition (Ref: par. .23-.25)

.A26 Current experience is described in paragraph .A22 of section 200.

.A27 The appropriate must-select experience may come from a member of the RAB, another AE's RAB member, or an individual from a list of consultants maintained by the AICPA. The AE will determine if the RAB will not have the

appropriate must-select experience and assign an individual with such experience prior to assigning the review to a RAB. The assigned individual with the appropriate must-select experience

- a. participates as a consultant,
- b. is not eligible to vote on acceptance of a review, and
- c. may attend the RAB meeting via teleconference.

Peer Review Evaluation (Ref: par. .26–.29)

.A28 The RAB may accept a *pass with deficiencies* or *fail* report without requiring corrective actions in certain circumstances including, but not limited to, the following:

- a. If the firm documented in its letter of response that it will no longer perform engagements in the industry or at the level of service related to the deficiencies or significant deficiencies
- b. If the firm's remediation described in its letter of response was completed and the team captain was able to review and was satisfied with the firm's action before the review was considered by the RAB

.A29 Guidance to assist outside third parties engaged to issue reports for corrective actions or implementation plans as a result of a peer review is discussed in appendix A, "Guidance for Outside Parties Engaged to Assist Firms in Completing Corrective Actions and Implementation Plans," of section 420.

Firm Cooperating and Complying With the Requirements of the Program (Ref: par. .34–.39)

.A30 After a firm receives a non-pass (*pass with deficiencies* or *fail*) peer review report, the firm is notified via a delivery method providing proof of delivery, such as via the electronic peer review system. If the firm fails to receive a pass report rating on its next peer review, it may be referred to the board for potential termination for failing to comply with the requirements of the program.

.A31 Referral for three or more consecutive non-pass peer review reports is presumptively mandatory but that presumption may be overcome.

.A32 When a firm has demonstrated improvement from the last peer review but other deficiencies were noted, causing a consecutive *pass with deficiencies* or *fail* report, referral to the board for failing to comply with the requirements of the program may not be necessary. In such circumstances, the firm took actions that corrected the prior deficiencies, but in doing so, may have created new deficiencies. Because the firm took remedial actions to correct the original deficiencies, the firm is deemed to have complied with the requirements of the program. Instead of referring the firm to the committee or board, the RAB may require additional corrective actions that will allow the firm to rectify the new deficiencies.

.A33 Reasons a RAB may decide not to refer a firm for failing to comply with the requirements of the program include, but are not limited to, the following:

- a. The firm has demonstrated genuine, significant improvement from the last peer review.
- b. The firm corrected deficiencies or significant deficiencies from the prior review, but in doing so, created new deficiencies or significant deficiencies.

- c. The RAB anticipates a pass report on the firm's next peer review due to aggressive actions taken by the firm to correct the deficiencies or significant deficiencies such as a firm that incorporates outside-party pre-issuance reviews of the engagements that led to the deficiencies or significant deficiencies.
- d. The RAB believes that, due to the nature and significance of the deficiencies or significant deficiencies, more targeted corrective actions can assist the firm in remediation.
- e. The firm voluntarily elects to cease performing certain engagements or engagements in certain industries specifically related to the deficiencies or significant deficiencies.

.A34 Documentation supporting referral of a firm to the board for potential termination includes, but is not limited to, the following:

- a. Warning letters issued to the firm
- b. Evidence of other correspondence whether verbal or written
- c. Notes or assessments from RAB or committee meetings (if applicable)
- d. A timeline outlining the various communications

.A35 Upon referral, the board will appoint a hearing panel to consider whether the firm's enrollment in the AICPA Peer Review Program should be terminated or whether some other action should be taken. Firms whose enrollment in the AICPA Peer Review Program is terminated have the right to appeal pursuant to fair procedures established by the board.

Considerations for the Recall of Peer Review Documents (Ref: par. .40–.42)

.A36 Appendix C provides additional guidance and considerations for evaluating the potential recall of a peer review report.

.A37 If a report was accepted more than three years and six months prior to the discovery of the information that may have affected the performance or acceptance of the peer review had it been known, recall considerations may not be necessary.

Technical Reviewer

Qualifications (Ref: par. .45–.46)

.A38 Peer review captain training courses are located on the Peer Review page of the AICPA website.

.A39 An appropriate level of accounting and auditing knowledge and experience may be obtained from on-the-job training, training courses, or a combination of both.

.A40 Technical reviewer training for single audits may be completed by taking the on-demand course developed by the AICPA or an alternative course approved by the board.

.A41 Examples of limitations or restrictions are included in paragraph .A14 of section 200. Although that paragraph refers specifically to peer reviewers, it is also applicable to technical reviewers who are not peer reviewers.

Evaluating Corrective Actions and Implementation Plans (Ref: par. .50–.53)

.A42 The technical reviewer may provide recommendations to the RAB regarding waiving or replacing corrective actions or implementation plans, taking into consideration the guidance in paragraphs .12–.13 of section 420.

Other Technical Reviewer Requirements (Ref: par. .54)

.A43 During RAB meetings, the technical reviewer may

- a. present matters of an administrative nature, such as due date extensions;
- b. present matters requiring consultation; and
- c. respond to questions from the RAB.

.A44

Exhibit A — Example Familiarity Threat Policies and Procedures

This exhibit includes examples of familiarity threats and potential safeguards used to mitigate the threats. These examples are not all-inclusive. In some instances, a safeguard could mitigate more than one threat; in other instances, however, depending on the significance of a threat, more than one safeguard may be necessary to properly mitigate it.

<i>Familiarity Threat</i>	<i>Safeguards to Mitigate the Threat</i>
.01 The peer reviews of the technical reviewers' and committee or report acceptance body (RAB) members' firms are presented for acceptance.	• The technical reviewers' and committee or RAB members' peer reviews will be accepted by a different administering entity (AE). We have partnered with AE "A" and have attached the agreement as addendum B. • The AE is split in more than one district, for example, east and west. The committee or RAB accepts reviews from a district other than its own. • The CPA on staff monitors the RAB process and reports preferential treatment or inconsistencies in the process. • The AE will designate a committee member (or other qualified individual) as an observer of RAB meetings to monitor the RAB process and report preferential treatment or inconsistencies in the process.
.02 Overreliance is placed on committee or RAB members, which leads to other members not reading the RAB package in its entirety.	• Arranging for RAB members from other AEs to participate in RABs • Having multiple committees or RABs that change composition regularly • Having RAB members acknowledge that they have read reviews before starting the meeting • Having the CPA on staff evaluate committee or RAB member performance

(continued)

<i>Familiarity Threat</i>	<i>Safeguards to Mitigate the Threat</i>
.03 The committee or RAB members have a long-standing relationship with the technical reviewers, which leads to overreliance on the technical reviewers' procedures and conclusions. For instance, it may not be apparent if an issue or a non-conforming engagement has been addressed, yet the committee or RAB decide not to investigate because members believe the technical reviewer would not have missed the issue.	● Engaging qualified individuals from another state to perform all technical reviews ● Arranging for RAB members from other AEs to participate in RABs ● Engaging a second technical reviewer to perform a selection of secondary technical reviews of high-risk reviewers, firms, and random samples
.04 The committee or RAB members have long-standing relationships with some reviewers, particularly those who perform a high volume of reviews.	● Arranging for another AE to accept an AE's high-volume reviewers' reviews ● Annually requesting committee or RAB members to identify conflicts of interest with reviewers and reviewed firms
.05 Technical reviewers have long-standing relationships with some reviewers, particularly those who perform a high volume of reviews.	● Engaging qualified individuals from another state to perform all technical reviews ● Arranging for another AE to accept reviews performed by a high-volume reviewer ● Annually requesting technical reviewers to identify conflicts of interest with reviewers and reviewed firms
.06 AEs are hesitant to provide feedback or consider deficiency letters for a variety of reasons including, but not limited to, the following: a. RAB members know the reviewer. b. The reviewer preforms a high volume of reviews in the state and the RAB is afraid to offend him or her. c. The reviewer is a RAB member (current or former) or is a technical reviewer.	● Engaging qualified individuals from another state to perform all technical reviews ● Arranging for RAB members from other AEs to participate in RABs ● Annually requesting committee or RAB members to identify conflicts of interest with reviewers and reviewed firms

<i>Familiarity Threat</i>	<i>Safeguards to Mitigate the Threat</i>
d. The reviewer teaches for the state CPA society or has some other society relationship that leads to a belief that the individual knows what the individual is doing.	
.07 A committee member is given informal feedback on reviews the committee member performed but a different reviewer is issued written feedback for the same issue.	• Arranging for RAB members from other AEs to participate in RABs • Having the CPA on staff monitor the RAB process and report preferential treatment or inconsistencies in the process • Having the AE designate a committee member (or other qualified individual) as an observer of RAB meetings to monitor the RAB process and report preferential treatment or inconsistencies in the process
.08 Following an enhanced oversight, the RAB has allowed the peer reviewer or reviewed firm to provide documentation not provided to the subject matter expert during the enhanced oversight (such documentation should have been provided at that time). This gives the appearance that reviewers or reviewed firms familiar to the RAB are being allowed to create working papers.	• Arranging for specialists from other states to participate in RABs • Arranging for RAB members from other AEs to participate in RABs • Having the CPA on staff monitor the RAB process and report preferential treatment or inconsistencies in the process
.09 RAB members mention a firm's reputation regarding a specific industry concentration when presented with issues (generally documentation issues), implying that because issues were not identified previously, it is unlikely issues exist now despite evidence to the contrary.	• Arranging for specialists from other states to participate in RABs

.A45

Appendix A — Failure to Cooperate or Comply With the Requirements of the Program Referral Responsibilities

This appendix describes the responsibilities of the peer review committee (committee) and report acceptance body (RAB) when a firm fails to cooperate or comply with the requirements of the program. Additional information regarding cooperating and complying with the requirements of the program is included in paragraphs .12–.17 of section 300, *General Principles and Responsibilities for Reviewed Firms*.

<i>Failure of a Firm to Comply With the Requirements of the Program</i>	<i>Report Acceptance Body Responsibility</i>	<i>Peer Review Committee Responsibility</i>
.01 Once the review has commenced, not responding to inquiries or not providing any information necessary to ensure the review is accepted and completed	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.02 Withholding information significant to the peer review	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.03 Not providing documentation including but not limited to the representation letter, quality control documents, engagement working papers, and all elements of the firm's system of quality control	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.04 Not responding to matters for further consideration or findings for further consideration timely	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.05 Limiting access to offices, personnel, or others once the review has commenced	Referral to board hearing panel must be supported by simple majority vote.	No action required.

<i>Failure of a Firm to Comply With the Requirements of the Program</i>	<i>Report Acceptance Body Responsibility</i>	<i>Peer Review Committee Responsibility</i>
.06 Not facilitating the arrangement for the exit conference on a timely basis	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.07 Failing to timely file a letter of response, if applicable	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.08 Failing to cooperate during oversight	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.09 Failing to timely acknowledge and complete required corrective actions or implementation plans	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.10 Failing to ensure that its peer review is submitted to the administering entity timely	Referral to board hearing panel must be supported by simple majority vote.	No action required.
.11 Failing to correct deficiencies or significant deficiencies after consecutive corrective actions required by the committee on the same peer review	Recommendation to full peer review committee must be supported by RAB simple majority vote.	Referral to board hearing panel must be supported by two-thirds vote of full peer review committee.
.12 Failing to provide the administering entity a substantive response, and the firm does not revise its response or provides additional responses that are not substantive as determined by the administering entity	Recommendation to full peer review committee must be supported by RAB simple majority vote.	Referral to board hearing panel must be supported by two-thirds vote of full peer review committee.

(continued)

<i>Failure of a Firm to Comply With the Requirements of the Program</i>	<i>Report Acceptance Body Responsibility</i>	<i>Peer Review Committee Responsibility</i>
.13 Failing to provide substantive responses during the administering entity's process of determining if erroneously provided or omitted information by a firm that results in a significant change in the planning, performance, evaluation of results, or peer review report is a matter of noncooperation	Recommendation to full peer review committee must be supported by RAB simple majority vote.	Referral to board hearing panel must be supported by two-thirds vote of full peer review committee.
.14 Failing to timely notify the administering entity that the firm is performing a type of engagement or engagements in an industry in which the firm had previously represented by written communication to the administering entity that it was no longer performing and had no plans to perform, in response to a related corrective action or implementation plan wherein the corrective action or implementation plan was eliminated by the administering entity based on the representation	Recommendation to full peer review committee must be supported by RAB simple majority vote.	Referral to board hearing panel must be supported by two-thirds vote of full peer review committee.
.15 Deficiencies or significant deficiencies indicate the firm is so seriously deficient in its performance that educational and remedial corrective actions or implementation plans would not be adequate	Recommendation to full peer review committee must be supported by RAB simple majority vote.	Referral to board hearing panel must be supported by two-thirds vote of full peer review committee.
.16 Other instances of noncooperation for which determination of sufficiency or appropriateness of firm actions warrant consideration by the administering entity's peer review committee	Recommendation to full peer review committee must be supported by RAB simple majority vote.	Referral to board hearing panel must be supported by two-thirds vote of full peer review committee.

<i>Failure of a Firm to Comply With the Requirements of the Program</i>	<i>Report Acceptance Body Responsibility</i>	<i>Peer Review Committee Responsibility</i>
.17 Receiving consecutive non-pass peer review reports and the second report is a <i>pass with deficiencies</i>	Assessment by the RAB after corrective actions related to the second non-pass review are submitted. Recommendation to the full peer review committee must be supported by RAB simple majority vote.	Assessment by the committee; referral to board hearing panel must be supported by two-thirds vote of full peer review committee.
.18 Receiving consecutive non-pass peer review reports and the second report is a <i>fail</i>	Assessment by the RAB after corrective actions related to the second non-pass review are submitted. Referral to the board is presumptively mandatory and must be supported by RAB simple majority vote.	Assessment by the committee; referral to board hearing panel must be supported by two-thirds vote of full peer review committee.
.19 Receiving a third consecutive non-pass peer review report.	Assessment by the RAB. Referral to the board is presumptively mandatory and must be supported by RAB simple majority vote.	No action required.

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Appendix B — Disagreements

Disagreements

.01 Professional judgment is part of the peer review process and individuals have the right to challenge one another on an issue. As such, disagreements may arise between parties to a peer review regarding topics including, but not limited to, the following:

- a. The peer review report rating to be issued
- b. The application of professional standards related to the review of an engagement
- c. The systemic cause of a deficiency or issues related to a design or compliance deficiency
- d. Whether the performance or reporting (or both) on an engagement results in a nonconforming engagement
- e. Whether actions planned or taken by the firm to address findings or deficiencies or to remediate nonconforming engagements, if any, are appropriate
- f. After acceptance of a peer review, whether peer review documents should be recalled (See paragraphs .40–.42.)

.02 Reviewers and reviewed firms may consult the administering entity (AE) for assistance in resolving disagreements and, if necessary, request that the AE form a disagreement panel to resolve the disagreements. A disagreement panel may be requested by any disagreeing party.

AE Considerations When Establishing Policies and Procedures Related to Disagreements

.03 Policies and procedures for handling disagreements between any parties to a peer review include, but are not limited to, the following:

- a. If a reviewed firm disagrees with one or more of its review team's conclusions, either party may consult with the AE. The AE attempts to resolve the disagreement, which may include discussions with the technical reviewer or the performance of oversight procedures. Additional matters may be identified in this process and may result in findings or deficiencies.
- b. After consultation with the AE, if the reviewed firm still disagrees with one or more of the review team's conclusions, the reviewed firm may
 - i. describe the reasons for the disagreement in the matters for further consideration, findings for further consideration, or the letter of response or
 - ii. request that the disagreement be referred to a disagreement panel prior to presentation to the report acceptance body (RAB).
- c. If the reviewed firm requests that the disagreement be referred to a panel of committee members (disagreement panel) for consideration, the AE follows procedures in the "Disagreement Panels" section of this appendix.
- d. Once the disagreement panel has reached a decision, even if the firm or reviewer still disagrees, the issue is considered resolved by

the AE. A decision letter containing the actions required by each party to cooperate with the committee will be sent to the firm and review team.

- e. Any of the disagreeing parties may request an appeal of the decision of a disagreement panel relating to a deficiency or significant deficiency (report-level issues, including corrective actions) by writing the board within 30 days of the decision. (See the section "Appeals of Disagreement Panel Decisions.")

Disagreement Panels

.04 The objective of a disagreement panel is to assist the disagreeing parties in resolving issues. A disagreement panel may be requested by any disagreeing party.

.05 Requests for a disagreement panel

- a. are submitted in writing to the AE via a method providing proof of delivery (including electronic means).
- b. provide details of the basis for the disagreeing parties' positions including, at a minimum,
 - i. the issue or issues to be resolved,
 - ii. reference to applicable professional standards, and
 - iii. a chronology of events with references to supporting documents (including relevant peer review documents).
- c. include any supporting documentation.

.06 Supporting documents may include, but are not limited to,

- a. peer review documents,
- b. team or review captain working papers,
- c. administrative and technical reviewer checklists, and
- d. oversight reports.

.07 The disagreement panel

- a. occurs within 60 days of receipt of the request for the disagreement panel.
- b. consists of at least three committee members who are independent of the disagreeing parties and not involved in the acceptance of the review.
- c. includes members with practice experience commensurate with the area or industry reviewed.
- d. may include independent committee members from another AICPA-approved AE.
- e. is led by one member of the panel serving as the chair.

.08 A notice informing the panel members and disagreeing parties of the date, time, and conference call information is sent at least 30 days in advance of the date of the panel. The notice includes the basis for the panel request and any supporting documentation submitted by the disagreeing parties.

.09 If new information relevant to the disagreement becomes available after the original submission of supporting documentation, such documentation is to be sent to the panel members only if the documentation can be provided for panel consideration at least 14 days prior to the panel date.

.10 In addition to providing written comments to the panel members for consideration, each disagreeing party has the right to participate in the panel. Participation includes the opportunity to make a presentation to the panel, respond

to questions, or both. If either party is unable or chooses not to participate, the panel will consider that party's position based on written correspondence received prior to the panel.

.11 At the discretion of the panel, AICPA staff may participate to provide guidance related to peer review standards.

.12 During the panel, the panel members discuss the disagreement, including the supporting documentation submitted by the disagreeing parties; the basis for the disagreement; and how the panel should resolve the disagreement. The panel may ask any questions and request additional information from the disagreeing parties, the AE, or AICPA staff to assist it in making its decision.

.13 The panel (and, at the discretion of the panel, AICPA staff) then discuss the issue or issues in an executive session without the disagreeing parties present. The panel may

- a. recommend performing oversight on the peer review or engagement, allowing the results of the oversight to assist it in resolving the disagreement.
- b. identify additional matters that may result in findings or deficiencies.
- c. adjourn to a later date, as determined by the panel, to enable it to reach a decision.

.14 The decision of the panel is provided to all parties immediately following the panel's decision. A written communication of the panel's decision is sent to all parties within three business days of the panel's decision.

Appeals of Disagreement Panel Decisions

.15 Any of the disagreeing parties may request an appeal of the decision of a disagreement panel relating to a deficiency or significant deficiency (report-level matters) by writing to the board and explaining why the party believes a review of the panel's decision is warranted. The request includes the disagreement panel decision letter, all documents provided to the disagreement panel, and any additional evidence supporting the appeal.

.16 An AICPA disagreement review panel will review and consider the appeal or request for review and take further action pursuant to fair procedures established by the board.

.17 The objective of the AICPA disagreement review panel is to assess the facts to determine whether the decision relating to a deficiency or significant deficiency (report-level issues, including corrective actions) of the earlier disagreement panel was appropriate and to provide procedural fairness by acting as an appeal mechanism.

.18 Decisions by the AICPA disagreement review panel are final.

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Appendix C — Considerations for the Recall of Peer Review Documents

Overview

.01 AICPA staff are notified and consulted when peer review documents are being considered for recall. (Ref: par. .42a)

.02 After the date of acceptance, neither the administering entity (AE) nor the reviewer have any obligation or expectation to perform any other peer review procedures with respect to the peer review report, acceptance letter, or letter of response, if applicable (referred to hereafter in this section as *peer review documents*), unless information that may affect an accepted peer review comes to either party's attention. Such information may come from various sources such as

- a. the AE,
- b. publicly available information,
- c. reviewers,
- d. AICPA staff, or
- e. other substantiated and reliable sources.

.03 The committee's decision to recall an acceptance letter invalidates the related peer review report and letter of response, if applicable, because it creates a situation in which the reviewed firm's peer review documents are no longer accepted by the AE. The committee may delegate the recall of a peer review acceptance letter to the RAB.

.04 The reviewer's decision to recall the peer review report necessitates recall of the related acceptance letter because such acceptance is not effective without the underlying report.

.05 If peer review documents are recalled, responsibilities of the parties involved include the following:

- a. The AE notifies applicable state boards of accountancy via letter, in jurisdictions where peer review is mandatory and state boards are not prohibited from accessing peer review documents, to inform them that the date of acceptance and period covered by the firm's most recently accepted peer review have changed and to contact the firm for further information. If a replacement review is allowed, the AE sends a similar communication in accordance with paragraph .08 when that review is accepted.
- b. The firm removes the recalled peer review documents from publicly available sources (such as the firm's website) and notifies all parties that might be relying on those documents to discontinue reliance.
- c. The reviewer follows guidance for replacement reviews as addressed in paragraphs .17–.20, if applicable.

Potential Reasons for Recall of Peer Review Documents

.06 AICPA and AE staff may assist the committee in investigating whether the recall of peer review documents is appropriate. Recalling previously accepted peer review documents is considered in situations including, but not limited to, the following:

- a. *Errors or omissions — Material departures directly affecting the peer review report* (See paragraph .08.)
 - i. The firm had an engagement review and failed to inform the AE or reviewer that the firm performed an engagement for the period covered by the peer review that would have required the firm to undergo a system review had the information been known to the AE or reviewer.
 - ii. The firm performed an engagement in a must-select category during the period covered by the peer review, and the reviewer did not consider or select a comparable must-select engagement during the system review.
- b. *Errors or omissions — Other departures that may affect the peer review report* (See paragraphs .09–.11.)
 - i. The firm had an engagement review and failed to inform the AE or reviewer that the firm performed a particular level of service required to be selected in an engagement review, and the reviewer did not consider or select a comparable engagement during the engagement review. For instance, compilations with disclosures were included in the engagement review, but compilations without disclosures performed by the firm were not considered in the engagement review.
 - ii. The firm omitted or misrepresented information relating to its accounting and auditing practice, other than instances covered under item (a).
 - iii. The firm failed to inform the reviewer of communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, auditing, or attestation engagement performed and reported on by the firm or limitations or restrictions on the firm's ability to practice public accounting related to the firm or its personnel within the three years preceding the firm's current peer review year-end and through the date of the exit conference.
 - iv. The firm provided erroneous information in response to inquiries from the AE, staff, or reviewer in relation to the peer review.
- c. *Reviewer disqualifications* (See paragraphs .12–.16.)
 - i. The reviewer or reviewing firm was not qualified (was ineligible) to perform the peer review or issue the peer review report because certain peer reviewer qualifications were not met at the time of the review, and this was not made known to staff or the AE during the scheduling, performance, or acceptance of the review.
 - ii. The reviewer or reviewing firm failed to inform staff or the AE about limitations or restrictions on the reviewer or reviewing firm's ability to practice public accounting. Considerations for recalling peer review documents are not necessary if there are allegations or investigations of deficiencies in the conduct of an accounting, auditing, or attestation engagement performed and reported on by the reviewer or reviewing firm that are discovered subsequent

to the acceptance of the peer review but that have not resulted in limitations or restrictions on the reviewer's or reviewing firm's ability to practice public accounting.

Voluntary Correction Program

.07 Firms that voluntarily notify the AE of an omission or misrepresentation resulting in a material departure will not be subject to a hearing panel. This notification from the firm must be prior to the AICPA or AE being otherwise notified of or discovering the omission or misrepresentation and prior to the firm receiving notification from another regulatory or monitoring agency. The peer review acceptance letter will be recalled and the firm will be required to undergo a replacement review due approximately 90 days after the firm's notification to the AE.

Material Departures

.08 For errors or omissions directly affecting the peer review report (the type of peer review, period covered, or must-select engagements), the committee is not required to deliberate whether to recall the acceptance letter. In such situations, responsibilities are as follows:

- a. *AE to contact the firm and reviewer.* After the information and evidence are confirmed as factual and reliable, the AE documents the situation in a notification that is sent to the firm by a means that provides proof of delivery (including electronic means) and is copied to the reviewer and AICPA staff. This notification
 - i. includes evidence supporting the error or omission,
 - ii. provides the firm the opportunity to dispute the evidence,
 - iii. indicates that the acceptance letter will be recalled,
 - iv. informs the firm it will be subject to a hearing panel of the board to consider whether to terminate the firm's enrollment in the program, and
 - v. informs the firm that if its enrollment in the program is not terminated, it will be required to undergo a replacement review due approximately 60 days from the date of the hearing panel's decisions and that the panel may also indicate other sanctions or specific criteria for the replacement review.
- vi. is followed by recall of the peer review documents when
 - (1) the firm acknowledges the notification and does not dispute the evidence, or
 - (2) the AE has proof of delivery of the notification (including via electronic means) and the firm has not disputed the evidence or acknowledged the notification timely.
- b. *Reviewer to consider recall.* The reviewer considers the aforementioned notification from the AE and responds in writing (this may include electronic means) with the reviewer's decision about whether to recall the peer review report. When a reviewer considers recall of peer review documents,
 - i. unless the reviewer recalls the peer review report, the reviewer will not be allowed to revise the peer review report or perform the firm's replacement review.
 - ii. if the notification regarding the material departure occurs within 120 days of the peer review completion date, the

reviewer continues to retain the working papers for the recalled review until completion of the revised or replacement review. The hearing panel may allow the reviewer to perform additional procedures and issue a revised report.

Other Departures That May Affect the Peer Review Report

.09 For errors or omissions that may affect the peer review report (the type of peer review, period covered, or must-select categories), the reviewer and committee independently consider the potential impact of the information on the results of the peer review. The peer review documents are recalled if the nature and effect of the matter are such that the reviewer or committee believes

- a. the peer review procedures, report, or both would have been affected if the information had been known to the reviewer as of the date of the report and
- b. persons who may attach importance to the omission or error are currently relying, or are likely to rely, on the peer review report.

.10 The following are examples of situations in which recall of the peer review documents is not necessary:

- a. The new information relates to one specific partner, the working papers are within the retention period, and a similar engagement from that partner was included within the peer review.
- b. In an engagement review, the reviewer becomes aware that the firm performed a review engagement that was not included in the firm's population of engagements and was therefore not subject to selection. The reviewer reviews the engagement and concludes that the inclusion of such engagement within the scope of the review would not have changed the peer review report.

.11 The reviewer communicates the decision of whether to recall the peer review report in writing (this may include electronic means) to the committee. If the committee has substantial reason to question the reviewer's decision not to recall the report, the committee consults AICPA staff and may undertake further measures.

Reviewer Disqualification

.12 When it comes to the attention of AICPA staff that a reviewer does not meet the qualifications to perform peer reviews, staff will notify the reviewer and applicable AEs. Staff will perform an analysis to determine if there are reviews that have been accepted that may have been performed when the reviewer was not qualified and notify affected AEs.

.13 The reviewer and committee independently consider the potential impact on the results of reviews performed when the reviewer was ineligible. The peer review documents are recalled if the reviewer disqualification would have caused a significant change in the planning, performance, evaluation of results, or peer review documents.

.14 The reviewer considers whether to voluntarily recall peer review reports issued when the reviewer was not qualified and inform the AE of the decision prior to informing the affected firms. The reviewer summarizes the basis for whether to recall each report and provides the summary to the AE promptly, but no later than 30 days from being notified of the issue.

.15 The committee (or the AE on behalf of the committee) contacts AICPA staff to discuss the impact the missing qualifications may have on reviews performed by the reviewer. This may result in

- a. additional procedures by an individual acceptable to the committee, possibly at the disqualified reviewer's expense;
- b. partial or full additional procedures regarding working papers, covering all related documents underlying the peer review or limited to certain aspects affected by the disqualified reviewer; or
- c. other procedures to determine the impact of the missing qualifications.

.16 Any additional procedures performed due to the missing qualifications

- a. occur within 30 days following the reviewer's decision not to recall the report and
- b. are fully reported on to the committee.

Replacement Review Considerations

.17 For a replacement review related to a material departure, the reviewer

- a. evaluates the systemic cause of the error or omission;
- b. prepares a matter for further consideration (MFC), at minimum; and
- c. ensures the replacement peer review report does not reference a previously issued and recalled report.

.18 If the peer review completion date was within 120 days of notification of the material departure and the original reviewer is allowed to perform additional procedures and issue a revised report, the reviewer submits any additional documentation and any documentation that significantly changed as a result of the additional procedures, including, at a minimum, the following:

- a. A revised Summary Review Memorandum or other memo addressing the omission or error in detail and fully explaining the impact and conclusion on significant peer review aspects, including changes in risk assessment, engagement selection, procedures, evaluation and elevation of matters, recommendations, or report rating
- b. A signed representation letter from the firm, specifically addressing the circumstances regarding information previously omitted or provided in error
- c. A revised report that is dated the date the reviewer obtained enough evidence to conclude on the results of the review with consideration of the newly discovered information and communicated those results to the firm (new exit conference date)

.19 If the peer review completion date is more than 120 days beyond the notification of the material departure, or the hearing panel requires a new review to be performed, the hearing panel may specify the period the replacement review covers. If the panel does not specify a period, the firm and approved reviewer

- a. consider whether it is appropriate for the replacement review to cover the same period or a subsequent period to include the previously omitted engagements, taking into consideration such factors as
 - i. the significance of and risks related to the omitted information or engagements or subsequently completed engagements,
 - ii. time elapsed,
 - iii. regulatory requirements, and
 - iv. the established due date of the firm's replacement review.

- b. may consult with the AE to determine an appropriate period for the replacement review to cover.

.20 The following examples can assist when determining the period to be covered by the replacement review:

Example 1: *Firm no longer performs similar engagements (Discovery within 12 months of review year-end; replacement review of same period)*

A firm failed to inform the AE or reviewer that it performed a particular level of service requiring a system review (engagement year-end June 30, 20X1) for the period under review (January 1, 20X1, to December 31, 20X1), and the firm no longer performs that level of service after the period covered by the recalled review. If 12 months or less have elapsed between the period covered by the recalled review and the notification of the material departure (notification made prior to December 31, 20X2), another peer review of the original period (January 1, 20X1, to December 31, 20X1) that includes the level of service that caused the replacement review would be appropriate. If reviewing a subsequent 12-month period would not include the level of service or engagements in question, then a replacement review of a subsequent period may not be appropriate.

Example 2: *Firm no longer performs similar engagements (Discovery more than 12 months after recalled review year-end; replacement review of subsequent period)*

A firm failed to inform the AE or reviewer that it performed must-select engagements (engagement year-end June 30, 20X1) for the period under review (January 1, 20X1, to December 31, 20X1), and the firm no longer performs engagements in the same must-select category after the period covered by the recalled review. If more than 12 months have elapsed between the period covered by the recalled review and the notification of the material departure (discovery communicated after December 31, 20X2), a replacement review of a subsequent period that includes the previously omitted engagements within scope would be appropriate. The greater the number of prior-year engagements considered, the greater the risk that the results of the review are not reflective of the peer review year covered by the report and the related peer review results. If several engagements were previously omitted, this may prompt re-performance of the peer review of the original period.

Example 3: *Firm continues to perform similar engagements*

A firm failed to inform the AE or reviewer that a particular level of service requiring a system review was performed or neglected to disclose that it performed a must-select engagement (engagement year-end June 30, 20X1) for the period under review (January 1, 20X1, to December 31, 20X1), and the firm has or will continue to perform similar engagements. The replacement review should include the most recently completed engagement similar to those previously omitted. The period covered should consider the time elapsed between the period covered by the previous peer review and the notification of the material departure.

In all the preceding examples, the firm's next peer review will have a due date of three years and six months from the year-end of the replacement review.

PR-C Section 410

The Report Acceptance Process

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains requirements and application material for the administering entity (AE), peer review committee (committee), report acceptance body (RAB), and technical reviewers regarding the evaluation and acceptance of all reviews. For purposes of this section, it is assumed that the committee has delegated the report acceptance function to the RAB, whose members may be, but are not required to be, members of the committee. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*, and section 400, *General Principles and Administration Responsibilities*. Additionally, individuals involved in the administration of the program should be familiar with reviewer and firm requirements in the following PR-C sections:

- a. Section 210, *General Principles and Responsibilities for Reviewers — System Reviews*
- b. Section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*
- c. Section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*
- d. Section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*

Effective Date

.02 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objective

.03 The objective of the report acceptance process is to outline the committee's responsibility to ensure that it considers the results of peer reviews it administers that are undertaken to meet the requirements of the program.

Definitions

.04 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Technical Reviewer's Evaluation of System Reviews

.05 The evaluation of a system review should include consideration of the following (as applicable):

- a. Peer review report and letter of response
- b. Firm representation letter
- c. Summary Review Memorandum
- d. Scope and results of engagements selected for review
- e. Matters for further consideration (MFCs)
- f. Findings for further consideration (FFCs)
- g. Disposition of Matters for Further Consideration (DMFC)
- h. Oversight report
- i. The engagement profile and the supplemental peer review checklist for single audits, which includes the explanation of "no" answers and other comments (Ref: par. .A1)
- j. Explanation of "no" answers for quality control checklists
- k. The firm's prior
 - i. peer review report and letter of response,
 - ii. FFCs,
 - iii. firm representation letter, and
 - iv. letters detailing required corrective actions or implementation plans
- l. Any other information that may affect the evaluation or results of the review
- m. In addition to consideration of (a)–(l), for reviews administered by the National Peer Review Committee,
 - i. engagement checklists,
 - ii. quality control checklists, and
 - iii. staff or focus group interviews

.06 The evaluation of whether system review documentation provides satisfactory evidence of compliance with the standards and supports the conclusions reached should include considering the following (as applicable):

- a. If an appropriate risk analysis was documented
- b. If the reviewer used a systemic approach
- c. If the peer review documents support any FFCs, deficiencies, significant deficiencies, and the report rating
- d. If the firm's responses on FFCs or the letter of response are in accordance with standards
- e. If the firm's actions, planned or taken, to remediate nonconforming engagements appear appropriate and in accordance with professional standards
- f. If the DMFC addresses all MFCs and appears appropriate
- g. If past reviewer performance feedback has an impact on the current review

- h.* If the review meets consent agenda criteria as defined in paragraph .11 of section 100, if applicable

.07 For system reviews that require RAB evaluation, the technical reviewer should provide the RAB with the necessary information to properly evaluate the review. (Ref: par. .A2)

Technical Reviewer's Evaluation of Engagement Reviews

.08 The evaluation of an engagement review should include consideration of the following (as applicable):

- a.* Peer review report and letter of response
- b.* Firm representation letter
- c.* Review Captain Summary
- d.* Scope and results of engagements selected for review
- e.* MFCs
- f.* FFCs
- g.* DMFC
- h.* Oversight report
- i.* The firm's prior
 - i.* peer review report and letter of response,
 - ii.* FFCs,
 - iii.* firm representation letter, and
 - iv.* letters detailing required corrective actions or implementation plans
- j.* For reviews with a committee-appointed review team, all peer review working papers
- k.* Any other information that may affect the evaluation or results of the review

.09 The evaluation of whether engagement review documentation provides satisfactory evidence of compliance with the standards and supports the conclusions reached should include considering the following (as applicable):

- a.* If the engagements selected for review conform to standards
- b.* If the report, FFCs, and letter of response are in accordance with standards
- c.* If the firm's actions, planned or taken, to remediate nonconforming engagements appear appropriate and in accordance with professional standards
- d.* If the DMFC addresses all MFCs and appears appropriate
- e.* If past reviewer performance feedback has an impact on the current review
- f.* If the review should be presented to the RAB or accepted by the technical reviewer on behalf of the RAB (see paragraph .11)
- g.* If the review meets consent agenda criteria as defined in paragraph .11 of section 100, if applicable

.10 For engagement reviews that require RAB evaluation, the technical reviewer should provide the RAB with necessary information to properly evaluate the review. (Ref: par. .A3)

RAB Peer Review Evaluation

.11 The AE should provide meeting materials to RAB members at least seven days in advance of the date of the RAB meeting in order to allow every RAB member adequate time to read the documents and be prepared to discuss the reviews being considered for acceptance. At a minimum, the following documents, if applicable, should be included to assist the RAB in its evaluation: (Ref: par. .A4–.A5)

- a. Peer review report and letter of response
- b. Firm representation letter
- c. Summary Review Memorandum or Review Captain Summary (for system or engagement reviews, respectively)
- d. Scope and results of engagements selected for review
- e. MFCs
- f. FFCs
- g. DMFC
- h. Oversight report
- i. The technical reviewer's summary and recommendations (which may be documented in the technical reviewer's checklist)
- j. The firm's prior
 - i. peer review report and letter of response,
 - ii. FFCs,
 - iii. firm representation letter, and
 - iv. letters detailing required corrective actions or implementation plans

.12 The RAB's evaluation of each peer review presented for acceptance, including those on the consent agenda, includes consideration of the technical reviewer's recommendations and the following: (Ref: par. .A6–.A7)

- a. Whether the review was performed and reported in accordance with the standards (See section 210 or section 220 for specific requirements.)
- b. Whether the reviewed firm's plan to remediate nonconforming engagements is in accordance with professional standards and, for system reviews, consideration of other weaknesses in the firm's system of quality control if the firm's remediation plan is not in accordance with professional standards
- c. Whether matters have been appropriately evaluated in accordance with the standards
- d. Whether FFCs, the report, the firm's representation letter, and the firm's letter of response, if applicable, are in accordance with the standards
- e. Whether corrective actions related to deficiencies or significant deficiencies in the report should be required (See paragraphs .07–.08 of section 420, *Corrective Actions and Implementation Plans*.)
- f. Whether an implementation plan related to findings on FFCs should be required (See paragraphs .07–.08 of section 420.)
- g. Whether reviewer performance feedback should be issued (See paragraphs .01–.17 of section 430, *Reviewer Monitoring and Performance*.)

Criteria for Delayed or Deferred Acceptance

.13 The RAB should use professional judgment in determining whether it is appropriate to accept or delay or defer acceptance of a peer review.

Delayed Acceptance

.14 The RAB should delay acceptance of a peer review for minor revisions in the following situations (this list is not all-inclusive): (Ref: par. .A8–.A10)

- a. When peer review reports and letters of response
 - i. do not indicate that a deficiency or significant deficiency is repeated from the prior peer review,
 - ii. have misleading grammar or excessively ambiguous language,
 - iii. include misquoted professional literature,
 - iv. reference professional standards unrelated to the subject matter, or
 - v. for system reviews, do not identify the industry and level of service for any deficiencies or significant deficiencies that are industry specific or related to a nonconforming must-select engagement
- b. When FFCs
 - i. have incorrect or missing references to the applicable professional standards;
 - ii. do not identify the MFC that led to the finding;
 - iii. incorrectly identify the type of matter;
 - iv. do not correctly identify whether the finding is a repeat;
 - v. do not describe the scenario that led to the finding;
 - vi. do not provide reference to the specific industry or engagement related to a nonconforming engagement, if applicable;
 - vii. do not have a clear description of the finding from the reviewer;
 - viii. are not signed by an authorized representative of the firm; or
 - ix. for system reviews, have incorrect or missing references to the applicable requirements of the Statements on Quality Control Standards
- c. When MFCs
 - i. are not completed properly or fully or
 - ii. contain firm or client references

Deferred Acceptance

.15 The RAB should defer acceptance of a review if there are unresolved questions significant enough that no decision can be made until further information is received and for significant revisions in the following situations (this list is not all-inclusive): (Ref: par. .A11–.A13)

- a. When peer review reports or letters of response
 - i. have significant departures from the standard report formats;

- ii. have an incorrect report rating or omitted deficiencies or significant deficiencies;
 - iii. have deficiencies or significant deficiencies that appear to set standards higher than those mandated by professional standards;
 - iv. for system reviews, have deficiencies or significant deficiencies that are not written systemically, or the systemic causes are not clear;
 - v. do not have responses that appropriately address deficiencies or significant deficiencies identified in the peer review report; or
 - vi. have responses that do not appropriately address nonconforming engagements, including responses that are unacceptably noncommittal, vague, or otherwise unclear or not responsive
- b. When FFCs
 - i. do not have a clear description of the finding from the reviewer and, on system reviews, do not include the systemic cause of the finding or
 - ii. include a response from the reviewed firm that does not appear comprehensive, genuine, and feasible
- c. When any other peer review documents need revision for the RAB to conclude whether the review was performed and reported on in accordance with the standards

Application and Other Explanatory Material

Technical Reviewer's Evaluation of System Reviews (Ref: par. .05–.07)

.A1 The RAB may delegate the review of the engagement profile and the supplemental peer review checklist for single audits to the technical reviewer if the technical reviewer has completed CPE as required by paragraph .45e of section 400. The technical reviewer may request that a member of the RAB perform the technical review of such documents when the technical reviewer has not obtained the required CPE.

.A2 The technical reviewer may provide information about the following, as applicable, to the RAB to assist it in evaluating a system review (this list is not all-inclusive):

- a. Administrative compliance issues such as
 - i. year-end changes,
 - ii. due date extensions,
 - iii. significant delays in presentation,
 - iv. team member qualifications and approvals,
 - v. reviewed firm or reviewer referral database entries, and
 - vi. significant reviewer performance issues
- b. The overall effect of matters, findings, deficiencies, or significant deficiencies on the review results

- c. The reviewer's assessment of peer review risk (including inherent, control, and detection risk) to provide a basis for engagement selections and the extent and location of procedures performed
- d. Whether the reviewer identified all matters and appropriately elevated them to findings, deficiencies, or significant deficiencies
- e. Whether the reviewer identified the appropriate systemic causes for any findings, deficiencies, or significant deficiencies
- f. The effect of nonconforming engagements on the review, including
 - i. potential reporting implications,
 - ii. the reviewer's consideration of expansion of scope,
 - iii. the firm's planned or taken remediation, and
 - iv. whether the reviewer adequately considered implications of an unresponsive firm
- g. Recommendations regarding
 - i. acceptance of the review (see paragraphs .13–.15, which address reasons for delayed or deferred acceptance),
 - ii. corrective actions and implementation plans (see paragraphs .07–.08 of section 420),
 - iii. captain or review team feedback (see paragraphs .01–.17 of section 430),
 - iv. any oversight procedures,
 - v. expansion of scope, and
 - vi. any other issues the technical reviewer believes warrant RAB evaluation
- h. Firms whose current review and two most recently accepted reviews resulted in non-pass reports (*pass with deficiencies* or *fail*) that may be referred to a hearing panel for failing to comply with the requirements of the program (see paragraphs .35–.39 of section 400)
- i. Whether there are any unresolved issues or disagreements that could affect the peer review results
- j. Significant issues identified in electronic data, such as
 - i. the firm's scheduling information and
 - ii. specific risks identified in the firm's practice such as a new must-select industry

Technical Reviewer's Evaluation of Engagement Reviews (Ref: par. .08–.10)

.A3 The technical reviewer may provide information about the following, as applicable, to the RAB to assist it in evaluating an engagement review (this list is not all-inclusive):

- a. Administrative compliance issues such as
 - i. year-end changes,
 - ii. due date extensions,
 - iii. significant delays in presentation,
 - iv. team member qualifications and approvals,
 - v. reviewed firm or reviewer referral database entries, and
 - vi. significant reviewer performance issues

- b. The overall effect of matters, findings, and deficiencies on the review results
- c. The scope of engagements selected for review
- d. Whether the reviewer identified all matters and appropriately elevated them to findings or deficiencies
- e. Nonconforming engagements and the firm's planned or taken remediation
- f. Recommendations regarding
 - i. acceptance of the review (see paragraphs .15–.23, which address reasons for delayed or deferred acceptance),
 - ii. corrective actions and implementation plans (see paragraphs .07–.08 of section 420),
 - iii. captain or review team feedback (see paragraphs .01–.25 of section 430),
 - iv. any oversight procedures, and
 - v. any other issues the technical reviewer believes warrant RAB evaluation
- g. Firms whose current review and two most recently accepted reviews resulted in non-pass reports (*pass with deficiencies* or *fail*) that may be referred to a hearing panel for failing to comply with the requirements of the program (see appendix A, "Failure to Cooperate or Comply With the Requirements of the Program Referral Responsibilities," of section 400)
- h. Whether there are any unresolved issues or disagreements that could affect the peer review results

RAB Peer Review Evaluation (Ref: par. .11–.12)

.A4 The meeting may be conducted in person or via conference call.

.A5 To further assist with its evaluation, the RAB may request that the engagement profile and the supplemental checklist for single audits, including the explanation of "no" answers and other comments, be included with the materials required by paragraph .11.

.A6 The RAB is authorized to make inquiries or request additional actions it considers necessary in the circumstances to properly evaluate the review. Such inquiries or actions include, but are not limited to, requesting

- a. an expansion of scope,
- b. corrections or clarifications to peer review documents,
- c. all peer review documentation from the team or review captain not previously provided, and
- d. oversight of engagements or peer review documents.

.A7 The RAB may refer difficult or problem reviews to the committee for acceptance or concurrence, or both.

Criteria for Delayed or Deferred Acceptance

Delayed Acceptance (Ref: par. .14)

.A8 The responsibility to approve revised peer review documents may be delegated to the technical reviewer or an individual member of the RAB.

.A9 Requesting revisions to the peer review report is not necessary in the following circumstances:

- a. System review report deficiencies or significant deficiencies contain a reference to the specific number of engagements where the matters were noted rather than using general terms such as *few* or *some*.
- b. Multiple deficiencies or significant deficiencies could have been combined.
- c. There are deficiencies or significant deficiencies where the reviewed firm understands the substance and responds appropriately but the deficiency or significant deficiency is not written clearly.

.A10 If the RAB delays acceptance of a review, a letter is sent to the captain and firm to request that the applicable parties revise the identified documents before the peer review can be accepted. The letter also advises the firm that once the RAB is satisfied, the RAB will submit an acceptance letter that may outline certain additional corrective actions, which the firm will be required to acknowledge prior to the review being accepted.

Deferred Acceptance (Ref: par. .15)

.A11 The RAB may also defer acceptance of a review to perform additional procedures to overcome significant concerns regarding the review or reviewer or to request revisions to other documents such as, but not limited to, the following:

- a. Summary Review Memorandum
- b. MFCs
- c. Engagement checklists
- d. Quality control checklists

.A12 When acceptance of a review is deferred, the RAB may also recommend that the report date be revised in circumstances including, but not limited to, the following:

- a. The report rating changed.
- b. FFCs were added.
- c. Substantive additional work was performed.

.A13 If the RAB defers acceptance of a review, a letter is sent to the firm and reviewer informing the parties that the RAB has deferred acceptance of the review because of unresolved issues related to the report and that, once the issues have been resolved, the review will be sent back to a RAB for further consideration.

PR-C Section 420

Corrective Actions and Implementation Plans

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains requirements and application material for technical reviewers and report acceptance bodies (RABs) when evaluating the types of corrective actions and implementation plans to recommend and require firms to complete and when evaluating the results of those actions. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*, and section 400, *General Principles and Administration Responsibilities*. Additionally, individuals involved in the administration of the program should be familiar with reviewer and firm requirements in the following PR-C sections:

- a. Section 210, *General Principles and Responsibilities for Reviewers — System Reviews*
- b. Section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*
- c. Section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*
- d. Section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*

Effective Date

.02 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objectives

.03 The objectives of corrective actions and implementation plans are to

- a. offer education and remediation guidance to firms,
- b. provide a mechanism for RABs to monitor firms' remedial actions in response to deficiencies and findings, and
- c. assist in meeting the program's objective of serving the public interest.

Definitions

.04 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Approving Due Date Extension Requests for Corrective Actions or Implementation Plans by Technical Reviewers or the CPA on Staff

.05 Technical reviewers and the CPA on staff should accept due date changes for corrective actions or implementation plans only if (Ref: par. .A1–.A2)

- a. such authority has been granted by the committee,
- b. the firm requested the due date change before the due date, and
- c. the new due date is three months or less from the original due date.

Approving Outside Parties to Perform Corrective Actions or Implementation Plans

.06 The RAB (or its designee) should evaluate whether outside parties should be approved to perform corrective actions and implementation plans based on considerations such as, but not limited to, the following: (Ref: par. .A3)

- a. The significance of the issues identified in the peer review resulting in corrective actions or implementation plans
- b. The nature of the corrective actions and implementation plans
- c. Whether the outside party's firm's most recently accepted peer review report was a pass report
- d. The extent of the outside party's experience
- e. If the outside party is a qualified reviewer, whether the outside party has relevant experience or any performance issues specific to the corrective actions or implementation plan

Determining When and What Type of Corrective Actions or Implementation Plans to Require

.07 The decision to require corrective actions or implementation plans should include

- a. considering the nature and significance of the findings, deficiencies, or significant deficiencies;
- b. evaluating whether the firm's actions taken or planned to remediate nonconforming engagements, if applicable, appear comprehensive, genuine, and feasible; and
- c. considering any actions the reviewed firm has already taken that were reviewed by the reviewer prior to RAB evaluation.

.08 If a finding, deficiency, or significant deficiency relates to an area where prevalent nonconformity has been identified through the AICPA Enhancing Audit Quality Initiative, then specific CPE to address the common areas of noncompliance should be required by the RAB. Either an AICPA course or an alternative course with substantially the same content as the AICPA course should be required by the RAB. (Ref: par. .A4)

.09 In situations in which the RAB concludes a firm should be required to complete corrective actions because of deficiencies or significant deficiencies,

determining the nature of corrective actions should include the following: (Ref: par. .A5)

- a. Considering the potential corrective actions in exhibit B, "Suggested Corrective Actions: Engagement Reviews," and exhibit D, "Suggested Corrective Actions: System Reviews," based on the applicable facts and circumstances
- b. For repeat findings, deficiencies, or significant deficiencies, evaluating whether the firm made a genuine effort to correct the prior issue and considering whether a more rigorous or targeted requirement is appropriate (Ref: par. .A6)
- c. For system reviews,
 - i. considering the systemic causes, pattern, pervasiveness, and relative importance to the system of quality control and whether the firm's actions taken or planned to remediate the firm's system of quality control appear comprehensive, genuine, and feasible; and
 - ii. considering prescribing actions that give the firm an opportunity to demonstrate the effectiveness of changes implemented or improvements made (Ref: par. .A7)
- d. For engagement reviews, considering whether the reviewed firm has a sufficient understanding of relevant accounting or reporting matters (or both)

.10 In situations in which the RAB concludes a firm should be required to complete an implementation plan because of findings, determining the nature of the implementation plan should include the following:

- a. Assigning only the allowable implementation plans in exhibit A, "Allowable Implementation Plans: Engagement Reviews," or exhibit C, "Allowable Implementation Plans: System Reviews," based on the applicable facts and circumstances
- b. For repeat findings, evaluating whether the firm made a genuine effort to correct the prior issue and considering whether a more rigorous or targeted implementation plan is appropriate (Ref: par. .A6)
- c. For system reviews, considering the systemic causes, pattern, pervasiveness, and relative importance of findings to the system of quality control and whether the firm's actions taken or planned to remediate the firm's system of quality control appear comprehensive, genuine, and feasible
- d. For engagement reviews, considering whether the reviewed firm has a sufficient understanding of relevant accounting or reporting matters (or both)

.11 If the RAB believes more extensive actions, beyond the allowable implementation plans in exhibits C and D, are necessary (such as submitting documents to an outside party), the RAB needs to consider whether the findings should have been elevated to deficiencies in the report.

Evaluating the Results of Corrective Actions and Implementation Plans

.12 The RAB's (and technical reviewer's) evaluation of the results of corrective actions and implementation plans should include considering the following: (Ref: par. .A8)

- a. Whether such actions have been completed as required
- b. Whether the results indicate additional remediation is in the firm's or the public's best interest
- c. If the actions have not been completed as required, whether this is a failure to cooperate that warrants referral to a board hearing panel for potential termination from the program

.13 The RAB's (and technical reviewer's) evaluation of whether the firm should be required to complete additional actions includes the following: (Ref: par. .A9)

- a. The amount of improvements made by the firm
- b. Whether the firm can continue to make improvements on its own
- c. The reason that improvement was not made as expected
- d. The significance of current issues
- e. The nature and size of the firm's practice, including the number of engagements and personnel and the engagements performed
- f. Whether actions were appropriate to remediate findings, deficiencies, or significant deficiencies
- g. Whether the firm had sufficient time to remediate findings, deficiencies, or significant deficiencies

Accepting Certain Corrective Actions and Implementation Plans by the CPA on Staff or Technical Reviewer

.14 The CPA on staff or technical reviewers should accept corrective actions or implementation plans on the committee's behalf only if such authority has been granted and there are clearly identifiable actions or procedures requested of the firm. (Ref: par. .A10)

When Corrective Actions or Implementation Plans Are Replaced, Waived, or Extended

.15 For requests to waive corrective actions or implementation plans, the RAB should first consider replacement options. Corrective actions or implementation plans should not be waived solely because the firm cannot meet the due date or has an upcoming review. (Ref: par. .A11–.A13)

Application and Other Explanatory Material

Approving Due Date Extension Requests for Corrective Actions or Implementation Plans by Technical Reviewers or the CPA on Staff (Ref: par. .05)

.A1 The committee, based on the nature of corrective actions or implementation plans and the background and experience of technical reviewers and the CPA on staff, may authorize those individuals to approve due date changes of corrective actions or implementation plans.

.A2 Technical reviewers and the CPA on staff may submit requests meeting the criteria in paragraph .05 to the RAB for approval based on professional skepticism, taking into consideration experience from the technical review process and the firm's history.

Approving Outside Parties to Perform Corrective Actions or Implementation Plans (Ref: par. .06)

.A3 The committee, based on the nature of corrective actions or implementation plans and the background and experience of technical reviewers and the CPA on staff, may authorize those individuals to approve outside parties to perform corrective actions and implementation plans.

Determining When and What Type of Corrective Actions or Implementation Plans to Require (Ref: par. .07–.11)

.A4 The AICPA courses located on the Peer Review page of the AICPA website provide the content intended to meet this requirement.

.A5 The potential corrective actions in exhibits B and D may be tailored to address deficiencies or significant deficiencies.

.A6 For repeat findings, deficiencies, and significant deficiencies, the RAB may determine that more than 8 hours of CPE is necessary and may require 24 hours, change the nature of the required courses, or require the firm to complete CPE and hire an outside party to review its internal monitoring or inspection report.

.A7 Requiring a firm to take CPE is a common required corrective action; however, the submission of CPE certificates alone does not necessarily give a firm an opportunity to demonstrate the effectiveness of changes implemented or improvements that may reduce the risk the firm will have repeat deficiencies or significant deficiencies. Additionally, for firms with a second consecutive non-pass report (but not a third), the RAB evaluates whether to refer the firm for potential termination based on the results of corrective actions. In such a situation, it may be appropriate to require the firm to take specified types and amounts of CPE and subsequently engage a third party to perform a pre-issuance or post-issuance review of a specific engagement to demonstrate improvement.

Evaluating the Results of Corrective Actions and Implementation Plans (Ref: par. .12–.13)

.A8 The RAB and administering entity (AE) may recommend to a firm that it request a change in the year-end of its subsequent peer review in situations including, but not limited to, the following:

- a. Significant portions of the firm's practice that would be subject to the firm's subsequent peer review without a year-end change were reviewed by an outside party as part of corrective actions or implementation plans.
- b. The review being evaluated is significantly overdue and there is concern that the firm would not have sufficient time to remediate issues on engagements issued that would be subject to the firm's subsequent peer review without a year-end change.
- c. Due to the nature of the firm's practice, a significant portion of the firm's engagements are not completed and available for review based on the firm's current peer review year-end.

.A9 The results from completed actions may provide more current information to the RAB regarding additional actions that may be more effective in correcting the issues identified in the firm's review.

Accepting Certain Corrective Actions and Implementation Plans by the CPA on Staff or Technical Reviewer (Ref: par. .14)

.A10 Identifiable actions or procedures that may be accepted by the CPA on staff or technical reviewers include, but are not limited to, the following:

- a. Submit proof of CPE taken.
- b. Submit proof of purchase of third-party-provided materials.
- c. Submit proof of licensure.
- d. Submit proof of a specific correction to a nonconforming engagement.
- e. Submit a report by an outside party approved by the RAB on the results of actions specified by the RAB where the outside party reports the firm's actions were favorable and additional corrective actions or implementation plans are not considered necessary.

When Corrective Actions or Implementation Plans Are Replaced, Waived, or Extended (Ref: par. .15)

.A11 The RAB may request corrective actions or implementation plans that are industry or engagement-type specific but address a firm's noncompliance with its system of quality control policies and procedures. If the firm represents it will no longer perform engagements in a specific industry, the RAB may replace the original request with a new corrective action or implementation plan. For example, if the RAB required a firm to have a pre-issuance review of a for-profit entity subject to the U.S. Department of Housing and Urban Development's uniform financial reporting standards but the firm will no longer perform such engagements, the RAB may require the firm to obtain a pre-issuance review of a single audit.

.A12 The RAB may permit a reviewed firm to undergo an accelerated peer review in lieu of completing corrective actions or implementation plans if the following apply:

- a. The firm has had sufficient opportunity to implement remedial actions prior to the anticipated commencement date of the accelerated review.
- b. The reviewed firm elects, in writing, to have an accelerated review.
- c. The corrective action or implementation plan is
 - i. an outside party's post-issuance review of certain types or portions of engagements,
 - ii. an outside party's review of the firm's remedial actions outlined in its letter of response or the appropriateness of alternative actions, or
 - iii. an outside party's review of the firm's internal inspection or monitoring report.

.A13 Situations in which it may be appropriate to waive corrective actions or implementation plans include, but are not limited to, the following:

- a. The firm represents it is no longer performing the engagements that were the source of the findings or deficiencies, and the systemic cause did not extend to other aspects of the firm's practice.
- b. The firm has given up its auditing and accounting practice and represents it has no plans to perform audit or accounting engagements in the future.

- c.* A partner leaves the firm, and that partner was the sole source of the engagement or systemic findings or deficiencies.
- d.* The firm has been sold and is no longer practicing and is not licensed to practice. This does not include mergers or situations in which a firm is no longer in existence and the partners have taken their respective clients to another firm.

.A14

Exhibit A — Allowable Implementation Plans:
Engagement Reviews

<i>Finding</i>	<i>Allowable Implementation Plan</i>
Engagements indicate the following: • Repeat findings	• Require members of the firm to take specified types and amounts of CPE.
• Failure to possess applicable firm licenses	• Require the firm to submit proof of its valid firm licenses.

.A15

Exhibit B — Suggested Corrective Actions: Engagement Reviews

<i>Deficiency</i>	<i>Suggested Actions to Be Performed as Soon as Reasonably Possible</i>
Deficiency	• Require members of the firm to take specified types and amounts of CPE. • Require the firm to hire an outside party approved by the report acceptance body (RAB) to perform a pre-issuance or post-issuance review of certain types or portions of engagements. • Require the firm to hire an outside party approved by the RAB to review the firm's remediation of nonconforming engagements. • Require the firm to engage an outside party approved by the RAB to review the firm's completion of its intended remedial actions as outlined in its letter of response or to evaluate the appropriateness of alternative actions. Though not required, this is commonly performed by the review captain. • Require the relevant members of the firm to submit proof of their valid individual licenses.

.A16

Exhibit C — Allowable Implementation Plans:
System Reviews

<i>Finding</i>	<i>Allowable Implementation Plan</i>
Nonconforming engagements and - initial findings on a must-select industry or - repeat findings for any industry	- Require members of the firm to take specified types and amounts of CPE. - Require the firm to hire an outside party approved by the report acceptance body (RAB) to perform a pre-issuance or post-issuance review of certain types or portions of engagements. - Require the firm to hire an outside party approved by the RAB to review the firm's remediation of nonconforming engagements. - Require the firm to hire an outside party approved by the RAB to review the firm's completion of its intended remedial actions outlined in its response on the finding for further consideration (FFC) form or to evaluate the appropriateness of alternative actions. - Require the firm to hire an outside party approved by the RAB to review the firm's internal monitoring or inspection report.
Engagements indicate repeat findings	- Require members of the firm to take specified types and amounts of CPE. - Require the firm to hire an outside party approved by the RAB to review the firm's internal monitoring or inspection report.
Failure to possess applicable firm licenses	Require the firm to submit proof of its valid firm licenses.

.A17

Exhibit D — Suggested Corrective Actions: System Reviews

<i>Deficiency or Significant Deficiency</i>	<i>Suggested Actions to Be Performed as Soon as Reasonably Possible</i>
Deficiency or significant deficiency related to engagement performance	• Require members of the firm to take specified types and amounts of CPE. • Allow firm members responsible for the applicable nonconforming engagements to pass the related AICPA advanced certificate exam, if applicable, in lieu of CPE. This option is applicable only for firms that have nonconforming engagements in certain industries that were identified in the peer review and for which a related AICPA advanced certificate exists. • Require the firm to hire an outside party approved by the report acceptance body (RAB) to perform a pre-issuance or post-issuance review of certain types or portions of engagements. • Require the firm to hire an outside party approved by the RAB to review the firm's remediation of nonconforming engagements. • Require the firm to hire an outside party approved by the RAB to review the firm's completion of its intended remedial actions as outlined in its letter of response or to evaluate the appropriateness of alternative actions. Though not required, this is commonly performed by the team captain of the peer review. • Require the firm to join an AICPA audit quality center applicable to the nonconforming engagements.
Deficiency or significant deficiency related to design of or noncompliance with another element of the quality control system	• Require the firm to hire an outside party approved by the RAB to review the firm's internal monitoring or inspection report. • Require the firm to hire an outside party approved by the RAB to perform a pre-issuance review of certain types or portions of engagements. • Require the relevant members of the firm to submit proof of their valid individual licenses.

.A18

Appendix A — Guidance for Outside Parties Engaged to Assist Firms in Completing Corrective Actions and Implementation Plans

This appendix contains guidance for outside parties engaged to assist firms in completing corrective actions or implementation plans required as a condition of acceptance of the firm's peer review.

Objectives

.01 The objectives of the outside party assisting a firm in the completion of corrective actions or implementation plans are to

- a. objectively determine whether the firm took one or more actions the firm represented it would perform in its letter of response or response to findings for further consideration (FFCs),
- b. evaluate the reviewed firm's compliance with the corrective actions or implementation plan, and
- c. issue a letter that describes the procedures performed and the conclusions reached as a result of those procedures, to enable the report acceptance body (RAB) to conclude on the adequacy of the reviewed firm's corrective actions or implementation plans.

Planning

.02 The outside party should first gain an understanding of the corrective actions or implementation plans agreed to by the firm and the procedures that need to be performed by obtaining and reading

- a. the acceptance letter describing the corrective actions or implementation plans required by the RAB;
- b. the firm's most recent peer review report;
- c. the firm's letter of response, if applicable; and
- d. the FFC forms, if applicable.

.03 The outside party may confirm the appropriateness of the procedures to be performed by contacting the administering entity's (AE's) peer review committee, its RAB, or the technical reviewer. If unsure who to contact, the outside party may contact the AICPA.

Procedures

.04 The outside party should perform procedures outlined in the acceptance letter while considering the elements required to be reported, which are outlined in the subsequent section.

.05 The outside party should discuss the procedures performed and conclusions reached as a result of those procedures with the reviewed firm. During those discussions, the outside party should ask whether the firm plans to implement further corrective actions to address any deficiencies or significant deficiencies or take additional steps to address any findings noted during the outside party's procedures because they will likely be mentioned in the outside party's letter or report.

Reporting

.06 The outside party should draft a letter or report to the RAB describing the procedures performed and conclusions reached. The letter or report should

- a. be issued on the letterhead of the outside party's firm,
- b. be addressed to the AE's RAB with a copy to the reviewed firm, and
- c. include the following elements:
 - i. A description of the corrective actions or implementation plans required by the RAB
 - ii. A description of the representations made by the reviewed firm regarding the changes made by the firm since its most recent peer review
 - iii. A description of the procedures performed by the outside party
 - iv. A summary of the results of the outside party's procedures, including a description of any representations made by the reviewed firm regarding further planned actions and the outside party's comments on the appropriateness of those actions
 - v. A statement that the letter or report is intended for limited distribution to the RAB and the reviewed firm and is not intended as a substitute or replacement for the peer review documents issued on the firm's peer review
 - vi. Information enabling the RAB to evaluate whether the firm has improved
 - vii. For system reviews, recommendations of additional actions if the outside party believes the results reveal continued weaknesses in the reviewed firm's system of quality control

Illustrative Letters

.07 The following letters are for illustrative purposes only. It is recommended, but not required, that the outside party adopt the form of these letters and tailor them to describe the conclusions reached based on the specific procedures performed.

SAMPLE LETTER ON AN OUTSIDE PARTY'S REVIEW OF A FIRM'S REMEDIAL ACTIONS — CORRECTIVE ACTIONS

[Outside Party's Firm Letterhead]

May 15, 20XX

[Name and Address of the Report Acceptance Body]

Dear Committee Members:

This letter is written to assist [reviewed firm's name] in complying with certain actions the firm voluntarily agreed to take in connection with the [name of the report acceptance body]'s consideration of acceptance of its 20XX peer review report and response thereto.

The [name of the administering entity's peer review committee or its report acceptance body] accepted the firm's 20XX peer review documents with the understanding that the firm agreed to permit an outside party, acceptable to the Committee chair, to:

- a. Review the planning for the firm's 20XX inspection program in advance.
- b. Review the results (with emphasis on those items noted in the 20XX peer review) and the corrective actions taken on the deficiencies or significant deficiencies noted.

- c. Provide a written communication on the firm's inspection to the Committee by September 30, 20XX.

Prior to the firm performing its 20XX inspection, I performed the following procedures:

- a. Reviewed a copy of the firm's 20XX peer review report, finding for further consideration (FFC) forms (if applicable), the firm's letter of response, and the acceptance letter describing the required corrective actions.
- b. Reviewed the firm's inspection planning documentation.

On April 19th, 20XX, after the completion of the firm's 20XX inspection, I performed the following procedures:

- a. Discussed the corrective actions described in its letter of response with the firm to determine if the actions had been fully implemented.
- b. Reviewed the firm's inspection report and underlying documentation of its performance, including the engagement review checklists prepared during the inspection.
- c. Reviewed the working papers of selected engagements with periods ending June 30, 20XX, that were included in the inspection and any changes in the firm's quality control materials to evaluate the effectiveness of the inspection and the corrective actions implemented by the firm as a result of its 20XX peer review.
- d. Discussed the inspection results and corrective action plan with the firm and evaluated the feasibility of the firm achieving its plan.

Discussed in the following sections are the results of the procedures I performed and a description of the firm's representations regarding planned corrective actions.

Procedures on the Audit of an Employee Benefit Plan Audit

The firm performed an audit of a defined benefit pension plan subject to ERISA requirements. The firm failed to test participant data and did not obtain a representation letter from its client or the plan administrator. The firm subsequently obtained the missing representation letter and performed the necessary tests. I reviewed this documentation before the firm's peer review documents were presented to the Committee. The firm's letter of response indicated it would obtain an industry-specific audit program and update its library to include AICPA Audit and Accounting Guide *Employee Benefit Plans*.

Results of the Firm's Remedial Actions Related to the Employee Benefit Plan Audit

The firm did not obtain a copy of the AICPA Audit and Accounting Guide and my review of a recently completed employee benefit plan audit subject to ERISA showed an industry-specific audit program was not obtained and used by the firm on the audit. In addition, some key confirmations relating to investment balances were not obtained, and alternative procedures were not performed. The partner with responsibility for the engagement indicated that the firm obtained a large new client that took up a lot of time, and as a result, the staff rushed through the ERISA audit using the prior year's working papers.

Planned Corrective Actions Related to Employee Benefit Plan Audits

The firm represented that the AICPA Audit and Accounting Guide and industry-specific practice aids that include model audit programs have been ordered. The firm has subsequently obtained confirmations and/or performed

alternative procedures to substantiate the investment balances. I reviewed the additional procedures performed and they are appropriate. In addition, the firm represented that it plans to send its audit staff responsible for conducting employee benefit plan audits to 8 hours of CPE audits of employee benefit plans.

Performance of Audits Subject to Government Auditing Standards and the Single Audit Act

The firm performed several audits subject to the Single Audit Act. The firm failed to issue the required reports on internal controls and compliance with laws and regulations, did not document its consideration and testing of the internal control structure, and did not perform the necessary procedures to test compliance with laws and regulations. In addition, the partner responsible for the engagement was not in compliance with the Yellow Book CPE requirement. The firm performed the omitted audit procedures and issued the missing reports, which I reviewed before the firm's peer review documents were presented to the Committee. The firm's letter of response stated that the partner would take the necessary CPE.

Results of the Firm's Remedial Actions Related to Audits Subject to Government Auditing Standards and the Single Audit Act

My review of a single audit performed subsequent to the firm's peer review noted that all required reports were issued on the engagement and that the owner participated in the necessary CPE. However, I was unable to determine the extent of the testing for compliance with laws and regulations because of significant documentation deficiencies. In addition, documentation deficiencies continued to exist with respect to considering and testing the entity's internal control structure and testing for compliance with the requirements applicable to the federal financial assistance programs.

Planned Corrective Actions Related to Audits Subject to Government Auditing Standards and the Single Audit Act

The firm represented that it plans to conduct a training session for partners and staff during the next month on documentation of audit procedures performed. In addition, the firm represented that it will instruct partners to focus on documentation during their review process and will amend the partner review checklist to add this focus.

Reports on Compiled Interim Financial Statements

The deficiency related to the firm's failure to issue accountants' compilation reports on monthly computer-generated financial statements. The firm's letter of response stated that the firm would revise its quality control policies and procedures to require the issuance of compilation reports with the accompanying financial statements.

Results of the Remedial Actions Related to Compiled Interim Financial Statements

The firm adopted a policy requiring the partners to ensure that an accountant's report accompanies compiled financial statements when those statements are issued to the client. The inspection results indicated that compilation reports were issued with monthly compiled financial statements. However, some of the reports did not disclose that the financial statements were presented using a special purpose framework (cash basis). This reporting error occurred because the firm obtained a copy of the standard compilation report from the reviewer and used it on all of its compiled financial statements. The firm was not familiar with cash basis reporting on Statements on Standards for Accounting and Review Services (SSARS) engagements and did not have any third-party reference material. In addition, the firm's accounting personnel had not taken any recent CPE courses relating to SSARS engagements.

Planned Corrective Actions Related to Compiled Interim Financial Statements

The firm implemented a reviewer checklist to provide assurance that the proper type of compilation report will be issued and its policies and procedures were revised to require completion of this checklist. In addition, the firm represented that all personnel involved in preparing and/or reviewing compilation engagements will take 8 hours of CPE on SSARS engagements within the next month. To assess the effectiveness of using the new checklist, the firm represented that it plans to review a sample of compilation reports issued subsequent to the implementation of the checklist.

Summary

The firm's inspection appears to have been comprehensive, suitably designed, and adequately documented, and the results appear to have been effectively communicated to professional personnel. However, the firm's inspection failed to identify the issues previously discussed. As a result, I believe the Committee should further monitor the firm's corrective actions because the results revealed that the firm has failed to adequately implement the corrective actions described in its letter of response. I recommend that the Committee consider requiring the firm to hire an outside third party sufficiently experienced in the industries in which the firm's clients operate to perform a pre-issuance review of the firm's employee benefit plan audits and those subject to *Government Auditing Standards* and the Single Audit Act.

This letter is intended solely for the information and use of the [name of the administering entity's peer review committee or its report acceptance body] and the owners of [reviewed firm's name] and is not intended as a substitute or replacement for the peer review documents issued on the firm's 20XX peer review.

Sincerely,

[Outside Party's Signature]

cc: [Reviewed Firm's Name]

**SAMPLE LETTER ON AN OUTSIDE PARTY'S REVIEW OF A
SUBSEQUENT ENGAGEMENT — CORRECTIVE ACTIONS**

[Outside Party's Firm Letterhead]

October 6, 20XX

[Name and Address of the Report Acceptance Body]

Dear Committee Members:

This letter is written to assist [reviewed firm's name] in complying with certain actions the firm voluntarily agreed to take in connection with the [name of the report acceptance body]'s consideration of acceptance of its 20XX peer review report and response thereto.

The [name of the administering entity's peer review committee or its report acceptance body] accepted the firm's 20XX peer review documents with the understanding that the firm agreed to permit an outside party, acceptable to the Committee chair, to review the report, financial statements, and working papers of an audit engagement issued subsequent to the firm's peer review and communicate to the Committee in writing on the results of that review by July 31, 20XX.

I performed the following procedures:

- a. Reviewed a copy of the firm's 20XX peer review report, finding for further consideration (FFC) forms (if applicable), and the firm's

letter of response, and the acceptance letter describing the required corrective actions.

- b. Reviewed the report, financial statements, and working papers for a not-for-profit audit engagement for the period ended June 30, 20XX, issued subsequent to the peer review to determine whether the engagement was performed in accordance with professional standards in all material respects. I documented my review using the AICPA "Not-for-Profit Audit Engagement Checklist."
- c. Discussed with the firm the review results and the corrective action plan and evaluated the feasibility of the firm achieving its plan.

While performing the procedures, I found some minor incomplete disclosures in the areas of promises to give and collections. The firm represented that it will conduct a "refresher" training session on disclosures for all owners and professional staff and will also instruct owners to focus on disclosures during their review process.

Because only minor matters were found on the engagement I reviewed, I believe no further monitoring of the firm by the *[name of the administering entity's peer review committee or its report acceptance body]* is necessary at this time.

This letter is intended solely for the information and use of the *[name of the administering entity's peer review committee or its report acceptance body]* and the owners of *[reviewed firm's name]* and is not intended as a substitute or replacement for the peer review documents issued on the firm's 20XX peer review.

Sincerely,

[Outside Party's Signature]

cc: *[Reviewed Firm's Name]*

PR-C Section 430

Reviewer Monitoring and Performance

Effective for peer reviews commencing on or after May 1, 2022.

Introduction

Scope of This Section

.01 This section contains requirements and application material for the administering entity (AE), peer review committee (committee), report acceptance body (RAB), and technical reviewer regarding monitoring reviewer performance. For purposes of this section, it is assumed that the committee has delegated reviewer monitoring responsibilities to the RAB (or other designee) whose members may be, but are not required to be, members of the committee. The requirements and guidance in this section supplement the requirements and guidance in section 100, *Concepts Common to All Peer Reviews*, and section 400, *General Principles and Administration Responsibilities*. Additionally, individuals involved in the administration of the program should be familiar with reviewer and firm requirements in the following PR-C sections:

- a. Section 210, *General Principles and Responsibilities for Reviewers — System Reviews*
- b. Section 220, *General Principles and Responsibilities for Reviewers — Engagement Reviews*
- c. Section 310, *General Principles and Responsibilities for Reviewed Firms — System Reviews*
- d. Section 320, *General Principles and Responsibilities for Reviewed Firms — Engagement Reviews*

Effective Date

.02 The effective date for this standard is for peer reviews commencing on or after May 1, 2022.

Objectives

- .03 The objectives of reviewer performance feedback are to
- a. aid reviewers in their performance by documenting specific areas of improvement and
 - b. help the AE and AICPA staff in monitoring the performance of the reviewer, including whether there is a pattern of reviewer performance findings.

Definitions

.04 Terms applicable to this section are defined in paragraph .11 of section 100.

Requirements

Reviewer Performance

.05 Reviewer performance findings and performance deficiencies should (Ref: par. .A1–.A5)

- a. be documented on a reviewer performance feedback form.
- b. be substantiated by peer review guidance.
- c. include sufficient explanation to ensure the reviewer understands the feedback.
- d. be signed and dated by the RAB, the committee, or a committee member.
- e. be approved by the RAB in conjunction with acceptance of the underlying peer review.
- f. be issued to the reviewer no later than the date the reviewer is notified that the underlying peer review was accepted.
- g. be issued regardless of whether the reviewer cooperated in revising documents or responding to questions and regardless of the status of the reviewer, including reviewers currently suspended or subject to other corrective actions, suspensions, or limited restrictions.

Performance Deficiency Letters

.06 Performance deficiency letters (PDLs) are issued to improve reviewer performance and assist the committee in ensuring reviewers are fulfilling all reviewer responsibilities in the performance of reviews. PDLs should be issued when there is (Ref: par. .A6–.A8)

- a. a pattern of reviewer performance findings by a reviewer or
- b. more than one reviewer performance deficiency on one review (regardless of whether a pattern is present).

.07 A PDL should do the following: (Ref: par. .A9)

- a. State that improvements are needed in the performance of the reviewer.
- b. Include an explanation of the performance deficiencies.
- c. Indicate that the individual must agree to comply with one or more corrective actions or restrictions in order to continue performing reviews, such as, but not limited to, the following:
 - i. Oversight (at the reviewer's expense) until performance improves
 - ii. Consulting with the AE to discuss the planning and performance of the next review until performance improves
 - iii. Submitting all reports and appropriate documentation on all outstanding peer reviews before scheduling or performing another review
 - iv. Having pre-issuance reviews of the report and peer review documentation on future peer reviews by an individual acceptable to the RAB (at the reviewer's expense)
 - v. Submitting evidence of completion of specified types of and amounts of CPE or training, or passing the related AICPA advanced certificate exam

- vi. Removing or revising certain peer reviewer resume items until appropriate proof of experience and knowledge have been provided to the satisfaction of the RAB
- d. Specify whether any corrective actions or restrictions are specific to the individual's performance as a captain or team member, if applicable.
- e. Indicate that other AEs will impose the preceding corrective actions or restrictions on the reviewer.
- f. Indicate that the committee may request that the board remove the individual's name from the list of qualified reviewers if improvements are not noted in the performance of the reviewer on subsequent reviews or the reviewer refuses to cooperate, such as by failing to return a signed acknowledgment copy of the letter within 30 days from the date of the letter.
- g. Indicate that the reviewer will be suspended from scheduling reviews and performing reviews that are scheduled but not commenced by all AEs if the reviewer has not acknowledged the letter within 30 days from the date of the letter.
- h. Give the reviewer an opportunity to appeal the decision before a hearing panel of the board, via telephone conference or in writing. (Ref: par. .A9)
- i. Indicate that a request for appeal must be made within 30 days of receipt of the letter and that the actions or restrictions outlined in the letter will remain in effect for all reviews that the reviewer commences, pending the appeal results.
- j. Be copied and sent to the managing partner of the reviewer's firm if the reviewer is not a sole practitioner and be sent to all AEs for which the reviewer is scheduled to perform reviews or has performed a review in the past year.

.08 The entity issuing a PDL should document its communication (either through discussion or email) with the reviewer to ensure the reviewer is knowledgeable about the evidence supporting the PDL. (Ref: par. .A10)

.09 Corrective actions or restrictions included in a PDL should be adhered to by all AEs and applied to the individual's participation in the performance of any peer review unless the condition is specific to the individual's service as a team captain, review captain, or team member. Corrective actions or restrictions included in a PDL should remain in effect for reviews that the reviewer commences after acknowledging receipt of the PDL until either

- a. the corrective actions and restrictions are withdrawn or
- b. the reviewer has appealed the PDL and the hearing panel determines that the corrective actions or restrictions should be removed or revised.

Withdrawal of Actions or Restrictions in a PDL

.10 Only the entity that issued the PDL should withdraw corrective actions or restrictions included in the PDL. The corrective actions or restrictions should be withdrawn once there is evidence supporting fulfillment of any obligations placed upon the reviewer or supporting why the action or restriction is no longer required. If no improvement or a lack of cooperation is evident, the reviewer should be referred to the board for reviewer removal (see paragraphs .13–.17).

Reviewer Removal

.11 The committee should issue a letter to the board recommending that a reviewer be removed from the list of qualified reviewers if the reviewer (Ref: par. .A11–.A14)

- a. refuses to cooperate with the committee or board (for example, by not acknowledging or appealing a PDL within 30 days).
- b. fails to correct performance deficiencies or findings after a corrective action has been required and the reviewer has had sufficient time and opportunity to correct the deficiencies or findings.
- c. has committed an egregious act in the performance of a peer review. (See paragraph .A44 of section 200, *General Principles and Responsibilities for Reviewers*.)

.12 Prior to referring a reviewer to the board for potential removal from the list of qualified reviewers, the AE should ensure the reviewer is fully knowledgeable about the evidence supporting the referral to the board. Such communication (either through discussion or email) should be documented. One objective of this communication is to determine if there is a disagreement between the reviewer and AE. If there is a disagreement, the committee should follow the guidance in appendix B, "Disagreements," of section 400.

.13 Referrals to the board to request removal of an individual from the list of qualified reviewers should be supported by an affirmative vote by a majority of the committee and include all supporting documentation. (Ref: par. .A15)

.14 The letter recommending that a reviewer be removed from the list of qualified reviewers should be sent by a delivery method providing proof of delivery (including electronic means) and should indicate the following:

- a. That the reviewer refuses to cooperate with the committee or board, failed to correct performance deficiencies or findings after a corrective action was imposed, failed to comply with peer review standards and guidance such that reviewer performance deficiencies were noted, or committed egregious acts in the performance of a review
- b. That the board is requested to consider whether the reviewer should be prohibited from performing reviews or whether some other action should be taken
- c. That the board is also requested to suspend the reviewer's ability to schedule future reviews until this matter is resolved

.15 The request to remove the reviewer from the list of qualified reviewers should include all supporting documentation. (Ref: par. .A15)

Considerations When a Reviewer Is Issued a PDL

.16 Because reviews will be in different stages of completion when a reviewer is issued a PDL, the AE should evaluate the situation and ensure appropriate actions are taken, if any, due to the PDL. (Ref: par. .A16)

Considerations When a Reviewer Is Removed From the List of Qualified Reviewers

.17 Because reviews performed by a reviewer will be in different stages of completion when the board removes the reviewer from the list of qualified reviewers, the AE should evaluate the situation and ensure appropriate actions are taken, if any, due to reviewer removal. (Ref: par. .A17)

Performing in a Timely and Professional Manner

.18 If a reviewer fails to timely and professionally submit peer review documentation (see paragraphs .A39–.A41 of section 200), the AE should suspend the reviewer from scheduling peer reviews within its jurisdiction. Prior to starting the suspension process, the AE should first confirm that it is the reviewer, not the reviewed firm that is failing to perform in a timely and professional manner. If there is a disagreement between the reviewer and reviewed firm, procedures in appendix B of section 400 are followed to resolve the disagreement. (Ref: par. .A18–.A19)

.19 Reviewer suspensions should not preclude the reviewer from

- a. performing already approved and scheduled reviews;
- b. receiving reviewer performance feedback or other communications, if warranted; or
- c. being suspended for failing to timely and professionally submit peer review documentation related to another review.

Reviewer Qualifications

.20 The AE should inform AICPA staff if the AE becomes aware that a reviewer no longer possesses one or more qualifications of a reviewer. (Ref: par. .A20–.A21)

.21 If the AE contacts a firm because its reviewer no longer meets qualifications and the reviewer has not contacted the firm (or team captain) to inform the firm that the reviewer will not be able to perform or continue to perform the firm's peer review, the AE should not provide details or explanation of the reason to the firm. It should be at the reviewer's discretion to discuss details with the firm if the reviewer chooses to do so. (Ref: par. .A22–.A23)

Considerations When a Reviewer Is Ineligible to Schedule or Perform Reviews

.22 Because reviews performed by a reviewer will be in different stages of completion when the reviewer is determined to be ineligible to schedule or perform reviews, the AE should consider the situation and ensure appropriate actions are taken, if any, due to reviewer ineligibility. (Ref: par. .A24)

Allegations or Investigations

.23 The AE and RAB should consider and investigate, as deemed necessary, whether any actions (such as oversight) on the reviewer or reviewing firm are appropriate to overcome any concerns due to the allegations or investigations. (Ref: par. .A25)

Limitations or Restrictions

.24 The AE should comply with any actions placed on reviewers and firms due to limitations or restrictions. (Ref: par. .A26–.A29)

.25 Because reviews performed by a reviewer will be in different stages of completion when a reviewer or reviewing firm becomes restricted or limited, the AE should evaluate the situation and ensure appropriate actions are taken, if any, due to limitations or restrictions. (Ref: par. .A30)

Reviewers That Consider Withdrawing From a Peer Review After the Commencement of the Review

.26 When a reviewer withdraws from a peer review after the review has commenced (based on the definition of *commencement* in section 100), the AE should evaluate whether the situation is a matter of firm noncooperation or reviewer performance and take appropriate action. (Ref: par. .A31–.A32)

Application and Other Explanatory Material

Reviewer Performance (Ref: par. .05)

.A1 Recommendations for reviewer performance feedback may be made by the technical reviewer, the board, or staff via the technical review process or other means such as oversight.

.A2 Examples of reviewer performance findings that may be documented on a reviewer performance feedback form include, but are not limited to, the following:

- a. Related to planning, the reviewer did not
 - i. obtain team member approval timely.
 - ii. obtain a sufficient understanding of the firm's accounting and auditing practice or system of quality control, resulting in the need to perform additional work after the working papers were submitted to the AE.
 - iii. address significant differences between the background information provided to the AE during scheduling and the information that the firm provided to the reviewer that would have affected peer review planning or procedures.
 - iv. adequately document a comprehensive risk assessment for the system review and additional clarification was necessary after working papers were submitted to the AE.
- b. Related to engagement selection and review, the reviewer
 - i. did not select a sufficient or appropriate scope of engagements for review; this includes selecting too many engagements on an engagement review.
 - ii. did not properly select the "surprise" engagement.
 - iii. did not provide sufficient documentation of reasoning for the surprise selection.
 - iv. identified all significant issues in an engagement but did not appropriately conclude on whether an engagement was nonconforming prior to technical review, oversight, or RAB consideration.
- c. Related to the assessment and disposition of matters, the reviewer did not
 - i. appropriately identify matters, findings, deficiencies, or significant deficiencies that would rise to the level of performance deficiencies.
 - ii. appropriately dispose of matters noted on the review.
 - iii. properly consider or document the need to expand scope to other engagements or functional areas.

- iv. appropriately aggregate or evaluate matters noted on the review.
- d. Related to the completion of findings for further consideration (FFCs), the reviewer did not
 - i. write findings systemically in a system review.
 - ii. sufficiently complete or write FFCs or evaluate the firm's response.
 - iii. properly identify a repeat finding.
- e. Related to reporting, the reviewer did not
 - i. provide sufficient working papers or documentation to support the report rating.
 - ii. present the report in standard form in accordance with peer review guidance, or significant revisions to the report were needed.
 - iii. properly review and evaluate the reviewed firm's letter of response prior to its submission to the AE.
 - iv. properly identify a repeat deficiency.
- f. Related to completion and submission of working papers, significant revisions to the working papers were needed or the reviewer did not
 - i. comprehensively complete peer review documentation.
 - ii. properly report engagement statistics.
 - iii. properly discuss consideration of a nonconforming engagement including consideration of the reviewed firm's response.
 - iv. use appropriate practice aids that follow current templates, materials, and checklists.

.A3 Examples of reviewer performance deficiencies that may be documented on a reviewer performance feedback form include, but are not limited to, the following:

- a. Related to engagement selection and review, the reviewer did not
 - i. appropriately identify a nonconforming engagement prior to technical review, oversight, or RAB consideration.
 - ii. demonstrate sufficient knowledge and experience required to review the engagement and identify issues prior to technical review, oversight, or RAB consideration.
- b. Related to assessment and disposition of matters, the reviewer did not appropriately aggregate or evaluate matters noted on the review such that the RAB determined
 - i. a deficiency was present but the reviewer did not elevate the matter beyond a matter for further consideration (MFC) or
 - ii. a significant deficiency (or a *fail* report rating on an engagement review) was present but the reviewer did not elevate the matter beyond an FFC.

.A4 Less critical reviewer performance matters may be provided informally, such as in an email or a call from the technical reviewer; however, the aggregation of less critical performance matters may warrant the issuance of a reviewer performance feedback form. Less critical matters include, but are not limited to,

- a. a checklist was not signed by the team captain,
- b. a reviewer's handwriting was difficult to read, or
- c. the peer review documents needed one minor revision.

.A5 Team member feedback may affect the team captain. For example, if the team member receiving performance feedback did not identify the matters on the checklist that would have informed the team captain to consider the issues, feedback for the team captain is not necessary. However, if the team member identified significant "no" answers on the checklists but did not properly conclude on the engagement, and the team captain did not question the conclusion, reviewer performance feedback for both individuals would be appropriate.

Performance Deficiency Letters (Ref: par. .06–.09)

.A6 If a reviewer's performance on a review is considered egregious, a PDL may be issued or the reviewer may be referred to the board for potential removal from the list of qualified reviewers. (See the section "Reviewer Removal.")

.A7 Determining whether there is a pattern of reviewer performance findings that warrants a PDL is a matter of professional judgment. The assessment includes considering the recentness, nature, and pervasiveness of the issues, factoring in the volume of reviews performed by the reviewer. For example,

- a. a pattern of performance findings may be present when a low-volume reviewer performs three reviews each peer review cycle and reviewer performance findings were noted for all three in that cycle.
- b. a pattern of performance findings may not be present when a high-volume reviewer performs over 100 reviews each peer review cycle and reviewer performance findings were noted on 3 of the reviews in that cycle.

.A8 If AICPA staff become aware of a pattern of reviewer performance findings or reviewer performance deficiencies (regardless of whether a pattern is present) by a particular reviewer, staff will consult with the affected AEs to determine whether a PDL is being drafted. If no PDL is being drafted or will be drafted, staff may refer the reviewer performance issue to the board. The board's process for issuing the PDL is consistent with the process at the AE level.

.A9 Details of the appeal process are covered in the "AICPA Peer Review Board Rules of Procedures for Reviewers," which are located on the AICPA website.

.A10 Evidence supporting the issuance of a PDL may include, but is not limited to,

- a. suspensions for failure to perform in a timely and professional manner,
- b. reviewer performance feedback forms,
- c. other PDLs, and
- d. results of oversight.

Reviewer Removal (Ref: par. .11–.15)

.A11 The committee may also recommend that a reviewer be removed from the list of qualified reviewers if the reviewer

- a. fails to comply with peer review standards and guidance such that reviewer performance deficiencies or a pattern of reviewer performance findings is noted.
- b. fails to submit documentation to support the experience reflected on the reviewer's resume.
- c. fails to perform in a timely and professional manner, resulting in suspension.

.A12 The board may remove the reviewer's name from the list of qualified reviewers or require some other actions based on the facts and circumstances presented.

.A13 AICPA staff will consult with the affected AEs to determine whether a letter requesting the reviewer be removed from the list of qualified reviewers is being drafted if AICPA staff become aware that a reviewer

- a. refuses to cooperate with the committee or board.
- b. failed to correct performance deficiencies or findings after a corrective action had been imposed.
- c. failed to comply with peer review standards such that reviewer performance deficiencies or a pattern of reviewer performance findings is noted.
- d. committed egregious acts in the performance of a review.

If no letter is being drafted or will be drafted by the AE, staff may refer the matter to the Oversight Task Force (OTF), which will consider the need to refer the reviewer to the board for potential removal from the list of qualified reviewers. The process for the OTF is consistent with the process at the AE level.

.A14 A reviewer may apply for reinstatement as a reviewer by writing a letter to the board. Reinstatement may be granted at the discretion of the board chair (or designee) no sooner than three years after the date the reviewer was removed from the list of qualified reviewers. If approved for reinstatement, the reviewer will be sent a letter indicating that the reviewer is able to schedule and perform reviews. It is expected that those reviewers who are granted reinstatement will be required to undergo corrective actions and may be subject to restrictions to be determined by the board chair (or designee). Those required actions or restrictions will also be detailed in the letter.

.A15 Documentation supporting removal from the list of qualified reviewers includes, but is not limited to,

- a. reviewer performance feedback forms issued,
- b. deficiency letters,
- c. results of oversight,
- d. information from other communications (whether verbal or written),
- e. notes from committee and RAB meetings, and
- f. a timeline outlining the various communications.

Considerations When a Reviewer Is Issued a PDL (Ref: par. .16)**.A16**

<i>Considerations When a Reviewer Has Restrictions or Corrective Actions Imposed via a PDL Not Acknowledged by the Reviewer</i>	
<u>Situation</u>	<u>Action</u>
The PDL has not been acknowledged or appealed within 30 days of the date of the letter (or an agreed-upon extended due date).	The reviewer is restricted from scheduling and performing reviews that have been scheduled but not commenced.
The PDL has not been acknowledged or appealed and the review has commenced.	Because the corrective actions cannot be imposed prior to acknowledgment or appeal from the reviewer, consider oversight on the review. If oversight is not performed, consider a full technical review of all working papers related to the peer review.
<i>Considerations When a Reviewer Has Restrictions or Corrective Actions Imposed via a PDL Acknowledged by the Reviewer</i>	
<u>Situation</u>	<u>Action</u>
The PDL requires oversight or a pre-issuance review and the technical reviewer has not submitted the review for RAB consideration.	The action in the PDL is adhered to by all AEs. Notify the firm if fieldwork has been completed and the action will delay the acceptance of the review.
The PDL requires oversight or a pre-issuance review but the technical reviewer has already submitted the review for RAB consideration.	Consider deferring acceptance of the review until oversight procedures can be performed. If oversight is not performed, consider a full technical review of all working papers related to the peer review. Based on the circumstances, the firm may be contacted to discuss the situation.
The PDL requires oversight or a pre-issuance review and the review has already been accepted but the acceptance letter has not been sent.	Consider delaying sending the acceptance letter until oversight or a full technical review of all working papers can be performed. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of the results. Based on the circumstances, the firm may be contacted to discuss the situation.
The PDL requires oversight or a pre-issuance review but the review has already been accepted, the acceptance letter has been sent, and the working papers are within the document-retention period.	Consider oversight or a full technical review of all working papers related to the peer review. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of the results.
The PDL requires oversight or a pre-issuance review and the review has already been accepted and the acceptance letter has been sent, but the working papers are not within the document-retention period.	Contact AICPA staff to discuss the impact on reviews performed by the reviewer.

Considerations When a Reviewer Is Removed From the List of Qualified Reviewers (Ref: par. .17)

.A17

<i>Considerations When a Reviewer Is Removed From the List of Qualified Reviewers</i>	
Situation	Action
The review has not commenced.	If the reviewer fails to contact the reviewed firm to withdraw from the review within five business days of being notified of removal, the AE may contact the firm to inform it that the reviewer will not be able to perform the firm's review. Only the reviewer is authorized to provide details or explanation of the reasons why the reviewer is unable to perform the review.
The review has commenced but fieldwork is not complete.	The reviewer is not eligible to complete the review. The firm needs to reschedule the review.
Fieldwork is complete but the technical reviewer has not submitted the review for RAB consideration.	Consider whether any oversight procedures should be performed. If oversight is not performed, consider a full technical review of all working papers related to the peer review. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The technical reviewer has submitted the review for RAB consideration.	Consider deferring acceptance of the review until oversight procedures can be performed. If oversight is not performed, consider a full technical review of all working papers related to the peer review. Based on the circumstances, the firm may be contacted to discuss the situation. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The review has been accepted but the acceptance letter has not been sent.	Consider delaying sending the acceptance letter until oversight or a full technical review of all working papers can be performed. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of the results. Based on the circumstances, the firm may be contacted to discuss the situation. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The review has been accepted, the acceptance letter has been sent, and the working papers are within the document-retention period.	Consider oversight or a full technical review of all working papers related to the peer review. Based on the results of any procedures, consider contacting AICPA staff (who may consult legal counsel) regarding the impact of the results. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The review has been accepted and the acceptance letter has been sent, but the working papers are not within the document-retention period.	Contact AICPA staff (who may contact legal counsel) to discuss the impact on reviews performed by the reviewer.

Performing in a Timely and Professional Manner (Ref: par. .18–.19)

.A18 The AE or AICPA staff may refer the reviewer to the board for national suspension. The technical director of the program (or designee) will determine if it is appropriate to form a hearing panel to consider the suspension.

.A19 A reviewer may appeal a suspension; however, the appeal does not lift nor delay the suspension. If the reviewer appeals a suspension, the technical director of the program (or designee) will determine if it is appropriate to form a hearing panel to consider the suspension appeal.

Reviewer Qualifications (Ref: par. .20–.21)

.A20 When it comes to the attention of AICPA staff that a reviewer may not meet all qualifications required by the standards, staff will contact the reviewer to validate the qualifications that the reviewer may no longer possess. The reviewer is expected to respond to such communication within the requested time and may be able to continue to schedule and perform reviews if the reviewer can provide proof of meeting the qualifications and in certain other situations. Situations in which it may be determined that the reviewer should still be eligible to schedule and perform reviews include, but are not limited to, the following:

- a. The reviewer's firm has not had its most recent peer review completed by the due date; however, the peer review working papers have been submitted and the peer review is scheduled to be presented for acceptance.
- b. An engagement within the reviewer's firm's peer review has been selected for oversight.
- c. The firm's records or offices have been severely damaged or destroyed because of a natural disaster or catastrophe.
- d. The firm was granted an extension so a major engagement can be completed and be subject to review.
- e. The firm was granted an extension to complete an initial engagement where there is no comparable engagement to review (such as a new must-select engagement).

.A21 If AICPA staff confirm the individual does not currently possess all reviewer qualifications, the individual is notified that the individual is prohibited from scheduling or performing reviews nationally. The individual remains ineligible until either

- a. AICPA staff or the board approves documented evidence that the reviewer possesses all the qualifications required of a reviewer or
- b. the reviewer appeals the ineligibility letter and a hearing panel determines that the reviewer possesses all reviewer qualifications.

.A22 Once AICPA staff receive evidence of compliance with reviewer qualifications, staff will

- a. approve reinstatement for certain ineligibility reasons or
- b. send evidence to three board members requesting approval to allow the reviewer to continue performing reviews.

.A23 AICPA staff may approve reinstatement if evidence is received that the following ineligibility reasons have been rectified:

- a. The reviewer's AICPA membership had lapsed or was suspended.

- b. The reviewer's firm's peer review was not accepted within the last three years and six months.
- c. The reviewer's firm's most recently accepted peer review resulted in a report rating of *pass with deficiencies* or *fail*.

Considerations When a Reviewer Is Ineligible to Schedule or Perform Reviews (Ref: par. .22)

.A24

Considerations When a Reviewer Is Deemed Ineligible to Schedule or Perform Reviews	
Situation	Action
The review has not commenced.	The reviewer is not eligible to perform the review. If the reviewer fails to contact the reviewed firm to reschedule or withdraw from the review, the AE may contact the firm to inform the firm that the reviewer will not be able to perform the firm's review. For instance, if a reviewer is notified that the reviewer is not qualified to schedule or perform peer reviews on May 1 and a review scheduled to commence on May 15 is not rescheduled by May 7, the AE may inform the firm that "its reviewer cannot perform the review at this time, and if further information is required, please contact your peer reviewer." Only the reviewer is authorized to provide details or explanation of the reasons why the reviewer is unable to perform the review.
The reviewer commenced the review after being deemed ineligible.	The reviewer is referred to the board for removal from the list of qualified reviewers (see paragraphs .20–.24).
The review has commenced but fieldwork is not complete.	Consider whether the remaining fieldwork needs to be performed by an eligible reviewer or whether any oversight procedures need to be performed.
Fieldwork is complete but the technical reviewer has not submitted the review for RAB consideration.	Consider whether any oversight procedures need to be performed. If oversight is not performed, consider a full technical review of all working papers related to the peer review. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The technical reviewer has submitted the review for RAB consideration.	Consider deferring acceptance of the review to perform oversight or a full technical review of all working papers. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of results. Based on the circumstances, the firm may be contacted to discuss the situation. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.

(continued)

<i>Considerations When a Reviewer Is Deemed Ineligible to Schedule or Perform Reviews</i>	
<u>Situation</u>	<u>Action</u>
The review has been accepted but the acceptance letter has not been sent.	Consider delaying sending the acceptance letter to perform oversight or a full technical review of all working papers. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of results. Consider contacting the firm to discuss the situation. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The review has been accepted, the acceptance letter has been sent, and the working papers are within the document-retention period.	Consider performing oversight or a full technical review of all working papers. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of results. Do not destroy the working papers until all procedures have been performed and a resolution has been reached. Based on the circumstances, the firm may be contacted to discuss the situation.
The review has been accepted and the acceptance letter has been sent, but the working papers are not within the document-retention period.	Contact AICPA staff to discuss the impact the missing qualifications may have on reviews performed by the reviewer.
A reviewer is suspended for failing to verify resume information.	Consider performing oversight procedures on reviews that have been submitted to the AE. For reviews that have been accepted within the document-retention period, consider performing oversight. Discuss the results with the reviewer if the results of the oversight indicate that the reviewer had performance issues. If the reviewer is unable to justify the reviewer's conclusions by citing professional standards, this may indicate reviewer performance deficiencies or findings. If there is concern about the reviewer's performance, contact AICPA staff to discuss the situation. Consider contacting the firm to discuss the situation.

Allegations or Investigations (Ref: par. .23)

.A25 Allegations or investigations do not automatically mean a reviewer is ineligible to perform reviews; however, there may be situations in which the AE or RAB conclude that the nature, significance, or pervasiveness of the alleged deficiencies or an already-existing preponderance of evidence necessitate immediate action to overcome any concerns.

Limitations or Restrictions (Ref: par. .24–.25)

.A26 Reviewers and firms may be subject to limitations or restrictions by a regulatory body that affect their ability to practice or perform peer reviews. Examples include

- a.* constraint of scope or volume of accounting and auditing engagements,
- b.* required periodic reporting to the regulatory body,
- c.* pre-issuance reviews of engagements, or
- d.* additional peer review or professional education requirements.

.A27 If a limitation is placed on a reviewer or reviewer's firm that limits the reviewer's ability to practice public accounting, the board will evaluate whether the reviewer is qualified to perform peer reviews or should be restricted from reviewing specific industries or engagements. The evaluation will include the status of any reviews that the reviewer and firm are or were associated with since the date of the notification by a government or regulatory authority.

.A28 Because reviews performed by a reviewer may be in different stages of completion when AICPA staff receive notification or knowledge of a limitation or restriction on a reviewer or reviewing firm, the board will consider various factors in determining if any reviews need to be

- a.* rescheduled,
- b.* subject to oversight or other additional procedures, or
- c.* if a new review should be performed.

.A29 Factors that the board will consider include, but are not limited to, the following:

- a.* The type of peer review and the role of the peer reviewer for each preceding review
- b.* The date of notification to the reviewer and reviewing firm by a government or regulatory authority of the limitation or restriction in comparison with the date of notification from the reviewer and firm to the AICPA staff
- c.* Whether the reviewer and firm appropriately and timely notified AICPA staff of the limitation or restriction
- d.* Whether the reviewer and firm scheduled reviews without notifying AICPA staff of such limitations or restrictions
- e.* Whether the limitation or restriction is related to a particular type of service (tax versus audit and attest or audits, reviews, or compilations); industry oversight; regulatory oversight, such as engagements falling under the purview of a particular regulator; or state board of accountancy oversight
- f.* Whether the limitation or restriction is permanent or indefinite in duration (that is, the reviewing firm is restricted from performing audits until the firm complies with some requirement, but the firm has chosen to no longer perform audits, so the limitation or restriction will always be there)
- g.* Whether the limitation or restriction is temporary
- h.* The history of qualification, performance, and noncooperation matters and any other information relevant to these matters

- i. Any documents that describe violations of professional standards as well as the reviewer's peer review history

.A30

<i>Considerations When a Reviewer or Reviewer’s Firm Becomes Restricted or Limited</i>	
<u>Situation</u>	<u>Action</u>
The review has not commenced — Total restriction	The reviewer is not eligible to perform the review because of the total restriction. If the reviewer fails to contact the reviewed firm to withdraw from the review, the AE may contact the firm to inform the firm that the reviewer will not be able to perform the firm's review. Only the reviewer is authorized to provide details or explanation of the reasons why the reviewer is unable to perform the review.
The review has not commenced — Limited restriction	Ensure the review team is reconfigured to comply with the limited restriction, if applicable. For example, if a reviewer's limited restriction is that the reviewer is restricted from reviewing employee benefit plans, a team member with appropriate qualifications may be added to review that engagement, if applicable.
The review has commenced but fieldwork is not complete.	Consider whether any oversight procedures should be performed. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
Fieldwork is complete but the technical reviewer has not submitted the review for RAB consideration.	Consider deferring acceptance of the review until oversight procedures can be performed. If oversight is not performed, consider a full technical review of all working papers related to the peer review. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The technical reviewer has submitted the review for RAB consideration.	Consider whether oversight procedures need to be performed. If oversight is not performed, consider a full technical review of all working papers related to the peer review. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of the results. Based on the circumstances, the firm may be contacted to discuss the situation. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.

<i>Considerations When a Reviewer or Reviewer's Firm Becomes Restricted or Limited</i>	
Situation	Action
The review has been accepted but the acceptance letter has not been sent.	Consider delaying sending the acceptance letter until oversight or a full technical review of all working papers can be performed. Based on the results of any procedures, consider contacting AICPA staff (who may consult legal counsel) to discuss the impact of the results. Based on the circumstances, the firm may be contacted to discuss the situation. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The review has been accepted, the acceptance letter has been sent, and the working papers are within the document-retention period.	Consider oversight or a full technical review of all working papers related to the peer review. Based on the results of any procedures, consider contacting AICPA staff to discuss the impact of the results. Do not destroy the working papers until all procedures have been performed and a resolution has been reached.
The review has been accepted and the acceptance letter has been sent, but the working papers are not within the document-retention period.	Contact AICPA staff to discuss the impact the limitation or restriction may have on reviews performed by the reviewer.

Reviewers That Consider Withdrawing From a Peer Review After the Commencement of the Review (Ref: par. .26)

.A31 Reasons a reviewer may withdraw from the peer review include, but are not limited to,

- a. poor health,
- b. not receiving the required documents from the reviewed firm within a reasonable time frame (or other lack of cooperation),
- c. personality conflicts with the reviewed firm that cannot be overcome,
- d. not meeting the requirements to be a peer reviewer after the field-work on a peer review has commenced.

.A32 Withdrawing may lead to some issues that will need to be resolved solely by the peer reviewer and firm. Other issues (based on the validity and types of reasons) may relate to firm noncooperation or reviewer performance. Appropriate actions include, but are not limited to, the following:

- a. Evaluating reviewer performance in accordance with paragraphs .05–.17 and acting accordingly, if applicable
- b. Evaluating reviewer cooperation with paragraphs .28–.38 of section 200 and acting accordingly, if applicable

- c. Evaluating the firm's compliance with paragraphs .12–.17 of section 300, *General Principles and Responsibilities for Reviewed Firms*, and acting according to appendix A, "Failure to Cooperate or Comply With the Requirements of the Program Referral Responsibilities," of section 400, if applicable
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TS Section
TAX SERVICES

STATEMENTS ON
STANDARDS FOR TAX SERVICES

The Statements on Standards for Tax Services (SSTSs) and interpretations, promulgated by the Tax Executive Committee, reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The statements are intended to be part of an ongoing process that may require changes to and interpretations of current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. *Interpretation No. 1-2* was approved by the Tax Executive Committee on August 21, 2003; its effective date is December 31, 2003.

The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to meet a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain items undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards* (ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

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Preface

Standards are the foundation of a profession. The AICPA aids its members in fulfilling their ethical responsibilities by instituting and maintaining standards against which their professional performance can be measured. Compliance with professional standards of tax practice also reaffirms the public's awareness of the professionalism that is associated with CPAs as well as the AICPA.

This publication sets forth enforceable tax practice standards for members of the AICPA, Statements on Standards for Tax Services (SSTSs or statements) (sections 100–700). These statements apply to all members providing tax services regardless of the jurisdictions in which they practice. Interpretations of these statements may be issued as guidance to assist in understanding and applying the statements. The SSTSs and their interpretations are intended to complement other standards of tax practice, such as Treasury Department Circular No. 230, *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service*; penalty provisions of the Internal Revenue Code; and state boards of accountancy rules.

The SSTSs are written in as simple and objective a manner as possible. However, by their nature, practice standards provide for an appropriate range of behavior and need to be interpreted to address a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain terms undefined. These terms are generally rooted in tax concepts and, therefore, should be readily understood by tax practitioners. Accordingly, enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards* (ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), will be undertaken on a case-by-case basis. Members are expected to comply with them.

History

The SSTSs have their origin in the Statements on Responsibilities in Tax Practice (SRTPs), which provided a body of advisory opinions on good tax practice. The guidelines as originally set forth in the SRTPs became more important than many members had anticipated when the guidelines were issued. The courts, the IRS, state accountancy boards, and other professional organizations recognized and relied on the SRTPs as the appropriate articulation of professional conduct in a CPA's tax practice. The SRTPs became *de facto* enforceable standards of professional practice, because state disciplinary organizations and courts regularly held CPAs accountable for failure to follow the guidelines set forth in the SRTPs.

The AICPA's Tax Executive Committee concluded it was appropriate to issue tax practice standards that would become a part of the AICPA's *Professional Standards*. At its July 1999 meeting, the AICPA Board of Directors approved support of the executive committee's initiative and placed the matter on the agenda of the October 1999 meeting of the AICPA's governing Council. On October 19, 1999, Council approved designating the Tax Executive Committee as a standard-setting body, thus authorizing that committee to promulgate standards of tax practice. As a result, the original SSTSs, largely mirroring the SRTPs, were issued in August 2000.

The SRTPs were originally issued between 1964 and 1977. The first nine SRTPs and the introduction were promulgated in 1976; the tenth SRTP was issued in 1977. The original SRTPs concerning the CPA's responsibility to sign

the tax return (SRTP No. 1, *Signature of Preparers*, and No. 2, *Signature of Reviewer: Assumption of Preparer's Responsibility*) were withdrawn in 1982 after Treasury Department regulations were issued adopting substantially the same standards for all tax return preparers. The sixth and seventh SRTPs, concerning the responsibility of a CPA who becomes aware of an error, were revised in 1991. The first interpretation of the SRTPs, Interpretation No. 1-1, "Realistic Possibility Standard," was approved in December 1990. The SSTSs and Interpretation No. 1-1, "Realistic Possibility Standard," of SSTS No. 1, *Tax Return Positions* (sec. 100), superseded and replaced the SRTPs and their Interpretation No. 1-1, effective October 31, 2000. Although the number and names of the SSTSs, and the substance of the rules contained in each of them, remained the same as in the SRTPs, the language was revised to both clarify and reflect the enforceable nature of the SSTSs. In addition, because the applicability of these standards is not limited to federal income tax practice (as was the case with the SRTPs), the language was changed to indicate the broader scope. In 2003, in connection with the tax shelter debate, SSTS Interpretation No. 1-2, "Tax Planning," of SSTS No. 1 (sec. 100) was issued to clarify a member's responsibilities in connection with tax planning; that interpretation became effective December 31, 2003.

When the original SSTSs were issued, an effort was made to keep to a minimum any changes in the language of the SSTSs from that of the predecessor SRTPs. This was done to alleviate concerns regarding the enforceability of standards that differed from the SRTPs under which members had been practicing. Since the issuance of the original SSTSs, members have asked for clarification on certain matters, such as the duplication of the language in SSTS No. 6, *Knowledge of Error: Return Preparation*, and No. 7, *Knowledge of Error: Administrative Proceedings*. Also, certain changes in federal and state tax laws have raised concerns regarding the need to revise SSTS No. 1 (sec. 100). As a result, in 2008, the original SSTS Nos. 1–8 (sections 100–800) were updated, effective January 1, 2010. The original SSTS Nos. 6–7 were combined into the revised SSTS No. 6, *Knowledge of Error: Return Preparation and Administrative Proceedings* (sec. 600). The original SSTS No. 8, *Form and Content of Advice to Taxpayers*, was renumbered SSTS No. 7 (sec. 700). In addition, various revisions were made to the language of the original SSTSs.

Ongoing Process

The following SSTSs and any interpretations issued thereunder reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The statements are intended to be part of an ongoing process of articulating standards of tax practice for members. These standards are subject to change as necessary or appropriate to address changes in the tax law or other developments in the tax practice environment.

Members are encouraged to assess the adequacy of their practices and procedures for providing tax services in conformity with these standards. This process will vary according to the size of the practice and the nature of tax services performed.

The Tax Executive Committee promulgates the SSTSs and their interpretations. Acknowledgment is also due to the many members who have devoted their time and efforts over the years to developing and revising the AICPA's standards.

TS Section 100

Tax Return Positions

Source: SSTs No. 1

Effective date, unless
otherwise indicated:
January 2010

Introduction

.01 This statement sets forth the applicable standards for members when recommending tax return positions, or preparing or signing tax returns (including amended returns, claims for refund, and information returns) filed with any taxing authority. For purposes of these standards

- a. a *tax return position* is (i) a position reflected on a tax return on which a member has specifically advised a taxpayer or (ii) a position about which a member has knowledge of all material facts and, on the basis of those facts, has concluded whether the position is appropriate.
- b. a *taxpayer* is a client, a member's employer, or any other third-party recipient of tax services.

.02 This statement also addresses a member's obligation to advise a taxpayer of relevant tax return disclosure responsibilities and potential penalties.

.03 In addition to the AICPA, various taxing authorities, at the federal, state, and local levels, may impose specific reporting and disclosure standards with regard to recommending tax return positions or preparing or signing tax returns.¹ These standards can vary between taxing authorities and by type of tax.

Statement

.04 A member should determine and comply with the standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position, or preparing or signing a tax return.

.05 If the applicable taxing authority has no written standards with respect to recommending a tax return position or preparing or signing a tax return, or if its standards are lower than the standards set forth in this paragraph, the following standards will apply:

- a. A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits if challenged.

¹ A member should refer to the current version of Internal Revenue Code Section 6694, *Understatement of taxpayer's liability by tax return preparer*, and other relevant federal, state, and jurisdictional authorities to determine the reporting and disclosure standards that are applicable to preparers of tax returns.

- b. Notwithstanding paragraph .05(a), a member may *recommend a tax return position* if the member (i) concludes that there is a reasonable basis for the position and (ii) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph .05(a), a member may *prepare or sign a tax return* that reflects a position if (i) the member concludes there is a reasonable basis for the position and (ii) the position is appropriately disclosed.

.06 When recommending a tax return position or when preparing or signing a tax return on which a position is taken, a member should, when relevant, advise the taxpayer regarding potential penalty consequences of such tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.07 A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows

- a. exploits the audit selection process of a taxing authority, or
- b. serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

.08 When recommending a tax return position, a member has both the right and the responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

Explanation

.09 The AICPA and various taxing authorities impose specific reporting and disclosure standards with respect to tax return positions and preparing or signing tax returns. In a given situation, the standards, if any, imposed by the applicable taxing authority may be higher or lower than the standards set forth in paragraph .05. A member is to comply with the standards, if any, of the applicable taxing authority; if the applicable taxing authority has no standards or if its standards are lower than the standards set forth in paragraph .05, the standards set forth in paragraph .05 will apply.

.10 Our self-assessment tax system can function effectively only if taxpayers file tax returns that are true, correct, and complete. A tax return is prepared based on a taxpayer's representation of facts, and the taxpayer has the final responsibility for positions taken on the return. The standards that apply to a taxpayer may differ from those that apply to a member.

.11 In addition to a duty to the taxpayer, a member has a duty to the tax system. However, it is well established that the taxpayer has no obligation to pay more taxes than are legally owed, and a member has a duty to the taxpayer to assist in achieving that result. The standards contained in paragraphs .04–.08 recognize a member's responsibilities to both the taxpayer and the tax system.

.12 In reaching a conclusion concerning whether a given standard in paragraph .04 has been satisfied, a member may consider a well-reasoned construction of the applicable statute, well-reasoned articles or treatises, or pronouncements issued by the applicable taxing authority, regardless of whether such sources would be treated as *authority* under Internal Revenue Code Section 6662, *Imposition of accuracy-related penalty on underpayments*, and the regulations thereunder. A position would not fail to meet these standards merely because it is later abandoned for practical or procedural considerations during an administrative hearing or in the litigation process.

.13 If a member has a good-faith belief that more than one tax return position meets the standards set forth in paragraphs .04–.05, a member's advice concerning alternative acceptable positions may include a discussion of

the likelihood that each such position might or might not cause the taxpayer's tax return to be examined and whether the position would be challenged in an examination. In such circumstances, such advice is not a violation of paragraph .07.

.14 A member's determination of whether information is appropriately disclosed by the taxpayer should be based on the facts and circumstances of the particular case and the disclosure requirements of the applicable taxing authority. If a member recommending a position, but not engaged to prepare or sign the related tax return, advises the taxpayer concerning appropriate disclosure of the position, then the member shall be deemed to meet the disclosure requirements of these standards.

.15 If particular facts and circumstances lead a member to believe that a taxpayer penalty might be asserted, the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, to avoid such penalty by disclosing the position on the tax return. Although a member should advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

.16 For purposes of this statement, preparation of a tax return includes giving advice on events that have occurred at the time the advice is given if the advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a tax return.

TS Section 9100

Tax Return Positions: Tax Services Interpretations of Section 100

Notice to Readers

The Statements on Standards for Tax Services (SSTSs) and interpretations, promulgated by the AICPA Tax Executive Committee (TEC), reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The SSTSs are intended to be part of an ongoing process that may require changes to, and interpretations of, current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. The original Interpretations No. 1-1, "Realistic Possibility of Success," and No. 1-2, "Tax Planning," were adopted in 2000 and 2003, respectively, and updated in 2010. The TEC adopted the updated Interpretations No. 1-1, "Reporting and Disclosure Standards," and No. 1-2, "Tax Planning," on August 15, 2011, effective on January 31, 2012.¹

The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to satisfy a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts and, therefore, they should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA Code of Professional Conduct, Rule 201, *General Standards* (ET sec. 201 par. .01), and Rule 202, *Compliance With Standards* (ET sec. 202 par. .01), will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

Preface

SSTS No. 1, *Tax Return Positions* (sec. 100), provides that a member should not recommend a tax return position or take a position on a tax return that the member prepares unless that position satisfies applicable reporting and disclosure standards. The tax laws of various taxing jurisdictions contain similar limitations on the ability to recommend or take certain tax return positions. This preface provides an overview of the most common tax return reporting

¹ These interpretations do not consider any impact of Section 1409 of the Health Care and Education Reconciliation Act of 2010, P.L. 111-152 (Codification of Economic Substance Doctrine and Penalties). Under Section 7701(o) of the Internal Revenue Code (IRC), in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into such transaction. Understatements of tax attributable to a failure to satisfy the economic substance doctrine, where relevant, can result in substantial taxpayer penalties.

standards and issues to be considered in determining if the applicable reporting standards and disclosure requirements have been satisfied.

Description of Various Reporting Standards

A brief description of the most common tax return reporting standards follows.²

More likely than not. The more likely than not standard generally is satisfied if it is reasonable to conclude in good faith that there is a greater than 50 percent likelihood that the position will be upheld on its merits if it is challenged.³

Substantial authority. The substantial authority standard is an objective standard and is satisfied if the weight of the authorities supporting the position is substantial in relation to the weight of authorities supporting a contrary treatment.⁴ In practice, the substantial authority standard generally is interpreted as requiring approximately a 40 percent likelihood that the position will be upheld on its merits if it is challenged.⁵

Realistic possibility of success. The realistic possibility of success standard generally is satisfied if there is approximately a 1-in-3 (33 percent) likelihood that the position will be upheld on its merits if it is challenged.⁶

Reasonable basis. The reasonable basis standard is satisfied if the position is reasonably based on one or more authorities, taking into account the relevance and persuasiveness of those authorities. The reasonable basis standard is lower than the realistic possibility of success standard but is "significantly higher than not frivolous or not patently improper . . . [and] is not satisfied by a return position that is merely arguable or that is merely a colorable claim."⁷ In practice, the reasonable basis standard generally is interpreted as requiring that there be approximately a 20 percent likelihood that the position will be upheld on its merits if it is challenged.⁸

Nature of the Analysis

The analysis used in determining if a reporting standard has been satisfied should involve a well-reasoned application of the relevant authorities to all pertinent facts and circumstances. The weight to be given to a particular authority depends on its relevance and persuasiveness. For example, all else being

² In some cases, the taxing authority may require that more than one standard be satisfied with respect to a return position. For example, in the case of a listed transaction or other reportable transaction with a significant tax avoidance purpose, a taxpayer penalty may apply under IRC Section 6662A unless the taxpayer reasonably believed the position satisfied the more likely than not standard, and the position does or did, in fact, satisfy the substantial authority standard.

³ Treasury Regulation Section 1.6662-4(g)(4).

⁴ Treasury Regulation Section 1.6662-4(d).

⁵ Joint Committee on Taxation, *Study of Present-Law Penalty and Interest Provisions as Required by Section 3801 of the Internal Revenue Service Restructuring And Reform Act of 1998 (Including Provisions Relating to Corporate Tax Shelters)* (JCS-3-99) (July 22, 1999), 1:152.

⁶ Treasury Regulation Section 1.6694-2(b) (prior to the revisions made by T.D. 9436, which became effective December 22, 2008).

⁷ Treasury Regulation Section 1.6662-3(b)(3).

⁸ Joint Committee on Taxation, *supra* at 152, assigns a 20 percent likelihood of success for the reasonable basis standard.

equal, more weight is given to a case or ruling that has facts similar to those at issue than to a case or ruling that has distinguishable facts. Similarly, more weight may be given to a case or ruling that provides an analysis of the facts and law, as opposed to one that merely states a conclusion. Assuming the same or similar issues, the type of authority also is significant; for example, more weight is given to a case or revenue ruling than to a private letter ruling issued to a third party, and more weight is given to an appellate court decision than to a lower court decision. For additional examples, see Treasury Regulation Section 1.6662-4(d)(3), which deals with the analysis used to determine if the substantial authority standard is satisfied for purposes of the federal taxpayer substantial understatement penalty.⁹

Note also that what constitutes an "authority" for purposes of the analysis can vary. For example, in determining if the realistic possibility of success standard and the reasonable basis standard of paragraph 5 of SSTS No. 1 have been satisfied, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of analysis commonly used by tax advisers and return preparers. In contrast, these authorities cannot be relied upon in determining if the substantial authority or more likely than not standards have been satisfied for purposes of Internal Revenue Code (IRC) Section 6662 (or 6694).

Appropriate Disclosure

In some instances, a member can satisfy the reporting and disclosure requirements of the applicable taxing authority or of SSTS No. 1 only if the particular tax position at issue is appropriately disclosed. The laws and regulations of the applicable taxing authority should be followed to ensure that pertinent disclosure provisions are satisfied. A member should consider all the facts and circumstances in evaluating whether a position is appropriately disclosed. SSTS No. 1 notes that, in the case of a nonsigning preparer, the adequate disclosure requirement is satisfied if the member advises the taxpayer regarding appropriate disclosure.

For purposes of the federal tax return preparer penalty provisions of IRC Section 6694(a), in general, a signing preparer satisfies the disclosure requirement if one of the following actions is taken:

1. The position is disclosed on Form 8275, "Disclosure Statement," or Form 8275-R, "Regulation Disclosure Statement," as appropriate, or in accordance with the requirements set forth in the annual revenue procedure regarding disclosure.
2. The preparer provides the taxpayer with a return that includes the appropriate disclosure.

Similarly, a nonsigning preparer who provides advice to a taxpayer satisfies the disclosure requirement for IRC Section 6694 purposes by (1) advising the taxpayer of any opportunity to avoid accuracy-related penalties that could apply with respect to the position and of the requirements for any applicable disclosure, and (2) contemporaneously documenting that advice in the files.¹⁰

⁹ Treasury Regulation Section 1.6694-2(b) incorporates this analysis in applying preparer standards for federal income tax purposes.

¹⁰ Treasury Regulation Section 1.6694-2(d)(3).

Interpretation No. 1-1, "Reporting and Disclosure Standards," of Statement on Standards for Tax Services No. 1, *Tax Return Positions*

Background

.01 SSTS No. 1 contains the standards a member should follow when recommending tax return positions or preparing or signing tax returns.

.02 A member should determine and comply with the reporting and disclosure standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position or preparing or signing a tax return.

If the applicable taxing authority has no written standards that apply with respect to recommending a tax return position or preparing or signing a tax return or if its standards are lower than the standards set forth in this paragraph, the following standards will apply:

- a. A member should not recommend a tax return position or prepare or sign a tax return taking a position unless the member has a good-faith belief that the position has at least a realistic possibility of being sustained administratively or judicially on its merits, if challenged (commonly referred to as the *realistic possibility of success* standard).
- b. Notwithstanding paragraph .02a, a member may *recommend a tax return position* if the member (i) concludes that there is a reasonable basis for the position, and (ii) advises the taxpayer to appropriately disclose that position. Notwithstanding paragraph .02a, a member may *prepare or sign a tax return* that reflects a position if (i) the member concludes there is a reasonable basis for the position, and (ii) the position is appropriately disclosed.

.03 Federal, state, local, and other taxing authorities may impose specific reporting and disclosure standards with respect to recommending tax return positions or preparing or signing tax returns that apply in addition to the AICPA standards. These standards vary among taxing jurisdictions and by type of tax. A member should refer to the current version of IRC Section 6694, "Understatement of Taxpayer's Liability by Tax Return Preparer," and the regulations thereunder to determine the reporting and disclosure standards applicable to preparers of federal tax returns.

.04 When recommending a tax return position, or when preparing or signing a tax return on which a position is taken, a member should, when relevant, advise the taxpayer regarding the potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.05 A member should not recommend a tax return position or prepare or sign a tax return reflecting a position that the member knows exploits the audit selection process of a taxing authority or serves as a mere arguing position advanced solely to obtain leverage in a negotiation with a taxing authority.

.06 When recommending a tax return position, a member has both the right and the responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

.07 A member also should consider SSTS No. 3, *Certain Procedural Aspects of Preparing Returns* (sec. 300), regarding the obligation to examine or verify certain supporting data or consider information related to another taxpayer, when preparing a taxpayer's tax return.

General Interpretation

.08 As described in the preface, the realistic possibility of success standard is a lower standard than the substantial authority standard and the more likely than not standard, but it is a higher standard than the reasonable basis standard. Therefore, if the standard of the applicable taxing authority is, for example, substantial authority, more likely than not, or some other standard that is higher than the realistic possibility of success standard, then the member should comply with that higher standard. In that case, the member is held to a standard higher than realistic possibility of success.

If the standard of the applicable taxing authority is lower than the realistic possibility of success standard, then the member should comply with the realistic possibility of success standard, which is reflected in paragraph .02a of this interpretation, or the reasonable basis standard with appropriate disclosure, which is reflected in paragraph .02b of this interpretation.

For purposes of this interpretation, the reporting and disclosure standards that apply in a given situation in accordance with SSTS No. 1 and this interpretation will be referred to as the *required reporting and disclosure standards*.

.09 A member should determine and comply with the rules of the applicable taxing authority regarding reliance on authorities (cases, rulings, regulations, treatises, and so forth). However, notwithstanding the rules of the applicable taxing authority, in determining whether a tax return position satisfies the realistic possibility of success standard or the reasonable basis standard with appropriate disclosure for purposes of paragraph .02a–b of this interpretation, a member may rely on authorities in addition to those evaluated when determining whether substantial authority exists for a return position or whether a position is more likely than not to prevail under IRC Section 6662. For purposes of paragraph .02a–b of this interpretation, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of tax analyses commonly used by tax advisers and preparers of returns. A member should exercise caution in relying on materials, such as treatises, that may not be accepted as authorities in all situations, such as under federal tax law.

.10 If particular facts and circumstances lead a member to believe that a taxpayer penalty could be asserted, then the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, to avoid such penalty by disclosing the position on the tax return. Although a member should so advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

.11 In determining if the required reporting and disclosure standards have been satisfied, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Consider applicable regulations and standards regarding reliance on information and advice received from a third party.

- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that there is a business purpose or economic substance generally is insufficient.)
- Consider whether the issue involves a listed transaction or a reportable transaction (or their equivalents) as defined by the applicable taxing authority.¹¹
- Arrive at a conclusion supported by the authorities.

.12 A member should consider the weight of each authority to determine whether the required reporting and disclosure standards have been satisfied. In determining the weight of an authority, a member should consider its source, relevance, and persuasiveness. Therefore, the type of authority is a significant factor. Other important factors include whether the facts stated by the authority are distinguishable from those of the taxpayer's situation and whether the authority contains an analysis of the issue or merely states a conclusion.

.13 A standard may be satisfied despite the absence of certain types of authority. For example, a member may conclude that the substantial authority standard has been satisfied when the position is supported only by a well-reasoned construction of the applicable statutory provision.

.14 In determining whether the required reporting and disclosure standards have been satisfied, the extent of research required is left to the professional judgment of the member, given the facts and circumstances known to the member. A member may conclude that more than one position satisfies a given reporting standard, such as the substantial authority standard.

Specific Illustrations

.15 The following illustrations address general fact patterns only. Accordingly, the application of guidance, as discussed in the previous section, "General Interpretation," to variations in such general fact patterns or to particular facts or circumstances may lead to different conclusions. In each illustration, no authority exists other than that which is indicated. A decision regarding what are the required reporting and disclosure standards for tax return positions should be consistent with the provisions of SSTS No. 1, as explained in the previous section, "Background."

Determination of the Standards

.16 *Illustration 1.* A member is preparing a U.S. income tax return at a time when the federal reporting standard is substantial authority for undisclosed positions and reasonable basis for disclosed positions.¹² One of the issues the member needs to address in preparing the return is the deductibility of a particular expenditure.

.17 *Conclusion.* The federal standard of substantial authority is higher than the realistic possibility of success standard; therefore, the member is required to comply with the federal standard of substantial authority for undisclosed positions on the return. If the member analyzes the law and applicable authorities regarding whether the expenditure is deductible and concludes that

¹¹ See, for example, Treasury Regulation Section 1.6011-4(b).

¹² See the preface for a description of the various reporting standards.

there is not substantial authority to support taking a deduction for the expenditure, the member should not prepare the return taking the deduction as an undisclosed position.

If the member concludes that there is sufficient authority to provide a reasonable basis for claiming the deduction, the member may prepare the return claiming the deduction if that position is appropriately disclosed.

.18 *Illustration 2.* A member is preparing a state inheritance tax return and needs to address the deductibility of a particular expenditure. The state does not have specific tax return reporting standards that apply.

.19 *Conclusion.* Because the applicable taxing authority (the state) does not have written tax return reporting standards that apply, the realistic possibility of success standard for an undisclosed position and the reasonable basis standard for an appropriately disclosed position apply. The member can prepare the return claiming the deduction if either of these is satisfied.

.20 *Illustration 3.* A taxpayer wants to take a position that a member has determined does not satisfy the reasonable basis standard. The taxpayer maintains that even if the taxing authority examines the return, the issue will not be raised.

.21 *Conclusion.* The member should not consider the likelihood of the issue being raised on examination when determining whether any reporting or disclosure standard has been satisfied. The member should not prepare or sign a return that contains a position that does not satisfy the reasonable basis standard, even if the position is disclosed.

.22 *Illustration 4.* A taxpayer wants to take a position on a federal tax return without disclosure; the member concludes that the position satisfies the substantial authority standard provided an assumption regarding an underlying nontax legal issue is appropriate. The member recommends that the taxpayer seek advice from its legal counsel, and the taxpayer's attorney gives an opinion on the nontax legal issue that is consistent with the assumption.

.23 *Conclusion.* A member may, in general, rely on a legal opinion on a nontax legal issue. A member should use professional judgment when relying on a legal opinion. If, on its face, the opinion of the taxpayer's attorney appears to be unreasonable, unsubstantiated, or unwarranted, the member, with appropriate consents from the taxpayer, should consult the member's attorney before relying on the opinion. A member should also refer to the illustrations in Interpretation No. 1-2, "Tax Planning," of SSTS No. 1 (sec. 9100 par. .50-.99), regarding the circumstances in which it is appropriate to rely on an opinion of legal counsel.

.24 *Illustration 5.* A taxpayer has obtained from its attorney an opinion on the tax treatment of an item and requests that a member rely on the opinion.

.25 *Conclusion.* If a member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the legal opinion, then the member may rely on that opinion when determining whether the required reporting and disclosure standards have been satisfied. The member should also refer to the illustrations in Interpretation No. 1-2 of SSTS No. 1 regarding the circumstances in which it is appropriate to rely on an opinion of legal counsel.

Application of the Taxing Authority's Standards

.26 As noted previously, SSTS No. 1 requires a member to determine and comply with the required reporting and disclosure standards, if any, that are imposed by the applicable taxing authority with respect to recommending a tax return position or preparing or signing a tax return. These standards, and the

methods in which they are to be applied, vary among taxing authorities based on the laws and regulations of the relevant jurisdictions; therefore, illustrating all specific taxing authority standards is beyond the scope of this interpretation. To assist members in their analysis of whether the standards of an applicable taxing authority have been satisfied, the preface contains a description of the most common tax return reporting standards, the nature of the analysis to be applied, and the common requirements for appropriate disclosure.

Application of the Realistic Possibility of Success and the Reasonable Basis Standards

.27 If the applicable taxing authority has no written tax return reporting or disclosure standards that apply or if its standards are lower than the realistic possibility of success standard for undisclosed positions or the reasonable basis standard for appropriately disclosed positions, SSTS No. 1 requires a member to comply with these latter standards, as stated in paragraph .02a–b of this interpretation.

The following illustrations pertain to situations in which a member is required to comply with these standards because the applicable taxing authority either has no written standards that apply or has standards that are lower than those described in paragraph .02a–b of this interpretation.

.28 Illustration 6. A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.

.29 Conclusion. The member cannot recommend the return position that is contrary to the new statute. A position contrary to a constitutional, clear, and unambiguous statute would ordinarily be considered a frivolous position and, even if appropriately disclosed, would not satisfy the reasonable basis standard.

.30 Illustration 7. The facts are the same as in illustration 6 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favorable to the taxpayer.

.31 Conclusion. In a case in which the statute is clearly and unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically addressing the taxpayer's situation, a return position based either on the statutory language or on the legislative history satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.32 Illustration 8. The facts are the same as in illustration 6 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the taxpayer's situation.

.33 Conclusion. In a case in which the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not satisfy the realistic possibility of success standard. However, because the legislative history

provides some support or evidence for the taxpayer's position, a member may recommend the position to the taxpayer if the member determines that there is a reasonable basis for the position and advises the taxpayer to appropriately disclose the position. Also, a member may prepare a return for the taxpayer taking such a position if the member determines that there is a reasonable basis for the position, and the position is appropriately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.34 Illustration 9. A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognized to contain a drafting error, and a technical correction proposal has been introduced. The taxing authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.

.35 Conclusion. A return position based on either the existing statutory language or the taxing authority's pronouncement satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.36 Illustration 10. The facts are the same as in illustration 9 except that no taxing authority pronouncement has been issued.

.37 Conclusion. In the absence of a taxing authority pronouncement interpreting the statute in accordance with the proposed technical correction, only a return position based on the existing statutory language will satisfy the realistic possibility of success standard. A member may recommend the position to the taxpayer if, based on the facts and circumstances, the member determines that a reasonable basis exists for the position and advises the taxpayer to appropriately disclose the position. Also, a member may prepare a return for the taxpayer taking such a position if, based on the facts and circumstances, the member determines that there is a reasonable basis for the position, and the position is appropriately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.38 Illustration 11. A taxpayer is seeking advice from a member regarding a recently amended statute. The member has reviewed the statute, the legislative history that specifically addresses the issue, and a recently published notice issued by the taxing authority. No cases, rulings, or other pronouncements exist regarding the statute. The member has concluded in good faith that, based on the statute and the legislative history, the taxing authority's position as stated in the notice does not reflect legislative intent.

.39 Conclusion. A return position supported by the statute and the legislative history satisfies the realistic possibility of success standard. (It also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.40 Illustration 12. The facts are the same as in illustration 11 except that the taxing authority's pronouncement is a temporary regulation.

.41 Conclusion. In determining whether a tax return position satisfies the realistic possibility of success standard, a member should determine the weight to be given the temporary regulation by analyzing factors, such as whether the

regulation is legislative or interpretative and if it is consistent with the statute. If the member concludes that the position does not satisfy the realistic possibility of success standard, the member may still recommend the position if the member determines that it satisfies the reasonable basis standard, and the member advises the taxpayer to appropriately disclose the position. The member may prepare a return for the taxpayer taking that position if the member determines that the position satisfies the reasonable basis standard, and the position is adequately disclosed. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.42 Illustration 13. A statute is passed requiring the capitalization of certain expenditures. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will have to acquire new computer hardware and software and implement a number of new accounting procedures. The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare and sign a return on which the new requirement is simply ignored.

.43 Conclusion. The return position desired by the taxpayer is frivolous, a standard below reasonable basis. The member should not prepare or sign the return.

.44 Illustration 14. The facts are the same as in illustration 13 except that the taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditures to be capitalized under the new provision.

.45 Conclusion. In this situation, assuming the taxpayer complied with the statutory and regulatory provisions classifying expenditures to be capitalized and those to be expensed and made a good-faith effort to determine the appropriate amounts to be capitalized and expensed, the realistic possibility of success standard would be satisfied for the return positions. (The substantial authority standard also may be satisfied.) When using estimates in the preparation of a return, a member should refer to SSTS No. 4, *Use of Estimates* (sec. 400). A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.46 Illustration 15. On a given issue, a member has located and weighed two authorities concerning the treatment of a particular expenditure. The taxing authority has issued an administrative ruling that requires the expenditure to be capitalized and amortized over several years. On the other hand, a court opinion permits the current deduction of the expenditure. The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.

.47 Conclusion. The realistic possibility of success standard is met by either position. (Either or both also may satisfy the substantial authority standard.) A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

.48 Illustration 16. A tax statute is silent on the treatment of an item. However, the legislative history explaining the statute directs the taxing authority to issue regulations that will require a specific treatment of the item. No regulations have been issued at the time the member must recommend a position on the tax treatment of the item.

.49 Conclusion. The position supported by the legislative history satisfies the realistic possibility of success standard. A member should, when relevant, advise the taxpayer regarding potential penalty consequences of the tax return position and the opportunity, if any, to avoid such penalties through disclosure.

Interpretation No. 1-2, "Tax Planning," of Statement on Standards for Tax Services No. 1, *Tax Return Positions*

Background

.50 SSTs are enforceable standards that govern the conduct of AICPA members in tax practice. A significant area of many members' tax practices involves assisting taxpayers in tax planning. Two of the seven SSTs issued as of the date of this interpretation's release (that is, the revised SSTs that became effective on January 1, 2010) directly set forth standards that affect the most common activities in tax planning. Several other SSTs set forth standards related to specific factual situations that may arise while a member is assisting a taxpayer in tax planning. The two SSTs that are most typically relevant to tax planning are SSTs No. 1, including Interpretation No. 1-1, "Reporting and Disclosure Standards," of SSTs No. 1 (sec. 9100 par. .01–.49), and SSTs No. 7, *Form and Content of Advice to Taxpayers* (sec. 700).

.51 Taxing authorities, courts, the AICPA, and other professional organizations have struggled with defining and regulating *tax shelters* and *abusive transactions*. Crucial to the debate is the difficulty of clearly distinguishing between transactions that are abusive and transactions that are aggressive and legitimate. At the same time, it must be recognized that taxpayers have a legitimate interest in arranging their affairs so that they pay no more than the taxes they owe. Tax professionals, including AICPA members, have a role to play in advancing these efforts.

.52 This interpretation is part of the AICPA's continuing efforts at self-regulation of its members in tax practice. It has its origins in the AICPA's desire to provide adequate guidance to its members with respect to providing services in connection with tax planning. This interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards, recognizing the compelling need for a comprehensive interpretation of a member's responsibilities in connection with *tax planning*. This guidance is intended to clarify how those standards would apply across the spectrum of tax planning, including those situations involving *tax shelters*, regardless of how that term is defined.

General Interpretation

.53 *Tax planning* encompasses a wide variety of situations. It includes situations in which the member provides advice on prospective or completed transactions, whether or not the advice reflects favorable or unfavorable treatment to the taxpayer. When providing professional services that include tax planning, a member should determine and comply with any applicable standards for reporting and disclosing tax return positions or for providing written tax advice. See SSTs No. 1 and Interpretation No. 1-1; SSTs No. 7; U.S. Treasury Department Circular 230, *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service*,¹³ and

¹³ Title 31, *Money and Finance: Treasury* of U.S. Code of Federal Regulations.

any other standards that may apply. A member may still recommend a position that does not satisfy the realistic possibility standard if (a) a reasonable basis exists for the position, (b) the member recommends appropriate disclosure, and (c) a higher standard is not required under applicable taxing authority rules. For purposes of this interpretation, the reporting and disclosure standards that apply in a given situation in accordance with SSTS No. 1 and Interpretation No. 1-1 will be referred to as the *required reporting and disclosure standards*.

.54 For purposes of this interpretation, *tax planning* includes, both with respect to prospective and completed transactions, recommending or expressing an opinion (whether written or oral) on (a) a tax return position or (b) a specific tax plan developed by the member, the taxpayer, or a third party. For tax planning with respect to a completed transaction, the member may be considered a nonsigning tax return preparer with respect to the items for which the tax planning is undertaken that subsequently are reflected on the taxpayer's tax return. The member should comply with tax return preparer standards promulgated by the applicable taxing authority.

.55 When issuing an opinion to reflect the results of the tax planning service, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Consider applicable regulations and standards regarding reliance on information and advice received from a third party.
- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that there is a business purpose or economic substance generally is insufficient.)
- Consider whether the issue involves a *listed transaction* or a *reportable transaction* (or their equivalents) as defined by the applicable taxing authority.¹⁴
- Consider other regulations and standards applicable to written tax advice promulgated by the applicable taxing authority.
- Arrive at a conclusion supported by the authorities.

The member also should consider SSTS No. 1, SSTS No. 7, Treasury Department Circular 230, and any other standards that may apply.

.56 In assisting a taxpayer in a tax planning transaction in which the taxpayer has obtained an opinion from a third party and is looking to the member for an evaluation of the opinion, the member should be satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion, which would include considering whether the opinion indicates the third party did all of the following:

- Established the relevant background facts.
- Considered the reasonableness of the assumptions and representations.
- Considered applicable regulations and standards.

¹⁴ See, for example, Treasury Regulation Section 1.6011-4(b).

- Applied the pertinent authorities to the relevant facts.
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction. (Mere reliance on a representation that a business purpose or economic substance exists generally is insufficient.)
- Considered whether the issue involves a listed transaction or a reportable transaction (or their equivalents) as defined by the applicable taxing authority.¹⁵
- Arrived at a conclusion supported by the authorities.

.57 In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of either (a) other procedures to support the advice, or (b) a representation from the taxpayer or another person. A member should also consider whether the member's tax advice might be communicated to third parties, particularly if those third parties may not be knowledgeable or may not be receiving independent tax advice with respect to a transaction.

.58 In tax planning, members often rely on assumptions and representations. Although such reliance is often necessary, the member should take care to assess whether such assumptions and representations are reasonable. In deciding whether an assumption or representation is reasonable, the member should consider its source (for example, the knowledge and expertise of the issuer), and consistency with other information known to the member. For example, depending on the circumstances, it may be reasonable for a member to rely on a representation made by the taxpayer but not on a representation made by a person who is selling, or otherwise promoting, the transaction to the taxpayer.

.59 When engaged in tax planning, the member should understand the business purpose and economic substance of the transaction when relevant to the tax consequences. If a transaction has been proposed by a party other than the taxpayer, the member should consider whether the assumptions made by the third party are consistent with the facts of the taxpayer's situation. If written advice is to be rendered concerning a transaction, the business purpose for the transaction generally should be described. If the business reasons are relevant to the tax consequences, it is not sufficient to assume merely that a transaction is entered into for valid business reasons without specifying what those reasons are. Similarly, if economic substance is relevant to the tax consequences, it is insufficient to assume merely that a transaction has economic substance without specifying the basis for making that determination. In providing written advice on these issues, the member should consider the written advice regulations and standards, if any, promulgated by the applicable taxing authority. The member also should consider SSTS No. 1, SSTS No. 7, Treasury Department Circular 230, and any other standards that may apply.

.60 The scope of the engagement should be appropriately determined, and the member should consider the necessity for an engagement letter. The member should be diligent in applying such procedures as are appropriate under the circumstances to understand and evaluate the entire transaction. The specific procedures to be performed in this regard will vary with the circumstances and the scope of the engagement.

¹⁵ See footnote 2.

Specific Illustrations

.61 The following illustrations address general fact patterns. Accordingly, the application of the guidance that is discussed in the previous section, "General Interpretation," to variations in such general fact patterns or to particular facts or circumstances, may lead to different conclusions. In each illustration, no authority exists other than that which is indicated.

.62 *Illustration 1.* The relevant tax code imposes penalties on taxpayers for substantial underpayments that are not associated with *tax shelters* as defined in such code, unless the positions resulting in the underpayments are supported by substantial authority.

.63 *Conclusion.* In assisting the taxpayer in tax planning in which any associated underpayment would be considered substantial, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration if that position does not satisfy the substantial authority standard. The member also should inform the taxpayer of the opportunities, if any, to avoid such penalties through appropriate disclosure. In such a situation, applicable standards may prohibit the member from preparing the tax return without appropriate disclosure.

.64 *Illustration 2.* The relevant tax code imposes penalties on taxpayers for underpayments attributable to *tax shelters* as defined in such code unless the taxpayer concludes that a position taken on a tax return associated with such a tax shelter is more likely than not the correct position.

.65 *Conclusion.* In assisting the taxpayer in tax planning, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration if that position satisfies the substantial authority standard but does not satisfy the more likely than not standard. This would also include advice regarding whether penalties can be avoided through disclosure by the taxpayer.¹⁶ In such a situation, applicable standards may prohibit the member from preparing the tax return without appropriate disclosure.

.66 *Illustration 3.* The relevant tax code imposes penalties on tax return preparers advising on return positions attributable to potentially abusive arrangements that are designated as listed transactions or reportable transactions with a significant purpose of avoidance or evasion of income tax, if there is a related understatement of income tax. The penalty does not apply if the preparer concludes that the position is more likely than not the correct position. The member advising the taxpayer in planning a transaction is later retained to prepare and sign the taxpayer's income tax return for the period that includes the taxpayer's participation in the transaction.

.67 *Conclusion.* A member engaged to prepare a return reflecting a transaction that the member assisted in planning should reevaluate the need to satisfy the more likely than not standard to avoid penalties (including potential sanction or discipline) as a preparer and whether potential penalties may be avoided through appropriate disclosure. The member also should consider whether a separate disclosure is required to avoid penalties under other statutory provisions (in addition to penalties applicable to understatement of tax). The member should inform the taxpayer of the taxpayer's penalty risks, as described in illustrations 1 and 2 of this interpretation. The member also should consider SSTS No. 1 and Interpretation No. 1-1.

¹⁶ The IRC Section 6662 substantial understatement penalty cannot be avoided by disclosure in the context of a tax shelter.

.68 Illustration 4. The relevant tax regulation provides that the details of (or certain information regarding) a specific transaction are required to be attached to the tax return, regardless of the level of authority supporting the associated tax return position (for example, even if there is substantial authority or a higher level of confidence for the position). While preparing the taxpayer's return for the year, the member is aware that an attachment is required.

.69 Conclusion. In general, if the taxpayer agrees to include the attachment required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the required reporting and disclosure standards. However, if the taxpayer refuses to include the attachment, the member should not sign the return unless the member concludes the associated tax return position satisfies the required reporting and disclosure standards, and reasonable grounds exist for the taxpayer's position with respect to the attachment. In this regard, the member should consider SSTS No. 2, *Answers to Questions on Returns* (sec. 200), which provides that the term *questions*, as used in the standard, "includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question," and that a "member should not omit an answer merely because it might prove disadvantageous to a taxpayer." The member also should consider SSTS No. 1 and Interpretation No. 1-1.

.70 Illustration 5. The relevant tax regulations provide that the details of certain potentially abusive transactions that are designated as listed transactions are required to be disclosed in attachments to tax returns (enhanced disclosure), regardless of the support for the associated tax return position (for example, even if the applicable taxing authority's standard is satisfied). Under the regulations, if the enhanced disclosure requirements for a listed transaction are not satisfied, the taxpayer will have additional penalty risks, including the possibility of a nonrescindable penalty. While researching the tax consequences of a proposed transaction, a member concludes that the transaction is a listed transaction.

.71 Conclusion. Notwithstanding the member's conclusion that the transaction is a listed transaction, the member may still recommend a tax return position with respect to the transaction if he or she concludes that the position satisfies the required reporting and disclosure standards (other than the enhanced disclosure). However, the member should inform the taxpayer of the enhanced disclosure requirements of listed transactions and the additional penalty risks for noncompliance, including the potential for enhanced or nonrescindable penalties or both.

.72 Illustration 6. The same regulations apply as in illustration 5. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that the taxpayer's transaction is a listed transaction.

.73 Conclusion. The member should inform the taxpayer of the enhanced disclosure requirements and the additional penalty risks for noncompliance. If the taxpayer agrees to make the enhanced disclosure required by the regulation, the member may sign the return if the member concludes the associated tax return position also satisfies the required reporting and disclosure standards. The member should not sign the return if the enhanced disclosure requirements are not satisfied. If the member is a nonsigning preparer of the return, the member should recommend that the taxpayer comply with the enhanced disclosure requirements regarding the transaction.

.74 Illustration 7. The same regulations apply as in illustration 5. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that there is uncertainty about whether the taxpayer's transaction is a listed transaction.

.75 Conclusion. The member should inform the taxpayer of the enhanced disclosure requirements and the additional penalty risks for noncompliance. If the taxpayer agrees to make the enhanced disclosure required by the relevant regulations, the member may sign the return if the member concludes the associated tax return position also satisfies the required reporting and disclosure standards. If the taxpayer does not want to provide the enhanced disclosure of the transaction because of the uncertainty about whether it is a listed transaction, the member may sign the return if the member concludes the associated tax return position satisfies the required reporting and disclosure standards (other than the enhanced disclosure requirements), and reasonable grounds exist for the taxpayer's position with regard to not providing enhanced disclosure of the transaction. In this regard, the member should consider SSTS No. 2, which indicates that the degree of uncertainty regarding the meaning of a question on a return may affect whether reasonable grounds exist for not responding to the question.

.76 Illustration 8. A member advises a taxpayer concerning the tax consequences of a proposed transaction involving a loan from a U.S. bank. In the process of reviewing documents associated with the proposed transaction, the member uncovers a reference to a deposit the taxpayer will make with an overseas branch of the U.S. bank. The transaction documents appear to indicate that this deposit is linked to the U.S. bank's issuance of the loan.

.77 Conclusion. The member should consider the effect, if any, of the deposit in advising the taxpayer about the tax consequences of the proposed transaction and with respect to other tax compliance matters reasonably likely to be at issue (for example, foreign bank account reporting).

.78 Illustration 9. Under the relevant tax law, the tax consequences of a leasing transaction depend on whether the property to be leased is reasonably expected to have a residual value of 15 percent of its value at the beginning of the lease. The member has relied on a taxpayer's instruction to use a particular assumption concerning the residual value.

.79 Conclusion. Such reliance on the taxpayer's instructions may be appropriate if the assumption is supported by the expertise of the taxpayer, by the member's review of information provided by the taxpayer or a third party, or through the member's own knowledge or analysis.

.80 Illustration 10. A member is assisting a taxpayer with evaluating a proposed equipment leasing transaction in which the estimated residual value of the equipment at the end of the lease term is critical to the tax consequences of the lease. The broker arranging the leasing transaction has prepared an analysis that sets out an explicit assumption concerning the equipment's estimated residual value.

.81 Conclusion. The member should consider whether it is appropriate to rely on the broker's assumption concerning the estimated residual value of the equipment instead of obtaining a representation from the broker concerning estimated residual value or performing other procedures to validate the amount to be used as an estimate of residual value in connection with the member's advice. In evaluating the appropriateness of the broker's assumption, the member should consider, for example, factors such as the broker's experience in the area,

the broker's methodology, and whether alternative sources of information are reasonably available.

.82 Illustration 11. The tax consequences of a particular reorganization depend, in part, on the majority shareholder of a corporation not disposing of stock received in the reorganization in a manner that would prevent the transaction from qualifying as a reorganization.

.83 Conclusion. The member should consider whether it is appropriate in rendering tax advice to assume that such a disposition will not occur or whether, under the circumstances, it is appropriate to request written representations regarding the intent of the shareholder and any other parties to the reorganization concerning this requirement, as a condition to issuing an opinion on the reorganization.

.84 Illustration 12. A taxpayer is considering a proposed transaction. The taxpayer and the taxpayer's attorney advise the member that the member is responsible for advising the taxpayer on the tax consequences of the transaction.

.85 Conclusion. In addition to complying with the requirements of paragraph .55 of this interpretation, the member generally should review all relevant draft transaction documents in formulating the member's tax advice relating to the transaction.

.86 Illustration 13. A member is responsible for advising a taxpayer on the tax consequences of the taxpayer's estate plan.

.87 Conclusion. Under the circumstances, the member should review the will and all other relevant documents to assess whether there appear to be any tax issues raised by the formulation or implementation of the estate plan.

.88 Illustration 14. A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support its recommendation, the investment bank offers a law firm's opinion on the tax consequences. The member reads the opinion and notes that it is based on a hypothetical statement of facts rather than the taxpayer's facts.

.89 Conclusion. The member may rely on the law firm's opinion when determining whether the required reporting and disclosure standards have been satisfied with respect to the tax consequences of the hypothetical transaction if the member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion. However, the member should be diligent in taking such steps as are appropriate under the circumstances to understand and evaluate the transaction as it applies to the taxpayer's specific situation. See paragraph .56 of this interpretation.

.90 Illustration 15. A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support that recommendation, the investment bank offers a law firm's opinion about the tax consequences. The member reads the opinion and notes that unlike the opinion described in illustration 14, it is carefully tailored to the taxpayer's facts.

.91 Conclusion. The member may rely on the opinion when determining whether the required reporting and disclosure standards have been satisfied with respect to the taxpayer's participation in the transaction if the member is satisfied about the source (for example, the knowledge and expertise of the issuer), relevance, and persuasiveness of the opinion. In making that determination, the member should consider whether the opinion indicates the law firm performed the steps listed in paragraph .56 of this interpretation.

.92 Illustration 16. A member is assisting a taxpayer with year-end planning in connection with the taxpayer's proposed contribution of stock in a closely held corporation to a charitable organization. The taxpayer instructs the member to calculate the anticipated tax savings assuming a contribution of 500 shares to a tax-exempt organization and assuming the stock has a fair market value of \$100 per share. The member is aware that on the taxpayer's gift tax returns for the prior year, the taxpayer reported that her stock in the corporation, gifted to her daughter, was worth \$50 per share.

.93 Conclusion. The member's calculation of the anticipated tax savings is subject to the general interpretations described in paragraphs .57 and .58 of this interpretation. Accordingly, even though this potentially may be a case in which the value of the stock substantially appreciated during the year, the member should consider the reasonableness of the assumption and consistency with other information known to the member in connection with preparing the projection. The member should consider whether to document discussions concerning the increase in value of the stock with the taxpayer. The member also should consider the applicability of the SSTs.

.94 Illustration 17. The tax consequences to Target Corporation's shareholders of an acquisition turn, in part, on Acquiring Corporation's continuance of the trade or business of Target Corporation for some time after the acquisition. The member is preparing a tax opinion addressed to Target's shareholders. The opinion is based on a written representation from Acquiring Corporation that Acquiring Corporation will continue Target's business for two years following the acquisition.

.95 Conclusion. In conducting the due diligence necessary to establish the relevant background facts, the member should consider the reasonableness of the representation before determining that it is appropriate to rely on the representation from Acquiring Corporation.

.96 Illustration 18. The member receives a telephone call from a taxpayer who is the sole shareholder of a corporation. The taxpayer indicates that he is thinking about exchanging his stock in the corporation for stock in a publicly traded business. During the call, the member explains how the transaction could be structured so it will qualify as a tax-free acquisition.

.97 Conclusion. Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, substantial dollar-value, or complicated transactions. The member should use professional judgment about the need to document oral advice. (See SSTs No. 7.)

.98 Illustration 19. The member receives a telephone call from a taxpayer who wants to know whether he or she should lease or purchase a car. During the call, the member explains how the arrangement should be structured so that it helps achieve the taxpayer's objectives.

.99 Conclusion. In this situation, the member's response is in conformity with this interpretation in view of the routine nature of the inquiry and the well-defined tax issues. However, the member should evaluate whether other considerations, such as avoiding misunderstanding with the taxpayer, suggest that the conversation should be documented.

TS Section 200

Answers to Questions on Returns

Source: SSTS No. 2

Effective date, unless
otherwise indicated:
January 2010

Introduction

.01 This statement sets forth the applicable standards for members when signing the preparer's declaration on a tax return if one or more questions on the return have not been answered. The term *questions* includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question.

Statement

.02 A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.

Explanation

.03 It is recognized that the questions on tax returns are not of uniform importance, and often they are not applicable to the particular taxpayer. Nevertheless, there are at least three reasons why a member should be satisfied that a reasonable effort has been made to obtain information to provide appropriate answers to the questions on the return that are applicable to a taxpayer:

- a. A question may be of importance in determining taxable income or loss, or the tax liability shown on the return, in which circumstance an omission may detract from the quality of the return.
- b. A request for information may require a disclosure necessary for a complete return or to avoid penalties.
- c. A member often must sign a preparer's declaration stating that the return is true, correct, and complete.

.04 Reasonable grounds may exist for omitting an answer to a question applicable to a taxpayer. For example, reasonable grounds may include the following:

- a. The information is not readily available and the answer is not significant in terms of taxable income or loss, or the tax liability shown on the return.
- b. Genuine uncertainty exists regarding the meaning of the question in relation to the particular return.
- c. The answer to the question is voluminous; in such cases, a statement should be made on the return that the data will be supplied upon examination.

.05 A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.

.06 A member should consider whether the omission of an answer to a question may cause the return to be deemed incomplete or result in penalties.

.07 If reasonable grounds exist for omission of an answer to an applicable question, a taxpayer is not required to provide on the return an explanation of the reason for the omission.

TS Section 300***Certain Procedural Aspects of
Preparing Returns*****Source: SSTS No. 3****Effective date, unless
otherwise indicated:
January 2010****Introduction**

.01 This statement sets forth the applicable standards for members concerning the obligation to examine or verify certain supporting data or to consider information related to another taxpayer when preparing a taxpayer's tax return.

Statement

.02 In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to the member. Further, a member should refer to the taxpayer's returns for one or more prior years whenever feasible.

.03 If the tax law or regulations impose a condition with respect to deductibility or other tax treatment of an item, such as taxpayer maintenance of books and records or substantiating documentation to support the reported deduction or tax treatment, a member should make appropriate inquiries to determine to the member's satisfaction whether such condition has been met.

.04 When preparing a tax return, a member should consider information actually known to that member from the tax return of another taxpayer if the information is relevant to that tax return and its consideration is necessary to properly prepare that tax return. In using such information, a member should consider any limitations imposed by any law or rule relating to confidentiality.

Explanation

.05 The preparer's declaration on a tax return often states that the information contained therein is true, correct, and complete to the best of the preparer's knowledge and belief based on all information known by the preparer. This type of reference should be understood to include information furnished by the taxpayer or by third parties to a member in connection with the preparation of the return.

.06 The preparer's declaration does not require a member to examine or verify supporting data; a member may rely on information furnished by the taxpayer unless it appears to be incorrect, incomplete, or inconsistent. However, there is a need to determine by inquiry that a specifically required condition,

such as maintaining books and records or substantiating documentation, has been satisfied and to obtain information when the material furnished appears to be incorrect, incomplete, or inconsistent. Although a member has certain responsibilities in exercising due diligence in preparing a return, the taxpayer has the ultimate responsibility for the contents of the return. Thus, if the taxpayer presents unsupported data in the form of lists of tax information, such as dividends and interest received, charitable contributions, and medical expenses, such information may be used in the preparation of a tax return without verification unless it appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member.

.07 Even though there is no requirement to examine underlying documentation, a member should encourage the taxpayer to provide supporting data where appropriate. For example, a member should encourage the taxpayer to submit underlying documents for use in tax return preparation to permit full consideration of income and deductions arising from security transactions and from pass-through entities, such as estates, trusts, partnerships, and S corporations.

.08 The source of information provided to a member by a taxpayer for use in preparing the return is often a pass-through entity, such as a limited partnership, in which the taxpayer has an interest but is not involved in management. A member may accept the information provided by the pass-through entity without further inquiry, unless there is reason to believe it is incorrect, incomplete, or inconsistent, either on its face or on the basis of other facts known to the member. In some instances, it may be appropriate for a member to advise the taxpayer to ascertain the nature and amount of possible exposure to tax deficiencies, interest, and penalties by taxpayer contact with management of the pass-through entity.

.09 A member should make use of a taxpayer's returns for one or more prior years in preparing the current return whenever feasible. Reference to prior returns and discussion of prior-year tax determinations with the taxpayer should provide information to determine the taxpayer's general tax status, avoid the omission or duplication of items, and afford a basis for the treatment of similar or related transactions. As with the examination of information supplied for the current year's return, the extent of comparison of the details of income and deduction between years depends on the particular circumstances.

TS Section 400

Use of Estimates

Source: SSTs No. 4

Effective date, unless
otherwise indicated:
January 2010

Introduction

.01 This statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but the taxpayer has the responsibility to provide the estimated data. Appraisals or valuations are not considered estimates for purposes of this statement.

Statement

.02 Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. The taxpayer's estimates should be presented in a manner that does not imply greater accuracy than exists.

Explanation

.03 Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

.04 When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.

.05 When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.

.06 Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

.07 Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual circumstances where nondisclosure might mislead the taxing authority regarding

the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:

- a.* A taxpayer has died or is ill at the time the return must be filed.
 - b.* A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
 - c.* There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
 - d.* Fire, computer failure, or natural disaster has destroyed the relevant records.
-

TS Section 500

Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision

Source: SSTS No. 5

Effective date, unless
otherwise indicated:
January 2010

Introduction

.01 This statement sets forth the applicable standards for members in recommending a tax return position that departs from the position determined in an administrative proceeding or in a court decision with respect to the taxpayer's prior return.

.02 For purposes of this statement, *administrative proceeding* includes an examination by a taxing authority or an appeals conference relating to a return or a claim for refund.

.03 For purposes of this statement, *court decision* means a decision by any court having jurisdiction over tax matters.

Statement

.04 The tax return position with respect to an item as determined in an administrative proceeding or court decision does not restrict a member from recommending a different tax position in a later year's return, unless the taxpayer is bound to a specified treatment in the later year, such as by a formal closing agreement. Therefore, the member may recommend a tax return position or prepare or sign a tax return that departs from the treatment of an item as concluded in an administrative proceeding or court decision with respect to a prior return of the taxpayer provided the requirements of TS section 100, *Tax Return Positions*, are satisfied.

Explanation

.05 If an administrative proceeding or court decision has resulted in a determination concerning a specific tax treatment of an item in a prior year's return, a member will usually recommend this same tax treatment in subsequent years. However, departures from consistent treatment may be justified under such circumstances as the following:

- a.* Taxing authorities tend to act consistently in the disposition of an item that was the subject of a prior administrative proceeding but generally are not bound to do so. Similarly, a taxpayer is not bound to follow the tax treatment of an item as consented to in an earlier administrative proceeding.

- b.* The determination in the administrative proceeding or the court's decision may have been caused by a lack of documentation. Supporting data for the later year may be appropriate.
- c.* A taxpayer may have yielded in the administrative proceeding for settlement purposes or not appealed the court decision, even though the position met the standards in TS section 100.
- d.* Court decisions, rulings, or other authorities that are more favorable to a taxpayer's current position may have developed since the prior administrative proceeding was concluded or the prior court decision was rendered.

.06 The consent in an earlier administrative proceeding and the existence of an unfavorable court decision are factors that the member should consider in evaluating whether the standards in TS section 100 are met.

TS Section 600

Knowledge of Error: Return Preparation and Administrative Proceedings

Source: SSTs No. 6

Effective date, unless
otherwise indicated:
January 2010

Introduction

.01 This statement sets forth the applicable standards for a member who becomes aware of (a) an error in a taxpayer's previously filed tax return; (b) an error in a return that is the subject of an administrative proceeding, such as an examination by a taxing authority or an appeals conference; or (c) a taxpayer's failure to file a required tax return. As used herein, the term *error* includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in TS section 100, *Tax Return Positions*. The term *error* also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retroactive effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability. The term *administrative proceeding* does not include a criminal proceeding.

.02 This statement applies whether or not the member prepared or signed the return that contains the error.

.03 Special considerations may apply when a member has been engaged by legal counsel to provide assistance in a matter relating to the counsel's client.

Statement

.04 A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. A member also should advise the taxpayer of the potential consequences of the error and recommend the corrective measures to be taken. Such advice and recommendation may be given orally. The member is not allowed to inform the taxing authority without the taxpayer's permission, except when required by law.

.05 If a member is requested to prepare the current year's return and the taxpayer has not taken appropriate action to correct an error in a prior year's return, the member should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer. If the member does prepare such current year's return, the member should take reasonable steps to ensure that the error is not repeated.

.06 If a member is representing a taxpayer in an administrative proceeding with respect to a return that contains an error of which the member is aware, the member should request the taxpayer's agreement to disclose the error to

the taxing authority. Lacking such agreement, the member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer.

Explanation

.07 While performing services for a taxpayer, a member may become aware of an error in a previously filed return or may become aware that the taxpayer failed to file a required return. The member should advise the taxpayer of the error and the potential consequences, and recommend the measures to be taken. Similarly, when representing the taxpayer before a taxing authority in an administrative proceeding with respect to a return containing an error of which the member is aware, the member should advise the taxpayer to disclose the error to the taxing authority and of the potential consequences of not disclosing the error. Such advice and recommendation may be given orally.

.08 It is the taxpayer's responsibility to decide whether to correct the error. If the taxpayer does not correct an error, a member should consider whether to withdraw from the engagement and whether to continue a professional or employment relationship with the taxpayer. Although recognizing that the taxpayer may not be required by statute to correct an error by filing an amended return, a member should consider whether a taxpayer's decision not to file an amended return or otherwise correct an error may predict future behavior that might require termination of the relationship.

.09 Once the member has obtained the taxpayer's consent to disclose an error in an administrative proceeding, the disclosure should not be delayed to such a degree that the taxpayer or member might be considered to have failed to act in good faith or to have, in effect, provided misleading information. In any event, disclosure should be made before the conclusion of the administrative proceeding.

.10 A conflict between the member's interests and those of the taxpayer may be created by, for example, the potential for violating Code of Professional Conduct Rule 301, *Confidential Client Information* (ET sec. 301 par. .01) (relating to the member's confidential client relationship); the tax law and regulations; or laws on privileged communications, as well as by the potential adverse impact on a taxpayer of a member's withdrawal. Therefore, a member should consider consulting with his or her own legal counsel before deciding upon recommendations to the taxpayer and whether to continue a professional or employment relationship with the taxpayer.

.11 If a member believes that a taxpayer may face possible exposure to allegations of fraud or other criminal misconduct, the member should advise the taxpayer to consult with an attorney before the taxpayer takes any action.

.12 If a member decides to continue a professional or employment relationship with the taxpayer and is requested to prepare a tax return for a year subsequent to that in which the error occurred, the member should take reasonable steps to ensure that the error is not repeated. If the subsequent year's tax return cannot be prepared without perpetuating the error, the member should consider withdrawal from the return preparation. If a member learns that the taxpayer is using an erroneous method of accounting and it is past the due date to request permission to change to a method meeting the standards of TS section 100, the member may sign a tax return for the current year, providing the tax return includes appropriate disclosure of the use of the erroneous method.

.13 Whether an error has no more than an insignificant effect on the taxpayer's tax liability is left to the professional judgment of the member based on all the facts and circumstances known to the member. In judging whether an erroneous method of accounting has more than an insignificant effect, a member should consider the method's cumulative effect, as well as its effect on the current year's tax return or the tax return that is the subject of the administrative proceeding.

.14 If a member becomes aware of the error while performing services for a taxpayer that do not involve tax return preparation or representation in an administrative proceeding, the member's responsibility is to advise the taxpayer of the existence of the error and to recommend that the error be discussed with the taxpayer's tax return preparer. Such recommendation may be given orally.

TS Section 700

Form and Content of Advice to Taxpayers

Source: SSTS No. 7

Effective date, unless
otherwise indicated:
January 2010

Introduction

.01 This statement sets forth the applicable standards for members concerning certain aspects of providing advice to a taxpayer and considers the circumstances in which a member has a responsibility to communicate with a taxpayer when subsequent developments affect advice previously provided. The statement does not, however, cover a member's responsibilities when the expectation is that the advice rendered is likely to be relied on by parties other than the taxpayer.

Statement

.02 A member should use professional judgment to ensure that tax advice provided to a taxpayer reflects competence and appropriately serves the taxpayer's needs. When communicating tax advice to a taxpayer in writing, a member should comply with relevant taxing authorities' standards, if any, applicable to written tax advice. A member should use professional judgment about any need to document oral advice. A member is not required to follow a standard format when communicating or documenting oral advice.

.03 A member should assume that tax advice provided to a taxpayer will affect the manner in which the matters or transactions considered would be reported or disclosed on the taxpayer's tax returns. Therefore, for tax advice given to a taxpayer, a member should consider, when relevant (a) return reporting and disclosure standards applicable to the related tax return position and (b) the potential penalty consequences of the return position. In ascertaining applicable return reporting and disclosure standards, a member should follow the standards in TS section 100, *Tax Return Positions*.

.04 A member has no obligation to communicate with a taxpayer when subsequent developments affect advice previously provided with respect to significant matters, except while assisting a taxpayer in implementing procedures or plans associated with the advice provided or when a member undertakes this obligation by specific agreement.

Explanation

.05 Tax advice is recognized as a valuable service provided by members. The form of advice may be oral or written and the subject matter may range from routine to complex. Because the range of advice is so extensive and because advice should meet the specific needs of a taxpayer, neither a standard format nor guidelines for communicating or documenting advice to the taxpayer can be established to cover all situations.

.06 Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, substantial dollar value, or complicated transactions. The member may use professional judgment about whether, subsequently, to document oral advice.

.07 In deciding on the form of advice provided to a taxpayer, a member should exercise professional judgment and should consider such factors as the following:

- a.* The importance of the transaction and amounts involved
- b.* The specific or general nature of the taxpayer's inquiry
- c.* The time available for development and submission of the advice
- d.* The technical complexity involved
- e.* The existence of authorities and precedents
- f.* The tax sophistication of the taxpayer
- g.* The need to seek other professional advice
- h.* The type of transaction and whether it is subject to heightened reporting or disclosure requirements
- i.* The potential penalty consequences of the tax return position for which the advice is rendered
- j.* Whether any potential applicable penalties can be avoided through disclosure
- k.* Whether the member intends for the taxpayer to rely upon the advice to avoid potential penalties

.08 A member may assist a taxpayer in implementing procedures or plans associated with the advice offered. When providing such assistance, the member should review and revise such advice as warranted by new developments and factors affecting the transaction.

.09 Sometimes a member is requested to provide tax advice but does not assist in implementing the plans adopted. Although such developments as legislative or administrative changes or future judicial interpretations may affect the advice previously provided, a member cannot be expected to communicate subsequent developments that affect such advice unless the member undertakes this obligation by specific agreement with the taxpayer.

.10 Taxpayers should be informed that (*a*) the advice reflects professional judgment based upon the member's understanding of the facts, and the law existing as of the date the advice is rendered and (*b*) subsequent developments could affect previously rendered professional advice. Members may use precautionary language to the effect that their advice is based on facts as stated and authorities that are subject to change.

.11 In providing tax advice, a member should be cognizant of applicable confidentiality privileges.

TS Section Appendix

Cross-Reference of Previous and Revised Statements

<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>	<i>2010 Revised Section</i>
1	111	Withdrawn 1982	—		
2	121	Withdrawn 1982	—		
3	131	Superseded by Statement No. 2, August 1988	122		
3	131	Superseded by Statement No. 2, August 2000		200	
3	131	Superseded by Statement No. 2, January 2010			200
4	141	Superseded by Statement No. 5, August 1988	152		
4	141	Superseded by Statement No. 5, August 2000		500	
4	141	Superseded by Statement No. 5, January 2010			500
5	151	Superseded by Statement No. 4, August 1988	142		
5	151	Superseded by Statement No. 4, August 2000		400	
5	151	Superseded by Statement No. 4, January 2010			400

(continued)

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6	161	Superseded by Statement No. 6, August 1988; Revised May 1991	162		
6	161	Superseded by Statement No. 6, August 2000		600	
6	161	Superseded by Statement No. 6, January 2010			600
7	171	Superseded by Statement No. 7, August 1988; Revised May 1991	172		
7	171	Superseded by Statement No. 7, August 2000		700	
7	171	Superseded by Statement No. 6, January 2010			600
8	181	Superseded by Statement No. 8, August 1988	182		
8	181	Superseded by Statement No. 8, August 2000		800	
8	181	Superseded by Statement No. 7, January 2010			700
9	191	Superseded by Statement No. 3, August 1988	132		
9	191	Superseded by Statement No. 3, August 2000		300	
9	191	Superseded by Statement No. 3, January 2010			300

<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>	<i>2010 Revised Section</i>
10	201	Superseded by Statement No. 1, August 1988	112		
10	201	Superseded by Statement No. 1, August 2000		100	
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PFP Section

PERSONAL FINANCIAL PLANNING

STATEMENT ON STANDARDS IN PERSONAL FINANCIAL PLANNING SERVICES

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Foreword

The Personal Financial Planning Executive Committee (PFP EC) has issued Statement on Standards in Personal Financial Planning Services No. 1 (the statement) to provide guidance to members and a framework for delivering PFP services with the highest levels of integrity, professionalism, objectivity, and competence so that a CPA financial planner can serve the best interests of

his or her clients and the public. The PFP EC is the senior committee of the AICPA designated to promulgate enforceable standards of PFP practice.¹

The statement applies to all members providing PFP services regardless of the jurisdictions in which they practice. Interpretations of the statement may be issued by the PFP EC as guidance to assist in understanding and applying the statement. The PFP EC interpretations are recommendations on the application of the statement. The statement and its interpretations are intended to complement other laws, regulations, and professional standards of PFP practice.

The statement is written in as simple and objective a manner as possible. However, by their nature, practice standards provide for an appropriate range of behaviors and need to be interpreted to address a broad range of personal and professional situations. Accordingly, enforcement of these rules, as part of the AICPA's Code of Professional Conduct "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) and "Compliance with Standards Rule" (ET sec. 1.310.001 and 2.310.001) as well as paragraphs .02–.05 of the "Application of the AICPA Code" (ET sec. 0.200.020), will be undertaken on a case-by-case basis.

¹ Per AICPA Bylaw Section 360R, *Implementing Resolutions Under Section 3.6 Committees*, the Personal Financial Planning Executive Committee (PFP EC) is an AICPA senior committee. The PFP EC is designated as a body that may promulgate technical standards under the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) and the "Compliance with Standards Rule" (ET sec. 1.310.001 and 2.310.001).

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PFP Section 100

Statement on Standards in Personal Financial Planning Services

(Supersedes the *Statement on Responsibilities in Personal Financial Planning Practice*.)

Source: Statement on Standards in Personal Financial Planning Services No. 1.

January 2014; revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.

Scope

.01 Statement on Standards in Personal Financial Planning Services No. 1 (the statement) addresses the responsibilities of AICPA members (members) who are described in paragraph .04 that follows. The statement applies when personal financial planning (PFP) services are provided, even if part of another engagement.

.02 The statement establishes the applicable standards for members with regard to PFP engagements. (Ref: par. .A1)

Nature of PFP Services

.03 PFP is the process of identifying personal financial goals and resources, designing financial strategies, and making personalized recommendations (Ref: par. .12) (whether written or oral) that, when implemented, assist the client in achieving these goals. This process may include implementation of recommendations or monitoring or updating the engagement. PFP services encompass one or more of the following activities:

- a.* Cash flow planning
- b.* Risk management and insurance planning
- c.* Retirement planning
- d.* Investment planning
- e.* Estate, gift, and wealth transfer planning
- f.* Elder planning
- g.* Charitable planning
- h.* Education planning
- i.* Tax planning

Applicability

.04 The statement applies when a member provides PFP services as defined in paragraph .12, and (Ref: par. .A2)

- a.* represents to the public or clients that the member provides PFP services,

- b. engages in activities that would require registration as an investment adviser under federal or state law,¹ or
- c. sells a product as a result of an engagement.

.05 The statement does not supersede other applicable AICPA professional standards, such as (Ref: par. .A2–.A3, .A11)

- a. the Statement on Standards for Accounting and Review Services (SSARS) No. 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (AR sec. 600), with regard to the compilation of personal financial statements;
- b. the Statements on Standards for Tax Services (SSTSs) with regard to tax services; and
- c. the Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* (VS sec. 100), with regard to valuation services.

Objective

.06 The statement provides authoritative guidance and establishes enforceable standards for members who provide PFP services to assist them in fulfilling their professional responsibilities.

Authority of the Statement

.07 The statement contains requirements designed to enable the member to meet the stated objective. It also includes related guidance in the form of application and other explanatory material that provides context relevant to a proper understanding of the statement and definitions.

.08 The requirements of the statement are expressed using the word *should*. If a standard provides that a member "should" perform an action, then unless prevailing facts and circumstances dictate otherwise, this action is required. If a standard provides that a procedure or action is one that the member "should consider," the consideration of the procedure or action is required, whereas carrying out the specified procedure or action is not. The professional requirements of the statement are to be understood and applied in the context of the explanatory material that provides guidance for their application.

.09 The "Application Material" section and other explanatory material provide further explanation of the requirements and guidance for carrying them out.

.10 The words *may*, *might*, and *could*, among others, are used to describe actions and procedures that are recommended but not required. Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements.

.11 The statement includes, under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the statement. These are provided to assist with the consistent application and interpretation of the statement and are not intended to override definitions that may be established for other purposes, whether by law or regulation.

¹ Reference The CPA's Guide to Investment Advisory Business Models published by AICPA.

Definitions

.12 For purposes of the statement, the following terms have the meanings attributed:

Personal financial planning services. The process of identifying personal financial goals and resources, designing financial strategies, and making personalized recommendations that, when implemented, assist the client in achieving these goals. (Ref: par. .03)

Personal financial planning engagement. An engagement in which a member provides PFP services and the statement applies. (Ref: par. .03–.04)

Implementation engagement. A PFP engagement that involves assisting the client in taking action on recommendations developed during the PFP engagement.

Monitoring engagement. A PFP engagement that involves tracking and communicating the client's progress in achieving established PFP goals.

Updating engagement. A PFP engagement that involves revising the client's existing financial plan and financial planning recommendations as the member and client agree upon.

Personalized recommendation. Financial advice directing a client to take action based on the client's personal financial information disclosed to the member. (Ref: par. .03)

Requirements

General Professional Responsibilities

.13 The member should read the entire statement, including its application and other explanatory material, to understand its objective and apply its requirements properly.

.14 The proper application of the requirements established by the statement is expected to provide a sufficient basis for the achievement of the objective. However, because circumstances vary widely and all such circumstances cannot be anticipated, the member should consider whether, due to the existence of particular matters or circumstances, procedures in addition to those required by the statement are needed to meet the stated objective.

.15 The member must comply with each requirement of the statement unless,

- a. in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist.
- b. the member judges it necessary to depart from a requirement. In such circumstances, the member should perform alternative procedures to achieve the intent of that requirement and document the justification for that departure.

.16 The member should consider applicable interpretive publications when providing PFP services. (Ref: par. .A5)

Independence and PFP Services

.17 If PFP services are performed for a client for which the member or member's firm also performs an *attest engagement* (ET sec. 0.400.04), the member should meet the requirements of the "Nonattest Services" subtopic

(ET sec. 1.295) under the "Independence Rule" (ET sec. 1.200.001) so as not to impair the member's independence with respect to the client.

Responsibilities of Members in PFP Engagements (Ref: par. .A6–.A13)

.18 The member should comply with relevant ethical requirements. (Ref: par. .A7)

.19 The member should possess a level of knowledge of PFP principles and theory, and a level of skill in the application of such principles, that will enable him or her to (Ref: par. .A8)

- a. identify client goals and objectives;
- b. gather and analyze relevant information;
- c. consider and apply appropriate planning approaches and methods; and
- d. use professional judgment when developing financial recommendations.

.20 The member should evaluate whether any conflicts of interest exist with regard to the engagement as follows: (Ref: par. .A9–.A10)

- a. If the member determines conflicts of interest exist, the member should determine whether the engagement can be performed objectively.
- b. If the member determines the engagement can be performed objectively, the member should disclose all known conflicts of interest and obtain consent as required under the "Conflicts of Interest" interpretations (ET sec. 1.110.010 and 2.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001 and 2.100.001).
- c. If the member determines that the engagement cannot be performed objectively, the engagement should be terminated.

.21 The member should comply with applicable federal, state, and other laws and regulations. The member should comply with professional standards applicable to the PFP engagement unless superseded by laws or regulations. When there is a conflict between the statement and laws or regulations, the laws or regulations will prevail unless less stringent than the statement. (Ref: par. .A11–.A12)

.22 Prior to beginning the engagement, and throughout the engagement as circumstances dictate, the member should disclose in writing all compensation the member and the member's firm or affiliates will receive for services rendered or products sold (Ref: par. .A6, .A13). The disclosure should include

- a. the method of compensation, including the impact of indirect compensation;
- b. the amount of compensation;
- c. the time period over which compensation will be received; and
- d. the compensation, including noncash benefits, received by the member for referrals to other providers.

.23 If compensation alternatives are offered, the member should disclose the differences in these alternatives in writing.

Planning the PFP Engagement (Ref: par. .A14–.A15)

.24 The member should document and communicate to the client the scope and nature of services to be provided and disclose the member's agreed upon compensation for such services. This communication should be documented in the file and include descriptions of the following when applicable to the engagement:

- a.* Engagement objectives
- b.* Scope of services to be provided
- c.* Roles and responsibilities of the member, client, and other service providers
- d.* Timing of the engagement
- e.* Scope limitations and other constraints
- f.* Conflicts of interest (Ref: par. .20)
- g.* Responsibility, or lack thereof, for helping the client implement planning decisions
- h.* Responsibility, or lack thereof, for monitoring the client's progress in achieving goals
- i.* Responsibility, or lack thereof, for updating the plan and proposing new action

.25 The member should evaluate the appropriateness of the original engagement as the engagement proceeds and document and communicate needed changes to the client.

.26 If the member is aware of a service needed to complete the engagement and does not, or will not, provide that service, the member should limit the scope of the engagement accordingly and recommend that the client engage another service provider for that service in writing.

.27 If the client declines to engage another service provider for services identified in paragraph .26, the member should consider whether this limitation impairs the ability to provide PFP services:

- a.* If the member determines that the ability to meet the standards established by the statement is impaired, the member should terminate the engagement in writing.
- b.* If the member determines that the ability to meet the standards established by the statement is not impaired, the member should communicate in writing that this limitation could affect the conclusions and recommendations developed in the engagement.

Obtaining and Analyzing Information

.28 The member should use professional judgment when obtaining and analyzing relevant information necessary to develop recommendations based on the stated engagement objectives.

.29 If the member is unable to collect sufficient relevant information to establish a reasonable basis for recommendations, the engagement scope may be restricted to those matters for which sufficient information is available. This scope limitation should be communicated to the client in writing, including that this limitation should be taken into account in the assessment of conclusions and recommendations developed. (Ref: par. .A16)

.30 If sufficient information does not exist to proceed as agreed, the member should terminate or modify the engagement through mutual agreement

with the client. This engagement modification or termination should be communicated in writing.

.31 When analyzing information obtained while performing the engagement, the member should

- a. evaluate the reasonableness of estimates and assumptions that are significant to the plan;
- b. use assumptions that are appropriate and consistent with each other; and
- c. consider the interrelationship of various PFP activities (Ref: par. .03).

Developing and Communicating Recommendations (Ref: par. .A16–.A20)

.32 The member should establish a reasonable basis for PFP recommendations.

.33 The member should develop recommendations derived from analyses of relevant information, client goals, and the client's overall financial circumstances. Even when an engagement addresses a limited number of personal financial goals, the member should consider the client's overall known financial circumstances.

.34 The nature and extent of analyses and other procedures performed when establishing a basis for recommendations are affected by the scope and objectives of the engagement and should be documented.

.35 The member should communicate to the client the assumptions and estimates that are significant to the recommendations. This should be documented and include the following:

- a. A summary of the client's goals
- b. Significant assumptions
- c. Estimates
- d. Recommendations
- e. A description of limitations on the work performed
- f. The recommendations in the engagement should contain qualifications to the recommendations if the effects of certain planning areas on the client's overall financial picture were not considered

Implementation Engagements (Ref: par. .A21–.A24)

.36 The member should document his or her understanding of the implementation engagement, including the roles and responsibilities of the member, the client, and other service providers. This documentation should include the following:

- a. A summary of the planning decisions being implemented
- b. A summary of recommended actions to be taken
- c. A description of limitations on the work performed in the implementation engagement

.37 The member should communicate in writing the level of responsibility, if any, for the following:

- a. Selecting and acquiring products

- b. Selecting service providers
- c. Establishing selection criteria
- d. Coordinating or reviewing the delivery of services or products by other service providers

.38 A member who is engaged to establish selection criteria should

- a. identify those criteria that are required to accomplish the client's objectives, subject to any constraints that result from the client's circumstances or as identified by the client.
- b. assist the client in evaluating the relative importance of criteria so that available alternatives can be compared.

.39 A member who is engaged to participate in recommending products should

- a. gather information that establishes a reasonable basis for determining whether a product meets the selection criteria.
- b. communicate this evaluation in writing, along with product recommendations.
- c. disclose in writing any compensation received for recommending products.

.40 A member who is engaged to assist the client in taking action on planning decisions developed in a PFP engagement in which the member did not participate should obtain an understanding of the planning decisions made.

.41 All other relevant guidance under the statement relating to providing PFP services should be followed in an implementation engagement.

Monitoring and Updating Engagements (Ref: par. .A25–.A28)

.42 In a monitoring engagement, the member should document the nature and extent of the member's services, including

- a. the frequency and time period of measuring the client's progress toward reaching the stated goals.
- b. utilization of monitoring criteria that are appropriate to, and consistent with, the criteria used to establish the goals being monitored.
- c. the criteria that are important to the achievement of the financial planning goals being monitored.
- d. the member's evaluation of progress toward achieving the client's financial planning goals, including whether the client's existing financial plan and specific financial planning recommendations should be updated.

.43 In an updating engagement, the member should document the nature and extent of the member's services, including

- a. the determination of whether the goals, objectives, information, and assumptions used as a basis for existing planning recommendations are still valid.
- b. the evaluation of the impact of revising recommendations on the client's ability to achieve other financial planning goals.

.44 All other relevant guidance under the statement relating to providing PFP services should be followed in a monitoring or an updating engagement.

Working With Other Service Providers

- .45** When referring another service provider to a client, the member should
- consider the professional qualifications of another service provider before referring the client to that service provider;
 - disclose, in writing, any compensation received for making such referrals; and
 - communicate, in writing, the extent to which the member will or will not evaluate the work performed by the service provider.

Using Advice Provided By Other Service Providers

.46 When the member uses the advice of another service provider when carrying out the PFP engagement, the member should understand the impact of the service provider's advice.

.47 If the member has evaluated the advice of the other service provider, and

- if the member concurs with the other service provider's advice, the member need not communicate this concurrence to the client because concurrence is implied by its use, or
- if the member does not concur with the other service provider's advice, the member should communicate this non-concurrence to the client in writing.

Application Material

Scope

.A1 The "Compliance With Standards Rule" (ET sec. 1.310.001 and 2.310.001) requires an AICPA member who performs a PFP engagement to comply with standards promulgated by the Personal Financial Planning Executive Committee (PFP EC). The PFP EC develops and issues standards in the form of statements through a process that includes deliberation in meetings open to the public, public exposure of statements, and a formal vote. The statements are codified in AICPA *Professional Standards*. (Ref: par. .02)

Applicability (Ref: par. .03–.05)

.A2 If any of the activities listed in paragraph .03 are provided as part of a PFP engagement, the activity is covered by the statement and should be considered in conjunction with the requirements set forth in the "Applicability" section (Ref: par. .04). In addition, depending on the nature of the service, other standards may apply (Ref: par. .05). For example, any personal income tax services provided as part of a PFP engagement are covered by the statement and are subject to the SSTs.

.A3 Examples of activities not covered by the statement include the following: (Ref: par. .03–.05)

- Tax advice: Advising a client regarding his or her income tax matters or gift and estate tax matters when PFP services as defined in paragraph .03 are not provided. These services are, however, subject to the SSTs.

- b. Valuation services: Any engagement that would be considered a valuation service under SSVS No. 1 when PFP services as defined in paragraph .03 are not provided. These services are, however, subject to SSVS No. 1.
- c. Business succession planning
 - i. Planning to prepare for a vacancy in a key position resulting from a sudden departure, disability, or death and no advice is given to an individual.
 - ii. Planning to prepare for the sale to another firm and no advice is given to an individual.
- d. Educational discussions or presentations covering PFP
 - i. A workshop presented to a group of company employees on a PFP activity (Ref: par. .03) that does not include personalized recommendations.
 - ii. A discussion with an individual that covers one or more PFP activities (Ref: par. .03) that does not result in a personalized recommendation.
- e. Mechanical computations
 - i. Computation of the current income tax deduction for a client's contribution of assets to a charitable remainder trust.
 - ii. Computation of the current yield on a client's investment portfolio.
 - iii. Computation of the gift tax on a transfer of an asset.

.A4 A member may identify and create an analysis of historical spending and income activity for a client as a purely mechanical computation, which would not be considered PFP services. However, extension of this analysis to future periods based on the judgment of the member that entails the use of assumptions and personalized recommendations regarding investing would be considered PFP services.

General Professional Responsibilities

.A5 Interpretive publications are not standards on PFP practice. Interpretive publications are recommendations on the application of the statement in specific circumstances. An interpretive publication is issued under the authority of the PFP EC after all members have been provided an opportunity to consider and comment on whether the interpretive publication is consistent with the statement. (Ref: par. .16)

Responsibilities of Members in PFP Engagements (Ref: par. .18-.23)

.A6 The member is required to comply with the "Commissions and Referral Fees Rule" (ET sec. 1.520.001). (Ref: par. .22)

.A7 The member is subject to relevant ethical requirements relating to PFP engagements (Ref: par. .18). Ethical requirements consist of the AICPA Code of Professional Conduct, rules of state boards of accountancy from which the member holds a license, and applicable regulatory agencies that are more stringent. The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- a. Responsibilities
- b. The public interest
- c. Integrity
- d. Objectivity and independence
- e. Due care
- f. Scope and nature of services

.A8 The "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) explains that professional competence means that a member shall "undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence." (Ref: par. .19)

.A9 The "Objectivity and Independence" principle (ET sec. 0.300.050) states that objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free from conflicts of interest. (Ref: par. .20)

.A10 The member is required to comply with AICPA's Code of Professional Conduct "Conflicts of Interest" interpretations (ET sec. 1.110.010 and 2.110.010). (Ref: par. .20)

.A11 Laws, regulations, and professional standards applicable to engagements to perform PFP services include, but are not necessarily limited to, the following: (Ref: par. .21, .A5)

- a. Investment Advisers Act of 1940; see Securities and Exchange Commission Interpretive Release IA-1092
- b. Treasury Department Circular No. 230
- c. State boards of accountancy
- d. AICPA Code of Professional Conduct
- e. Statements on Standards for Tax Services (SSTSs)
- f. Statement on Standards for Valuation Services (SSVS) No. 1
- g. Statement on Standards for Consulting Services No. 1
- h. Statements on Standards for Accounting and Review Services (SSARS) No. 6
- i. Maintaining adequate data protection safeguards regarding a client's nonpublic personal information
- j. Maintaining client confidentiality in accordance with the applicable rules of professional conduct and federal and state laws and regulations

.A12 Compliance with the AICPA Code of Professional Conduct depends primarily on the member's understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the rules. (Ref: par. .21)

.A13 The member is not required to follow a standard format when communicating or documenting communication.

Planning the Engagement (Ref: par. .24–.27)

.A14 An understanding of the client may include understanding matters such as the client's family situation, commitment to the planning process, current cash flow and assets available, personal preferences, and relationships

with other professionals. This understanding may be obtained through comprehensive information gathering or may result from knowledge gained during a long-term relationship with the client.

.A15 Additional services that require understanding and agreement by the client include the following:

- a. Implementing plan recommendations
- b. Monitoring the client's progress in achieving goals
- c. Updating recommendations

Developing and Communicating Recommendations (Ref: par. .32–.35)

.A16 Developing a reasonable basis for recommendations involves the following (Ref: par. .29):

- a. Collecting relevant quantitative and qualitative information. The nature and amount of information will depend on the scope and complexity of the engagement. This information may include, but is not limited to
 - i. the client's goals, existing financial situation, and available resources;
 - ii. nonfinancial factors, such as client attitudes, risk tolerance, family considerations, age, health, and life expectancy;
 - iii. external factors, such as estimates of inflation, taxes, economic conditions, legislative activity, investment markets, and interest rates; and
 - iv. reasonable estimates, projections, and assumptions furnished by the client, provided by other service providers, or developed by the member.
- b. Analyzing the client's current situation as it relates to the client's goals and objectives and identifying strengths and weaknesses of the existing financial situation.
- c. Formulating, evaluating, and recommending appropriate strategies for achieving the client's goals after due consideration of appropriate alternatives.

.A17 The member's knowledge and experience also contribute to the basis for recommendations.

.A18 PFP recommendations are suggested actions developed to help the client achieve personal financial goals.

.A19 Recommendations are based on analyses and other procedures conducted prior to, and in preparation for, developing suggested actions.

.A20 The member should help the client prioritize recommended tasks that are essential to enabling the client to act on planning decisions.

Implementation Engagements (Ref: par. .36–.41)

.A21 Implementation may include such activities as assisting the client in selecting other advisors, restructuring debt, obtaining new or updated estate documents, establishing cash reserves, preparing budgets, and selecting and acquiring specific investments and insurance products.

.A22 In those situations in which the member may be functioning in a fiduciary or agency relationship, state law will control.

.A23 The member may be engaged to assist the client in taking action on planning decisions, which may include the member doing one or more of the following:

- a. Taking responsibility for the selection and acquisition of products²
- b. Taking responsibility for the selection of service providers
- c. Establishing selection criteria
- d. Coordinating or reviewing the delivery of services or products by other service providers

.A24 Implementation is typically completed when products are acquired or services are rendered based on the recommendations developed during the PFP engagement.

Monitoring and Updating Engagements (Ref: par. .42–.44)

.A25 A member may be engaged to assist the client in tracking progress in achieving established PFP goals or revising an existing personal financial plan, or both.

.A26 The member may be specifically engaged by a client to provide monitoring services, updating services, or both. The member would typically have informed the client during a PFP engagement, in which planning recommendations are developed, that monitoring and updating are important elements of the financial planning process and that the member is not responsible for undertaking these services except by specific agreement with the client.

.A27 Monitoring and updating engagements are typically undertaken after implementation of actions and recommendations developed during a PFP engagement. Monitoring and updating engagements may be either separate or combined engagements.

.A28 Monitoring engagements vary in complexity, scope, and the nature and extent of assistance to be provided by the member. In other words, the member may undertake some or all of the monitoring services, coordinate or review monitoring services performed by other service providers, or monitor progress toward goals in a financial plan developed by other service providers.

² Members advising clients on the selection or acquisition of products (such as investments or insurance policies) should determine whether they meet the qualifications and licensing requirements established by applicable federal and state laws.

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CPE Section

CONTINUING PROFESSIONAL EDUCATION

These standards have been approved by the joint AICPA/NASBA CPE Standards Committee and the Board of Directors of both the AICPA and NASBA.

Unless otherwise established by state licensing bodies or other professional organizations, these standards are to be effective on December 31, 2019.

Continuing professional education (CPE) is required for CPAs to maintain or improve their professional competence and provide quality professional services. CPAs are responsible for complying with all applicable CPE requirements, rules and regulations of boards of accountancy, as well as those of membership associations and other professional organizations.

The Statement on Standards for CPE Programs (Standards) is published jointly by the AICPA and the National Association of State Boards of Accountancy (NASBA) to provide a framework for the development, presentation, measurement, and reporting of CPE programs. The Standards were last revised in 2016.

The Standards are periodically reviewed in their entirety by the CPE Standards Working Group (Working Group). The Working Group comprises 13 members representing the various stakeholders in the CPE arena, including boards of accountancy, state societies, educators, CPE providers, and the AICPA. If the Working Group determines that revisions or modifications are required, then the Working Group will make its recommendations to NASBA's CPE Committee (CPE Committee), which, in turn, makes recommendations to the Joint AICPA/NASBA CPE Standards Committee (Joint Committee). The Joint Committee will then make its recommendation to the respective AICPA and NASBA Boards of Directors. Any revisions or modifications to the Standards will be posted to the AICPA and NASBA websites for comment.

The Standards are intended to be an "evergreen" document. As questions arise related to implementation and application of the Standards, the questions will be presented to the Working Group. NASBA will communicate the findings of the Working Group to the specific CPE program sponsor. Authoritative interpretations will only be issued by the CPE Committee in limited cases in which the matter is not addressed in the Standards, cannot be addressed specifically with the CPE program sponsor, or cannot be addressed in the "Best Practices" web pages. All interpretations issued by the CPE Committee will be reviewed and considered by the Joint Committee upon the next revision of the Standards.

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CPE Section 100

Preamble

Revised, December 2019.

.01 The right to use the title "Certified Public Accountant" (CPA) is regulated by each state's board of accountancy in the public interest and imposes a duty to maintain public confidence by enhancing current professional competence, as defined in the Standards, in all areas in which they provide services. CPAs must accept and fulfill their ethical responsibilities to the public and the profession regardless of their fields of employment.¹

.02 The profession of accountancy is characterized by an explosion of relevant knowledge, ongoing changes and expansion, and increasing complexity. Advancing technology, globalization of commerce, increasing specialization, proliferating regulations, and the complex nature of business transactions have created a dynamic environment that requires CPAs to continuously maintain or improve their professional competence.

.03 The continuing development of professional competence involves a program of lifelong educational activities. *Continuing professional education (CPE)* is the term used in these Standards to describe the educational activities that assist CPAs in achieving and maintaining quality in professional services.

.04 The following Standards have been broadly stated in recognition of the diversity of practice and experience among CPAs. They establish a framework for the development, presentation, measurement, and reporting of CPE programs and thereby help to ensure that CPAs receive the quality CPE necessary to satisfy their obligations to serve the public interest. The spirit of the Standards is to encourage high quality learning with measurable objectives by providing baseline requirements. These Standards may also apply to other professionals by virtue of employment or membership. Boards of accountancy have final authority on the acceptance of individual courses for CPE credit.

.05 Advances in technology, delivery and workplace arrangements may lead to innovative learning techniques. Learning theory is evolving to include more emphasis on outcome based learning. These Standards anticipate innovation in CPE in response to these advances. Sponsors must ensure innovative learning techniques are in compliance with the Standards. CPE program sponsors are encouraged to consult with the National Association of State Boards of Accountancy (NASBA) regarding questions related to compliance with the Standards when using innovative techniques.

.06 These Standards create a basic foundation for sound educational programs. Sponsors may wish to provide enhanced educational and evaluative techniques to all programs.

¹ The term *CPAs* is used in these Standards to identify all persons who are licensed or regulated by boards of accountancy.

CPE Section 200

General Guidelines for CPAs

Revised, December 2019.

Professional Competence

.01 All CPAs should participate in learning activities that maintain or improve their professional competence.¹

.02 Selection of learning activities should be a thoughtful, reflective process addressing the individual CPA's current and future professional plans, current knowledge and skills level, and desired or needed additional competence to meet future opportunities or professional responsibilities or both.

.03 CPAs' fields of employment do not limit the need for Continuing Professional Education (CPE). CPAs performing professional services need to have a broad range of professional competence. Thus, the concept of professional competence may be interpreted broadly. Accordingly, acceptable continuing education encompasses programs contributing to the development and maintenance of professional skills.

.04 The fields of study, as published on NASBA's website, www.nasbaregistry.org, represent the primary knowledge and skill areas needed by CPAs to perform professional services in all fields of employment.

.05 To help guide their professional development, CPAs may find it useful to develop a learning plan. Learning plans are structured processes that help CPAs guide their professional development. They are dynamic instruments used to evaluate and document learning and professional competence development. They may be reviewed regularly and modified as CPAs' professional competence needs change. Plans include a self-assessment of the gap between current and needed professional competence; a set of learning objectives arising from this assessment; and learning activities to be undertaken to fulfill the learning plan.

CPE Compliance

.06 CPAs must comply with all applicable CPE requirements.

.07 CPAs are responsible for compliance with all applicable CPE requirements, rules, and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies. CPAs should contact each appropriate entity to which they report to determine

¹ The terms *should* and *must* are intended to convey specific meanings within the context of this joint AICPA/NASBA *Statement on Standards for Continuing Professional Education Programs*. The term *must* is used in the Standards applying to CPAs and Continuing Professional Education (CPE) program sponsors to convey that CPAs and CPE program sponsors are not permitted any departure from those specific Standards. The term *should* is used in the Standards applying to both CPAs and CPE program sponsors and is intended to convey that CPAs and CPE program sponsors are encouraged to follow such Standards as written. The term *may* is used in the Standards applying to both CPAs and CPE program sponsors and is intended to convey that CPAs and CPE program sponsors are permitted to follow such Standards as written.

its specific requirements or any exceptions it may have to the standards presented herein.

.08 Periodically, CPAs participate in learning activities which do not comply with all applicable CPE requirements, for example specialized industry programs offered through industry sponsors. If CPAs propose to claim credit for such learning activities, they must retain all relevant information regarding the program to provide documentation to state licensing bodies or all other professional organizations or bodies that the learning activity is equivalent to one which meets all these standards.

CPE Credits Record Documentation

.09 CPAs are responsible for accurate reporting of the appropriate number of CPE credits earned and must retain appropriate documentation of their participation in learning activities.

.10 To protect the public interest, regulators require CPAs to document maintenance or improvement of professional competence through periodic reporting of CPE. For convenience, measurement is expressed in CPE credits. However, the objective of CPE must always be maintenance or improvement of professional competence, not attainment of credits. Compliance with regulatory and other requirements mandates that CPAs keep documentation of their participation in activities designed to maintain or improve professional competence. In the absence of legal or other requirements, a reasonable policy is to retain documentation for a minimum of five years from the end of the year in which the learning activities were completed.

.11 Participants must document their claims of CPE credit. Examples of acceptable evidence of completion include the following:

- For group, blended learning, and independent study programs, a certificate or other verification supplied by the CPE program sponsor
- For self study and nano learning programs, a certificate supplied by the CPE program sponsor after satisfactory completion of a qualified assessment
- For instruction or content review credit, appropriate supporting documentation that complies with the requirements of the respective state boards subject to the guidelines in Standard No. 20 in the "Standards for CPE Program Measurement" section of the Standards
- For a university or college course that is successfully completed for credit, a record or transcript of the grade the participant received
- For university or college noncredit courses, a certificate of attendance issued by a representative of the university or college
- For published articles, books, or CPE programs:
 - a copy of the publication (or in the case of a CPE program, course development documentation) that names the CPA as author or contributor
 - a statement from the writer supporting the number of CPE hours claimed
 - the name and contact information of the content reviewer(s) or publisher

Reporting CPE Credits

.12 CPAs who complete sponsored learning activities that maintain or improve their professional competence must claim no more than the CPE credits recommended by CPE program sponsors subject to state board regulations.

.13 CPAs may participate in a variety of sponsored learning activities. While CPE program sponsors determine credits, CPAs must claim credit only for activities through which they maintained or improved their professional competence. CPAs who participate in only part of a program must claim CPE credit only for the portion they attended or completed.

Independent Study

.14 CPAs may engage in independent study under the direction of a CPE program sponsor who has met the applicable standards for CPE program sponsors when the subject matter and level of study maintain or improve the CPA's professional competence.

.15 Independent study is an educational process designed to permit a participant to learn a given subject under the guidance of a CPE program sponsor. Participants in an independent study program must

- a. enter into a written learning contract with a CPE program sponsor that must comply with the applicable standards for CPE program sponsors. A learning contract
 - i. specifies the nature of the independent study program and the time frame over which it is to be completed, not to exceed 15 weeks.
 - ii. specifies that the output must be in the form of
 - (1) a written report that will be reviewed by the CPE program sponsor or a qualified person selected by the CPE program sponsor or
 - (2) a written certification by the CPE program sponsor that the participant has demonstrated application of learning objectives through
 - (a) successful completion of tasks or
 - (b) performance of a live demonstration, oral examination, or presentation to a subject matter expert.
 - iii. outlines the maximum CPE credit that will be awarded for the independent study program, but limits credit to actual time spent.
- b. accept the written recommendation of the CPE program sponsor regarding the number of credits to be earned upon successful completion of the proposed learning activities. CPE credits will be awarded only if
 - i. all the requirements of the independent study as outlined in the learning contract are met;
 - ii. the CPE program sponsor reviews and signs the participant's report;
 - iii. the CPE program sponsor reports to the participant the actual credits earned; and

- iv. the CPE program sponsor provides the participant with contact information.

The maximum credits to be recommended by an independent study CPE program sponsor must be agreed upon in advance and must be equated to the effort expended to maintain or improve professional competence. The credits cannot exceed the time devoted to the learning activities and may be less than the actual time involved.

- c. retain the necessary documentation to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.
-

CPE Section 300

Standards for CPE Program Sponsors

Revised, December 2019.

General Standards

.01 Standard No. 1. Continuing Professional Education (CPE) program sponsors are responsible for compliance with all applicable Standards and other CPE requirements.

.02 S1-01. CPE requirements of licensing bodies and others. CPE program sponsors may have to meet specific CPE requirements of state licensing bodies, other governmental entities, membership associations, or other professional organizations or bodies. Professional guidance for CPE program sponsors is available from the National Association of State Boards of Accountancy (NASBA); state-specific guidance is available from the boards of accountancy. CPE program sponsors should contact the appropriate entity to determine requirements.

Standards for CPE Program Development

.03 Standard No. 2. Sponsored learning activities must be based on relevant learning objectives and outcomes that clearly articulate the professional competence that should be achieved by participants in the learning activities.

.04 S2-01. Program knowledge level. Learning activities provided by CPE program sponsors for the benefit of CPAs must specify the knowledge level, content, and learning objectives so that potential participants can determine whether the learning outcomes are appropriate to their professional competence development needs. Knowledge levels consist of basic, intermediate, advanced, update, and overview.

.05 Standard No. 3. CPE program sponsors must develop and execute learning activities in a manner consistent with the prerequisite education, experience, or advance preparation of participants.

.06 S3-01. Prerequisite education and experience. To the extent it is possible to do so, CPE program sponsors should make every attempt to equate program content and level with the backgrounds of intended participants. All programs identified as Intermediate, Advanced or Update must clearly identify prerequisite education, experience, and advance preparation in precise language so that potential participants can readily ascertain whether they qualify for the program. For courses with a program knowledge level of Basic and Overview, prerequisite education or experience and advance preparation, if any, must be noted, otherwise, state "none" in the course announcement or descriptive materials.

.07 Standard No. 4. CPE program sponsors must employ activities, materials, and delivery systems that are current, accurate, and effectively designed. Course documentation must contain the most recent publication, revision or review date. Courses must be revised as soon as feasible following changes to relative codes, laws, rulings, decisions,

interpretations, and the like. Courses in subjects that undergo frequent changes must be reviewed by a subject matter expert at least once a year to verify the currency of the content. Other courses must be reviewed at least every two years.

.08 S4-01. Developed by subject matter expert(s). Learning activities must be developed by subject matter expert(s).

.09 Standard No. 5. CPE program sponsors of group, self study, nano learning, and blended learning programs must ensure learning activities are reviewed by content reviewers other than those who developed the programs to assure that the program is accurate and current and addresses the stated learning objectives. These reviews must occur before the first presentation of these materials and again after each significant revision of the CPE programs.

The participation of at least one licensed CPA (in good standing and holding an active license or the equivalent of an "active" CPA license in a U.S. jurisdiction) is required in the development of every program in accounting and auditing. The participation of at least one licensed CPA, tax attorney, or IRS enrolled agent (in good standing and holding an active CPA license or the equivalent of an "active" license in a U.S. jurisdiction) is required in the development of each program in the field of study of taxes. In the case of the subject matter of international taxes, the participation of the equivalent of an "active" licensed CPA for the international jurisdiction involved is permitted. As long as this requirement is met at some point during the development process, a program would be in compliance. Whether to have this individual involved during the development or the review process is at the CPE program sponsor's discretion.

.10 S5-01. Qualifications of content reviewers. Individuals or teams qualified in the subject matter must review programs. When it is impractical to review certain programs in advance, such as lectures given only once, greater reliance should be placed on the recognized professional competence of the instructor or presenter.

.11 S5-02. Review responsibilities if content is purchased from another entity. CPE program sponsors may purchase course content from other entities and developers. The organization that issues the certificate of completion under its name to the participants of the program is responsible for compliance with all Standards and other CPE requirements.

If a CPE program sponsor plans to issue certificates of completion under its name, then the CPE program sponsor must first consider whether the content was purchased from an entity registered with NASBA on the National Registry of CPE Sponsors.

- If the content is purchased from a sponsor registered with NASBA on the National Registry of CPE Sponsors, then the CPE program sponsor may maintain the author/developer and content reviewer documentation from that sponsor to satisfy the content development requirements of the Standards. The documentation should be maintained as prescribed in Standard No. 24.
- If the content is purchased from an entity not registered with NASBA on the National Registry of CPE Sponsors, then the CPE program sponsor must independently review the purchased content to ensure compliance with the Standards. If the CPE program sponsor does not have the subject matter expertise on staff, then

the CPE program sponsor must contract with a content reviewer to conduct the review. The CPE program sponsor must maintain the appropriate documentation regarding the credentials and experience of both the course author/developer(s) and content reviewer(s) as prescribed in Standard No. 24.

.12 Standard No. 6. CPE program sponsors of independent study learning activities must be qualified in the subject matter.

.13 S6-01. Requirements of independent study sponsor. A CPE program sponsor of independent study learning activities must have expertise in the specific subject area related to the independent study. The CPE program sponsor must also

- review, evaluate, approve, and sign the proposed independent study learning contract, including agreeing in advance on the number of credits to be recommended upon successful completion.
- evidence program completion by at least one of the following:
 - reviewing and signing the written report developed by the participant in independent study.
 - certifying in writing that the applicant has demonstrated application of learning objectives through successful completion of tasks.
 - certifying in writing that the applicant has performed a live demonstration, oral examination or presentation to a subject matter expert.
- retain the necessary documentation as included in Standard No. 24 to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.

.14 Standard No. 7. Group live programs must employ instructional strategies that clearly define learning objectives, guide the participant through a program of learning and include elements of engagement within the program.

Whether a program is classified as group live or group internet based is determined by how the participant consumes the learning (in a group setting or on an individual basis) and not by the technology used in program delivery. Group live examples include but are not limited to: classroom setting with a real time instructor; participants in a group setting and calling in to a teleconference; and participants in a group setting and watching a rebroadcast of a program with a real time subject matter expert facilitator.

.15 S7-01. Required elements of engagement. A group live program must include at least one element of engagement related to course content during each full credit of CPE (for example: group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program). In certain limited circumstances, for example, a high-profile keynote session, an element of engagement may not be appropriate. In such cases, the sponsor should document the justification.

.16 S7-02. Real time instructor during program presentation. Group live programs must have a real time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). Once a group live program is recorded for future presentation, it will continue to be considered a

group live program only where a real time subject matter expert facilitates the recorded presentation. CPE credit for a recorded group live program facilitated by a real time subject matter expert will be equal to the CPE credit awarded to the original presentation.

.17 S7-03. No real time instructor during recorded program presentation. A group live program that is recorded for future presentation that does not include a real time subject matter facilitator is no longer a group live program and will only be classified as a self study program if it meets all self study delivery method requirements with the exception of the basis for CPE credit. CPE credit for a recorded group live program not facilitated by a real time subject matter expert will be equal to the CPE credit awarded to the original presentation or it may be determined by either of the two self study credit determination methodologies described in Standard No. 17: pilot testing or the prescribed word count formula, at the sponsor's discretion.

.18 Standard No. 8. Group Internet based programs must employ instructional strategies that clearly define learning objectives, guide the participant through a program of learning, and provide evidence of a participant's satisfactory completion of the program.

Whether a program is classified as group live or group Internet based is determined by how the participant consumes the learning (in a group setting or on an individual basis) and not by the technology used in program delivery. Group Internet based examples include but are not limited to: participation in a webcast individually; participating in a broadcast of a group live presentation on an individual basis; and participants calling in to a conference call on an individual basis.

.19 S8-01. Real time instructor during program presentation. Group Internet based programs must have a real time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). Once a group Internet based program is recorded for future presentation, it will continue to be considered a group Internet based program only where a real time subject matter expert facilitates the recorded presentation. CPE credit for a recorded group Internet based program, facilitated by a real time subject matter expert, will be equal to the CPE credit awarded to the original presentation.

.20 S8-02. No real time instructor during recorded program presentation. A group Internet based program that is recorded for future presentation that does not include a real time subject matter facilitator is no longer a group Internet based program and will only be classified as a self study program if it meets all self study delivery method requirements with the exception of the basis for CPE credit. CPE credit for a recorded group Internet based program not facilitated by a real time subject matter expert will be equal to the CPE credit awarded to the original presentation or it may be determined by either of the two self study credit determination methodologies described in Standard No. 17: pilot testing or the prescribed word count formula, at the sponsor's discretion.

.21 Standard No. 9. Self study programs must employ instructional strategies that clearly define learning objectives, guide the participant through a program of learning, and provide evidence of a participant's satisfactory completion of the program.

.22 S9-01. Guide participant through a program of learning. To guide participants through a program of learning, CPE program sponsors of self study programs must elicit participant responses to test for understanding

of the material. Appropriate feedback must be provided. Satisfactory completion of the program must be confirmed during or after the program through a qualified assessment.

.23 S9-02. Use of review questions or other content reinforcement tools. Review questions or other content reinforcement tools must be placed throughout the program in sufficient intervals to allow the participant the opportunity to evaluate the material that needs to be re-studied. At least three review questions or other content reinforcement tools with score responses per CPE credit must be included. If the program is marketed for one-half CPE credits, then two review questions or other content reinforcement tools with scored responses must be included. Other content reinforcement tools with scored responses, such as simulations, that guide participants through structured decisions can be used in lieu of review questions.

After the first full credit and the minimum of three review questions or other content reinforcement tools with scored responses, additional review questions or other content reinforcement tools with scored responses are required based on the additional credit measurement amount of the program as follows:

Additional Credit	Additional Review Questions or Other Content Reinforcement Tools
0.2	0
0.4	1
0.5	2
0.6	2
0.8	3
Next full credit	3

.24 S9-03. Evaluative and reinforcement feedback on review questions or other content reinforcement tools. When review questions, such as the multiple choice method are used, evaluative feedback for each incorrect response must explain specifically why each response is wrong, and reinforcement feedback must be provided for correct responses, even when the minimum number of review questions or other content reinforcement tools requirement has otherwise been exceeded. When other content reinforcement tools, such as drag-and-drop, rank order, or matching activities, are used, then it is permissible to provide single feedback to explain the correct response. Other content reinforcement tools, such as simulations, that guide participants through structured decisions could provide feedback at irregular intervals or at the end of the learning experience. In those situations, single feedback would be permissible. "True or false" questions do not count toward the number of required review questions per CPE credit. Sponsors that elect to include "true or false" questions must provide evaluative and reinforcement feedback. Forced choice questions other than "true or false" questions, when used as part of an overall learning strategy, are allowed as review questions and can be counted in the number of review questions required per CPE credit. There is no minimum passing rate required for review questions or other content reinforcement tools.

.25 S9-04. Qualified assessment requirements. To provide evidence of satisfactory completion of the course, CPE program sponsors of self study programs must require participants to successfully complete a qualified assessment during or after the program with a cumulative minimum passing grade of at least 70 percent before issuing CPE credit for the course. Assessments

may contain questions of varying format (for example, multiple choice, essay, and simulations). At least 5 questions and scored responses per CPE credit must be included on the qualified assessment or 3 assessment questions and scored responses if the program is marketed for one-half CPE credits. For example, the qualified assessment for a 5-credit course must include at least 25 questions and scored responses. Alternatively, a 5 1/2 credit course must include at least 28 questions and scored responses. Except in courses in which recall of information is the learning strategy, duplicate review and qualified assessment questions are not allowed. "True or false" questions are not permissible on the qualified assessment.

After the first full credit and the minimum of 5 questions and scored responses per CPE credit, additional qualified assessment questions and scored responses are required based on the additional credit measurement amount of the program as follows:

Additional Credit	Additional Questions/ Scored Responses
0.2	1
0.4	2
0.5	3
0.6	3
0.8	4
Next full credit	5

If a pre-program assessment is used in the course, then the pre-program assessment cannot be included in the determination of the recommended CPE credits for the course. If a pre-program assessment is used and feedback is provided, then duplicate pre-program assessment and qualified assessment questions are not permitted. If a pre-program assessment is used and feedback is not provided, then duplicate pre-program assessment and qualified assessment questions are permissible. Feedback may comply with the feedback for review questions as described in S9-03 or take the form of identifying correct and incorrect answers.

A qualified assessment must measure a representative number of the learning objectives for the program. A representative number of the learning objectives is 75 percent or more of the learning objectives for the program. The representative number of the learning objectives can be less than 75 percent of the learning objectives for the program only if a randomized question generator is used and the test bank used in the creation of the assessment includes at least 75 percent of the learning objectives for the program. Assessment items must be written to test the achievement of the stated learning objectives of the course.

.26 S9-05. Feedback on qualified assessment. Providing feedback on the qualified assessment is at the discretion of the CPE program sponsor. If the CPE program sponsor chooses to provide feedback and

- uses a test bank, then the CPE program sponsor must ensure that the question test bank is of sufficient size to minimize overlap of questions on the qualified assessment for the typical repeat test taker. Feedback may comply with the feedback for review questions as described in S9-03, or take the form of identifying correct and incorrect answers.

- does not use a test bank, whether or not feedback can be given depends on whether the participant passes the qualified assessment, then
 - on a failed assessment, the CPE program sponsor may not provide feedback to the test taker.
 - on assessments passed successfully, CPE program sponsors may choose to provide participants with feedback. This feedback may comply with the type of feedback for review questions as described in S9-03 or take the form of identifying correct and incorrect answers.

.27 S9-06. Program or course expiration date. Course documentation must include an expiration date (the time by which the participant must complete the qualified assessment). For individual courses, the expiration date is no longer than one year from the date of purchase or enrollment. For a series of courses to achieve an integrated learning plan, the expiration date may be longer.

.28 S9-07. Based on materials developed for instructional use. Self study programs must be based on materials specifically developed for instructional use and not on third party materials. Self study programs requiring only the reading of general professional literature, IRS publications, or reference manuals followed by a test will not be acceptable. However, the use of the publications and reference materials in self study programs as supplements to the instructional materials could qualify if the self study program complies with each of the CPE standards.

Instructional materials for self study include teaching materials which are developed for instructional educational purposes. These materials must demonstrate the expertise of the author(s). At a minimum, instructional materials must include the following items:

1. An overview of topics
2. The ability to find information quickly (for example, an index, a detailed menu or key word search function)
3. The definition of key terms (for example, a glossary or a search function that takes a participant to the definition of a key word)
4. Instructions to participants regarding navigation through the course, course components, and course completion
5. Review questions with feedback
6. Qualified assessment

.29 Standard No. 10. Nano learning programs must employ instructional strategies that clearly define a minimum of one learning objective, guide the participant through a program of learning and provide evidence of a participant's satisfactory completion of the program. Satisfactory completion of the program must be confirmed at the conclusion of the program through a qualified assessment. Review questions or other content reinforcement tools that comply with S9-03 may be included in a nano learning program.

.30 S10-01. Qualified assessment requirements. To provide evidence of satisfactory completion of the course, CPE program sponsors of nano learning programs must require participants to successfully complete a qualified assessment with a passing grade of 100 percent before issuing CPE credit for the course. Assessments may contain questions of varying format (for example, multiple choice, rank order, and matching). Only two questions must be

included on the qualified assessment. "True or false" questions are not permissible on the qualified assessment. If the participant fails the qualified assessment, then the participant must re-take the nano learning program. The number of re-takes permitted a participant is at the sponsor's discretion.

.31 S10-02. Feedback on qualified assessment. Providing feedback on the qualified assessment is at the discretion of the CPE program sponsor. If the CPE program sponsor chooses to provide feedback and

- uses a test bank, then the CPE program sponsor must ensure that the question test bank is of sufficient size for no overlap of questions on the qualified assessment for the typical repeat test taker. If the multiple choice method is used, evaluative feedback for each incorrect response must explain specifically why each response is wrong and reinforcement feedback must be provided for correct responses. If rank order or matching questions are used, then it is permissible to provide single feedback to explain the correct response. Feedback may also take the form of identifying correct and incorrect answers.
- does not use a test bank, whether or not feedback can be given depends on whether the participant passes the qualified assessment, then
 - on a failed assessment, the CPE program sponsor may not provide feedback to the test taker.
 - on assessments passed successfully, CPE program sponsors may choose to provide participants with feedback. This feedback may comply with the type of feedback described in the preceding paragraph or take the form of identifying correct and incorrect answers.

.32 S10-03. Program or course expiration date. Course documentation must include an expiration date. The expiration date is no longer than one year from the date of purchase or enrollment.

.33 S10-04. Based on materials developed for instructional use. Nano learning programs must be based on materials specifically developed for instructional use and not on third party materials. Nano learning programs requiring only the reading of general professional literature, IRS publications or reference manuals followed by an assessment will not be acceptable.

Acceptable instructional materials for a nano learning program include intentional, engaged learning activities developed for focused content delivery. Nano learning programs may incorporate techniques such as visuals, slide reinforcements, role play, demonstrations, or use of a white board. The intent of a nano learning program is to transfer knowledge that is interactive—seeking to teach by example—to supply information to understand a specific concept, complete a certain task or computation, or to problem-solve or make decisions through role play or demonstration. At a minimum, nano learning programs must include the following items:

1. The learning objective(s) of the program
2. Any instructions that participants need to navigate through the program
3. A qualified assessment

.34 Standard No. 11. Blended learning programs must employ instructional strategies that clearly define learning objectives and guide

the participant through a program of learning. Pre-program, post-program, and homework assignments should enhance the learning program experience and must relate to the defined learning objectives of the program.

.35 S11-01. Guide participant through a program of learning. The blended learning program includes both asynchronous and synchronous learning; different instructional strategies (for example, lectures, discussion, guided practice, reading, games, case studies, and simulation); different instructional delivery methods (group live, group Internet based, nano learning, or self study); or different levels of guidance (for example, a program led by an individual, instructor or subject matter expert, or group and social learning). To guide participants through the learning process, CPE program sponsors must provide clear instructions and information to participants that summarize the different components of the program and what must be completed or achieved during each component in order to qualify for CPE credits. The CPE program sponsor must document the process and components of the course progression and completion of components by the participants.

.36 S11-02. Primary components of blended learning program are synchronous learning activities. If the primary components of the blended learning program are synchronous learning activities, then CPE credits for pre-program, post-program, and homework assignments cannot constitute more than 25 percent of the total CPE credits available for the blended learning program.

.37 S11-03. Primary components of blended learning program are asynchronous learning activities. If the primary components of the blended learning program are asynchronous learning activities, then the blended learning program must incorporate a qualified assessment in which participants demonstrate achievement of the learning objectives of the program.

.38 S11-03.1. Qualified assessment requirements. A qualified assessment must measure a representative number of learning objectives for the program. A representative number of the learning objectives is 75 percent or more of the learning objectives for the program. The qualified assessment must be completed during or after the program with a cumulative minimum passing grade of at least 70 percent before issuing CPE credit for the course.

.39 S11-04. A course for credit from an accredited university or college. A course from an accredited university or college that is successfully completed for credit will be considered to be a blended learning program. CPE program sponsors should refer to respective state board of accountancy requirements for definition of an accredited university or college.

Standards for CPE Program Presentation

.40 Standard No. 12. CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. For CPE program sponsors whose courses are developed for sale or for external audiences (that is, not internal training), CPE program sponsors must make the following information available in advance:

- Learning objectives
- Instructional delivery methods
- Recommended CPE credit and recommended field of study
- Prerequisites

- **Program knowledge level**
- **Advance preparation**
- **Program description**
- **Course registration and, where applicable, attendance requirements**
- **Refund policy for courses sold for a fee or cancellation policy**
- **Complaint resolution policy**
- **Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits)**

For CPE program sponsors whose courses are purchased or developed for internal training only, CPE program sponsors must make the following information available in advance:

- **Learning objectives**
- **Instructional delivery methods**
- **Recommended CPE credit and recommended field of study**
- **Prerequisites**
- **Advance preparation**
- **Program knowledge level (for optional internal courses only)**
- **Program description (for optional internal course only)**

.41 S12-01. Disclose significant features of program in advance. For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (such as through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund and cancellation policies as well as complaint resolution policies.

.42 S12-02. Disclose advance preparation and prerequisites. CPE program sponsors must distribute program materials in a timely manner and encourage participants to complete any advance preparation requirements. All programs must clearly identify prerequisite education, experience, and advance preparation requirements, if any, in the descriptive materials. Prerequisites, if any, must be written in precise language so that potential participants can readily ascertain whether they qualify for the program.

.43 Standard No. 13. CPE program sponsors must ensure instructors are qualified with respect to both program content and instructional strategies used.

.44 S13-01. Qualifications of instructors. Instructors are key ingredients in the learning process for any group or blended learning program. Therefore, it is imperative that CPE program sponsors exercise great care in selecting qualified instructors for all group or blended learning programs. Qualified instructors are those who are capable, through training, education, or experience

of communicating effectively and providing an environment conducive to learning. They must be competent and current in the subject matter, skilled in the use of the appropriate instructional strategies and technology, strive to engage participants and prepared in advance.

.45 S13-02. Evaluation of instructor's performance. CPE program sponsors should evaluate the instructor's performance at the conclusion of each program to determine the instructor's suitability to serve in the future.

.46 Standard No. 14. CPE program sponsors must employ an effective means for evaluating learning activity quality with respect to content and presentation, as well as provide a mechanism for participants to assess whether learning objectives were met.

.47 S14-01. Required elements of evaluation. The objectives of evaluation are to assess participant and instructor satisfaction with specific programs and to increase subsequent program effectiveness. Evaluations, whether written or electronic, must be solicited from participants and instructors for the overall program, including self study and nano learning programs. Sponsors may elect to solicit evaluations for each session within an overall program. Evaluations determine, among other things, whether

- stated learning objectives were met.
- stated prerequisite requirements were appropriate and sufficient.
- program materials, including the qualified assessment, if any, were relevant and contributed to the achievement of the learning objectives.
- time allotted to the learning activity was appropriate.
- instructors were effective. (Note: This topic does not need to be included in evaluations for self study and nano learning programs.)

If the instructor is actively involved in the development of the program materials, then it is not necessary to solicit an evaluation from the instructor.

.48 S14-02. Evaluation results. CPE program sponsors must periodically review evaluation results to assess program effectiveness and should inform developers and instructors of evaluation results.

.49 Standard No. 15. CPE program sponsors must ensure instructional strategies employed are appropriate for the learning activities.

.50 S15-01. Assess instructional strategy in context of program presentation. CPE program sponsors must assess the instructional strategies employed for the learning activities to determine whether the delivery is appropriate and effective.

.51 S15-02. Facilities and technology appropriateness. Learning activities must be presented in a manner consistent with the program materials provided. Integral aspects of the learning environment that should be carefully monitored include the number of participants and the facilities and technologies employed in the delivery of the learning activity.

Standards for CPE Program Measurement

.52 Standard No. 16. Sponsored learning activities are measured by actual program length, with one 50-minute period equal to one CPE credit. Sponsors may recommend CPE credits under the following scenarios:

- **Group programs, independent study, and blended learning programs**—A minimum of one full credit must be awarded initially, but after the first credit has been earned, credits may be awarded in one-fifth increments or in one-half increments (1.0, x.2, x.4, x.5, x.6, x.8, and so on).
- **Self study**—A minimum of one-half credit must be awarded initially, but after the first full credit has been earned, credits may be awarded in one-fifth increments or in one-half increments (0.5, 1.0, x.2, x.4, x.5, x.6, x.8, and so on).
- **Nano learning**—Credits must be awarded only as one-fifth credit (0.2 credit). A 20-minute program would have to be produced as two stand-alone nano learning programs.

CPE Program	Minimum initial credit that must be earned	After first credit has been earned, credit may be earned in these increments, in addition to one whole credit
Group	One	One-fifth or one-half
Independent study	One	One-fifth or one-half
Blended learning	One	One-fifth or one-half
Self study	One-half	One-fifth or one-half
Nano learning	One-fifth	Not applicable (single nano learning program is one-fifth credit)

Sponsors may round down CPE credits awarded to the nearest one-fifth, one-half, or whole credit, at their discretion and as appropriate for the instructional delivery method; however, the CPA claiming CPE credits should refer to respective state board requirements regarding acceptability of one-fifth and one-half CPE credits.

Only learning content portions of programs (including pre-program, post-program, and homework assignments, when incorporated into a blended learning program) qualify toward eligible credit amounts. Time for activities outside of actual learning content including, for example, excessive welcome and introductions, housekeeping instructions, and breaks, is not accepted toward credit.

.53 S16-01. Learning activities with individual segments. For learning activities in which individual segments are less than 50 minutes, the sum of the segments would be considered one total program. For example, five 30-minute presentations would equal 150 minutes and would be counted as three CPE credits. When the total minutes of a sponsored learning activity are greater than 50, but not equally divisible by 50, the CPE credits granted must be rounded down to the nearest credit basis depending on the instructional delivery method of the program. For example, a group live program must be rounded down to the nearest one-fifth, one-half, or whole credit. Thus, learning activities with segments totaling 140 minutes would be granted two and four-fifths CPE credits if using one-fifth increments and two and one-half credits if using one-half increments.

For learning activities in which segments are classified in multiple fields of study, the CPE credits granted should first be computed based on the content time of the total program. Next, the CPE credits granted should be allocated

to the fields of study based on the field of study content time. If the sum of the individual segments by field of study content time does not equal the CPE credits computed based on the content time for the total program, then the difference should be allocated to the primary field of study for the program.

.54 S16-02. Responsibility to monitor attendance. Although it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient.

.55 S16-03. Monitoring mechanism for group Internet based programs. In addition to meeting all other applicable group program standards and requirements, group Internet based programs must employ some type of real time monitoring mechanism to verify that participants are participating during the course. The monitoring mechanism must be of sufficient frequency and lack predictability to ensure that participants have been engaged throughout the program. The monitoring mechanism must employ at least three instances of interactivity completed by the participant per CPE credit. CPE program sponsors should verify with respective boards of accountancy on specific interactivity requirements. Additional monitoring mechanisms are required based on the additional credit amount of the program as follows:

Additional Credit	Additional Monitoring Mechanisms
0.2	0
0.4	1
0.5	2
0.6	2
0.8	3
Next full credit	3

.56 S16-04. Small group viewing of group Internet based programs. In situations where small groups view a group Internet based program such that one person logs into the program and asks questions on behalf of the group, documentation of attendance is required in order to award CPE credits to the group of participants. Participation in the group must be documented and verified by the small group facilitator or administrator in order to authenticate attendance for program duration.

.57 S16-05. University or college credit course. For university or college credit courses that meet these CPE Standards, each unit of college credit shall equal the following CPE credits:

- Semester System 15 credits
- Quarter System 10 credits

.58 S16-06. University or college noncredit course. For university or college noncredit courses that meet these CPE standards, CPE credit shall be awarded only for the actual classroom time spent in the noncredit course.

.59 S16-07. Participant preparation time. Credit is not granted to participants for preparation time, unless the program meets the criteria for blended learning in Standard No. 11.

.60 S16-08. Committee or staff meetings qualification for CPE credits. Only the portions of committee or staff meetings that are designed as programs of learning and comply with these Standards qualify for CPE credit.

.61 Standard No. 17. CPE credit for self study learning activities must be based on one of the following educationally sound and defensible methods:

Method 1: Pilot test of the representative completion time.

Method 2: Computation using the prescribed word count formula.

If a pre-program assessment is used, the pre-program assessment is not included in the CPE credit computation.

.62 S17-01. Method 1—Sample group of pilot testers. A sample of intended professional participants must be selected to test program materials in an environment and manner similar to that in which the program is to be presented. The sample group must consist of at least three qualified individuals who are independent of the program development group.

- For those courses whose target audience includes CPAs, the sample group must be licensed CPAs in good standing, hold an active CPA license or the equivalent of an "active" CPA license in a U.S. jurisdiction, and possess the appropriate level of knowledge before taking the program.
- For those sponsors who are subject to various regulatory requirements that mandate a minimum number of CPE credits and offer courses to non-CPAs, those courses do not have to be pilot tested by licensed CPAs.
- For those courses whose target audience includes CPAs and non-CPAs, the sample group must be representative of the target audience and contain both CPAs, as defined previously, and non-CPAs.

.63 S17-02. Method 1—CPE credit based on representative completion time. The sample does not have to ensure statistical validity; however, if the results of pilot testing are inconsistent, then the sample must be expanded or, if the inconsistent results are outliers, the inconsistent results must be eliminated. CPE credit must be recommended based on the representative completion time for the sample. Completion time includes the time spent taking the final examination and does not include the time spent completing the course evaluation or pre-program assessment. Pilot testers must not be informed about the length of time the program is expected to take to complete. If substantive changes are subsequently made to program materials, whether in one year or over a period of years, further pilot tests of the revised program materials must be conducted to affirm or amend, as appropriate, the representative completion time.

.64 S17-03. Method 1—Requirement for re-pilot testing. If, subsequent to course release, actual participant completion time warrants a change in CPE credit hours, re-pilot testing is required to substantiate a change in CPE credit prospectively.

.65 S17-04. Method 1—Pilot testing when course is purchased from vendor or other developer. CPE program sponsors may purchase courses from other vendors or course developers. For purchased courses where pilot tests were conducted and provided, CPE program sponsors must review results of the course developer's pilot test results to ensure that the results are appropriate. For purchased courses where no pilot tests were conducted or provided, CPE program sponsors must conduct pilot testing or perform the word count formula as prescribed in method 2 in S17-05.

.66 S17-05. Method 2—Basis for prescribed word count formula. The prescribed word count formula begins with a word count of the number

of words contained in the text of the required reading of the self study program and should exclude any material not critical to the achievement of the stated learning objectives for the program. Examples of information material that is not critical and, therefore, *excluded* from the word count are course introduction, instructions to the participant, author/course developer biographies, table of contents, glossary, pre-program assessment, and appendixes containing supplementary reference materials.

Again, only course content text that is critical to the achievement of stated learning objectives should be included in the word count formula. If an author/course developer determines, for example, that including the entire accounting rule or tax regulation is beneficial to the participant, the accounting rule or tax regulation should be included as an appendix to the course as supplementary reference material and excluded from the word count formula. Only pertinent paragraphs or sections of the accounting rule or tax regulation required for the achievement of stated learning objectives should be included in the actual text of the course and therefore included in the word count formula.

Review questions, exercises, and qualified assessment questions are considered separately in the calculation and should not be included in the word count.

.67 S17-06. Method 2—Calculation of CPE credit using the prescribed word count formula. The word count for the text of the required reading of the program is divided by 180, the average reading speed of adults. The total number of review questions (including those above the minimum requirements), exercises and qualified assessment questions is multiplied by 1.85, which is the estimated average completion time per question. These two numbers plus actual audio/video duration time (not narration of the text), if any, are then added together and the result divided by 50 to calculate the CPE credit for the self study program. When the total minutes of a self study program are not equally divisible by 50, the CPE credits granted must be rounded down to the nearest one-half credit, one-fifth credit or whole credit using the guidelines of Standard No. 16.

$$[(\# \text{ of words}/180) + \text{actual audio/video duration time} + (\# \text{ of questions} \times 1.85)] / 50 = \text{CPE credit}$$

.68 S17-07. Method 2—Consideration of audio and video segments in word count formula. If audio and video segments of a self study program constitute additional learning for the participant (that is, not narration of the text), then the actual audio/video duration time may be added to the time calculation as provided in the prescribed word count formula. If the entire self study program constitutes a video, then the prescribed word count formula in S17-06 would consist of the actual video time plus the total number of review questions (including those above the minimum requirements), exercises, and qualified assessment questions multiplied by 1.85, divided by 50 (that is, there would be no word count for text used in the formula).

$$[\text{actual audio/video duration time} + (\# \text{ of questions} \times 1.85)] / 50 = \text{CPE credit}$$

.69 S17-08. Method 2—Word count formula when course is purchased from vendor or other developer. CPE program sponsors may purchase courses from other vendors or course developers. For purchased courses where the word count formula was calculated, CPE program sponsors must review the results of the course developer's word count formula calculation to ensure that results are appropriate. For purchased courses where the word count formula calculation was not performed or provided, CPE program sponsors must perform the word count formula calculation or conduct pilot testing as described in method 1 in S17-01 and S17-02.

.70 S17-09. CPE credit calculation for an adaptive learning self study program. CPE credit for an adaptive learning self study program must be based on one of the following educationally sound and defensible methods:

- Adaptive Learning Method 1: Pilot test of the representative completion time
- Adaptive Learning Method 2: Computation using the prescribed word count formula

.71 S17-10. Adaptive Learning Method 1—Sample group of pilot testers. A sample of intended professional participants must be selected to test program materials in an environment and manner similar to that in which the program is to be presented. The sample group must consist of at least seven qualified individuals who are independent of the program development group.

- For those courses whose target audience includes CPAs, the sample group must be licensed CPAs in good standing, hold an active CPA license or the equivalent of an "active" CPA license in a U.S. jurisdiction, and possess the appropriate level of knowledge before taking the program.
- For those sponsors who are subject to various regulatory requirements that mandate a minimum number of CPE70 credits and offer courses to non-CPAs, those courses do not have to be pilot tested by licensed CPAs.
- For those courses whose target audience includes CPAs and non-CPAs, the sample group must be representative of the target audience and contain both CPAs, as defined previously, and non-CPAs.

.72 S17-11. Adaptive learning self study Method 1—CPE credit based on representative completion time. The sample does not have to ensure statistical validity; however, if the results of pilot testing are inconsistent, then the sample must be expanded or, if the inconsistent results are outliers, the inconsistent results must be eliminated. CPE credit must be recommended based on the representative completion time for the sample. Completion time includes the time spent taking the qualified assessment. Pilot testers must not be informed about the length of time the program is expected to take to complete. If substantive changes are subsequently made to program materials, whether in one year or over a period of years, further pilot tests of the revised program materials must be conducted to affirm or amend, as appropriate, the representative completion time.

.73 S17-12. Adaptive learning self study Method 1—Requirement for re-pilot testing. If, subsequent to course release, actual participant completion time warrants a change in CPE credit hours, re-pilot testing is required to substantiate a change in CPE credit prospectively.

.74 S17-13. Adaptive learning self study Method 1—Pilot testing when course is purchased from vendor or other developer. CPE program sponsors may purchase courses from other vendors or course developers. For purchased courses in which pilot tests were conducted and provided, CPE program sponsors must review results of the course developer's pilot test results to ensure that the results are appropriate. For purchased courses in which no pilot tests were conducted or provided, CPE program sponsors must conduct pilot testing as prescribed in S17-10 and S17-11.

.75 S17-14. Adaptive learning self study Method 2—Computation using the prescribed word count formula. For adaptive learning self study programs, the CPE credit issued must be based on the average word count formula calculation of each potential path the learner could take to complete the

program using the prescribed word count formula as described in S17-16. All potential paths must be documented. For example, if the adaptive learning self study program has nine potential paths a learner could take to complete the program, then the word count formula must be calculated for each of the nine potential paths, with the sum of the results divided by nine.

.76 S17-15. Adaptive learning self study Method 2—Basis for prescribed word count formula. The prescribed word count formula begins with a word count of the number of words contained in the text of the required reading of the adaptive learning self study program and should exclude any material not critical to the achievement of the stated learning objectives for the program. Examples of information material that is not critical and, therefore, excluded from the word count are course introduction, instructions to the participant, author/course developer biographies, table of contents, glossary, pre-program assessment, and appendixes containing supplementary reference materials.

Again, only course content text that is critical to the achievement of stated learning objectives should be included in the word count formula. If an author/course developer determines, for example, that including the entire accounting rule of tax regulation is beneficial to the participant, the accounting rule or tax regulation should be included as an appendix to the course as supplementary reference material and excluded from the word count formula. Only pertinent paragraphs or sections of the accounting rule or tax regulation required for achievement of the stated learning objectives should be included in the actual text of the course and, therefore, included in the word count formula.

Review questions, exercises, and qualified assessment questions are considered separately in the calculation and should not be included in the word count.

.77 S17-16. Adaptive learning self study Method 2—Calculation of CPE credit for each potential learning path using the prescribed word count formula. The word count for the text of the required reading of the program is divided by 180, the average reading speed of adults. The total number of review questions (including those above the minimum requirements), exercises, and qualified assessment questions is multiplied by 1.85, which is the estimated average completion time per question. These two numbers plus actual audio/video duration time (not narration of the text), if any, are then added together and the result divided by 50 to calculate the CPE credit for the adaptive learning self study program. When the total minutes of an adaptive learning self study program are not equally divisible by 50, the CPE credits granted must be rounded down to the nearest one-half credit, one-fifth credit, or whole credit using the guidelines of Standard No. 16.

$$\left[\left(\frac{\text{\# of words}}{180} \right) + \text{actual audio/video duration time} + (\text{\# of questions} \times 1.85) \right] / 50 = \text{CPE credit}$$

.78 S17-17. Adaptive learning self study Method 2—Word count formula when course is purchased from vendor or other developer. CPE program sponsors may purchase from other vendors or course developers. For purchased courses in which the word count formula was calculated, CPE program sponsors must review the results of the course developer's word count formula calculation to ensure that results are appropriate. For purchased courses in which the word count formula calculation was not performed or provided, CPE program sponsors must perform the word count formula calculation or conduct pilot testing as described in method 1.

.79 Standard No. 18. CPE credit for nano learning programs must be based on the duration of the program including review questions or other content reinforcement tools plus the qualified assessment,

which, when combined, should be a minimum of 10 minutes. The maximum credit to be awarded for a single nano learning program is one-fifth (0.2) credit. Sponsors must use Method 2 in S17-07 to confirm that the nano learning program is a minimum of 10 minutes and less than 20 minutes.

.80 Standard No. 19. CPE credit for blended learning programs must equal the sum of the CPE credit determinations for the various completed components of the program. CPE credits could be determined by actual duration time (for example, audio/video duration time or learning content delivery time in a group program) or by a pilot test of the representative completion time as prescribed in S17-01 or word count formula as prescribed in S17-06 (for example, reading, games, case studies, simulations).

.81 Standard No. 20. Instructors and discussion leaders of learning activities may receive CPE credit for their preparation, review, and presentation time to the extent the activities maintain or improve their professional competence and meet the requirements of these Standards. Content reviewers of learning activities may receive CPE credit for actual review time up to the actual number of CPE credits for the programs, subject to the regulations and maximums established by boards of accountancy.

.82 S20-01. Instructor CPE credit parameters. Instructors, discussion leaders, or speakers who present a learning activity for the first time may receive CPE credit for actual preparation time up to 2 times the number of CPE credits to which participants would be entitled, in addition to the time for presentation, subject to regulations and maximums established by the state boards. For example, for learning activities in which participants could receive 8 CPE credits, instructors may receive up to 24 CPE credits (16 for preparation plus 8 for presentation). For repeat presentations, CPE credit can be claimed only if it can be demonstrated that the learning activity content was substantially changed and such change required significant additional study or research.

.83 S20-02. Presenting a program. The CPA claiming CPE credits should refer to respective state board requirements.

.84 S20-03. Content reviewer CPE credit parameters. Content reviewers who review a learning activity for the first time may receive CPE credit for actual review time up to the actual number of CPE credits for the program, subject to regulations and maximums established by state boards. For repeat content reviews, CPE credit can be claimed only if it can be demonstrated that the learning activity content was substantially changed and such change required significant additional study or research.

.85 Standard No. 21. Writers of published articles, books, or CPE programs may receive CPE credit for their research and writing time to the extent it maintains or improves their professional competence.

.86 S21-01. Requirement for content review. Writing articles, books, or CPE programs for publication is a structured activity that involves a process of learning. For the writer to receive CPE credit, the article, book, or CPE program must be formally reviewed by a content reviewer other than the writer. CPE credits should be claimed only upon publication.

.87 S21-02. Authoring a program. As a general rule, receiving CPE credits for authoring and presenting the same program should not be allowed. The CPA claiming CPE credits should refer to respective state board requirements.

.88 Standard No. 22. CPE credits recommended by a CPE program sponsor of independent study must not exceed the time the participant devoted to complete the learning activities specified in the learning contract.

.89 S22-01. CPE credits agreed to in advance. The maximum credits to be recommended by an independent study CPE program sponsor must be agreed upon in advance and must be equated to the effort expended to improve professional competence. The credits cannot exceed the time devoted to the learning activities and may be less than the actual time involved.

Standards for CPE Program Reporting

.90 Standard No. 23. CPE program sponsors must provide program participants with documentation (electronic or paper) of their participation (certificate of completion), which includes the following:

- CPE program sponsor name and contact information
- Participant's name
- Course title
- Date offered or completed
- If applicable, location
- Type of instructional and delivery method used
- Amount of CPE credit recommended by field(s) of study
- Verification by CPE program sponsor representative
- Sponsor identification number or registration number, if required by the state boards
- NASBA time statement stating that CPE credits have been granted on a 50-minute hour
- Any other statements required by board of accountancy

The documentation should be provided as soon as possible and should not exceed 60 days (so that participants can report their earned CPE credits in a timely manner).

.91 S23-01. Entity to award CPE credits and acceptable documentation. The CPE program sponsor is the individual or organization responsible for issuing the certificate of completion and maintaining the documentation required by these Standards. The entity whose name appears on the certificate of completion is responsible for validating the CPE credits claimed by a participant. CPE program sponsors must provide participants with documentation (electronic or paper) to support their claims of CPE credit. Acceptable evidence of completion includes the following:

- For group, blended learning, and independent study programs, a certificate or other verification supplied by the CPE program sponsor
- For self study and nano learning programs, a certificate supplied by the CPE program sponsor after satisfactory completion of a qualified assessment

- For instruction or content review credit, appropriate supporting documentation that complies with the requirements of the respective state boards subject to the guidelines in Standard No. 20 in "Standards for CPE Program Measurement"
- For a university or college course that is successfully completed for credit, a record or transcript of the grade the participant received
- For university or college noncredit courses, a certificate of attendance issued by a representative of the university or college
- For published articles, books, or CPE programs:
 - A copy of the publication (or in the case of a CPE program, course development documentation) that names the CPA as author or contributor
 - A statement from the writer supporting the number of CPE hours claimed
 - The name and contact information of the content reviewer(s) or publisher

.92 S23-02. Certificate issuance for simultaneous delivery of a group live and group Internet based program. In circumstances where the CPE program sponsor is providing simultaneous delivery of a group live and group Internet based program, the CPE program sponsor, at its discretion, may issue the certificate of completion to all program participants by awarding CPE credits under the instructional delivery method attended by the majority of the participants. The delivery and attendance monitoring requirements of the respective instructional delivery methods still apply.

.93 Standard No. 24. CPE program sponsors must retain adequate documentation (electronic or paper) for a minimum of five years to support their compliance with these standards and the reports that may be required of participants.

.94 S24-01. Required documentation elements. Evidence of compliance with responsibilities set forth under these standards that is to be retained by CPE program sponsors includes the following:

- Records of participation.
- Dates and locations.
- Author/instructor, author/developer, and content reviewer, as applicable, names and credentials. For the CPA and tax attorney acting as an author/instructor, author/developer, and content reviewer for accounting, auditing, or tax program(s), the state of licensure, license number, and status of license should be maintained. For the enrolled agent acting in such capacity for tax program(s), information regarding the enrolled agent number should be maintained.
- Number of CPE credits earned by participants.
- Results of program evaluations.
- Program descriptive materials (course announcement information).

Information to be retained by CPE program sponsors includes copies of program materials, evidence that the program materials were developed and reviewed by qualified parties, and a record of how CPE credits were determined.

.95 S24-02. Maintenance of documentation as basis for CPE credit for self study programs. For CPE program sponsors using method 1 (pilot tests) as the basis for CPE credit for self study programs, as well as adoptive learning self study programs, appropriate pilot test records must be retained regarding the following:

- When the pilot test was conducted
- The intended participant population
- How the sample of pilot testers was selected
- Names and credentials and relevant experience of sample pilot test participants
- For CPA pilot testers, the state of licensure, license number, and status of license should be maintained.
- A summary of pilot test participants' actual completion time
- Statement from each pilot tester to confirm that the pilot tester is independent from the course development group and that the pilot tester was not informed in advance of the expected completion time

For CPE program sponsors using method 2 (word count formula) as the basis for CPE credit for self study programs, the word count formula calculation, as well as the supporting documentation for the data used in the word count formula (for example, word count; number of review questions, exercises, and final examination questions; duration of audio or video segments, or both, if applicable; and actual calculation), must be retained. For adaptive learning self study programs, all potential paths that a learner could take to complete the program must be documented and retained.

.96 S24-03. Maintenance of documentation of element of engagement for group live programs. In addition to the requirements in S24-01, group live CPE program sponsors must retain the program outline, agenda, speaker notes or other documentation that evidences the element of engagement related to course content during each credit of CPE planned for the group live program. As noted in S7-01, in certain limited circumstances, such as a high-profile keynote session, an element of engagement may not be appropriate. In such cases, the sponsor should document the reasons for justification.

.97 S24-04. Maintenance of documentation of instructions and information to participants regarding the components that comprise a blended learning program. In addition to the requirements of S24-01, blended learning CPE program sponsors must retain clear instructions and information that summarizes the different components of the blended learning program and what must be completed or achieved during each component in order to qualify for CPE credits. The CPE program sponsor must also retain documentation of the course progression and what CPE credits were earned by participants upon the completion of the components.

.98 S24-05. Maintenance of documentation of an independent study program. The CPE program sponsor of independent study learning activities must retain the approved, signed independent study learning contract. The CPE program sponsor must also retain the documentation to evidence program completion, such as the written report developed by the participant, a certification that the participant has demonstrated the application of learning

objectives, or a certification that the participant has performed a live demonstration, oral examination, or presentation to a subject matter expert.

Effective Date

.99 Unless otherwise established by state licensing bodies or other professional organizations, these standards are to be effective on December 31, 2019.

CPE Section 400

Glossary

Revised, December 2019.

.01 Adaptive learning self study program. A self study program that uses a computer algorithm, other predictive analytics tools, or learner-driven selections to orchestrate interaction with the learner and deliver customized learning activities to assist the learner in meeting the course's stated learning objectives. CPE credit for an adaptive learning self study program must be determined based on the methodologies detailed in S17-09 through S17-17.

.02 Advanced. Program knowledge level most useful for individuals with mastery of the particular topic. This level focuses on the development of in-depth knowledge, a variety of skills, or a broader range of applications. Advanced level programs are often appropriate for seasoned professionals within organizations; however, they may also be beneficial for other professionals with specialized knowledge in a subject area.

.03 Asynchronous. A learning activity in which the participant has control over time, place or pace of learning.

.04 Basic. Program knowledge level most beneficial to CPAs new to a skill or an attribute. These individuals are often at the staff or entry level in organizations, although such programs may also benefit a seasoned professional with limited exposure to the area.

.05 Blended learning program. An educational program that includes both asynchronous and synchronous learning activities, and incorporates different instructional delivery methods or instructional strategies, or different levels of guidance.

.06 Content reinforcement tools. Tools used within the overall learning activity to reinforce learning and influence behavior change throughout the learning or at the end of the learning. Examples include but are not limited to simulations, drag-and-drop, rank order, or matching activities.

.07 Content reviewer. Individuals or teams qualified in the subject matter other than those who developed the content.

.08 Continuing professional education (CPE). An integral part of the lifelong learning required to provide competent service to the public. The set of activities that enables CPAs to maintain or improve their professional competence.

.09 CPE credit. Fifty minutes of participation in a program of learning equals one CPE credit.

.10 CPE program sponsor. The individual or organization responsible for issuing the certificate of completion, and maintaining the documentation required by the Statement on Standards for CPE Programs.

.11 Elements of engagement. Tools within the overall learning activity of a group live program to encourage the participation of learners within the program. Examples include but are not limited to group discussion, polling questions, instructor-posed question with time for participant reflection, role play, demonstration or use of a case study with different engagement elements throughout the program.

.12 Evaluative feedback. Specific response to incorrect answers to questions in self study programs.

.13 Group Internet based program. Individual participation in synchronous learning with real-time interaction of an instructor or subject matter expert and built-in processes for attendance and interactivity.

.14 Group live program. Synchronous learning in a group environment with real time interaction of an instructor or subject matter expert that provides the required elements of attendance monitoring and engagement.

.15 Group program. Any group live or group Internet based programs.

.16 Independent study. An educational process designed to permit a participant to learn a given subject under a learning contract with a CPE program sponsor.

.17 Instructional delivery methods. Delivery formats used for CPE programs as defined within these Standards: group live, group Internet based, self study, nano learning, and blended learning.

.18 Instructional strategies. Strategies such as but not limited to case studies, computer-assisted learning, lectures, group interaction, programmed instruction, and use of audiovisual aids employed within the instructional delivery methods of group, self study, or independent study programs or other innovative programs.

.19 Intermediate. Program knowledge level that builds on a basic program and is most appropriate for CPAs with detailed knowledge in a particular topic. Such persons are often at a mid-level within the organization, with operational or supervisory responsibilities.

.20 Learning activity. An educational endeavor that maintains or improves professional competence.

.21 Learning contract. A written contract signed by an independent study participant and a qualified CPE program sponsor prior to the commencement of the independent study.

.22 Learning objectives. Measurable outcomes that participants should accomplish upon completion of a learning activity. Learning objectives are useful to program developers in deciding appropriate instructional strategies and allocating time to various subjects.

.23 Nano learning program. A program designed to permit a participant to learn a given subject in a minimum of 10 minutes and less than 20 minutes through the use of electronic media (including technology applications and processes and computer-based or web-based technology) and without interaction with a real-time instructor. A nano learning program differs from a self study program in that it is typically focused on a single learning objective and is not paper-based. A nano learning program is not a group program. Nano learning is not a substitute for comprehensive programs addressing complex issues.

.24 Overview. Program knowledge level that provides a general review of a subject area from a broad perspective. These programs may be appropriate for professionals at all organizational levels.

.25 Pilot test. A method to determine the recommended CPE credit for self study programs that involves sampling of individuals who are independent of the development team and are representative of the intended participants to measure the representative completion time.

.26 Pre-program assessment. A method of measuring prior knowledge that is given before the participant has access to the course content of the program.

.27 Professional competence. Having requisite technical competence, professional skills, values, ethics and attitudes to provide quality services as defined by the technical and ethical standards of the profession. The expertise needed to undertake professional responsibilities and to serve the public interest.

.28 Program of learning. A collection of learning activities that are designed and intended as continuing education and that comply with these Standards.

.29 Qualified assessment. A method of measuring the achievement of a representative number of the learning objectives for the learning activity.

.30 Reinforcement feedback. Specific responses to correct answers to questions in self study programs.

.31 Self study program. An educational program completed individually without the assistance or interaction of a real-time instructor.

.32 Social learning. Learning from one's peers in a community of practice through observation, modeling, and application.

.33 Subject matter expert. A person who has expertise in a particular area or topic. Expertise may be demonstrated through practical experience or education, or both.

.34 Synchronous. A group program in which participants engage simultaneously in learning activities.

.35 Word count formula. A method, detailed under S17-05 method 2, to determine the recommended CPE credit for self study programs that uses a formula including word count of learning material, number of questions and exercises, and duration of audio and video segments.

.36 Update. Program knowledge level that provides a general review of new developments. This level is for participants with a background in the subject area who desire to keep current.

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